BAE SYSTEMS

Annual Report 2022
BAE Systems plc

baesystems.com

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Financial statements

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

Our purpose

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

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

We have an important role in society because we:

- help our customers to **provide security and safety**;
- **contribute to the economic prosperity** of the places where our people live and work;
- **support high-value jobs** in our business and in our supply chains;
- **value our people and their diversity** so they can fulfil their potential in an inclusive and supportive working environment;
- seek to **identify opportunities** for individuals from disadvantaged backgrounds;
- **support employees' rights** in relation to freedom of association;
- **inspire and excel** in the work we do – the technologies we develop and the talent we build;
- **develop cutting-edge technologies** to sustain the competitive strength of the Company in global markets;
- **create best-in-class products** and services by forging strong relationships with our suppliers and partners;
- care for and **support our local communities**; and
- use our knowledge and technologies to reduce the environmental impacts of our activities. We have set ourselves the target of achieving **net zero greenhouse gas emissions** across our operations (Scope 1 and 2) by 2030.

How our purpose connects to our strategy

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

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Our strategic framework

How our purpose connects to our culture

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

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Our stakeholders

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The work of the Board

Our business at a glance

At BAE Systems, we provide some of the world's most advanced, technology-led defence, aerospace and security solutions. We employ a skilled workforce of 93,100[1] people in around 40 countries. Working with customers and local partners, we develop, engineer, manufacture, and support products and systems to deliver military capability, protect national security, and keep critical information and infrastructure secure.

2022 revenue

£21,258m

2022 sales[2]

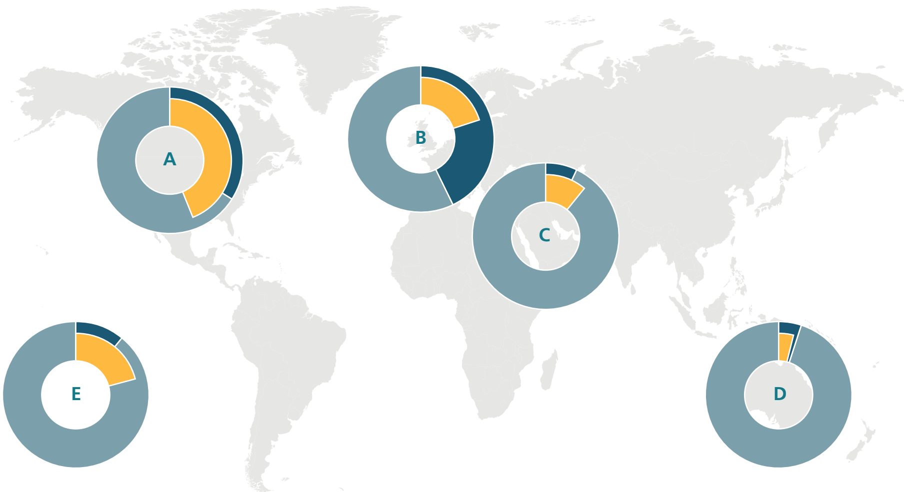
£23,256m

Where we operate

BAE Systems maintains leading positions in major defence and security markets around the world – in the US, UK, the Kingdom of Saudi Arabia and Australia – as well as established positions in a number of other international markets.

Sales[2] by destination

A	US	44%
B	UK	20%
C	Kingdom of Saudi Arabia	11%
D	Australia	4%
E	Other international markets	21%



Total employees[1]

93,100

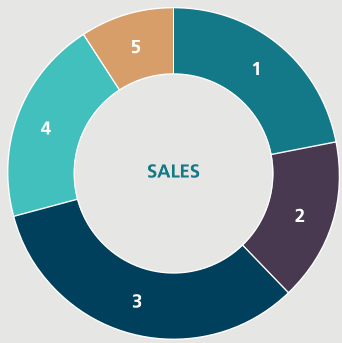
Employees by location

A	US	31,300	34%
B	UK	39,600	43%
C	Kingdom of Saudi Arabia	6,700	7%
D	Australia	4,900	5%
E	Other	10,600	11%

BAE Systems focuses its operations across five[3] key sectors:

Sales[2] by sector

1	Electronic Systems	22%
2	Platforms & Services	16%
3	Air	33%
4	Maritime	20%
5	Cyber & Intelligence	9%



Employees by sector[1]

6	Electronic Systems	16,900	18%
7	Platforms & Services	12,200	13%
8	Air	24,400	26%
9	Maritime	24,200	26%
10	Cyber & Intelligence	10,500	11%
11	HQ/Other	4,900	6%

Page 20 Our markets
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Page 93 Segmental review

1. Including share of equity accounted investments.
2. Sales is defined in the Financial Glossary on page 302.
3. The Group has five operating sectors which, together with HQ, make its six operating segments as defined by IFRS 8 Operating Segments.

Electronic Systems

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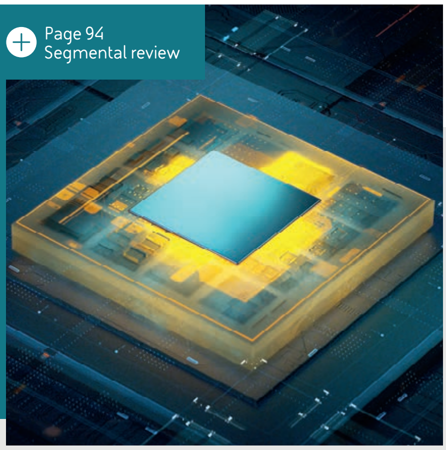
Segmental review



We provide:

- Design, build and support of integrated electronic warfare systems.
- Development and production of avionics and electronic systems for military and commercial aircraft.
- Design and manufacture of state-of-the-art systems and technology to enable the execution of precision strike missions.
- Next-generation threat detection, countermeasure and attack solutions.
- Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) systems for airborne persistent surveillance, identification systems, signals intelligence, underwater and surface warfare solutions, and space resiliency.
- Electric and hybrid power and propulsion solutions to advance vehicle mobility, efficiency and capability.

Platforms & Services

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Segmental review

We provide:

- Design, manufacture, upgrade and support of tracked and amphibious combat vehicles.
- Manufacture, maintenance, repair and upgrade of naval gun systems, artillery, advanced weapons, missile launchers and precision munitions.
- Sustainment activities and services, including naval ship repair, modernisation and overhaul in the US.
- Management and operation of government-owned munitions facilities in the US.
- Production and upgrades for tracked and wheeled military vehicles for Turkish and international customers through a 49% interest in FNSS.

Air

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Segmental review

We provide:

- World-leading capabilities in military and commercial aircraft technology.
- A wide range of munitions, explosives, gun systems and artillery systems.
- Training to the armed forces to train the right people to the right standard, at the right time.
- Test support to commercial, military and aerospace customers.
- Design and integration of new technology and systems upgrades to existing aircraft.
- Advanced computer simulation to create realistic and immersive synthetic environments.
- Advanced radar solutions to detect threats quicker and enable faster response times.
- Design and manufacture of missiles and missile systems through a 37.5% interest in MBDA.

Maritime

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Segmental review

We provide:

- Design, manufacture and support of submarines and complex warships.
- In-service support to surface ships and facilities management in the UK.
- Design, manufacture and support of naval gun systems, torpedoes, radars, and naval command and combat systems.
- Design and delivery of training systems and services for maritime platforms and equipment.
- Design and manufacture of ammunition, precision munitions, artillery systems and missile launchers for UK and other armed forces.

Cyber & Intelligence

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Segmental review

We provide:

- Cyber, intelligence and security capabilities to US, UK and other government agencies to detect, deter and dissuade threats to national security.
- Engineering, integration and sustainment services for critical weapon systems, Command, Control, Communications, Computers, Cyber, Intelligence, Surveillance and Reconnaissance (C5ISR) and cyber security.
- Air and space force solutions to modernise, maintain, test, and cyber-harden aircraft, radars, strategic missile systems mission applications and information systems.
- A range of space capabilities that enable integration across cyberspace, sea, land and air, allowing secure access to intelligence.
- Mission-enabling solutions and services to intelligence and federal/civilian agencies.

Our financial highlights

We monitor the underlying financial performance of the Group using the alternative performance measures defined in the financial performance metrics on page 82. These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-Generally Accepted Accounting Practice (GAAP) measures. Accordingly, the relevant IFRS measures are also presented where appropriate.

Financial performance measures defined by the Group[1]

Sales
KPI

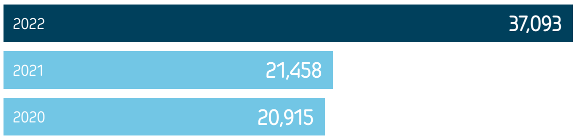
£23,256m

4% growth[2]

Order intake
BONUS KPI

£37,093m

£15,635m increase



Underlying EBIT
KPI

£2,479m

5% growth[2]

Underlying earnings per share[3]
BONUS KPI

55.5p

9% growth[2]

Free cash flow
KPI

£1,950m

£86m higher

Net debt (excluding lease liabilities)
BONUS KPI

£(2,023)m

£137m decrease

Order backlog

£58.9bn

£14.9bn increase

KPI

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

BONUS

75% of the UK executive directors' annual bonuses are based on the achievement of financial KPIs (see page 179).

1. The definitions of all financial performance measures, and purpose for financial performance measures defined by the Group, are provided on pages 82 to 83.
2. Growth rates for Sales, Underlying EBIT and Underlying EPS are on a constant currency basis (i.e. current year compared with prior year translated at current year exchange rates). All other growth rates and year-on-year movements are on a reported currency basis.
3. Growth rate disclosed excludes the impact of the 2021 one-off tax benefit of £94m in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company Regime and the impact of the UK tax rate adjustment (see note 6). For 2021, Underlying EPS of 47.8p is shown excluding the one-off tax benefit and of 50.7p including the one-off tax benefit.

Financial performance measures derived from IFRS[1]

Revenue

£21,258m

9% growth

Order book

£48.9bn

£13.4bn increase

Operating profit

£2,384m

Stable

Basic earnings per share

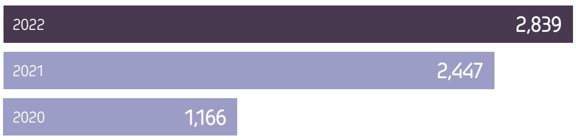
51.1p

7% decrease

Net cash flow from operating activities

£2,839m

£392m higher



Group's share of net post-employment benefits surplus/(deficit)

£0.6bn

£2.7bn improvement

Dividend per share

27.0p

7.6% growth

Our business highlights

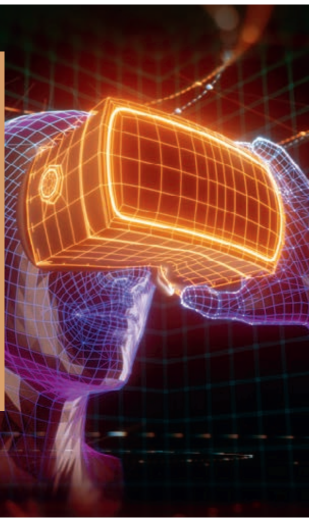
In 2022, we delivered on our customers' key programmes in a challenging global environment.

Typhoon and Hawk in service

Eight Typhoon aircraft now delivered and in service with the Qatar Emiri Air Force. Nine Hawk advanced jet trainer aircraft accepted and delivered to 11 Squadron, the joint Qatar-UK Hawk squadron based at RAF Leeming, UK.

Acquisition of Bohemia Interactive Simulations (BISim)

The experienced BISim team of engineers develops high-fidelity, cost-effective training and simulation software products and components to meet the growing demand for defence applications.



Launch of the Global Combat Air Programme

BAE Systems will support defence partners in the UK, Japan and Italy to deliver the next generation of combat air fighter jets.

F-35 Lightning II programme

The F-35 Lightning II programme has delivered a cumulative total of over 1,200 electronic warfare systems. We are also supporting the Block 4 modernisation efforts under multiple contracts worth over $957m (£796m). F-35 rear fuselage manufacturing continued at full-rate production through 2022, with 150 rear fuselage assemblies completed during the year.

Industry-leading Gen3 electric drive technology

US-based bus manufacturers Hometown Manufacturing and ElDorado National both chose our next-generation Gen3 electric drive technology to power their zero emission vehicles.

HMS Glasgow, first of Class Type 26 frigate

HMS Glasgow successfully completed float-off in December 2022 in a deep-water location in the West of Scotland. HMS Glasgow has been under construction since steel was cut in 2017. The second and third ships, HMS Cardiff and HMS Belfast, are currently in build in Govan. Also during 2022, the Ministry of Defence awarded BAE Systems a £4.2 billion contract to build a further five Type 26 City Class frigates for the Royal Navy, sustaining 4,000 jobs across BAE Systems and the wider UK maritime supply chain.

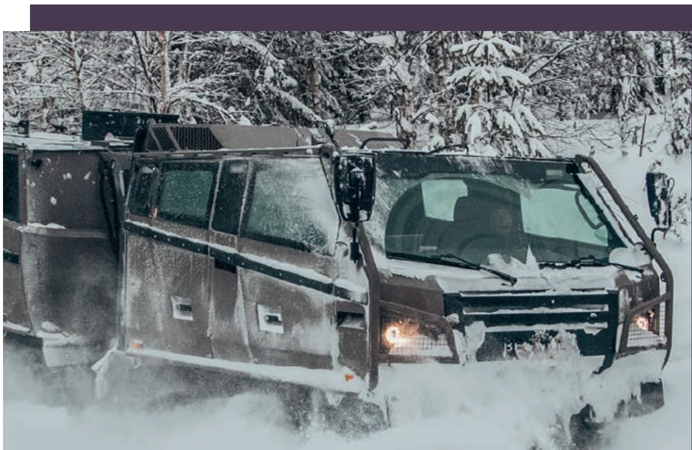
2022 RoSPA Gold Medal Award

Gold Medal Awards in 2022

BAE Systems Naval Ships and Munitions businesses were awarded RoSPA Gold Medal Awards in 2022, with both receiving the awards now for five consecutive years.

Fifth Astute Class submarine, HMS Anson, commissioned

Our shipyard in Barrow-in-Furness, Cumbria, hosted the commissioning of the fifth Astute Class submarine, HMS Anson, which exited our Barrow shipyard to commence sea trials in February 2023. The Astute Class is the most technologically advanced attack submarine ever operated by the Royal Navy.



Beowulf selected for US Army Arctic Strategy

Our Beowulf vehicle won the US Army's Cold Weather All-Terrain Vehicle competition. Under a five-year contract worth $278m (£231m), Beowulf will replace legacy Small Unit Support Vehicles and provide extended operations and force projection capabilities under extreme, Arctic weather conditions.

CV9035 infantry fighting vehicles

As part of a government-to-government agreement between Sweden and the Slovak Republic, the Ministry of Defence of the Slovak Republic has signed a $1.4bn (£1.2bn) agreement for the delivery of 152 CV9035 infantry fighting vehicles from BAE Systems.

Chairman's letter

As one of the world's largest defence contractors, our technology, capabilities and global footprint ensure we play a leading role in helping our government customers meet the elevated threat environment.

Our performance over the last 12 months has delivered results which are a credit to the outstanding leadership of Charles Woodburn, Tom Arseneault and Brad Greve who continue to lead our remarkable people across the globe with professionalism, energy, authenticity and absolute integrity. This has enabled the Board to reward shareholders through the buyback of £788m of our own shares and to recommend a final dividend of 16.6 pence making a total of 27.0 pence for the full year.

Throughout my time as Chairman, I have been fortunate to be supported by executives of the highest calibre and a workforce of considerable ability with absolute dedication to our purpose: serving, supplying and protecting those who serve and protect us. And for that, I thank them all.

There is no doubt that being Chairman of the Board of a global defence and security company is occasionally challenging, but is fundamentally engaging and satisfying, and it has been my privilege to have had this role for the last nine years.

It has provided an unparalleled platform of engagement in geopolitics, government policy, the military, and cutting-edge technology. It has also enabled me to work with some of the most talented and able engineers, technologists and technicians on the planet.

During my time as Chairman, I have witnessed BAE Systems build and supply some of the finest defence equipment and services in the world. Amongst others, the Queen Elizabeth and Prince of Wales aircraft carriers, the Typhoon military jet, Type 26 and Hunter Class frigates, the Astute Class submarine, advanced electronics and armoured vehicles for the UK, Europe, and the US. I have also seen our outstanding teams commence work on the next generation of submarines, Dreadnought, and the sixth generation of fighter aircraft, Tempest, to ensure the UK and its allies are protected for decades to come.

Whilst achieving remarkable feats of engineering, it is an industry that is sometimes misunderstood, but fundamentally a force for good. It helps governments deliver their prime responsibility in providing security and safety for their citizens whilst simultaneously underpinning the prosperity agenda with high-quality, well-paid, sustainable employment.

Not everyone shares this perspective. There are some who believe that all arms manufacture is wrong and that the moral dimension should supersede all other arguments. Their views are to be respected, if not accepted.

In recent times, however, the case against defence has drifted to a wider group in the investment community whose analysis of the Environmental, Social and Governance qualities of all companies has, on occasion, failed to adequately characterise BAE Systems, and companies like ours, who are highly regulated, ethically led, and government-backed defence contractors.

It is a mischaracterisation that is both dangerous and damaging to the reputation of some of the finest companies in the UK and ultimately to their cost of capital and their ability to invest and to attract the fine minds that are required to preserve the cutting-edge capabilities that are vital to global security.

Visit to Osborne Naval Shipyard
Sir Roger on a visit to Osborne Naval Shipyard, South Australia, November 2022.

> BAE Systems continues to make a significant contribution to both the prosperity and levelling up agendas in the UK and elsewhere in the world.

Sir Roger Carr
Chairman

Over the course of this year, the war in Ukraine has caused many to recalibrate their views on defence and has reinforced the understanding that a strong defence capability is essential to deter well-armed aggressors from furthering conflict. In particular, the war in Ukraine underpins the case for the UK's continuous at sea nuclear deterrent in keeping foes in check.

It should not have taken a war to wake up the West and catalyse NATO members to meet their commitments to invest 2% of GDP in their own protection, but it did.

And it should not have taken a war for the investment community to reassess the value of BAE Systems shares, but it has.

The case for defence and security is not simply to have the right equipment for the rainy day – it is to invest in the industrial umbrella that will build skills, secure employment, and provide prosperity while peace prevails.

And to that end, BAE Systems continues to make a significant contribution to both the prosperity and levelling up agendas in the UK and elsewhere in the world.

In 2020, according to Oxford Economics, in the UK alone, we contributed over £10bn to the country's GDP and around £4bn to exports, as well as supporting a total tax contribution approaching £3bn and 143,000 full time jobs across the UK through a supply chain of 5,000 companies. We invest more than £1bn in technology and R&D. This includes our own capital and that of our customers and partners.

Employees[1]

93,100

Sales[2]

£23,256m

Dividend per share

27.0p (7.6% growth)

25.1p	23.7p[3]	23.2p[3]	22.2p
2021	2020	2019	2018

1. Including share of equity accounted investments.
2. Sales is defined in the financial glossary on page 302.
3. 2020 does not include the interim dividend paid of 13.8p per share paid in September in respect of 2019 performance. This amount is reflected in the 2019 dividend history.

Throughout our history we have been committed to supporting young people, recruiting more than 1,000 apprentices in the UK this year alone, and making some significant headway in recruiting more women to make our Group more diverse.

We provide considerable in-kind support working with Local Enterprise Partnerships across the UK to develop communities and mentoring small businesses to help improve those that are far behind in productivity.

As a result, we have a direct impact in the communities in which we operate and because, for strategic reasons, military equipment sites were located outside of cities and major towns, some 40% of our employees reside in some of the UK's most deprived regions.

We are committed to making important economic and social contributions wherever we are active – in the US, the Gulf and Australia. Added to this, we are making progress against a 2030 net zero (Scope 1 and 2) carbon target across our operations and developing exciting sustainable technologies to support our route to net zero.

So, as a Board, our focus is not simply how much money we make, but how we make money.

During the last 12 months, the Board has continued to be refreshed as those who have made a major contribution to the development of the Company conclude their nine-year tenure and are replaced by a new generation of talented businesses leaders.

Against this background, Ian Tyler stepped down from the Board at last year's Annual General Meeting (AGM) having chaired both our Remuneration and ESG Committees and having been a material contributor to the strategic direction of the Company.

In November, we were fortunate to be joined by Cressida Hogg, who will replace me as Chair when I step down at the AGM, and Lord Mark Sedwill as non-executive directors. Both will add to the substance and breadth of the Board with Cressida bringing a wealth of experience as both a chair and business leader and Lord Sedwill having served as Cabinet Secretary and Head of UK National Security. Finally, I would like to thank Philip Bramwell, who retired last year after serving 15 years as Group General Counsel. He was a trusted adviser to the Board and a highly respected member of our executive leadership team.

Finally, I am pleased to report that when I step down as Chairman at the AGM, I will leave the Company in good health and safe hands led by a Board and executive team with impeccable credentials and invaluable skills, who are united by a passion and pride in what we do and a commitment to the principles of being both performance driven and values led.

I wish the Company and all of its stakeholders continued success and a prosperous future.

Sir Roger Carr
Chairman

Apprentices at the Academy for Skills & Knowledge in Samlesbury and our Warton site in Lancashire, UK.


BAE SYSTEMS


ASK
Academy
for Skills &
Knowledge

Chief Executive's review

I am pleased to report another year of strong operational performance which has delivered increased sales and underlying earnings per share, and is underpinned by a record annual order intake and another exceptional year for free cash flow.

> Our record orders and financial performance give us confidence in delivering long-term growth and to continue investing in new technologies, facilities and thousands of highly skilled jobs, whilst increasing shareholder returns.
>
> **Charles Woodburn**
> Chief Executive

Overview

I am pleased to report that BAE Systems delivered another strong year of performance in 2022, both financially and operationally. This was achieved despite the headwinds presented by the COVID-19 pandemic, continued supply chain disruptions, rising inflation and ongoing labour shortages. Whilst we expect that some of these challenges will persist, we enter 2023 with a robust competitive position, multiple new business opportunities, and significant financial resources – all of which point to another productive year ahead for BAE Systems and our shareholders.

These outcomes were driven by our people, their unwavering focus on our purpose – "to serve, supply and protect those who serve and protect us" – and a values-led culture, committed to sustainable business practices and inclusion. This is underpinned by a robust governance structure and high ethical standards.

In 2022, global events resulted in a renewed recognition of the importance of the defence industry and our role in assisting governments in protecting their countries and citizens.

As one of the world's largest defence contractors, our technologies, capabilities and global footprint ensure we play a leading role in helping our customers meet an elevated threat environment.

This past year, the Group designed, developed, and manufactured a cutting-edge set of products – across the domains of air, land, sea, cyber and space – that our customers count on. Our exceptional product portfolio is enhanced with enabling technologies including artificial intelligence, autonomy, cryptography, and cyber defence, ensuring we remain at the forefront of national security-related technologies.

In addition to our defence portfolio, we continued to see a recovery in our commercial aviation product lines, as passenger flying hours continue to increase. Further, demand for our low and zero emission hybrid and fully electric drive and propulsion systems continued to grow, with emerging opportunities to take these applications into the defence arena, as well as maritime and air applications.

Our markets

A differentiating strength of BAE Systems is our geographic diversity and exposure to many of the world's largest national defence budgets. Most of the countries in which we operate have either announced increases or are making plans to increase spending to address the elevated threat environment. Whilst global economic and fiscal pressures weigh on governments, the commitment to defence in our major markets remains robust.

Our standing as the UK's largest defence company, a top 10 defence prime contractor in the US, the largest defence company in Australia, our enduring relationships with multiple customers in the Middle East, and strong European presence contributed to a record annual order intake of £37bn, driving our defence order backlog up to £59bn. This geographic footprint also provides us with the ability to export from the US, the UK, Australia and Sweden into countries which are also planning to increase defence spending.

In the US, by far the world's largest defence market, we are well aligned to the Department of Defense (DoD)'s emphasis on advanced technologies, which is the fastest growing part of the US budget. In areas like electronic warfare, multi-domain operations, Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) systems and advanced Defense Advanced Research Projects Agency (DARPA) projects, BAE Systems technologies are world-class and map directly into priorities in the US National Defense Strategy. In addition, we expect the renewed importance of armoured combat vehicles in the Ukraine conflict to benefit our combat vehicles business.

In the UK, the 2021 Defence Command Paper renewed commitments to our major programmes in complex warship, submarine and combat aircraft design and build, allowing for long-term investment in these key sovereign capabilities, as well as strong support for the cyber domain.

Our healthy opportunity pipeline is growing with domestic, export and collaboration opportunities, and we have the capabilities to support our UK customer in its emerging space ambitions.

In Europe, where the threat level is acute, the need for new equipment is most urgent and many defence budgets are rising. Our involvement in the Eurofighter Typhoon consortium, shareholding in missile-maker MBDA, ownership of the growing Hägglunds and Bofors businesses, acquisition of Bohemia Interactive Simulations and participation in US foreign military sales enable us to serve the European/NATO market through multiple channels.

The Air sector continues to support a global customer base and we have a significant operational business presence in the Middle East, notably in the Kingdom of Saudi Arabia, Qatar and Oman.

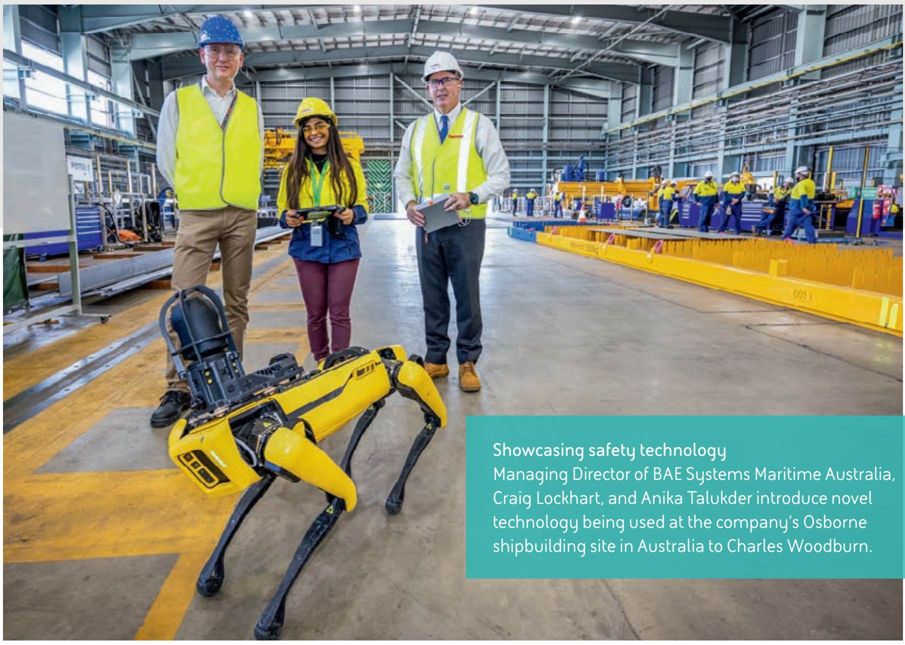
In December 2022, the governments of the UK, Japan and Italy announced their shared ambition to develop a next-generation fighter aircraft under a new Global Combat Air Programme (GCAP). The launch of GCAP firmly positions the UK, alongside Japan and Italy, as leaders in the design, development and production of next-generation combat air capability. Working closely with our UK industry partners, the Air sector intends to strengthen its ties with Japanese and Italian industries as we work together to deliver this programme.

Returns to shareholders

£1,590m

Order backlog

£59bn



Showcasing safety technology
Managing Director of BAE Systems Maritime Australia, Craig Lockhart, and Anika Talukder introduce novel technology being used at the company's Osborne shipbuilding site in Australia to Charles Woodburn.

2022 financial performance

Our key financial metrics of sales, margin, underlying earnings per share, and free cash flow increased despite supply chain interruptions, labour shortages and the inflationary environment. This was possible because of the excellent work of our employees on programme execution, as well as the internal efficiency and competitiveness initiatives we have underway.

On a constant currency basis, we grew sales by 4%, increased return on sales by 20 basis points, grew underlying earnings per share by 9%, and recorded another exceptional year for free cash flow of £2.0bn. Together with 2020 and 2021, we over-performed on our stated three-year free cash flow target by more than £1bn.

This collection of strong results was enhanced by our share repurchase programmes. In 2022, we repurchased £793m of our shares, or about 3% of our outstanding shares, completing the remainder of the Board's 2021 £500m authorisation and the initial tranche of the Board's three-year £1.5bn authorisation, approved in mid-2022.

Balance sheet strength

BAE Systems ended 2022 with a strong balance sheet, featuring a cash position of £3.1bn, net debt (excluding lease liabilities) of £2.0bn, and a net pension position that has swung from a significant accounting deficit to an accounting surplus, thanks to the Group's funding commitments over the years and the higher interest rate environment.

The outcome of the triennial review with the pension Trustee and the Pensions Regulator was positive and has enabled the Group to move forward with a sensible capital allocation strategy that prioritises investing in the business for the long term through R&D and acquisitions in high growth/high return parts of the business, and capital expenditures to ensure our systems and facilities are modern and can support the Group's expected growth. We are also committed to returning value to shareholders through an attractive dividend which has increased for 19 consecutive years, and share buybacks based on our confidence in the outlook.

2022 operational performance

Set against the backdrop of macro-economic challenges and heightened global tensions, we made excellent progress in meeting the strategic objectives we have been pursuing for several years. Our intense focus on operational excellence continues to benefit our customers and shareholders as we execute on complex, long-duration programmes like the Astute and Dreadnought submarine programmes, Type 26 and Hunter Class frigates, Typhoon and F-35 fighter jets, electronic warfare systems, and a leading portfolio of land combat vehicles, among many other programmes. This relentless attention to delivering for our customers has positioned the Group as a trusted supplier of advanced technology solutions and industrial capabilities to help customers achieve their critical national and global security missions.

Each of our business sectors contributed to making 2022 a strong year for the Group:

Our **Electronic Systems** sector was the business unit most impacted by the global shortage of microelectronics, as well as by labour and staffing shortages within our operations and across our supply chain. The team developed operational approaches that helped mitigate the schedule and financial impacts of the supply chain constraints, producing another solid year with continued high margins and a robust order book. We are optimistic that these supply chain pressures will continue to ease in the near term.

Our **Platforms & Services** sector maintained relatively stable sales, whilst delivering margin expansion in 2022. The impacts from the COVID-19 pandemic negatively affecting the business began to abate in 2022. Our US combat vehicles business has ramped up the production of key programmes like the Armored Multi-Purpose Vehicle (AMPV) and Amphibious Combat Vehicle (ACV), and our Swedish Hägglunds business recorded outstanding levels of new orders. Margins in our Ship Repair business have improved as we worked to address workforce challenges and operational performance post-COVID.

Our **Air** sector posted steady sales growth and increased margins, highlighted by the production of Typhoon fighters for Qatar, Germany and other customers, and the delivery of F-35 aft fuselage tail sections. The Tempest technology maturation programme is progressing well, and work continues to plan on the Future Combat Air System (FCAS) Concept & Assessment Phase, a contract we received in 2021. In 2022, the UK government announced plans to lead the development of a new flying combat air demonstrator, set to fly within the next five years, and the GCAP coalition with Japan and Italy. In addition, we renewed a major portion of our Saudi support business for another five years under a UK/Saudi government-to-government agreement.

CV90 combat vehicles
The Czech Republic, Sweden and BAE Systems have signed a non-binding Memorandum of Understanding that provides a framework for negotiations of an agreement to deliver CV90 combat vehicles to the Armed Forces of the Czech Republic.

Our **Maritime** sector posted good sales growth in 2022, and maintained steady margins, as major submarine and ship programmes continued to ramp up. Margin performance reflected the high volume of Dreadnought sales and increased Company-funded R&D expenditure. The Dreadnought nuclear deterrent submarine and the Global Combat Ship programmes (UK's Type 26, Australia's Hunter Class and Canada's licensed frigate) all grew year-over-year.

The **Cyber & Intelligence** sector recorded good sales growth and margin performance. The sector benefited from better workforce utilisation and efficiency following the worst of the pandemic. In the US, the Intelligence & Security business continued to demonstrate the value of its differentiated systems integration expertise, providing leading engineering, modelling and simulation capabilities to its customers, expanding in this area through the acquisition of Bohemia Interactive Simulations. In the UK, we established the Digital Intelligence business, bringing together capabilities in cyber, space, intelligence, security and data into one organisation to improve our customer alignment.

I am proud to report that the fundamentals of the business are solid, the outlook is bright and our team is focused on our purpose.

Our ESG agenda

We operate our business for the long term and place incorporating sustainable business practices in all aspects of our operations at the core of our approach. This includes, for example, our focus on employee safety and wellbeing, creating a diverse and inclusive workspace, supporting and engaging with the communities in which we operate and delivering leading apprentice and graduate programmes to prepare the next generation of workers for the future. It also includes our focus on responsible environmental stewardship in our operations. We underpin everything with a robust governance structure that applies to all aspects and required adherence to our Code of Conduct.

I am exceptionally proud of what the Group accomplished in 2022. We hired a record number of UK apprentices and graduates and I am particularly pleased that we increased the number of women to 30% of that intake. We progressed our climate resilience programmes and each of our sectors developed decarbonisation roadmaps to outline short-, medium- and long-term activities to support the Group's net zero ambition by 2030 (Scope 1 and 2). Our employees continue to be engaged in our sustainability programmes, actively participating across many elements. We have made substantial progress in our sustainability agenda over the past several years, and we recognise there is more work to do in the years ahead. I am convinced these efforts will make us a better, higher-performing company in the future.

New Chair

This year's Annual General Meeting of shareholders will mark the conclusion of Sir Roger Carr's remarkable tenure as Chair. We have named Cressida Hogg as Sir Roger's successor, completing an intensive search for the most qualified candidate to fill the role. We all look forward to benefiting from her experience, wisdom and energy in the coming years.

Executive Committee changes

In the second half of 2022, we welcomed two new members to our Executive Committee (EC). Caitlin Hayden has joined as Group Communications Director following her role as Senior Vice President of Communications at BAE Systems, Inc. in the US. Ed Gelsthorpe also joined the EC as Group General Counsel. Ed has enjoyed a long and varied career in the Group and has served in several senior legal leadership positions.

Summary

As we close the book on 2022, on behalf of all of my BAE Systems colleagues, I am proud to report that the fundamentals of the business are strong, the outlook is bright, and our team is focused on our purpose – "to serve, supply and protect those who serve and protect us". While it is tragic that it took a war in Europe to raise the awareness of the importance of defence around the globe, BAE Systems is well positioned to help national governments keep their citizens safe and secure in an elevated threat environment.

For shareholders, the record order intake and increased order backlog, our position on major and enduring programmes, the pension accounting surplus, and management's continued attention to operational excellence and financial discipline together provide a high level of visibility for sales growth, margin expansion, cash generation and capital returns over the coming years.

Thank you for your support of the Group and our strategy for value creation. We look forward to another productive and rewarding year in 2023 for all stakeholders.

Charles Woodburn
Chief Executive

Our strategic framework

Our vision

... is to be the premier international defence, aerospace and security company.

Our mission

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

Our strategy

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

1 Sustain and grow our defence business

- Deliver on our commitments effectively and efficiently
- Develop our offerings to meet the future defence and security needs

2 Continue to grow our business in adjacent markets

- Take our capabilities into adjacent attractive markets
- Develop dual-use opportunities delivering civil solutions to leverage back to meet challenges for our defence customers

3 Develop and expand our international business

- Mature our international activities, broadening our offerings to our established customers
- Develop relations with additional customers

4 Inspire and develop a diverse workforce to drive success

- Ensure we diversify our thinking and harness the full potential of our people
- Create an environment and proposition in which our people will thrive

5 Enhance financial performance and deliver sustainable growth in shareholder value

- Seek opportunities to drive efficiency, standardisation and synergies
- Identify opportunities for higher-margin offerings

6 Advance and integrate our sustainability agenda

- Emphasise the vital role we play in protecting countries and civilians and supporting our communities
- Progress the delivery of our decarbonisation strategy

Our strategic priorities

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

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

Our sectors

- Electronic Systems Page 94
- Platforms & Services Page 98
- Air Page 102
- Maritime Page 106
- Cyber & Intelligence Page 110

Our values:
Trusted, Innovative and Bold

Our strategy in action

Drive operational excellence

UK MoD © Crown Copyright

F-35 programme

BAE Systems has been part of the F-35 programme since its inception, bringing our expertise into the development, advanced manufacture, electronic warfare systems and sustainment of the world's largest defence programme. Led by the US, with participation from the UK, Italy, Netherlands, Australia, Canada, Denmark and Norway, this collaborative programme delivers a stealthy, multi-role combat aircraft capable of operating from land and sea to nations across the globe.

As a key partner, we collaborate with the programme's prime contractor, Lockheed Martin, to deliver around 15% of each aircraft (excluding propulsion), playing a major role in the development, production and sustainment of each jet.

New Jacksonville, Florida ship lift

To improve production efficiency and increase capacity, we have embarked on the process of constructing a new, modern ship lift/land-level ship repair complex at our Jacksonville, Florida shipyard. Once it is fully operational, the complex will feature a ship lift that can easily move vessels in excess of 25,000 tons, and the new land-level repair complex will enable the team to work on three or more ships simultaneously parked ashore with access to their hulls.

The $200m (£166m) investment will bring a 300% increase to the shipyard's current dry-docking capacity and expand the shipyard's customer diversity by bringing in more commercial work.

Continuously improve competitiveness and efficiency

Advance and further leverage our technology

Team Tempest

BAE Systems is working with partners to design and deliver a new flying combat air demonstrator, which will play a critical role in the delivery of the UK's Future Combat Air System. The flagship project is part of a suite of novel technologies being developed by Team Tempest, which will see BAE Systems engineers lead the design, test, evaluation and build process and bring together new digital engineering technologies. The first flight of the demonstrator is set to take place within the next five years.

Our business model

Our unique strengths and resources provide opportunities to create sustainable value for our stakeholders.

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

Inputs:

Our people

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

Page 60
Creating opportunity for people and communities

Our technology

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

Page 26
Our investment in technology

Responsible sourcing and impact

We take pride in managing our operations responsibly. We use our expertise to reduce the environmental impacts we have around the globe and to develop products and services for our customers to reduce their impacts on the environment. Our goal is to achieve net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030.

Page 40
Addressing climate risks

Our governance framework

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

Page 134
Governance framework

Our partners and key relationships

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

Page 68
Success through partnering

Identifying customer needs

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

Research and development

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

Bidding and contracting

- We focus on value for our customers while effectively managing risk
- We maintain a record of delivery on complex projects
- We develop partnerships with a network of suppliers supporting economic prosperity and development

Designing and developing

- We provide engineering expertise in developing cutting-edge products and services
- We develop products designed to minimise environmental impacts during service and at end of life
- Our products are designed and developed in a way that provides for future flexibility with the ability to upgrade in an agile manner

Advanced manufacturing, commissioning and integration

- We continuously invest in advanced manufacturing techniques and facilities
- We focus on operational excellence with safety as a priority
- We manage complex projects and collaborations across global supply chains

Services, sustainment and upgrade

- We provide competitive services that add value for our customers
- We develop technical expertise, which is acquired through product design and development
- We use flexibility and responsiveness to maximise availability of our customers' products

The value we create:

Customers

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

- BAE Systems has continued to invest in research, design and development during the year, integrating advanced technology into our products. Our dedicated FAST Labs™ R&D group creates advanced technologies that give our customers an edge. We have continued to work in partnership with small and large companies across industries and academic institutions to develop new capability to support our customers.
- During the year, BAE Systems opened a new engineering and manufacturing centre of excellence in Cedar Rapids, Iowa as well as a new engineering and production facility in Austin, Texas. These facilities are providing a world-class work environment that will support innovation, production, and teamwork, and will help our teams to continue to deliver cutting-edge technology to our customers.

Employment

We support high-value jobs in our business and in our supply chains, this includes through direct employment as well as indirect employment in our supply chain and through those jobs supported by the consumer spending of our employees and of those in our supply chain.

- In the UK, our award-winning early career and skills programme supported around 4,500 young people in training in 2022, with women representing 30% of the 2022 intake. In 2023, we plan to further expand our career and skills programme. Read more on page 62.
- During the year, BAE Systems was accredited as a 'Menopause Friendly Employer', through work to raise awareness of menopause symptoms and provide resources and training to help create a working environment that supports everyone to be the very best they can be.

Supporting our communities

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

- Our support for the military has once again won us an Employer Recognition Scheme Gold Award from the UK Ministry of Defence.
- We were awarded 'Employer of the Year' at the Movement to Work Social Mobility Awards, in recognition of our contribution to supporting the recruitment of young people during the COVID-19 pandemic. Read more on page 63.
- We provided £160,000 to foodbanks associated with the Trussell Trust, providing emergency food and support to people locked in poverty across the UK, including those local to our sites in Kent, Cumbria, Hampshire, Monmouthshire, Lancashire and Glasgow.

Returns for shareholders

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

- For the year ending 31 December 2022, we had a record annual order intake of £37bn, driving order backlog to £59bn.
- During the year, the 2021 commitment to return £500m to shareholders through share buybacks was completed. In June, a further return of £1.5bn was announced.
- Dividends have increased for a 19th year in a row, with 27.0p returned to shareholders in 2022.
- A total of £1.6bn was returned to shareholders via dividends and buybacks during the year.

Environment

We acknowledge the significant and lasting impacts of climate change. Our goal is to develop and implement a long-term strategy that reduces the impact of our activities, supply chain and products on the climate by using our world-class engineering capabilities and cutting-edge technologies. We will also work to progress our ambition of net zero greenhouse gas emissions (Scope 1 and 2) by 2030.

- This year, BAE Systems set out a roadmap towards reaching our net zero targets. Read more on page 40.
- We further progressed our climate resilience programmes, and our sustainability agenda. Read more on page 47.

Our markets

BAE Systems maintains leading positions in major defence and security markets around the world – in the **US, UK, the Kingdom of Saudi Arabia and Australia** – as well as established positions in a number of other international markets. We are not only one of the world's largest defence and security companies, but are one of the most geographically diverse, providing us with a competitive advantage.

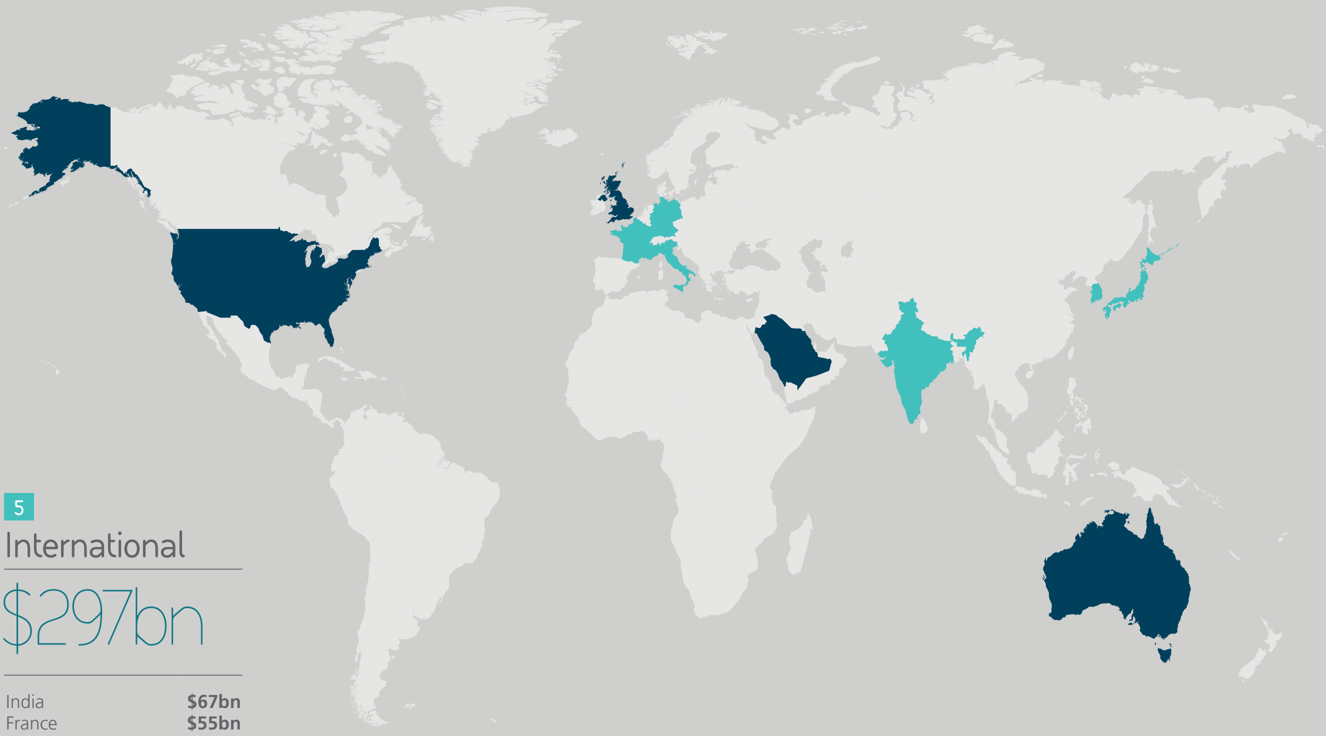
Value of the top global defence markets accessible for business by the Group[1]

1 US
$817bn

2 UK
$70bn

3 Kingdom of Saudi Arabia
$65bn

4 Australia
$35bn



5 International
$297bn

India	**$67bn**
France	**$55bn**
Germany	**$53bn**
South Korea	**$50bn**
Japan	**$41bn**
Italy	**$31bn**

1. Markets inaccessible for business by BAE Systems are excluded.

Source: The US budget figure shown is the enacted defense budget for fiscal year 2023 and, outside the US, Jane's Defence Budgets (based on 2022 total defence budgets and forecast average exchange rates for 2023 in US dollars respectively).

Supporting our customers' evolving needs

Our strategy, as shown on page 16, is focused on providing a vital advantage to our customers around the world through advanced technologies, innovation and agility, global industrial capacity, and responsiveness. In particular, we have built strong positions aligned with our core defence platforms to support our customers in our principal markets. These principal markets – the US, UK, the Kingdom of Saudi Arabia and Australia – have shown a significant and sustained commitment to their defence and security, and support for their allies. BAE Systems has established strong and enduring relationships in these markets and is recognised as playing a key role in the industrial capability of each of these countries.

Our unique position and capabilities

Our strong position in the US through the Special Security Agreement, together with our standing as the leading defence contractor in the UK and Australia, provides us with unique capabilities that can be leveraged across the Group to support our customers. Examples include our major role on the F-35 programme, our involvement alongside Japan and Italy in the Global Combat Air Programme to design, develop and produce the next generation of combat air capability, as well as being well positioned to support the emergent AUKUS defence co-operation agreement between Australia, the UK and the US.

These major programmes demonstrate the global nature of the defence industry and how nations are collaborating and coordinating to operate in a multi-domain environment to address the significantly elevated level of geopolitical threat.

In addition, our diverse portfolio of capabilities in the air, maritime, land and cyber domains provides us with a comprehensive offering for our customers around the world, making us one of the broadest and most geographically diverse major defence companies.

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

Programme diversity and longevity

The Group's wide diversity of capabilities, products and programmes, together with the geographical spread of our operations, means we are not heavily concentrated on a small number of key programmes or franchises. Additionally, our record annual order intake of £37bn, driving order backlog to £59bn, includes major programmes that are well positioned to extend beyond their current funded backlog for many years, and in some cases, multiple decades (see Our key programmes and franchises on page 24).

Response to increasing threat environment

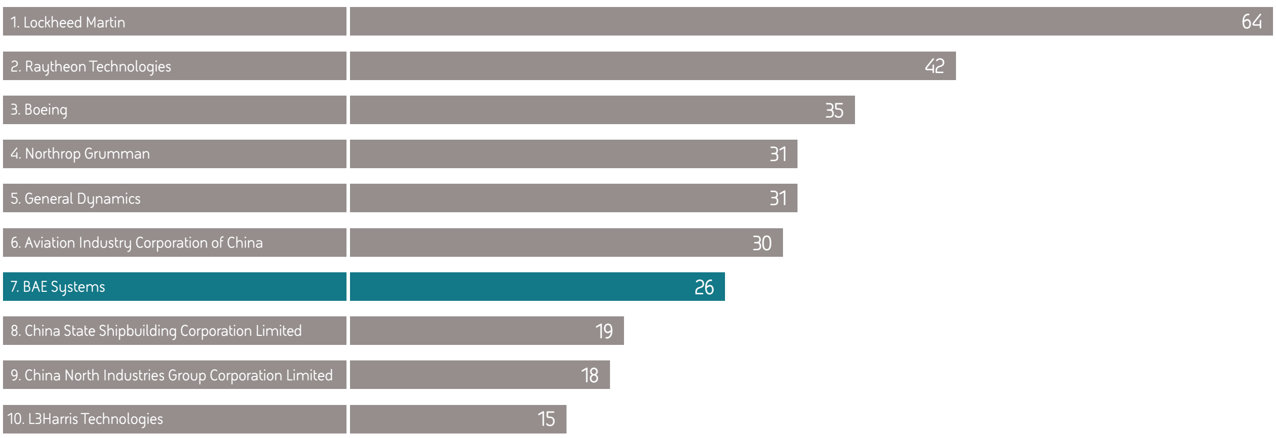
Our business continues to evolve and respond to geopolitical and technology trends that will influence and shape our customers' defence and security priorities now and in the future. Our demonstrated excellence in complex engineering, developing cutting-edge technology and seeking innovative solutions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

Growth aspirations

In response to significantly elevated global tensions and the acute threat environment, many countries around the world have announced and are in the process of enacting defence and security budget increases. We are only now beginning to see the new orders related to these increases. Along with the order backlog of £59bn, we have confidence in the medium-term outlook for sustained top-line growth. Through our long-standing customer relationships and the development of new ones we expect to see further opportunities in a number of international markets as the increased defence spending from these nations provides a response to the multi-faceted threat environment.

BAE Systems' global defence market position

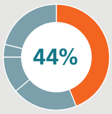
Top ten global defence contractors' revenue ($bn)



Source: Defense News Top 100 for 2022 (based on 2021 numbers). Exchange rate applied to BAE Systems is $1.263/£1.

1 US

Sales[1] by destination



£10,166m

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

Through a range of innovative technologies and proven capabilities, the US business continues to sustain its diverse portfolio of long-term defence programmes for the US Department of Defense and international allies. This US-based portfolio is well aligned to our customers' highest priority areas. These include electronic warfare, precision-guided munitions, space security, naval ship repair and modernisation, and combat vehicles. The threat environment is driving continued bi-partisan support for defence spending increases. The backlog for the US-based business remains robust and provides multi-year visibility.

BAE Systems is a leader in advanced electronic systems, real-time intelligence and analysis, naval gun systems, naval ship repair and modernisation, and tracked combat vehicles. Our position is supported by our key role on a number of franchise US defence programmes, including F-35 Lightning II and legacy fighter programmes, B-21 bomber, Sentinel and Minuteman ICBM, M109 self-propelled howitzer, Armored Multi-Purpose Vehicle and Amphibious Combat Vehicle.

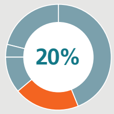
In addition to our position on US defence programmes, the US-based portfolio also benefits from Foreign Military Sales and direct international sales to allied nations. We continue to deliver on and enhance existing commercial programmes, including engine and flight controls, and electric drive propulsion systems and capabilities, which we are leveraging to advance sustainable technologies across multiple markets and domains.

Opportunities: Budget increases or prioritisation towards our capabilities; increased Foreign Military Sales; continuation of civil aerospace post-COVID recovery; technology investments to market and synergy with existing capabilities; expanded work scope platform positions; and commercial operation expansion especially in sustainable technologies and space.

Risks: Continued supply chain disruptions around microelectronics and other critical components; labour availability; defence budget constraints driven by US debt levels or spend priorities; slower civil aerospace recovery cycle post-pandemic.

2 UK

Sales[1] by destination



£4,608m

As the largest defence company in the UK, BAE Systems has strong and enduring relationships with the UK Ministry of Defence and our domestic supply chains.

In the UK, the government continues to provide budgetary support to more than meet the NATO target of spending at least 2% of Gross Domestic Product on defence. The budgetary outlook, provided in late 2022, maintained a defence funding outlook that enables the UK government to maintain its commitments to our major long-term programmes in complex warship, submarine and combat aircraft design, build and support, ensuring these key sovereign capabilities remain world-class, as well as strongly supporting the UK's cyber capabilities.

Despite the significant domestic economic challenges, we have long-term visibility for our major UK programmes and operations and we see further prospects in a number of new capability requirements which will create opportunities in the coming years. As one of the UK's largest employers of engineers, we have a central role in the engineering and manufacturing fabric of the country and we are currently training around 4,500 apprentices and graduates on our early careers programmes. We collaborate with suppliers, SMEs and regional partners, including universities, to support and deliver long-term economic growth and productivity, technological know-how and the development of skills.

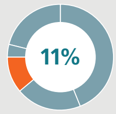
Cyber security and information advantage is an increasingly critical area for national security and is achieved through advanced digital capabilities that we are building in our workforce and for our customers. The UK cyber budget is well supported and we are positioned to benefit from this increased focus.

Opportunities: Leveraging our expertise and capabilities into new domestic and export prospects and partnerships; expand capabilities and offerings in the digital, cyber and space domains.

Risks: Long-term spending pressure on some capabilities due to shift in economic priorities.

3 Kingdom of Saudi Arabia

Sales[1] by destination



£2,539m

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

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

We provide support and sustainment services to the country's air and naval forces through UK/Saudi government-to-government programmes. The Saudi British Defence Co-operation Programme was renewed in 2022 for another five-year period and we anticipate the Salam Typhoon project will be extended early in 2023, also for a five-year term.

The Kingdom of Saudi Arabia's 'Vision 2030' outlines a route map for transforming the social and economic landscape in the Kingdom of Saudi Arabia through increased accessibility – removing barriers to industry, and appealing to international and domestic visitors and tourists – and a continuing commitment to attract and support internal and external investment; to unlock non-oil related economic opportunities; to achieve greater regional and global integration, and co-operation; and to promote in-Kingdom industrialisation.

Three of the key pillars of Vision 2030 are: a 'Vibrant Society', a 'Thriving Economy' and an 'Ambitious Nation'. Each of these are directly supported and championed by the Group through: (i) the localisation of sovereign defence capability and related technology transfers; (ii) a focus on Saudi National human capital, resulting in increased employment and Saudisation; and (iii) economic diversification, creating direct and indirect benefits in the communities that we are part of.

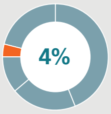
Finally, we continue to work with key local partners, including Saudi Arabian Military Industries, to explore additional collaboration opportunities to build on our lengthy history in the Kingdom of Saudi Arabia. We remain well placed, as a leading in-country contractor, in support of air defence platforms and training systems for the Royal Saudi Air Force, as well as support for mine countermeasure vessels for the Royal Saudi Naval Forces.

Opportunities: Extending Salam Typhoon contract; securing orders for additional support and training, new equipment, upgrades and defence infrastructure programmes.

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

4 Australia

Sales[1] by destination



£854m

As the largest defence company in Australia, BAE Systems has a strong presence across all domains and is growing as the country's defence budget increases and major programmes ramp up.

Australia's defence budget increases are being driven by the regional Asia Pacific threat environment and the need to rapidly modernise its military and incorporate advanced technologies to ensure the country's national security and its ability to interoperate with key allies in all defence and security domains. The government's commitment to defence, as evidenced by its ten-year funding model for defence spending, is fuelling a major recapitalisation of air, maritime and land programmes. Our business in Australia is also underpinned by the government's policies of developing a strong, sustainable and secure Australian defence industry and supporting leading-edge technological innovation.

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

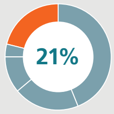
Initial details of the strategically important AUKUS submarine and defence technology co-operative agreement are due to be released in early 2023. We believe we are well positioned to assist the Australian government to meet its goals under this programme with our established workforce across more than 25 sites throughout the country, in addition to a strong ability to leverage BAE Systems' international positions to support domestic products in international markets.

Opportunities: Securing additional workshare from the increased spending outlook and the AUKUS agreement.

Risks: Long-term spending pressure on some capabilities due to shift in government priorities.

5 International

Sales[1] by destination



£5,089m

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

Acute security tensions around the world, the growing emphasis on indigenous capabilities, the need for allied interoperability, and varying economic conditions continue to influence defence spending internationally. BAE Systems aims to further its already strong relationships with partners and customers in a number of countries in the European/NATO community, the Middle East and elsewhere.

In Europe, we are meeting the increased demand for advanced military equipment across all domains, as countries are transitioning away from older generation systems and recapitalising with modern, more advanced air-, land- and sea-based systems. Through our shareholding in MBDA, our position in the missiles and missile systems market continues to grow in European and other international markets. We are also working with the Eurofighter Consortium on potential opportunities for further orders from the Partner Nations. Our ownership of the Sweden-based Hägglunds and Bofors businesses positions us to benefit from current opportunities and future demand, as the conflict in Ukraine has reawakened the importance of tracked combat vehicles, mobile artillery and cold-weather military transport. We are making excellent progress on the Tempest next-generation combat air system. In 2022, we announced our intention to fly a new combat air demonstrator within the next five years, which is an accelerated schedule as compared to legacy fighter aircraft programmes.

In December 2022, the governments of the UK, Japan and Italy announced their shared ambition to develop a next-generation fighter aircraft under a new Global Combat Air Programme (GCAP), which will bring together the Tempest and F-X programmes. The launch of GCAP firmly positions the UK, alongside Japan and Italy, as leaders in the design, development and production of next-generation combat air capability.

The Group's US-based business exports combat vehicles, electronics and precision weapon systems, amongst other systems, to a number of allied customers and participates in additional international markets through partnerships in defence and commercial electronics markets.

In the Middle East, in addition to our business in the Kingdom of Saudi Arabia, the contract for 24 Typhoons and nine Hawks for the Qatar Emiri Air Force is progressing well and our relationships are strengthening as we implement our support and training commitments with the Qatari Armed Forces. We also continue to support other customers that operate the Hawk platform, such as Oman and Bahrain.

In Canada, BAE Systems is the warship design partner on the Canadian Surface Combatant programme of up to 15 ships for the Royal Canadian Navy.

In India, we have long-established relationships with local industry partners on Hawk aircraft and on M777 howitzers.

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

In the Asia-Pacific region, we are a supplier to a number of armed forces, both directly and through joint ventures. We are also pursuing an expanded technology and industrial relationship with Japan, highlighted by co-operation on the GCAP, as that country reassesses its defence posture, with plans to double its defence budget to 2% of GDP over the next five years.

Opportunities: Sustained demand for upgrades to existing equipment, and for next-generation combat air systems, means that we are confident in our long-term business prospects, including development of the GCAP. A significant part of our income comes from providing upgrade, support and training services.

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

1. Sales is defined in the Financial glossary on page 302.

Our key programmes and franchises

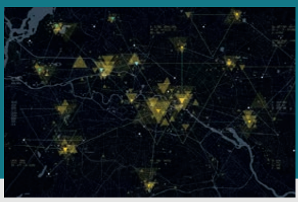
BAE Systems has strong, established and growing positions supplying defence equipment, electronics and services, as well as cyber, intelligence and security solutions for governments. We also have adjacent commercial positions, including in the sustainable technology and space markets, which we aim to expand pursuant to our strategy.

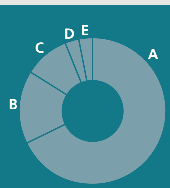
The programmes and franchises underpinning these positions are primarily long term in nature giving us high visibility of our order backlog and sales outlook. This allows us to plan effectively to ensure we have the right people, processes and facilities to enable delivery.

We have strong technological and programme diversity across our sectors.

Sales[1] by key programme

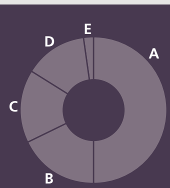
Electronic Systems





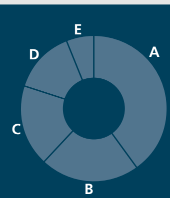
A	Defence electronics	68%
B	F-35 Lightning II	16%
C	Commercial avionics equipment	10%
D	Commercial other	3%
E	Space	3%

Platforms & Services



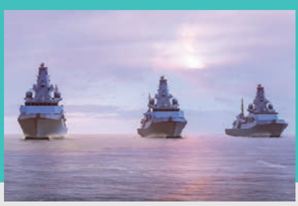
A	Combat vehicles	50%
B	US naval ship repair	18%
C	Munitions	16%
D	Weapon systems	14%
E	Other	2%

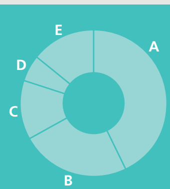
Air



A	Typhoon	40%
B	Tornado	22%
C	Weapons Systems	18%
D	F-35 Lightning II	14%
E	Other	6%

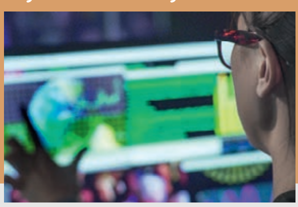
Maritime

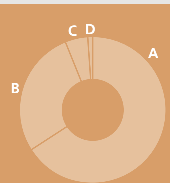




A	Submarines	43%
B	Complex warships	24%
C	UK naval support	13%
D	Munitions	6%
E	Other	14%

Cyber & Intelligence





A	US government	66%
B	UK and other governments	28%
C	Commercial	5%
D	Other	1%

1. Sales is defined in the Financial glossary on page 302.

Defence electronics

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

Commercial avionics equipment

Design, manufacture and support of avionics equipment across multiple commercial aircraft platforms, including engine and flight controls, and cabin and cockpit systems, together with aftermarket support services. BAE Systems is a leading supplier of engine controls for GE, and is a major supplier of flight control electronics for Boeing and other aircraft platforms. Working with our key customers, we scaled the business during the COVID-19 pandemic, whilst ensuring we maintained our capabilities to meet the expected return of long-term demand.

Weapon systems and munitions

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

F-35 Lightning II manufacturing

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

Air support and training

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

Typhoon and Hawk manufacture and capability development

Manufacture of Typhoon major units and final assembly of aircraft. Expansion of the capabilities of the aircraft with the E-Scan radar and ongoing development of new technologies aligned with the UK Combat Air Strategy and forward progress on the Tempest programme. Typhoon manufacturing is currently underpinned by the orders from Qatar, Germany and Spain which will ensure continuity of production of major units into the mid-2020s.

Space

World leader in radiation-hardened electronics for spacecraft and satellites, with more than 10,000 cumulative years in orbit. Our orbital expertise combined with next-generation ground resiliency and data analytics solutions help to keep assets performing effectively in the harsh environments of space. The acquisition, in 2021, of In-Space Missions has added the capability to design, build and operate satellites and satellite systems.

Submarines

Design and manufacture of seven Astute Class nuclear-powered attack submarines for the Royal Navy. The first four Astute Class submarines are in operational service with the Royal Navy, while the fifth boat exited our Barrow shipyard to commence sea trials in February 2023. The remaining two boats are at an advanced stage of build, and the final boat is expected to enter service in the mid-2020s. Design and manufacture of four Dreadnought Class nuclear-powered submarines to carry the UK's Trident ballistic missiles. Manufacture of the first three Dreadnought Class boats is underway, with production on the programme to continue into the 2030s. Early design and mobilisation activities are underway on the Submersible Ship Nuclear Replacement (SSNR) programme, which will deliver a replacement for the Astute Class.

Naval ship repair and support

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

Complex warships

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

Sustainable technology

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

Unmanned and future air system capabilities

Development of future air system capabilities, including joint investment with the UK government and industry in a next-generation combat air system under the Tempest programme, which was launched in 2018 in support of the UK Combat Air Strategy. The Tempest programme is progressing, with the development of a new flying combat air demonstrator, set to fly within the next five years. The Tempest partners are currently working on more than 60 technology demonstrations, and we are operating under an initial Concept and Assessment Phase contract.

Combat vehicles

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

Cyber security and intelligence

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

Our investment in technology

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

Focus areas

There are five core technology areas that support our aspirations for growth beyond our core defence franchises.

Autonomy

Military equipment is becoming increasingly autonomous and this trend is set to accelerate. Supporting human decision-making as well as taking people out of harm's way is a clear advantage, but we also need to help our customers think about how they would respond to adversaries' use of autonomous weapons.

In recent and ongoing conflicts we can see the growing importance of Uncrewed Air Vehicles (UAVs), which have proven highly effective in both reconnaissance and in delivering explosive payloads. Whilst the majority of these UAVs have been controlled remotely by a human operator, there is no doubt that future iterations will have increasing levels of autonomy.

Our military customers cannot be at a disadvantage to adversaries using autonomy on the battlefield, so we are developing a range of autonomous platforms at sea, on land and in the air. In parallel, we are developing a common autonomous architecture so that platforms can more easily be integrated with command and control systems, as well as having the ability to share data and collaborate.

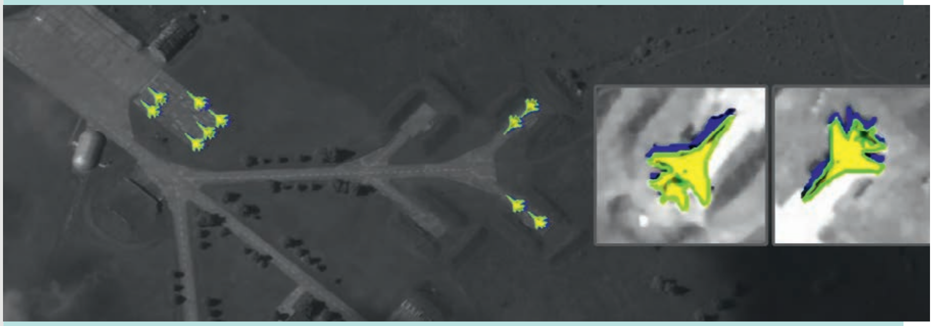
During the year, our P24 autonomous small boat took part in the NATO 'REPMUS' trials in Portugal, preventing access to a vessel taking on the role of an adversary. We continue to develop this boat as well as developing a larger version, which will be able to carry a greater range of payloads.

Undersea, we unveiled our Herne® Extra Large Autonomous Underwater Vehicle. Herne brings together our proven experience in payload integration, sensor packages, mission planning, electronic architecture and mothership integration to deliver an agile and adaptive solution.

Uncrewed Air System technology

We released our new Uncrewed Air System concepts, which are currently being developed to enhance the operational effect of current and future crewed platforms by augmenting the force mix. These concepts have the potential to add combat power, carrying between 40kg and 500kg payloads and are designed to be re-usable in multiple missions, whilst being affordable enough to be sacrificed.

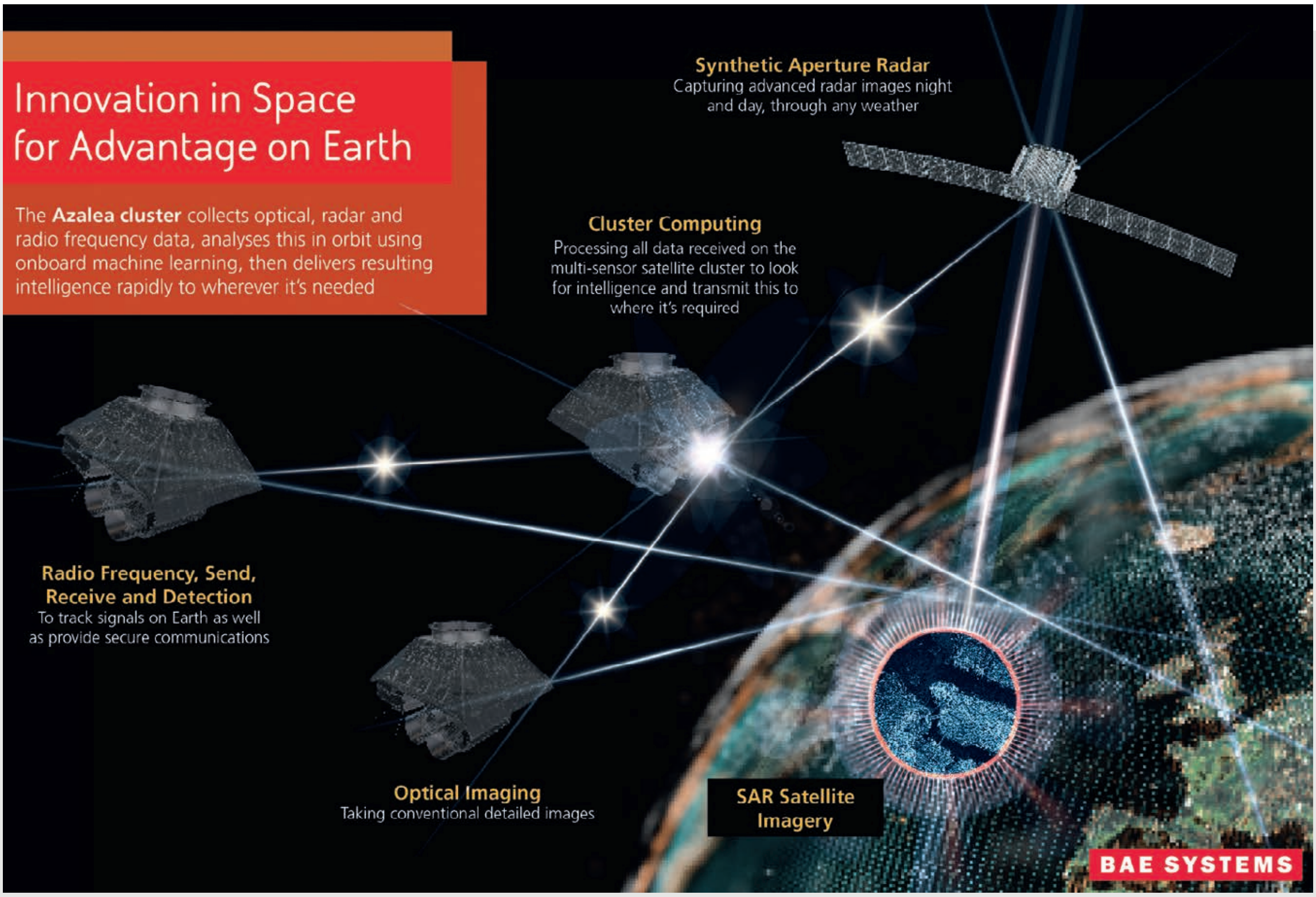
We have also continued our prominent role in developing the flight control and navigation systems for the Royal Australian Air Force's Ghost Bat programme, working alongside Boeing. This work is helping certification of the platform, where we need to prove to the Defence and Civil Aviation Authorities that the vehicle will perform safely in shared airspace.



Autonomous detection capabilities

Leveraging customer R&D funding, Electronic Systems FAST Labs™ has been on the leading edge of developing 3D shape-based object detection technologies that can quickly, accurately and autonomously recognise objects in challenging conditions like rain and fog. The team has matured this technology such that it drastically shortens the time it takes to find objects of interest and engage with them.

In 2022, Electronic Systems employees in FAST Labs and the Command, Control, Communications, Computers, Intelligence Surveillance and Reconnaissance (C4ISR) business collaborated to quickly and successfully integrate this object detection technology into the Geospatial eXploitation Products (GXP) software ecosystem. GXP® software enables timely and effective decision-making through discovery, exploitation, analysis and dissemination of mission-critical geospatial data. With the help of a GXP customer, the teams realised that the GXP product could be further enhanced by FAST Labs' object detection technology, as it would help with tackling hard-to-find targets.



Space

The use of systems in space is becoming increasingly important for our customers to detect and actively monitor activity around the globe.

We added to our space capability in 2021 with the acquisition of In-Space Missions, a UK-based satellite company, which gives us additional Low Orbit capability, complementing what we do in secure communications and tracking, telemetry and control.

We are developing a new multi-sensing satellite cluster, Azalea, which will collect data from a range of sensors and analyse that information in space, allowing it to more rapidly flag threats to users. It will deliver timely, actionable intelligence, essential for military operations and disaster response and our aim is to launch the cluster in 2024. As well as supporting military customers, Azalea will also be able to support civilian operations such as disaster response, coastal and flood monitoring. We are also now talking to other third parties on what they could bring to Azalea.

In the US, we are a world leader in developing, manufacturing and deploying state-of-the-art, radiation-hardened circuits for use in defence, space, intelligence, research, and commercial missions, resulting in our selection by the Department of Defense to qualify a new generation of integrated circuit technology for use in the harsh environment of space. The new 12-nanometre technology uses a smaller feature size that provides a dramatic leap forward in space-based computing compared to current 45-nanometre technology, marking a significant improvement in functionality for space vehicles where volume and power are limited resources.

Sustainability

Our ambition is to deliver more sustainable products without compromising performance – even enhancing performance where possible.

We are exploring a number of technologies to help achieve this and have created an R&D fund specifically to support early-stage sustainability technology projects. One example is our work with Clean Maritime on the Thames Clipper, where we proved that Thames Uber boats could be powered entirely by battery, requiring only a single charge each day.

In addition to our existing work to provide low and zero emission urban transit bus systems, we are developing sustainable air transportation to reduce its carbon emissions. Key technology to providing safe, affordable and reliable hybrid electric and fully electric aircraft in this domain is the development of sustainable battery technology that is dense enough to store adequate energy for air travel and safety margins necessary for contingencies such as reroutes. We are investigating technologies that could help us manage this type of sustainable battery technology, and we are in a unique position to develop and deliver integrated flight controls and propulsion solutions to this emerging market.

We are also playing an important role in integrating a hybrid electric drive into the Bradley armoured fighting vehicle. For more information on this and how we are using our technological expertise to deliver our sustainability agenda please see pages 54 to 59.

Manufacturing and design

As military equipment advances it becomes more complex, but we are determined to make our future platforms more quickly and economically. To achieve this we need to develop and apply new technologies.

Manufacturing efficiency is a key element in making good on our ambition to deliver the next-generation combat aircraft quicker and cheaper than previously. One example is how we're simulating temperature-controlled environments through digital twins.

To manufacture parts for individual aircraft across international locations we currently need to carefully control temperature and humidity, because aluminium panels flex and stretch if these factors change. We have now combined 5G connectivity and machine learning to dynamically adjust the position of the machines to allow for variations in temperature and humidity, machining parts so they are the correct shape and specification for a given set of environmental conditions. This way, we no longer need to heat an entire hangar, so are reducing both CO_2 and energy usage.

One of the most transformational changes in manufacturing and design are our digital ways of working. We can now transfer a digital design into manufacture much more quickly, given that our flexible robotic manufacturing facility can work from the design file with far less interim steps than has been previously possible.

Factory of the future

In our Electronic Systems Factory Workplace of the Future, digital transformation is bringing accurate and actionable data to our fingertips, evolving our legacy manufacturing operations, and achieving operational excellence. In Electronic Combat Solutions, our team used data-driven dashboards and interfaces to manage the business's manufacturing operations and drive a dramatic reduction in the cost of manufacturing, while improving quality. Building on these initiatives, we facilitated an Automated On-Time Delivery tool to provide a high-fidelity view of what was expected to be delivered and when it needed to ship. This dramatically reduced the number of hours spent collecting and analysing the data. The teams were recognised with a Manufacturing Leadership Award from the US National Association of Manufacturers' Manufacturing Leadership Council.

Multi-domain and digital integration

The future battlefield and the future security environment will have many common features including huge volumes of data, a range of people and platforms requiring coordination, and a need to respond quickly. We are using our extensive experience across both military domains and government digital services to help integrate and make sense of this data for our customers.

We launched our deployable open networking product, NetVIPR™, which provides intelligent and secure military communication networks linking everything from small reconnaissance drones to combat vehicles, fighter jets, aircraft carriers or military commands. Recognising the range of systems used by militaries around the world, NetVIPR is a software product designed to work in any standard platform regardless of hardware vendor.

Cloud technology is likely to enable many advances in data integration for our military customers, particularly across domains and in maintaining dynamic access to platform data. We are working with a number of providers to explore the use of the cloud, including Microsoft, to create a 'digital thread' with our naval platforms, to enable data to be shared securely and then analysed in order to inform maintenance and future design choices.

In the US, the Electronic Systems FAST Labs™ research and development organisation won a contract from the Air Force Research Laboratory to introduce artificial intelligence into an interactive game environment to revolutionise air operations planning for contested environments. As part of the Fight Tonight programme, we will provide air operations planners with the tools they need to dramatically accelerate the process of planning complex air attack operations, as well as generate and assess multiple plan options and select the most robust one.

How we innovate

We have a number of research labs across the Group that act as incubators for applying new technologies in order to solve customer problems. Our labs also foster collaborative partnerships with academic and other outside organisations in order to bring a greater level of diverse thinking into BAE Systems.

We have research labs in the following businesses:

- BAE Systems, Inc. – FAST Labs™
- Australia – Red Ochre Labs
- Air – AirLabs
- Maritime – MarLabs
- Digital Intelligence – AI Labs

Research and Development (R&D)

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

In 2022, we spent £2.0bn (2021 £1.6bn) on R&D, of which £287m (2021 £255m) was funded by BAE Systems. In addition, the Group's share of the R&D expenditure of its equity accounted investments in 2022 was £0.4bn (2021 £0.4bn).

We continue to protect our investments in technologies and have a portfolio of patents and patent applications covering more than 2,500 inventions internationally. Combined with a clear strategy for managing our intellectual property (including technology and know-how), we seek to create value in different ways through, for example, licensing, industrial participation, sales of rights and R&D collaborations as part of offset agreements.

Collaboration

As technology gets more complex, no single company can specialise in every area. That's why we work with six strategic universities in the UK, a number of preferred academic partners in the US, two formal university partners in Australia and another in Malaysia. We also bring in expertise from a range of small to medium enterprises (SMEs) such as DIEManalytics, an SME with specialist understanding of data analysis and artificial intelligence, to explore the potential of new and untested technologies in the development of a future combat air system.

We are continuously looking to help small innovative companies bring something unique to defence, by helping them overcome the barriers to entry that are common to the market. Since running the UK Ministry of Defence Serapis framework, we have doubled the number of SMEs working on space projects for the UK government.

Synthetic training
Our engineers are harnessing the power of technologies including virtual and mixed reality to train fast jet pilots and maintainers.

Our global reach also allows us to help support collaboration across governments, such as in the development and production of the Global Combat Ship. Sufficient commonality will be retained to create opportunities for sharing training, operational experience and shipbuilding skills, each of which offers enormous value in bringing friendly maritime nations together.

Under a $60m (£50m) contract from the US Army Contracting Command – Rock Island, the FAST Labs organisation is developing certain types of next-generation, radiation-hardened by design microelectronics. In collaboration with Cadence Design Systems, Carnegie Mellon University, Movellus, Reliable MicroSystems, Sandia National Laboratories, and others, the team is building a new design library that can be used to develop advanced, high-reliability microelectronics and expand the domestic supply of this technology for the defence and aerospace community.

Priorities for 2023

Data and data exploitation will continue to be a focus in 2023, helping both support our physical platforms and deliver actionable intelligence.

By making our ships, aircraft, vehicles and other platforms digitally enabled from the ground up, we are able to more easily provide insights that reduce overall support and maintenance costs. While we have been doing this for a number of years, in 2023 we will be testing new approaches to securely analysing data and making it more available to engineers. In design and manufacture, our increasing use of digital twins will continue to reduce the need for physical prototypes and testing, contributing to our sustainability goals.

We will continue to work on a suite of autonomous vehicles, along with a common autonomous architecture to allow these vehicles to be more interoperable with one another and with third-party platforms and services.

Sustainability remains an important and complex area for us and our customers, given the need for maximum performance in all operating environments. Our work into electrification will continue, for example our pursuits on quadcopters that could take on some traditional helicopter roles, as well as further capability improvements on our hybrid electric and fully electric propulsion systems, which have been installed on buses, ferries and now an armoured vehicle. We will continue to explore a range of technologies to support our work towards our own net zero target across our operations (Scope 1 and 2) by 2030. We will also progress several projects supported by an internal Sustainability Accelerator fund to develop cutting-edge technologies to help us and our customers.

In 2023, we will be developing our cluster of multi-sensing satellites in order to deliver highly detailed radar imagery day and night, in any weather conditions.

We will also continue our government digital transformation work, which has already delivered impressive results supporting the police in finding criminal gangs who exploit children and the vulnerable. In 2023 we plan to offer this service to more customers.

Our investment proposition

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

As one of the world's largest aerospace and defence companies, employing a highly skilled global workforce of approximately 93,100[1] people located in around 40 countries, the geographic diversity of our business is a major strength and differentiator among our peers in the defence sector. We are the largest defence contractor in both the UK and Australia, and a top ten defence prime contractor in the US. Our business spans all domains of the global security market, from air and space, to land, sea and cyber domains.

BAE Systems is poised for further top-line growth and profitability based on robust end markets, the value drivers of our operating model, and the strategic actions we are taking, presenting a compelling investment case for current and prospective shareholders.

Our investment proposition is driven by our consistent strategy and strategic priorities to...

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

Page 16
Our strategic framework

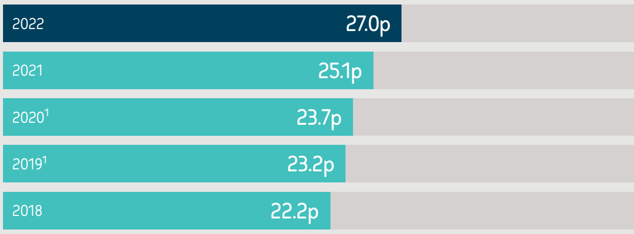
1. Including share of equity accounted investments.

These strategic priorities, together with our ESG agenda, strong business performance outcomes, risk management, and sustainable management and governance of our business are creating and delivering value for our stakeholders.

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

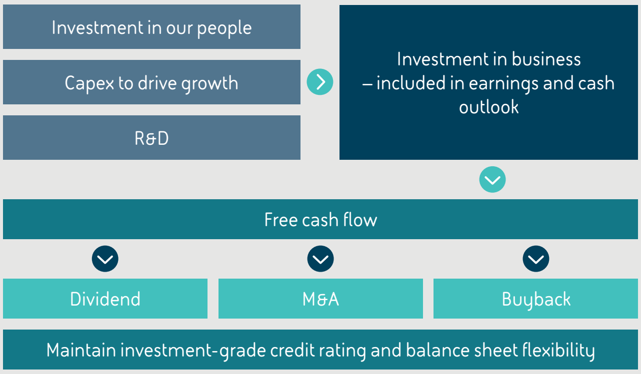
Shareholder returns

19 years of dividend increases

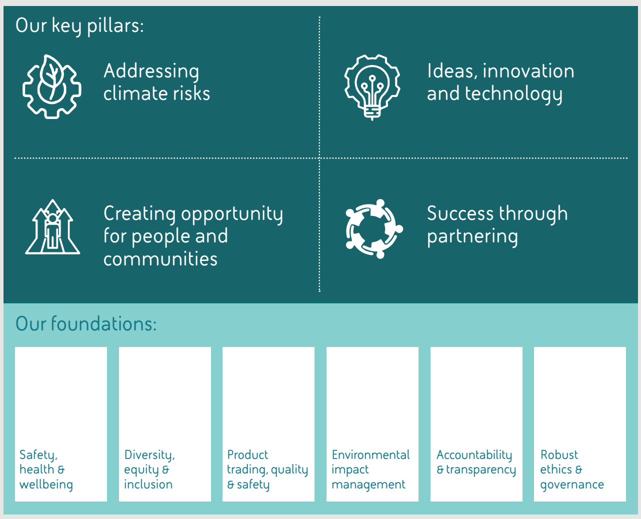


1. 2020 does not include the interim dividend paid of 13.8p per share paid in September in respect of 2019 performance. This amount is reflected in the 2019 dividend history.

Clear, consistent and careful capital allocation



Our sustainability agenda (see page 38)



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

1 Contract backlog provides high level of sales visibility driven by multi-year programmes

- Record annual order intake of £37bn, driving backlog up to £59bn – expect another solid year of order activity in 2023[1].
- Incumbent positions on key long-term programmes in all sectors.
- Backlog represents only currently funded scope, which in many cases is a subset of the expected value of the programme lifecycle. Examples include:
  - F-35;
  - Dreadnought submarines;
  - Type 26 and Hunter Class frigates;
  - Typhoon support;
  - Kingdom of Saudi Arabia support;
  - US combat vehicle production; and
  - Electronic warfare technology.
- Provides visibility on value generators for years to come.
- All sectors positioned to grow from backlog and known programmes with a good opportunity pipeline.

1. Projections are based on internal management estimates and reflect management's current assumptions, including assumed receipt of future orders.

2 World-class defence capabilities

Electronic Warfare
A leader in full-spectrum electronic warfare technology and solutions – continued customer focus supporting growth expectation.

Combat Air
Consortium positions on F-35 and Typhoon – proven availability model for combat aircraft support – leading development of sixth-generation Tempest combat air systems and related technologies.

Combat Vehicles
Build four of five vehicles in US Heavy Brigade Combat Team; CV90/BvS10 manufactured in Sweden for allied customers.

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

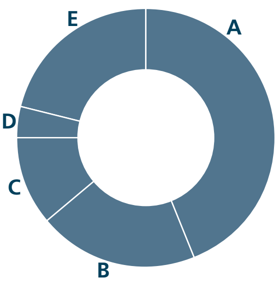
Cyber
Trusted partner for allied nations in an increasingly critical market in cyber security, technology support, modelling and simulation.

Naval Ships
Design, build, support and integrate complex naval ships.

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

3 Diverse geographic footprint – deep customer relationships

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



Sales[1] by destination

A	US	44%
B	UK	20%
C	Kingdom of Saudi Arabia	11%
D	Australia	4%
E	Other international markets	21%

1. Sales is defined in the financial glossary on page 302.

4 Differentiated technology

- We have differentiated technology incumbent positions and are fostering a high-performance, innovative culture.
- More than 2,500 inventions protected by patents or patent applications.
- We are positioning for future growth aligned to customer priorities as threats in the grey zone mean defence needs to adapt.
- The Group's investment in R&D is increasing as we look to build on existing world-leading technologies and generate new differentiating capabilities.
- We are accelerating the pace of innovation through collaboration and partnerships with leading defence laboratories and educational institutions.

R&D investment increasing

Multi-domain	Autonomy	Manufacturing and design	Advanced electronics

Sustainable technology	Electronic warfare	Space	Cyber	Sensors and processing

5 Value-creating operating model

Attractive operating model that runs on negative working capital

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

Creating attractive shareholder returns

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

- Strong consistent programme performance
- Technology investment
- Efficiency and simplification in working
- Portfolio shaping for value creation
- Secure further opportunities and widen market base
- Accelerate our sustainability agenda
- Top-line growth
- Increased return on sales
- Strong cash conversion
- Focused capital allocation
- Higher return on capital employed (ROCE)

Our stakeholders

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

Stakeholders	Areas of interest	Why we engage	How we engaged in 2022
Our people Employees of BAE Systems Page 62 More information	– Safety and wellbeing – Ensuring our people can fulfil their potential at work – Recruitment – Training and development – Reward and recognition – Diversity, equity and inclusion – How we work together – Business conduct – Environmental and social considerations	The skills, capabilities and commitment of our people are critical to ensuring the long-term sustainability of our business and delivering the innovation needed to solve our customers' complex challenges. Effective engagement enables our employees to contribute to improving business performance and helps us to create an environment in which everyone is valued and can fulfil their potential. We have an active commitment to account for the health and safety of all employees, and to provide a safe working environment.	We used a range of channels to engage with employees across the Group, including in-person and virtual meetings, briefings, conferences, toolbox talks, stand-downs and listening forums at all levels. Leaders provided regular updates through videos and podcasts, as well as attending events throughout the year. We also used digital channels including our Employee App, intranet, email and TV systems. Employees were encouraged to share feedback and get involved in Group activities. We ran surveys and insight sessions to measure employee sentiment in the year. Engagement has continued with trades unions in Australia and the UK and labour unions in the US. We engaged with employees on health and safety issues through regular communications, as well as ensuring ongoing maintenance and review of health and safety standards to ensure compliance.
Our customers and end-users Large governments and their procurement bodies, large prime contractors and commercial businesses The people who use our products and services, often members of the armed forces and security services Page 75 More information	– Value for money – Quality of products and services – Risk management – Timely delivery – Safety and wellbeing – Environmental and social considerations – Reliability of our teams to rectify issues quickly	Understanding our customers' needs and challenges is central to our strategy and how and where we invest in technologies and infrastructure. Our end-users protect people, information and nations.	Following travel disruption caused by the global pandemic, we have engaged with our customers and end-users in person. We attended major events including the Farnborough International Airshow in the UK and the World Defense Show in the Kingdom of Saudi Arabia. International summits like the Shangri-La Dialogue (Singapore) and Atlantic Future Forum (New York City) provided strategic access to key customers and stakeholders. We engage at customer meetings and programme reviews and are proud to host customers at our international sites. An example was the roll-out ceremony for the first Typhoon aircraft to the Qatar Emiri Air Force. We also worked closely with end-users at customer facilities, bases and sites. We continue to have regular dialogue with senior military leaders as well as senior ministers and political officials in our key markets.
Our suppliers The companies we work with to deliver products and services to our customers Page 78 More information	– Labour and skills requirements – Cost of materials and operations – Terms of trade – Timely payment – Sustainable sourcing – Supply chain resilience and continuity of supply	Our suppliers and an effective, efficient and sustainable supply chain are essential to enable us to deliver for our customers and end-users. Engaged suppliers perform at a much higher level, knowing they are regarded as valued partners and critical to mutual success.	We worked hard to engage directly with our suppliers and maintained close relationships to ensure continuity of supply and to proactively manage risks arising from supply chain disruptions as a result of global events. This enabled us to support our suppliers, for example by providing extended demand visibility, and providing our expertise to find mutual solutions to identified risks. We also engaged on the topic of sustainability, sharing our ambitions and expectations so that we can generate value for mutual benefit.

Stakeholders	Areas of interest	Why we engage	How we engaged in 2022
Our partners Other industry companies or academic institutions who we work with Page 68 More information	– Product and service development – R&D investment	We benefit from collaborating with other organisations to use our collective expertise and technology to offer the best possible products and services to our customers.	We engaged extensively with our partners, which included our second annual PhD event to share research co-sponsored with UK Research and Innovation. We have maintained regular dialogue with industry partners, organisations such as think tanks and customers around challenges that require a multi-partner approach, such as multi-domain integration, resilient use of space for intelligence and communications, and sustainability.
Our shareholders Investors who provide capital to the business Page 36 More information	– Profitability, growth potential and cash generation – Capital allocation; returns via dividend and buyback – Operational performance – Quality of management – ESG considerations – Share price performance	To ensure the owners of our shares and potential investors in the Company have a full understanding of our business including the strategy, growth potential and risks in the business as well as the overall performance of the business.	We conducted an enhanced investor programme with an Investor Relations Officer now based full time in the US, allowing us to conduct more investor engagements in North America. Meeting format was a mix of in-person and virtual. Engagements were a balance of management and Investor Relations meetings, attendance at investor conferences, trade shows and bank-led Q&A sessions. In addition to the core programme, we hosted briefings with a number of investors at the Farnborough International Airshow and held a capital markets event focused on ESG and our Digital Intelligence business.
Our communities The people who live where we work and charitable organisations we support Page 60 More information	– The value we bring to the communities in which we operate – Employment – Local community factors including environmental and social considerations	To ensure we maintain the trust of the communities where we work. To understand and respond to any issues important to our communities. To provide employment opportunities and contribute to the economic prosperity of the places where our people live and work.	Fundraising returned to our sites in 2022, with large-scale employee fundraising activities taking place, as well as longer-term, cause-based, fundraising campaigns. We continued to support the advancement of skills and education initiatives across our markets through charitable and non-charitable sponsorships with new and existing partners, as well as supporting our local communities through new forms of skills-based volunteering.
Regulators Governmental bodies that oversee industry or business activities Page 75 More information	– Relevant laws and regulations	In order to have a constructive dialogue with those who oversee the regulations which can impact our business.	We liaised openly and constructively with various regulators, including conducting ongoing discussions with UK and US regulators in support of efforts to drive efficient compliance, improve bilateral and multilateral defence trade co-operation and support the Group's licensing strategy. We supported initiatives by industry associations to work with regulators to the same end.
Our pension scheme members Members and trustees of our pension schemes Page 36 More information	– Group performance – Member benefits – Pension fund investment strategy – Deficit recovery	To make sure current and former employees in our pension schemes are informed about how we continue to meet our commitments to them and ensure they have access to all the information they need to manage their pension arrangements.	We continued to engage with our UK members via our pensions website, ensuring they have access to key scheme documents and pensions information. All members received a newsletter to keep them updated and engaged in their pension planning; for members of our defined benefit pension schemes, this included an annual report on the financial health of their particular scheme. We worked with our Consultative Committees, to ensure ongoing dialogue between the Company, the Trustee and members. During 2022, consultations with members of the UK schemes with defined contribution benefits took place regarding a change in provider for pension provisions.

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

The work of the Board

We set out our business model on page 18, which highlights the key elements of how we do business. The requirements of the s.172 directors' duty are closely aligned to those that underpin our business model and these principles are not only considered at Board level, they are firmly part of how we do business across the Company. In order to achieve long-term sustainable success, the Board regularly considers the views and interests of stakeholder groups throughout its decision-making process. In this statement, we highlight some of the key discussions and decisions undertaken by the Board during 2022.

The Board receives an update from the Executive Directors at each Board meeting which details any substantial engagement and developments with key stakeholders.

Companies Act 2006, Section 172(1)

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

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

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

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

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

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

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

Key matters considered and decisions made in 2022

Environment and climate change

The Group has set a net zero ambition for Scope 1 and 2 operations by 2030 and to be working towards a net zero value chain by 2050. During the year, the Board and Environmental, Social and Governance (ESG) Committee received updates on the progress towards our 2030 target, and the work undertaken to increase usage of green energy sources and improve the Group's ability to monitor and measure carbon emissions. The Group has also initiated a programme of activities aimed at developing its reporting against Task Force on Climate-related Financial Disclosures (TCFD) requirements – a methodology to model climate change-related risks and opportunities. This has also been the subject of Board and ESG Committee review.

To better articulate our decarbonisation strategy, the Group undertook a detailed evaluation of its carbon reduction plans. The output of this is embedded in the Integrated Business Plan (IBP) that sets the five-year financial plan against the strategic priorities for the business. With regards to the Scope 1 and 2 elements of our net zero programme, the resulting IBP outputs were reviewed and approved by the Board in November. This includes the work undertaken in our business sectors to identify areas to reduce energy consumption and increase efficiency of energy use. The Board recognises that in order to meet our net zero ambitions for our value chain (Scope 3), we will need to work closely with customers and suppliers to advance green technology solutions and align how we are working to define and achieve common objectives.

As part of its annual Strategy Review, the Board considered how climate change considerations are increasingly impacting defence and commercial markets. The strategy adopted by the Board in 2022 identifies business solutions in defence and adjacent markets. These include building on the success of our low and zero emission vehicles business based in the US, further investment in the electrification of land, sea and air platforms, for both military and commercial customers, and the development of sustainable solutions for customers in support of climate change-related goals.

The Board also undertook further externally facilitated training to ensure that we continue to improve our knowledge of the matter and understand the risks and opportunities for the Group.

Company culture and employee engagement

In accordance with Provision 5 of the UK Corporate Governance Code 2018 (the Code), the ESG Committee undertakes workforce engagement on behalf of the Board, and Dr Jane Griffiths, Chair of the ESG Committee, provides regular updates to the Board on employee engagement. Additionally, reports from members of the Executive team, and our first-hand interactions with employees, allowed for discussions on various employee-related matters throughout the year. We engaged directly with employees through a mix of site visits, town hall Q&A sessions, informal discussions during on-site lunches, and dinners with high-potential employees. A fuller overview of our engagement during the year and our employee engagement framework can be found on pages 152 to 153.

The Group ESG, Culture & Business Transformation Director engaged with us on key employee-related matters. During these conversations we remarked on the step-change we achieved in the quality of employee communications during the peak of the pandemic, when engagement was more direct and personal. We have continued to build on these foundations in order to progress conversations on wellbeing and mental health and to foster inclusive practices. In September, the Board looked in detail at how organisational transformation activity is being used to create a more agile and efficient organisation with greater emphasis on employee empowerment, diversity, equity and inclusion, talent development and retention.

The Board discussed at length the challenges of post-pandemic global increases in workforce attrition and labour shortages, and the impact the cost of living crisis is having on our employees. Various initiatives were deployed across the Group to attract, develop and retain a talented workforce for now and for the future. In our US business, an Employer of Choice initiative sought to better articulate our employee value proposition and career development prospects. To ensure that employees felt included and were aware of the career development opportunities available to them, our HR teams worked with line managers to support them in dealing with changes in the workplace resulting from more flexible ways of working. Overall, we made progress in addressing the labour attrition issue through a hiring and retention strategy that stressed the quality of our employment proposition – often offering job-sharing and more flexible work patterns for employees.

The Board appreciates the importance of workplace culture in the attraction and retention of a high-performance workforce. In particular, it welcomed the emphasis the businesses have placed on developing the right workplace culture and the work being done to maintain that, as we adopt more flexible working practices with increased levels of home working.

The Board was pleased to learn of the number of former employees electing to return to the organisation, and the positive implications of that in terms of our culture and workforce offering. In order to gauge sentiment, the UK business launched monthly pulse surveys which allowed for a consistent assessment of culture throughout the year. Positive results in key indicators such as financial performance, ethics concerns, safety performance, absence rates and commercial success, highlighted the improvements in the Group's culture.

The Behavioural Framework is a key element of how we provide clear guidance on what we expect from our business leaders and stress the equal importance of what we do and how we do it. The Group HR Director explained that these behaviours were embedded within the personal objective-setting process, as well as within development and training materials for managers and individual contributors.

We also received updates about the various initiatives underway across the Group in response to the rising cost of living crisis and the resulting impact on employees and their families. The Chief Executive kept us appraised on the progress of pay negotiations with our unionised workforce, and the positive outcome achieved for all parties – further details can be found on pages 63 to 64. Employees were also reminded of the resources available by way of the Employee Assistance Programme, the employee Credit Union and other mental health and wellbeing resources to manage additional stresses.

Suppliers

The macroeconomic disruptions resulting from COVID-19 and geopolitical instability from the Ukraine war caused a strain on supply chains for us and many other companies. Throughout 2022, the Board placed a high priority on monitoring how our supply chain teams were managing the challenges and mitigating the impact on performance. Supply chain disruption was, and continues to be, a significant issue for the business but early recognition of the potential problem, coupled with active engagement by supply chain and business teams, has helped contain the impact on performance.

Over the past few years, the Board has been supportive of the priority the Chief Executive has placed on developing a Group-wide procurement function. The transformation programme for the function has focused on developing its people and systems and introduced long-term supply contracts that leverage the scale of the Group and deepen our relationships with key commodity suppliers. These efforts were vital in helping the Company mitigate supply chain disruption in the last year and are evolving beyond procurement, to include other aspects of the supply chain.

Supplier relations are also crucial to how we progress our decarbonisation ambitions. During the year, a review of the Group's supplier base was undertaken to assess ESG risks and create better metrics to support value chain decisions.

Our Chief Procurement Officer also updated us on the refreshed Supplier Principles which have been revised to encourage suppliers to assess the impact of their operations through an ESG lens. The Board noted that the Group was exploring opportunities to share skills and support supplier development, in recognition of the more broadly based relationships we are looking to develop within the supply chain.

Stakeholder engagement

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

Page 32
Our stakeholders

Page 60
Creating opportunity for people and communities

Page 151
Environmental, Social and Governance Committee report

Investors

The Group provides regular updates to investors and engages in meaningful dialogue on operational and financial performance, and increasingly ESG matters, to allow investors to take a holistic view of the Group's performance. The Board has discussed how the Group can best communicate its ESG credentials and the progress and ambitions it had in respect of these issues. We agreed the need for the Group to continue to be transparent on the progress we are making on the ESG agenda and provide purposeful updates in our communications to stakeholders. We also heard about the Group's performance in ESG ratings and indices.

Throughout the year, the Chairman and the Executive Directors reported on the discussions they'd had with investors regarding ESG progress and to highlight the importance of defence and security, and the role played by the defence industry.

Building on the positive feedback from the previous year, the Group held an ESG event in October 2022. More than 150 investors dialled in or attended the event in person. The Chairman, Chair of the ESG Committee, and the Executive Directors presented a detailed overview of our Company purpose and the progress against our ESG priorities in the year. Attendees were also given an overview of how we apply ESG across the Group, including case studies on how we are implementing novel heat and power solutions, reducing energy consumption, adopting low and zero carbon emission transport options, developing employees and embedding ESG considerations into future programmes.

Following the full-year and half-year results, the Chief Executive, President and Chief Executive Officer of BAE Systems, Inc. and Group Finance Director undertook various investor roadshows and discussed the Group performance with shareholders representing over 50% of the share capital. The key themes of these conversations concerned capital allocation priorities, supply chain pressures, labour market challenges and how heightened geopolitical threats could affect order intake. In response, we continued to provide updates on these matters in our half-year results and trading statements. Separate from the investor relations work that the executive directors undertake, the Chairman also engages regularly with shareholders.

Spotlighting our disruptive technology
FAST Labs™ research & development team leaders brief members of the Innovation & Technology Committee during a September visit to the Electronic Systems Merrimack, New Hampshire facility.

His conversations with investors are focused on governance matters and he regularly provides feedback to the Board on these meetings. During the year, he reported on the positive comments made by investors on the Group's performance and their support for the executive team. We heard that progress in managing succession planning is a key issue for investors and we have provided more information on this in the Nominations Committee report (see pages 140 to 143).

To provide the directors with direct feedback on how the Group is viewed by investors, we also undertook an externally facilitated investor study, which included interviews with 20 leading investors, representing a third of the Company's issued share capital. Overall, investor comments were positive. The interviews showed that investors valued the improved financial performance, strong leadership team and well-balanced geographic spread of the Group's portfolio. Investors also stressed the importance of the Group maintaining strong operational performance and robust programme execution.

From our various engagements with investors during the year we gained a good understanding of their view of capital allocation priorities, including investment in R&D, value-adding M&A and shareholder returns.

Capital allocation – share buyback decision

In publishing its half-year results in July the Board announced a three-year £1.5bn share buyback programme. This decision was based on continued good operational performance, a positive outcome to the UK pension triennial review and confidence in the future outlook for the Group.

In making this decision, the Board considered its stakeholders, the long-term needs of the business, investor feedback and the need to maintain the necessary flexibility to prudently manage the Group's operations. It was important to us that we continued to maintain our capital allocation priorities and manage the balance sheet conservatively, whilst maintaining our objective of paying dividends, in line with our policy of cover of around two times underlying earnings. We also noted that the Group's continued investment in R&D had increased during the year, and we were satisfied that the level of Group-funded R&D was appropriate.

One of the key stakeholder groups we considered was the Group's employees – past and present, and the protection of their post-employment benefits within the pension schemes. In light of the strength of the Company's covenant, and noting that all schemes were fully funded on a technical provisions basis at their last actuarial valuations, the Company made its final deficit reduction contribution under the previously agreed main scheme recovery plan in March 2021. The elimination of this funding obligation materially strengthened the balance sheet. As part of the buyback decision, the Board also agreed that a payment would be made to the scheme, in accordance with an agreement with the Trustee.

Ethical business conduct

Behaving ethically is fundamental to our values and at the bedrock of our culture. The Board sets the ethical standards that guide all that we do as a Group. The Group operates in highly regulated sectors which require strict adherence to local and international regulations and our Code of Conduct makes our expectations clear to employees. In implementing key considerations and decisions made in the year, the Board considered the different interests of our stakeholder groups and sought to act fairly between them.

We regularly review the efficacy of the Group's ethics programmes by undertaking an annual review into ethical conduct. During our most recent review in July, we reviewed key indicators from various data and metrics, to monitor trends, provide insight and facilitate benchmarking on the ethics programme. An analysis of this data was undertaken against a global benchmark which gave us reassurance that the programme was effective. The Board noted certain workplace and external factors that will need to be monitored to ensure they do not impact performance, including increased levels of remote working, workplace stress and the cost of living challenge.

Community engagement and investment

The Board understands that the Group's operations put it at the heart of local communities – the places where we operate and our employees live and work. The Group seeks to play a constructive role in tackling issues through engagement and investment, and by identifying what is important to these communities and how best to collaborate to find solutions.

In 2019, the Company received shareholder approval to amend the Company's Articles of Association, in order to facilitate an asset re-unification programme to identify shareholders who had lost touch with the Company. In 2020, the Board agreed a programme whereby unclaimed shares were sold and the proceeds used to fund good causes benefiting the local communities wherein we operate (with a proportion of funds retained to be used, should it be possible to locate the former owners of the assets at a future date). These monies would allow for further commitments for community initiatives, in addition to our regular funding.

During 2022, funds raised through the programme were committed to six community projects in the UK, the Kingdom of Saudi Arabia and Australia, further details of which can be found on pages 66 to 67.

Customer and other stakeholder engagement

The Group engages with a variety of stakeholders on a regular basis. Feedback is received on a number of different topics and helps inform numerous decisions made on a delegated basis across the Group – but within the highly developed governance structure approved and overseen by the Board. Stakeholder feedback is also received by the directors, either directly, via executive management or through formal reporting processes. In particular, the Chief Executive briefs the Board regularly on key customer relationships, which is supplemented by feedback provided by the Chairman based on his high-level engagement with customers in the UK, Kingdom of Saudi Arabia and Australia. Further information on stakeholders and how we engage can be found on page 32.

A look inside the APKWS® factory
Board members tour the Electronic Systems factory where APKWS laser-guidance kits are produced.

Our sustainability agenda

Sustainability is fundamental to our business performance and the delivery of our sustainability agenda is how we address our material Environment, Social and Governance (ESG) risks and opportunities.

Our sustainability agenda supports our purpose – "to serve, supply and protect those who serve and protect us". Our products and services help to enable governments to defend the lives and freedoms of people around the world, support international stability and keep people safe. At the same time our business supports the prosperity agenda of nations with high-quality, well-paid sustainable employment and being a valued member of the communities we operate in.

Many of our programmes are complex, pushing the boundaries of current technology. The products we design and build now will remain in service for decades to come which emphasises the need to develop long-term sustainable solutions. This is why we are strongly aligned with governments' national decarbonisation programmes, working closely with our customers and partners in developing sustainable solutions, as well as setting a target of achieving net zero greenhouse gas emissions across our own operations (Scope 1 and 2) by 2030.

Reducing the impact of our products and wider value chain, whilst maintaining or improving delivery of our customers' capability, is also a key part to this. To do this we collaborate with our customers and partners and every year we invest in research, development and skills.

Our ability to meet these complex engineering and technology challenges depends on the commitment, skills and talent of our people and it is critical that we continue to attract, retain and develop the very best talent. To do this we must ensure that our workplaces provide an environment where our employees feel valued, included and able to thrive in their professional development. By contributing to activities and organisations that align with our business, we also aim to make a positive social and economic contribution to the communities in which we live and work.

Sustainability integrated into all we do

Our sustainability agenda is driven from the top by our Chief Executive, who has primary responsibility for delivery of the Group's strategy. He is supported on sustainability matters by the Group ESG, Culture & Business Transformation Director who advises on the strategy with input from a wide range of stakeholders.

Sustainability is integrated throughout our business from our strategic framework, our governance systems and policies, to the integrated financial planning process and business review cycles. Cross-functional and cross-sector steering groups provide expertise and oversight and our assurance framework and Internal Audit regularly assess compliance with policies and processes.

Our Board Environmental, Social and Governance Committee provides oversight and assurance of the Group's agenda and progress, including approving ESG-related objectives and targets which form part of the executive incentives. At each meeting the Committee hears from both senior management and the Group's subject matter experts. The Committee routinely reviews data and participates in site visits and meetings to engage directly with employees and hear their views. This dialogue enables the Committee to reflect employee perspectives in boardroom discussions.

Clear and open two-way communication from the boardroom, through the executive and across all our sites ensures our employees understand, appreciate and can contribute to the sustainability agenda which underpins strong operational performance and value for stakeholders.

Our foundations and key pillars

We recognise that sustainability is a broad area with many criteria. We focus on the areas which are most material to our sector, our communities and our business. We then collectively address these areas with our customers and supply chain.

Our agenda has evolved during 2022 to both confirm the strong ESG foundations that are core to our business and the four key pillars which present opportunities for us to accelerate our agenda and harness our strengths and capabilities. The progress on both our core foundations and the work to embed the four key pillars is detailed below.

Our key pillars:

Our foundations:

Addressing climate risks

Read more on page 40

Ideas, innovation and technology

Read more on page 54

Creating opportunity for people and communities

Read more on page 60

Success through partnering

Read more on page 68

Safety, health & wellbeing

Read more on page 72

Diversity, equity & inclusion

Read more on page 73

Product trading, quality & safety

Read more on page 75

Environmental impact management

Read more on page 75

Accountability & transparency

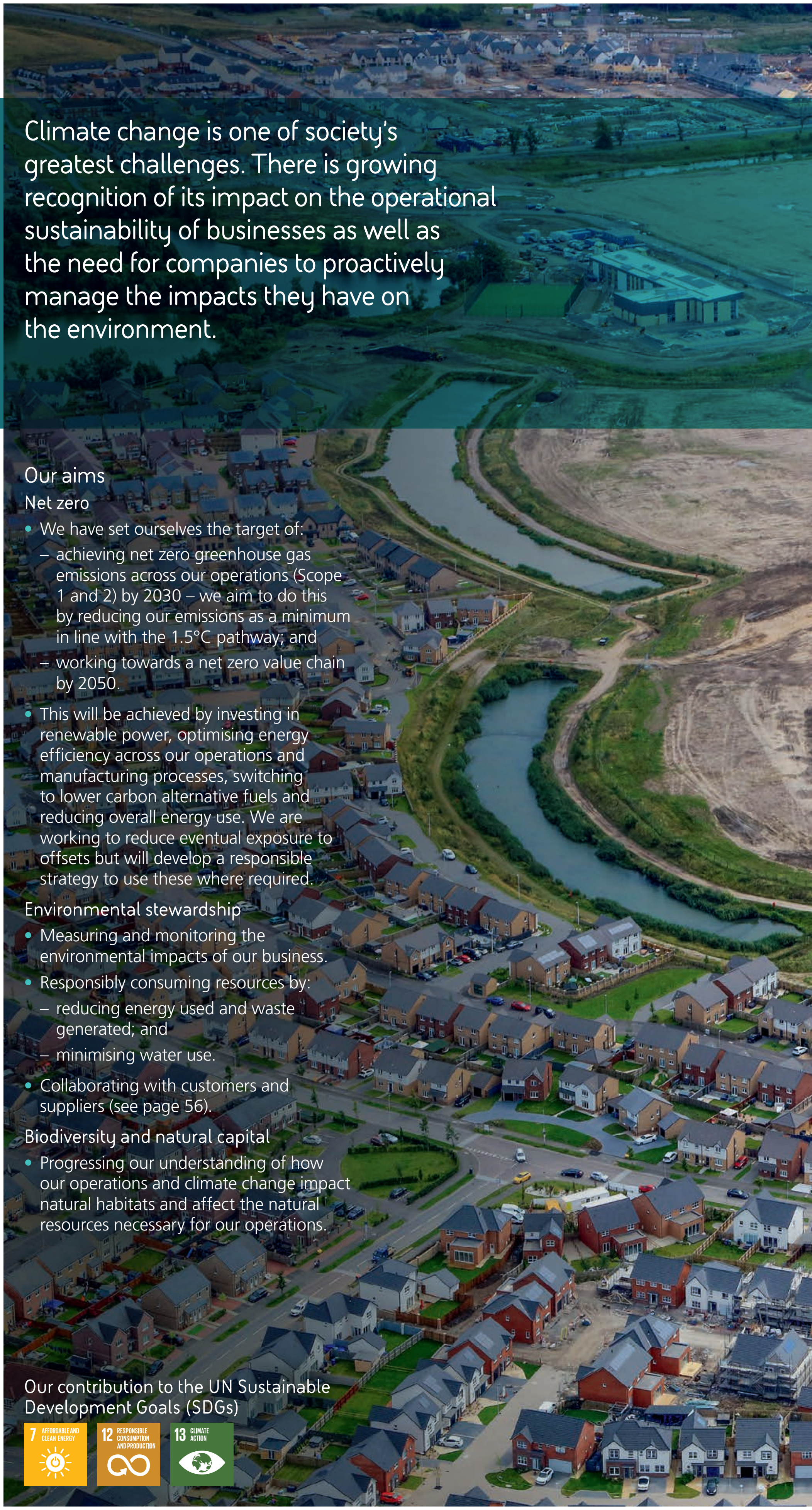
Read more on page 75

Robust ethics & governance

Read more on page 75

Our key pillars

Addressing climate risks



Climate change is one of society's greatest challenges. There is growing recognition of its impact on the operational sustainability of businesses as well as the need for companies to proactively manage the impacts they have on the environment.

Why is this important to BAE Systems?

Solving the challenge of climate change requires all of us to act together. Our approach to climate resilience includes both assessment of the physical and strategic impacts on our own sites and operations and the development of a wider decarbonisation strategy that encompasses the transition plan (where planned actions are summarised on page 42) and sector net zero roadmaps, with the aim of:

- decarbonising our operations by 2030 to reduce the impacts of our own activities (see page 42);
- supporting our customers on their transition to net zero by developing low carbon products and services (see page 56);
- developing the skills and capability of our employees to drive innovation to deliver a portfolio of low carbon products and services (see page 63);
- supporting and collaborating with suppliers on their sustainability journeys (see page 56); and
- working with our local communities to support sustainable initiatives (see page 64).

This is underpinned by strong governance, with the capability in place to contribute to global decarbonisation efforts.

Our aims

Net zero

- We have set ourselves the target of:
  - achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030 – we aim to do this by reducing our emissions as a minimum in line with the 1.5°C pathway; and
  - working towards a net zero value chain by 2050.
- This will be achieved by investing in renewable power, optimising energy efficiency across our operations and manufacturing processes, switching to lower carbon alternative fuels and reducing overall energy use. We are working to reduce eventual exposure to offsets but will develop a responsible strategy to use these where required.

Environmental stewardship

- Measuring and monitoring the environmental impacts of our business.
- Responsibly consuming resources by:
  - reducing energy used and waste generated; and
  - minimising water use.
- Collaborating with customers and suppliers (see page 56).

Biodiversity and natural capital

- Progressing our understanding of how our operations and climate change impact natural habitats and affect the natural resources necessary for our operations.

Our contribution to the UN Sustainable Development Goals (SDGs)

Building a sustainable community

The closing of the Bishopton Royal Ordnance Factory in 2001, which had manufactured explosives in Scotland for over 80 years, presented us with a significant opportunity to transform this 2,400-acre brownfield site into a sustainable community where housing, facilities and infrastructure have been built alongside green spaces and in harmony with the natural environment.

From design to delivery, we've invested significantly in the sustainable regeneration of the site. We have created accessible off-road paths, landscaped green spaces and community woodland areas as well as park and ride facilities, to allow the community to have increased access to nature.

At each stage of the development, we sought to create open, natural spaces, re-use and recycle materials, promote walking and cycling, protect and enhance ecological biodiversity, and support the local economy.

The programme has won awards from the Royal Town Planning Institute, Homes for Scotland, the Scottish Environmental Protection Agency and Green Apple, as well as three Brownfield Awards.

The work at Bishopton demonstrates how we conduct our business in a socially responsible manner, valuing the communities we work in, and leaving behind a positive legacy for future generations.

What have we achieved in the year?

Progress towards net zero

Our ambition is to be carbon neutral across our operations (Scope 1 and 2) by 2030; we will seek to minimise the requirement for offsets through this process.

We have established a roadmap based on phases of activity and level of investment, to monitor our progress to decarbonise our operations (Scope 1 and 2) by 2030. In putting together the roadmap we have considered the commitments made by the UK government. We have aligned our Scope 1 and 2 carbon reduction roadmaps to a science-based pathway of 1.5°C and set progress against this in both our in-year and long-term incentives (see page 181). We continue to mature our approach to the quantification and understanding of the more complex Scope 3 emissions. We will therefore delay our submission to the Science Based Targets Initiative (SBTi) whilst we continue to do this. We remain committed to aligning to a 1.5°C reduction pathway for Scope 1, 2 and 3.

Our in-year and long-term incentives are aligned to the Group achieving a 4.2% operational greenhouse gas (GHG) emissions reduction target, in line with a science-based pathway of 1.5°C, year-on-year over ten years (against a baseline year of 2019), with a 90% reduction in GHG emissions being achieved by 2050. As our understanding of Scope 3 emissions matures, we will consider reduction pathways in line with a science-based pathway of 1.5°C.

Our sectors have each developed decarbonisation roadmaps that outline short-, medium- and long-term activities to support the Group's decarbonisation ambition against three emissions reduction levers – increase use of renewable energy through investment in both power purchase agreements and self-generation, reduce and optimise energy consumption, and invest in and procure green technology. These roadmaps form the basis of our net zero programme, and identify the level of activity and investment required across the business, to decarbonise our operations by 2030. Key activities outlined within the roadmaps are included within the Integrated Business Plan (IBP), which is reviewed annually by the Board as part of our Strategy review and are part of the Group's financial planning. Activities include long-term power purchase agreements, site consolidations, improving energy efficiency of buildings, on-site renewable energy installations, LED lighting and wider use of electric vehicles. Other activities and opportunities to improve efficiencies and reduce emissions are being considered over the long term, for example, decarbonisation

Net zero programme emissions reduction levers	Activity	Timeline[1]
Invest in renewable energy	• Power purchase agreements • On-site renewables	Short to medium term
Reduce and optimise energy consumption	• Real estate utilisation/consolidation • Implement energy efficiency measures – LED lighting, switch to electric fleet vehicles, retrofitting buildings	Short to medium term
Switch to lower carbon alternative fuels	• Replace operational aviation fuel use with alternatives • Monitor and apply development of low carbon heat sources	Short to medium term Medium to long term
Offset Our current approach is based on the principle of reducing emissions as far as practicable prior to engaging in offsetting	• Offset residual greenhouse gas emissions	Medium to long term

1. Short- (less than two years), medium- (three to ten years) and long-term (beyond ten years) time horizons. Time horizons are linked to the Integrated Business Planning Process.

of heating systems via electric power and carbon capture technology. We will also continue to monitor and apply developing technologies over the medium to long term to further decarbonise our operations. As activities are added to the roadmaps, they will be included as part of the IBP process.

Once our emissions have been reduced as much as practicable, we will consider the use of offsets to decarbonise our operations by 2030.

We have also strengthened our governance model to support our transition to a low carbon company, amending key policies and processes including our environment policy and Operational Framework to consider climate-related impacts.

We continue to assess and manage the climate-related physical risks and impacts across our global facilities, implementing improvement recommendations, including investment to improve facilities.

Environmental stewardship

We have continued to proactively manage the impacts of our business on the environment by responsibly consuming resources. Consumption of resources and materials can be different year-on-year, due to the differences in geography and stage of manufacture of our platforms and programmes.

We are taking a business-led approach to setting reduction targets and driving improvement programmes and activities to support responsible consumption. Sectors set objectives to improve the performance of their operations such as reducing energy used and the generation of waste, emissions and other discharges, such as effluents.

All sectors are developing plans for increasing renewable energy generation in line with our net zero roadmaps, whilst progressing energy efficiency measures.

We have continued to progress activities across our sites to reduce waste by addressing the specific production and non-production waste streams of programmes and facilities.

Activities have included reducing the amount of waste going to landfill via recycling, treatment and incineration, and adapting our manufacturing processes.

The sectors have also continued to minimise the water used across our facilities and manufacturing processes, in order to protect and support the water ecosystems on which our facilities and communities depend. Some sectors set initiatives and targets to reduce water consumption annually as appropriate. Initiatives are specific to how the sectors consume water operationally and incorporate stages of manufacture, for example, flooding of dry docks.

During 2023, we will be establishing Group targets for water use and waste management. These targets will be disclosed in 2024.

Biodiversity and natural capital

Nature loss and degradation poses a major risk to both the environment and society. We are undertaking surveys and assessments to better evaluate how our facilities and operations impact the surrounding natural habitat.

Operationally, significant aspects of biodiversity are addressed via our environmental management system (EMS) which includes protecting natural habitats, conserving protected species and the management of invasive species in and around our sites.

Our sectors have established a number of initiatives to support their local ecosystems from installing bat roosts, removing invasive species, planting wildflowers to attract bees, cleaning up water courses and restoring underwater environments.

Across major UK sites, we also undertook a lifecycle environmental assessment for our products to understand our nature-related impacts, supported by natural capital evaluations carried out by third parties across major UK sites.

We are monitoring the progress of the Task Force on Nature-related Financial Disclosures.

Climate and environmental risk management

Climate and environmental risk is embedded within our approach to risk management (see page 124) via our business and project risk registers. Climate-related physical and transition risks have been identified and assessed as part of our decarbonisation strategy.

Wider environmental risks have been identified as part of our EMS – consideration of current and emerging regulation is key to mitigating risk. Identified regulatory risks include energy-related taxes and the increased costs of compliance with energy-related schemes.

Understanding how our businesses may be impacted by changing environmental factors is important to mitigating emerging, medium- and longer-term risk. Water scarcity is an example of an environmental factor that has the potential to impact our operations, for example, at those sites extracting water for process use.

The direct environmental risks we have identified and have set mitigation plans to address include:

- expanding environmental regulation and permitting requirements;
- transitioning to a low carbon economy;
- physical risk related to extreme weather events;
- technology and innovation evolution required to respond to future requirements of customers;
- maintaining skills and capabilities to sustain our current and future operations;
- social and political change, differing legislation and policy in our various markets; and
- risks associated with climate-related physical and transition risks (see page 124).

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

Climate change and environment is identified as one of the principal risks for the Group (see page 124). Climate-related risks may present as financial or non-financial risks depending on the extent to which their impacts are associated with the near-term financial planning or have a wider reputational or strategic impact.

During 2022, our sectors started to incorporate wider climate risk within risk registers, including probability, speed and mitigation impact. This activity will progress in 2023 supported by the maturing over time of sector net zero roadmaps.

Building sustainably

In the autumn of 2022, we finished building the Maritime Integration and Support Centre in Portsmouth. The £10m investment provides a specialist facility for research and collaboration on Royal Navy warships and combat systems and technologies.

The building was designed with sustainability in mind. We installed water-efficient appliances and digital monitoring to allow a 40% reduction in its overall water usage. Responsible waste management, and recycled or sustainably sourced materials, were also used throughout the new building.

In Samlesbury, our eco-friendly-designed Bowland Centre houses a restaurant and wellbeing centre designed by our employees, for our employees. It was constructed to high environmental standards and achieved a rating of 'excellent' from BREAAM (Building Research Establishment Environmental Assessment Method) which puts the centre in the top 10% of UK non-domestic buildings in terms of energy efficiency. The centre features many environmentally-friendly elements such as natural lighting and renewable energy generation.

A wetland garden developed to the rear of the building has turned into a thriving habitat for local wildlife. Nearby, our solar farm, the size of eight football pitches, helps to power the advanced manufacturing of world-class fighter jets on-site.

Task Force on Climate-related Financial Disclosures (TCFD)

The following tables summarise our disclosures relating to the four TCFD Recommendations and the 11 Recommended Disclosures pursuant to Listing Rule 9.8.6(R)(8). We have made considerable progress in our net zero programme. We have established a roadmap based on phases of activity and level of investment, to monitor our progress to decarbonise our operations by 2030 (Scope 1 and 2). Our sectors have each developed decarbonisation roadmaps that outline short-, medium- and long-term activities to support the Group's decarbonisation ambition. We have aligned our Scope 1 and 2 carbon reduction roadmaps to a science-based pathway of 1.5°C and set progress against this in both our in-year and long-term incentives.

We believe our approach is consistent with nine of the 11 TCFD Recommendations. The areas we will continue to work on during 2023 are: Metrics and Targets, part b and c, and we expect to be able to make a recommended disclosure in respect of these items in our 2023 Annual Report.

Governance

Pillar/recommendation	Key points	Further detail
Disclose the organisation's governance around climate-related risks and opportunities		
a) Describe the Board's oversight of climate-related risks and opportunities.	Our Board oversees, through the Environmental, Social and Governance (ESG) Committee, our approach to sustainability, including climate change. The Committee ensures that appropriate climate resilience and environmental programmes are in place and remuneration is set as required to drive the reduction in the Group's environmental impact. Other elements of our approach to sustainability have oversight via other Board committees. During 2022, the Board and ESG Committee received updates on the progress towards our 2030 target, and the work undertaken to increase usage of green energy sources and improve the Group's ability to monitor and measure carbon emissions. With regards to our net zero ambition, the Integrated Business Plan (IBP) reviewed and approved by the Board in November, underpins how the Group plans to achieve its Scope 1 and 2 ambitions, including the work undertaken in our business sectors to identify areas to reduce energy consumption and increase efficiency of energy use. The Board recognises that in order to meet our net zero ambitions for our value chain (Scope 3), we will need to work closely with customers and suppliers to advance green technology solutions and align how we are working to define and achieve common objectives. As part of its annual Strategy Review, the Board considered how climate change considerations are increasingly impacting defence and commercial markets. The strategy adopted by the Board in 2022 identifies business solutions in defence and adjacent markets. During 2022, the ESG Committee also received training on climate risk. Progress of our decarbonisation strategy is embedded within our senior executives' remuneration.	Page 34 The work of the Board Page 131 Board of directors Page 134 Governance framework Page 139 Board information Page 140 Nominations Committee report Page 151 Environmental, Social and Governance Committee report Page 160 Remuneration Committee report
b) Describe management's role in assessing and managing climate-related risks and opportunities.	Climate-related risks and opportunities are embedded across our Operational Framework, including roles and responsibilities, key policies and processes. Our Executive Committee is responsible for managing climate-related risks and opportunities and for delivering the decarbonisation programme through our business and value chain.	Page 134 Governance framework

How we manage climate-related risk and opportunity

Oversight of climate-related risk and opportunity

BAE Systems Board

Nominations Committee	Audit Committee	Environmental, Social and Governance Committee	Innovation and Technology Committee	Remuneration Committee

The Board – has oversight of climate-related risks and opportunities impacting the Group and incorporates climate-related matters when setting overall strategy, including climate-related expenditure and investments as part of our IBP process. Some elements of responsibilities are delegated to committees of the Board. Directors' skills and experience are on page 139, including the details of those who have experience in environmental and social matters.

Nominations Committee – is responsible for succession planning and ensuring the future skills and experience required for both executive and non-executive members of the Board, including on climate-related matters.

Audit Committee – is responsible for reviewing and approving the content of our TCFD recommendations for disclosure within our Annual Report, including auditor requirements. The Committee also ensures that, where material, climate change is factored into the financial statements and disclosed appropriately.

Environmental, Social and Governance Committee – is responsible for overseeing the Group's ESG performance, including overseeing the progress of the executive team in ensuring that the Group takes an integrated, strategic approach to addressing climate transition risks and opportunities and monitors progress in this area, including progress against objectives and targets.

Innovation and Technology Committee – is responsible for overseeing efforts by the executive team to stimulate and maintain an innovative culture, which facilitates the Group's ability to make technological advancements through the introduction of low or zero emission technologies for existing or new products and services. Additionally, the Committee oversees the Group's progress in identifying potential longer-term revenue opportunities in these technologies, in accordance with the Group's strategy.

Remuneration Committee – is responsible for determining our remuneration policy, including the introduction of Long-Term Incentive Plan (LTIP) performance conditions on climate change and other ESG-related matters.

Management's role in climate-related risk and opportunity

Executive Committee	Sustainability Council	Functional Councils	Net Zero Working Group	Sectors

Executive Committee (EC) – responsible for managing climate-related risks and opportunities and for delivering the decarbonisation strategy to decarbonise our business and value chain, including climate-related expenditure and investments as part of our IBP process.

Group ESG, Culture & Business Transformation Director – has day-to-day responsibility for environmental issues, including those related to climate, and our decarbonisation strategy. She is part of the EC and gives regular updates on our environmental and net zero programme. She is also the owner of our Environmental Policy, which details our commitment to addressing environmental impacts related to our products and activities including climate-related issues. The net zero working group and Safety, Health and Environment (SHE) team report to her and she monitors and receives regular reports on progress.

Sustainability Council – reporting to the Group ESG, Culture & Business Transformation Director, supports the Group's strategy, recommending to the EC areas of sustainability to be given priority and focus for the forthcoming year and supporting Line and Functional leaders in the implementation of the Group's sustainability agenda.

Net Zero Working Group – co-ordinates the progression of our decarbonisation ambitions. The group is made up of functional representatives, business leads and environmental specialists. This group reports to the Group ESG, Culture & Business Transformation Director.

Sector net zero leads – progress decarbonisation ambitions of each sector.

Channels and frequency of climate-related information

The Board
Quarterly

Updates from Committees | Chief Executive presentation | Annual strategy review process
Integrated Business Plans – annual review alongside strategy and ongoing to monitor performance

Audit Committee
Quarterly

Operational Assurance Statement
Risk Register and Non-financial Risk Register

Environmental, Social and Governance Committee
Quarterly

Non-financial Risk Register Progress against decarbonisation objectives and targets

Remuneration Committee
Quarterly

Progress against climate-related objectives

Executive Committee
Monthly

Decarbonisation progress against roadmaps and key deliverables | Sustainability Council Updates
Operational Assurance Statement | Risk Register and Non-financial Risk Register | Integrated Business Plans

Chief Executive's Business Review (Core Business Process)
Quarterly

Top-level review of progress against decarbonisation strategy and key sector deliverables

Quarterly Business Review (Core Business Process)
Management review of the performance of each of the Group's businesses against decarbonisation objectives and targets

Integrated Business Plan (Core Business Process)
Twice a year

Annual long-term strategy review and five-year plan for each sector, including investment case to decarbonise

Business Risk (Mandated Risk Management Policy)
Six-monthly

Includes Operational Assurance Statement (Mandated Process)
– Management self-assessment of compliance with the Operational Framework and summary of key risks

Sustainability Council
Monthly

Net zero progress against roadmaps and key deliverables

Net Zero Programme
Monthly

Group and sector progress and key deliverables

Strategy

Pillar/recommendation	Key points	Further detail
Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material		
a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term; and b) describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	Our decarbonisation strategy supports our purpose and strategic framework in delivering a sustainable business and is an overriding initiative that encompasses the transition plan (where planned actions are summarised on page 40) and sector net zero roadmaps (see page 42). It encompasses how we will decarbonise our operations and product and service portfolio, whilst supporting our customers and suppliers in their transition, as a minimum in line with a 1.5°C pathway. Our sector net zero roadmaps form the basis of our net zero programme and identify the level of activity and investment required across the business, to decarbonise our operations (Scope 1 and 2) by 2030. Key activities outlined within the roadmaps are included within the IBP, which is reviewed annually by the Board as part of our Strategy review and is part of the Group's financial planning. Decarbonisation of our products and services will be achieved by making our current products and services more efficient where practicable and by introducing low or zero emissions products and technology for new and future requirements. The Group has already established some lower carbon products and invested in simulation technology. Although the continued progression to low and zero emissions products and technology for the defence sector will require a significant transition it is anticipated it may lead to revenue opportunities for the Group over the long term. We have set a decarbonisation ambition that will drive efficiency, innovation and collaboration across our value chain. We recognise that our supply chain emissions are many times those of our Scope 1 and 2 emissions, and it is critical that we partner and collaborate with our suppliers to reduce supply chain emissions by 2050 (Scope 3 emissions). The decarbonisation strategy encompasses material climate-related risks and opportunities that have the potential to impact our business model and strategy over the short, medium and long term taking into consideration our assets and infrastructure. We have considered the outputs from our scenario planning work and assessed these as part of our decarbonisation strategy. We can confirm that this strategy and our ongoing approach to business continuity encompasses the material risks and opportunities we have identified through the scenario planning process. These will continue to be monitored, managed and, to the extent necessary, mitigated. These activities will be included within the annual business planning processes, and our current assessment is that the financial risk associated with the impact of climate risk on our operations is not considered to be material, provided that this risk continues to be appropriately managed and mitigated.	Page 16 Our strategic framework Page 18 Our business model Page 26 Our investment in technology Page 32 Our stakeholders Page 40 Addressing climate risks Page 44 UK pension scheme – TCFD statement Page 48 Climate and environmental risk management Page 49 Climate scenario planning Page 54 Ideas, innovation and technology Page 68 Success through partnering Page 116 Risk
c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	We have progressed scenario analysis to allow us to further test the resilience of our strategic framework and to ensure we continue to address material climate-related risks and opportunities. During 2022, we progressed quantification of three global, material climate-related risks (physical and transition) and developed our qualitative understanding of transition opportunities. We will continue to address material climate-related risks and opportunities as part of our decarbonisation strategy. In the UK, the Responsible Investment Committee, of the BAE Systems Pensions Schemes, has assessed the climate-related investment risk and opportunities relating to climate change for the Scheme's assets, liabilities, and employer covenant.	Page 44 UK pension scheme – TCFD statement Page 49 Climate scenario planning

Risk management

Pillar/recommendation	Key points	Further detail
Disclose how the organisation identifies, assesses, and manages climate-related risks		
a) Describe the organisation's processes for identifying and assessing climate-related risks; b) describe the organisation's processes for managing climate-related risks; and c) describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	Our approach to identifying, assessing and managing environmental risks, including climate-related risk, is embedded within our approach to risk management, via our business and project risk registers. Climate and environmental risks may present as financial or non-financial risks depending on the extent to which their impacts can be quantified, and how they have been classified. In 2020, as part of the Board's ongoing assessment of emerging and principal risks for the Group, climate change and environmental impacts were recognised as a principal risk for the Group. Principal risks include those that would threaten the Group's business model, future performance, solvency, liquidity or reputation. Risks have been identified as principal based on the likelihood of occurrence, the potential impact on the Group and the timescale over which they might occur. Material climate and environmental risks were identified in 2021, as part of the Group's materiality assessment (see page 124), with further work undertaken during 2021 to develop our qualitative understanding of material climate-related risks and opportunities via scenario planning and the impact on the Group. During 2022, we progressed material physical risk and transition risks quantification and continued qualitative analysis on transition opportunities (see page 50). Material risks and opportunities identified are mitigated and managed as part of our sustainability agenda. Climate-related risks include those identified in our materiality assessment, scenario planning and decarbonisation strategy. Incorporation of climate-related risk within our registers will progress in 2023 supported by the maturing over time of sector net zero roadmaps and physical risk climate scenarios for Tier 1 critical suppliers. Associated climate-related risks are also embedded in our sector Environmental Management Systems. The potential impact and associated costs of addressing climate change are incorporated into our IBP, which identifies investment to achieve net zero across our operations (Scope 1 and 2) by 2030. This is reviewed annually by the Board. Our financial statements and viability statement reflect our best estimate of the impact of climate change on future business performance, based on currently available information and taking into account the mitigation measures we have in place.	Page 49 Climate scenario planning Page 116 Risk

Metrics and targets

Pillar/recommendation	Key points	Further detail
Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material		
a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	We aim to reduce our emissions as a minimum in line with the 1.5°C pathway by achieving net zero greenhouse gas emissions across our direct operations (Scope 1 and 2) by 2030 and by implementing the actions set out in our net zero roadmaps for the relevant sectors, and working towards a net zero value chain by 2050. We have aligned our Scope 1 and 2 carbon reduction roadmaps to a science-based pathway of 1.5°C, and set progress against this in both our in-year and long-term incentives (see page 181). We continue to mature our approach to the quantification and understanding of the more complex Scope 3 emissions. Our in-year and long-term incentives are aligned to the Group achieving a 4.2% operational GHG emissions reduction target, in line with a science-based pathway of 1.5°C, year-on-year over ten years (from a baseline year of 2019), with a 90% reduction in GHG emissions being achieved by 2050. As our understanding of Scope 3 emissions matures, we will consider reduction pathways in line with a science-based pathway of 1.5°C. Building on 2022 net zero objectives, for 2023, decarbonisation of operations and setting targets for water use and waste management are part of our Executive Committee's objectives and remuneration targets. We use our GHG emissions per employee as our intensity ratio. We disclose revenue from alternative energy-related products within our Annual Report (see page 54) and Sustainability Accountability Standards Board (SASB) disclosure – Resource Transformation sector disclosure. We disclose our energy consumption within our Annual Report. And also disclose other key environmental metrics – water consumption, waste production and electricity consumption.	Page 26 Our investment in technology Page 40 Addressing climate risk Page 54 Ideas, innovation and technology Page 93 Segmental review Page 160 Remuneration Committee report

Metrics and targets continued

Pillar/recommendation	Key points	Further detail
	Sectors set objectives to improve the performance of their operations such as reducing energy consumed and the generation of waste, emissions and other discharges, such as effluents. Some of our sectors also set targets to reduce water consumption. We disclose our investment in R&D within our Annual Report (see page 29). As our decarbonisation strategy develops and matures, we will continue to develop the use of other metrics, including industry best practice, to assess climate-related risks and opportunities.	
b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.	We report our greenhouse gas Scope 1, 2, 3 (employee and business travel only) emissions in line with Streamlined Energy and Carbon Reporting (SECR) regulations. This data is externally assured, to a limited level of assurance, by Deloitte LLP. We continue to mature our approach to the quantification and understanding of our more complex Scope 3 emissions.	Page 52 Greenhouse gas emissions
c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	Our in-year and long-term incentives are aligned to the Group achieving a 4.2% operational GHG emissions reduction target, in line with a science-based pathway of 1.5°C, year-on-year over ten years (baseline year is 2019), with a 90% reduction in GHG emissions being achieved by 2050. For 2023 we aim to reduce operational Scope 1 and 2 emissions in line with a science-based pathway. We have established a roadmap based on phases of activity and level of investment, to monitor our progress to decarbonise our operations by 2030. Going forwards, progress towards the 2030 net zero milestone will also be aligned to long-term incentive plans and in-year remuneration targets (see page 181). Decarbonisation of operations and setting targets for water use and waste management are part of our Executive Committee's 2023 objectives and remuneration targets. During 2022, the Group was rated B in the 2022 CDP Climate Change disclosure and B– in the 2022 CDP Water Security disclosure. During 2023, we will be establishing improvement targets for water use and waste management. These targets will be disclosed in 2024. Our UK BAE Systems Pension Scheme has set targets, aligned with a 1.5°C pathway, for its investment portfolio to have net zero GHG emissions by 2050, recognising that the Trustee believes this to be in the best long-term financial interest of the scheme's members. To support this, interim targets have been set to aim to reduce the GHG emissions that are financed by a meaningful portion of the scheme's asset portfolio by 50% by 2030, relative to the emissions in 2021.	Page 160 Remuneration Committee report Page 49 UK pension scheme – TCFD statement

Climate scenario planning

We use climate scenarios to assess the resilience of our business, decarbonisation strategy and our approach to managing climate-related risk and opportunities including the impact on our financial results.

Climate scenarios demonstrate different possible futures, based on expert peer reviewed projections, but they are not forecasts. They are designed for companies to test their business resilience against a range of different future states to inform strategic decision-making. Scenario analysis is a necessary exercise to understand what parts of the business are exposed to and impacted by climate change.

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

During 2022, we built upon our qualitative scenario planning work that we commenced last year, by progressing material physical risk and transition risks quantification and continuing qualitative analysis on transition opportunities (see pages 50 to 51). Materiality of risk and opportunities was based on the likelihood of occurrence and potential impact on the Group. For each area, we identified sub-risks and opportunities for quantification. Analysis of these risk and opportunity areas has helped BAE Systems to understand the scale of the unmitigated impact, through the development of a methodology and calculation of the possible financial impact.

Scenario planning – material climate-related risk and opportunity

Physical risk

Materiality of risk or opportunity/timeframe[1]
Short, medium and long term

Description	Unmitigated potential impact	Business readiness
We have assessed the future physical risk of extreme weather on 140 priority sites globally. We have operations in around 40 countries, with a focus in the UK, US, the Kingdom of Saudi Arabia and Australia; therefore our operational exposure to physical risks is diverse and varies by region. Risks have been quantified for seven hazards in future periods to 2100 under three scenarios. Unmitigated damage and disruption losses have been financially quantified for 140 priority sites.	The impact of the physical risks of climate change, such as increasing frequency and severity of extreme weather events, will affect BAE Systems' operations and vary depending on the particular hazard and geography. Overall, extreme weather events are likely to result in repair costs, adaptation investments and reductions in productivity. **Financial impact** Low	We currently assess the physical locations of our global sites against physical risk of extreme weather events. This includes risk engineering reviews at site level and a quantification of current potential financial impacts. Any mitigation actions arising from these assessments are included within sector IBP. Our mitigation work is also supported by work underway and planned by central and local government departments within the countries and counties/states that we have facilities in.

Transition risk – regulation

Materiality of risk or opportunity/timeframe[1]
Medium term

Description	Unmitigated potential impact	Business readiness
We have assessed the transition risk of tightening environmental laws and regulations in relation to carbon pricing globally. Carbon pricing is an approach used to reduce carbon emissions through market mechanisms. It passes the societal cost of climate change from the emissions of greenhouse gases back to the organisations responsible for emitting them. As a result, it has the purpose of discouraging the use of greenhouse gas-emitting activities in order to protect the environment, address the causes of climate change, and meet national and international climate agreements. Carbon pricing instruments can take many forms, with the most common being carbon taxes, taxes on fuels, and trading schemes/levies. The cost of carbon to 2050 was calculated using Scope 1 and 2 measured emissions. This was performed using prices modelled in three IEA transition scenarios: STEPS, APS and NZE (see page 51). The cost of carbon assumes a 100% passthrough from energy suppliers, and has been analysed under two pathways: (a) static emissions; and (b) decarbonisation to net zero by 2050.	Carbon pricing has the potential to increase operational costs via carbon taxes and levies to the business for energy and fuel use; and indirect taxes which are passed to the Group through purchased energy. **Financial impact** Low	Our decarbonisation strategy and operational low carbon pathway will lower our exposure to carbon taxes. We will continue to monitor environmental laws and regulations in relation to carbon pricing, including any potential financial impacts on the Group.

Transition risk – technology

Materiality of risk or opportunity/timeframe[1]
Medium to long term

Description	Unmitigated potential impact	Business readiness
In the UK, nearly half of BAE Systems' emissions come from heating buildings. To support the decarbonisation of our heating systems over the long term, we could consider switching to lower-emissions heating technology. The decarbonisation of energy for heating poses a challenge, as most cost-effective solutions are currently expensive and subscale. This could result in increased costs arising from the need to replace existing plant and equipment to incorporate lower-emissions technologies, such as heat pumps. We have reviewed the roll-out of heat pumps as a potential option to replace current gas-fired heating systems and this was assessed under three IEA pricing scenarios to 2050.	Introducing alternative energy sources such as renewable energy-powered heat pumps will lower our emissions, but at this point would require significant capital expenditure to retrofit our sites and install the devices. Due to the difficulties of switching fuels and maintaining legacy systems, installing heat pumps is considered one of the best transition solutions over the long term. This is because heat pumps are more efficient than other heating systems in producing more heat energy than the amount of electricity consumed. Heat pump technology is currently expensive, as the technology and market is still developing. **Financial impact** Low	In the UK, we have considered the feasibility of introducing renewable energy-powered heat pumps over the long term, as part of the decarbonisation strategy. We will continue to monitor the development of lower-emissions heating technology, over the long term, as a way to support the delivery of our net zero ambitions.

1. Short- (less than two years), medium- (three to ten years) and long-term (beyond ten years) time horizons. Time horizons are linked to the Integrated Business Planning process.

Transition opportunity – products

Materiality of risk or opportunity/timeframe[1]
Medium

Description	Unmitigated potential impact	Business readiness
The transition to a low carbon economy presents opportunities for BAE Systems and continued innovation will be required to provide solutions to existing and new customer bases.	Our ability to increase revenues will be dependent on applying advanced engineering capabilities to develop new products that support lower-emissions requirements, creating new business lines and enhancing competitive positions in order to retain and grow market share. Continued investment, both Group and customer, in research and development will be required.	To decarbonise by 2050, we must ensure that our products and services support a decarbonisation pathway. This will be achieved by advancing the efficiency of our products and services, in the short term, and transitioning to lower or zero emissions products and technology longer term. This will require continued investment in our R&D activities. We have been engaging with our customers to understand their decarbonisation pathways including the challenges they face regarding operational effectiveness and availability. Many customers are setting targets and looking for lower carbon, sustainable products. We are working to understand and influence their future requirements to help inform and shape product innovation and development. Sustainable fuels will help facilitate our product and service decarbonisation pathway over the long term. BAE Systems can use the market presence and brand recognition for its electric and hybrid propulsion systems portfolio developed through the well-established urban transit bus products, by leveraging and transitioning this expertise to other, emerging and nascent markets such as aviation, maritime and heavy industrial transport vehicle markets.

For transition risks and opportunities, IEA scenario data has been used, due to its relevance to the Group's decarbonisation strategy, global and regional coverage, timeframes considered and information on drivers and frequency of scenario updates.

1.5°C Net Zero Emissions scenario (NZE) Source: IEA Net Zero Economy by 2050
Announced Pledges Scenario (APS) Source: IEA Announced Pledges Scenario
Stated Policies Scenario (STEPS) Source: IEA Stated Policies Scenario

We have used the following key assumptions within our scenarios:

Assumption	Rationale
No action is taken by BAE Systems to mitigate or limit the impacts of each risk being assessed.	Uncovers what the implications are if climate risks are left unmitigated to help facilitate a response plan. These results can be used by the business to test whether current mitigation is sufficient.
Mutual exclusivity is applied to the scenarios and underlying climate attributes (i.e. impacts are not aggregated or offset).	Ensures that no impacts are cancelled out. We do not assess scenarios where both transitions risks and physical risks take place at the same time (although this is inevitable).
Business activities are static over the future period (revenue streams, operating model, emissions, etc).	Isolates the climate element of the risks to show implications on strategy in a world where business as usual remains.

Climate scenarios and data used

For physical risk, TCFD scenario analysis guidance recommends analysing at least three different climate scenarios to ensure a broad range of outcomes are considered. Each scenario causes different levels of future physical risk, and resulting losses. This enables the user to draw comparisons between the scenarios and the level of risk and subsequent damage and disruption for future periods. We have focused on the worst-case scenario (SSP 5 – RCP 8.5)[2] in the analysis below, as this presents the most risk to our operations.

Physical risk scenario	Intergovernmental Panel on Climate Change trajectory alignment	Scenario policy action
>4°C	SSP 5 – RCP 8.5[2] Temperature rise by 2100: 4.4°C	No additional policy action
2–3°C	SSP 2 – RCP 4.5[2] Temperature rise by 2100: 2.7°C	Late policy action
<2°C	SSP 1 – RCP 2.6[2] Temperature rise by 2100: 1.8°C	Early policy action

2. Shared Socioeconomic Pathway (SSP). Representative Concentration Pathway (RCP).

Measuring progress

Greenhouse gas emissions data

Absolute energy consumption

	2022[1]		2021	
	Global[2] kWh	**UK kWh**	Global kWh	UK kWh
Energy consumption Scope 1 and 2	**1,469,387,190**	**594,930,180**	1,624,601,505	725,396,538

Greenhouse gas emissions data

	2022[1]		2021	
Scope definition	**Global[2] tonnes CO_2e**	**UK tonnes CO_2e**	Global tonnes CO_2e	UK tonnes CO_2e
1 Emissions from activities which BAE Systems owns or controls (Scope 1)	**113,089**	**55,686**	142,241	76,133
2 Emissions from the electricity and steam purchased for BAE Systems' use (Scope 2 – location-based)	**281,182**	**60,374**	268,735	71,602
Total gross Scope 1 and 2 emissions	**394,271**	**116,059**	410,976	147,735
3 Emissions from employee business travel (Scope 3)	**62,519**	**20,999**	24,094	4,145

Greenhouse gas emissions per employee

	2022[1]		2021	
	Global[2] tonnes CO_2e	**UK tonnes CO_2e**	Global tonnes CO_2e	UK tonnes CO_2e
Per each full-time equivalent employee (Scope 1 and 2)	**4**	**3**	5	4

1. Relevant reporting period 1 November 2021 to 31 October 2022.
2. Deloitte have provided independent limited assurance in accordance with the International Standard for Assurance Engagements 3000 (ISAE 3000) and Assurance Engagements on Greenhouse Gas Statements (ISAE 3410) issued by the International Auditing and Assurance Standards Board (IAASB) over the selected metrics identified with a [1]. Deloitte's full unqualified assurance opinion, which includes details of the selected metrics assured, can be found at baesystems.com/annual-report

2022 key environment data[1]

Water consumption[2]

	2022 cubic metres	2021 cubic metres
Mains	**2,409,896**	2,270,390
Abstracted	**5,968,417**	14,186,391
Total	**8,378,313**	16,456,781
Recycled	**728,911**	951,847

Waste production[2]

	2022 tonnes	2021 tonnes
Non-hazardous	**42,413**	41,747
Hazardous	**5,072**	8,690
Total	**47,485**	50,437
Recycled[3]	**33,167**	42,103

Electricity consumption

	2022 kWh	2021 kWh
Grid	**877,726,240**	754,143,257
Renewable	**5,951,873**	2,486,109
Total[4]	**883,678,113[5]**	756,629,366

1. Relevant reporting period 1 November 2021 to 31 October 2022.
2. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes, and controls are in place to collate, validate and report this data. Based on the procedures and the evidence obtained, nothing has come to its attention that indicates the disclosures have not been properly prepared in accordance with such systems, processes, and controls.
3. For 2021, includes non-hazardous, hazardous and construction waste recycling. For 2022, includes non-hazardous and hazardous waste recycling.
4. For 2021, restated to include estimates in line with SECR requirements. For 2022, estimates now reported in line with SECR requirements.
5. Deloitte have provided independent limited assurance in accordance with the International Standard for Assurance Engagements 3000 (ISAE 3000) and Assurance Engagements on Greenhouse Gas Statements (ISAE 3410) issued by the International Auditing and Assurance Standards Board (IAASB) over the selected metrics identified with a [4]. Deloitte's full unqualified assurance opinion, which includes details of the selected metrics assured, can be found at baesystems.com/annual-report

Abstracted water volumes have decreased compared to 2021 consumption due to the three-yearly fluctuations in production/operational activities at one of our UK locations. Recycled water volumes have decreased compared to 2021 due to reductions at sites in the Kingdom of Saudi Arabia. Hazardous waste volumes have decreased largely due to reductions at one of our US sites.

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

During 2020, we removed two facilities from our organisational reporting boundary, as we do not have operational control of these facilities. Another business entity includes the emissions for these facilities within their environmental reporting obligations.

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

Methodology

Greenhouse gas emissions data is reported in line with an operational control method; we use the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard as guidance to support our approach to reporting. Our reporting boundary for Streamlined Energy and Carbon Reporting (SECR) is the same as our reporting boundary for the purposes of our financial statements.

Data covers a 12-month period between 1 November 2021 and 31 October 2022.

The GHG protocol allows participants to arrange their organisational boundaries using two different methodologies: one using the equity share approach and one using the control approach. The business has chosen to use the control approach. Furthermore, the control approach selected allows for two further methodologies to be applied to define control using either a financial approach or an operational approach. The business uses the latter.

As a business we utilise a tool called the Global Property Database (GPD) to record and monitor locations which we either own or lease. Every location listed on the GPD for the purpose of GHG emissions reporting falls within our organisational boundary, however we may not report emissions from all these locations as we may not have operational control.

Emission factors for fuels and UK electricity are published at www.gov.uk/government/collections/government-conversion-factors-for-company-reporting. Emission factors for US electricity and natural gas are published at https://www.epa.gov/climateleadership/ghg-emission-factors-hub. Emissions factors for Australia (AUS) electricity and natural gas are published at https://www.dcceew.gov.au/climate-change/publications/national-greenhouse-accounts-factors-2021. Natural gas emission factors for Sweden's (SWE) operations are published at https://unfccc.int/documents/224123. Electricity emission factors for SWE, Kingdom of Saudi Arabia (KSA), and Rest of World (RoW) are published at https://www.iea.org/data-and-statistics/data-product/emissions-factors-2022.

For the 2022 reporting cycle, the 2022 UK government emissions factors published by the Department for Business, Energy and Industrial Strategy (BEIS) have been used for the majority of Scope 1 and 3 calculations. The most up-to-date Emissions and Generation Resource Integrated Database (eGRID) factors published by the US Environmental Protection Agency (EPA) are used for US electricity. For the 2022 reporting cycle, the most recent electricity US factors are from the year 2020. The US EPA is due to release the updated figures in quarter one of this year, however they have not been released in time to be used for the current calculations. Country-specific emission factors for electricity and natural gas have been used where available.

The principal record of the Group's worldwide facilities is its legal department's Global Property Database. The database holds records of all locations which are either wholly-owned, leased or licensed sites.

Greenhouse gas emissions are primarily calculated from energy consumption records, e.g. invoiced data or meter reads reported via the Group's global environmental database (CR Desktop). Where consumption records are not available estimates may be used and these will be highlighted in the database.

Where actual usage data is not available for facilities and residences within the Global Property Database, an estimated consumption is used based on the type of building.

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

Emissions from pension scheme properties not occupied by the Group are not included.

The property database details are taken in quarter 3 of the financial reporting year (Jan-Dec), this means any properties acquired between quarter 4 of the previous year and quarter 3 of the reporting year are included within the reporting boundary. If a business is acquired within quarter 4 of the financial reporting year it will be included in the reporting boundary in the next full reporting year after the change.

If a business or facility has closed between quarter 4 of the previous year and quarter 3 of the current year, it will not be included within the reporting boundary. Any locations which close in quarter 4 of the reporting year will be removed from reporting boundary in the next full reporting year after the change. Emissions from joint ventures are included in the data set if BAE Systems has operational control at the site.

Trading of emissions are not taken into account for the purposes of reporting, for example where the business has a requirement to maintain compliance with trading schemes, e.g. UK ETS, the total energy consumed is reported regardless of emissions trading.

The Scope 2 Greenhouse Gas Emissions associated with the GHG Protocol 'Market-Based' method have been calculated as 264,374[1] tCO_2e. In line with the GHG Protocol Guidance, this figure has been calculated using residual-mix emission factors where available for our UK, US and Swedish operations. In our other significant operating regions, residual mix emission factors are either unavailable or the resulting absolute emissions at Group level are within the margin of error and therefore country-specific emissions factors have been used in line with the GHG Protocol Guidance. If sites consume grid electricity backed by Renewable Energy Guarantees of Origin (REGOs), this has been taken into consideration within the calculations.

Fugitive emissions have been calculated for a sample of several locations using Fluorinated Greenhouse records. The results have been scaled up using number of employees. The total losses amount to less than 5% of Scope 1 emissions and are considered to be immaterial, and are therefore not disclosed.

Our top ten largest sites accounted for 42% of our total energy consumption. By these sites setting energy reduction targets, they have the biggest influence in reducing our energy use and, in turn, our direct and indirect greenhouse gas emissions. Please see page 75 on environmental management systems certified to ISO[2] 14001.

During the reporting year, we have seen a reduction in Scope 1 emissions. This is due mainly to a reduction in natural gas consumption in the US and the UK. Scope 2 emissions have increased by 5%, however this was largely a result of an update to the electricity benchmarks for locations that need to be estimated, in order to improve the accuracy of those estimations.

Overall Group-wide greenhouse gas emissions have increased by 5%, which is mainly due to an increase in Scope 3 business travel, largely caused by flights. Whilst travel has increased (post COVID recovery), business travel emissions are still well below the levels seen prior to the COVID-19 pandemic.

To see our Basis of Reporting 2022 visit baesystems.com/annual-report

Our priorities for the year ahead

Net zero Scopes 1 and 2

- Progress decarbonisation of own operations (Scope 1 and 2) in line with science-based pathway of 1.5°C.

Environmental stewardship

- Mature water and waste management; improve disclosures and set targets for 2024.

1. Deloitte have provided independent limited assurance in accordance with the International Standard for Assurance Engagements 3000 (ISAE 3000) and Assurance Engagements on Greenhouse Gas Statements (ISAE 3410) issued by the International Auditing and Assurance Standards Board (IAASB) over the selected metrics identified with a [1]. Deloitte's full unqualified assurance opinion, which includes details of the selected metrics assured, can be found at baesystems.com/annual-report
2. International Organization for Standardization.

Ideas, innovation and technology

We are committed to using our world-class engineering capabilities and cutting-edge technologies to address climate change and progress the decarbonisation of our portfolio of products and services.

Why is this important to BAE Systems?

We know that innovation is key to delivering a sustainable future and to progress the decarbonisation of our products and services by 2050. Technology is at the core of our business (see page 26) and we will leverage this to progress our decarbonisation strategy (see page 40) and support our customers in transitioning to a low carbon economy.

It is also important that we recognise and understand the challenges that climate change will bring so that we continue to design defence and security systems fit for operation in these future environments.

Decarbonisation of our products and services will be achieved by making our current products and services more efficient where practicable and by introducing lower or zero emissions products and technology for new and future requirements. The Group has already established some low carbon products and invested in simulation technologies. Although the continued progression to lower and zero emissions products and technologies for the defence sector will require a significant transition it is anticipated it may lead to revenue opportunities for the Group over the long term.

Our aims

Emissions baseline and governance

- We have set ourselves the target of working towards a net zero value chain by 2050 (see page 42). To help us achieve this target we need to mature our approach to understanding the Scope 3 emissions of our products' lifecycle to drive efficiencies across our current portfolio. Our sustainable supply chain efforts are detailed in the Foundations section on page 78.

Our contribution to the UN Sustainable Development Goals (SDGs)

7 AFFORDABLE AND CLEAN ENERGY
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
12 RESPONSIBLE CONSUMPTION AND PRODUCTION
17 PARTNERSHIPS FOR THE GOALS

Sustainable ground power for UK Typhoons

Typhoon jets in the UK will be powered up by 40 new electric battery ground power units following a trial conducted in 2022 by BAE Systems and the Royal Air Force. The Electric Ground Power Units (eGPUs) are replacing diesel-powered systems, and studies across the Typhoon Total Availability Enterprise (TyTAN) estimate that the use of eGPUs in the fleet could reduce running costs by 80%. Studies in civil aviation also estimate that eGPU units reduce harmful fumes by 95% and CO_2 emissions by 90%, against their diesel equivalents.

Based on supplier data, the battery-powered units will deliver sustainable ground power to Typhoon jets at RAF Lossiemouth and RAF Coningsby and it is estimated that the units will save more than three million kgs of CO_2 emissions based on five and a half hour usage a day over a one-year period.

The TyTAN enterprise estimates that over 40% of the CO_2 footprint from Typhoon ground operations comes from the previous diesel units so this transition will help to reduce those emissions.

Based on a trial delivered by the TyTAN enterprise, the new ground power units only require an eight-hour charge to power a Typhoon aircraft for an entire week. This is the equivalent of 16 aircraft turnarounds. The MoD estimates that this could save them energy costs of more than £13m across the fleet over the next decade, based on the 40 units that have been purchased. The new units also require less maintenance and spares.

Data from the supplier demonstrates that the electric batteries produce less than 60 decibels of noise which is equivalent to the sound of a dishwasher or electric shower. Along with the air quality improvements, this will significantly reduce hazards and improve conditions for ground crew and pilots.

Emissions baseline and governance

The decarbonisation pathway for our products and services will be achieved by advancing the efficiency of our products and services in the short term, and transitioning, where possible, to lower or zero emissions products and technology in the longer term.

We will seek to use our knowledge of in-life emissions of existing products to deliver lower emission solutions as we maintain existing products through-life. We recognise this will be challenging given the operational environments in which our products are used. We are already working on a range of technologies to help drive efficiencies in current products and services during product build, upgrades and maintenance including low-emission propulsion, energy storage, augmented and virtual reality, artificial intelligence and automation.

We are also introducing new manufacturing techniques to reduce the energy used to support our decarbonisation strategy, by developing industry 4.0 technologies to make manufacturing more sustainable (see page 54).

Supporting our customers in their transition

In the UK, we have engaged with our customers to understand their decarbonisation pathways and their challenges in ensuring operational effectiveness and availability. Many customers are setting targets and looking for lower-carbon, sustainable products.

We will work closely and collaboratively on their future requirements to help inform and shape lower-emission product innovation and development.

Sustainable fuels will be part of our customers' product and service decarbonisation pathway over the long term. We will work with our UK customers to understand their future fuel transition requirements, including the economics of when best to transfer to sustainable fuels, whilst continuing to work to understand the scalability of sustainable fuels and interdependencies on new product development. In the UK, the RAF has committed to moving to sustainable and synthetic fuels for aircraft by 2040. We are working to support our customers' ambitions in this area.

Sustainable innovation pipeline

We are investing in the research and development (see page 54) of sustainable products and building an innovation pipeline.

Part of the investment portfolio advances research and development to improve our existing products and support our customers in their decarbonisation plans. For example, we have been developing novel waste-heat-to-power technology in the Maritime sector for future warship energy efficiencies. In the Air sector, we are working with industry partners to optimise the energy usage for future aircraft.

Additionally, we have skills and technology that can be transferred to new markets, and we are investing to support new customers in their low carbon transition. During 2023, we will accelerate our sustainable product pipeline by developing electric aircraft capability and expanding our hybrid clean energy technology into the commercial maritime sector.

Transitioning to low and zero emissions products and technology represents a revenue opportunity for the Group over the long term (see page 51).

Collaboration and engagement

To support the decarbonisation of our product portfolio we are investing in the skills and capability of our employees to drive innovation (see page 62) and collaborating with suppliers and partners to develop a low carbon supply chain (see page 70).

Collaborating with others is key to driving innovation and accelerating our position on sustainable products. For example, we are progressing technologies that will enable lighter-weight, cost-competitive energy storage solutions for hybrid aircraft engines such as our collaborative work with Jaunt Air Mobility and others. We are working with Malloy Aeronautics, a UK-based SME specialising in electric uncrewed air vehicles, to create a new all-electric heavy lift Uncrewed Aerial System (UAS) quadcopter. This has the potential to deliver cost-effective, sustainable, rapid response capability to military, security and civilian customers, without putting human pilots at risk when used in hazardous locations.

We have signed a Memorandum of Understanding with Embraer Defense & Security. This confirmed an intent to create a joint venture to develop a defence variant of the Eve electrical Vertical Take-Off and Landing (eVTOL) vehicle for the defence and security market. Teams from both companies will work together to explore how the aircraft, designed for the urban mobility market, can provide cost-effective, sustainable and adaptable capability as a defence variant. We also plan to collaborate with Pipistrel Aircraft on the development of solutions for the defence and security market, including the application of electric aircraft.

Our priorities for the year ahead

- Understand how and when we can reduce the emissions of our current portfolio of products.
- Continue to develop opportunities to collaborate and engage with partners, suppliers and the wider industry to decarbonise our product portfolio.

Electrification of aircraft
Through our work with Pipistrel Aircraft we are exploring the development of lightweight, sustainable aircraft.

Electrifying the combat vehicle force of the future

Under a US Army Rapid Capabilities and Critical Technologies Office contract, we have delivered two Bradleys with an integrated hybrid electric drive (HED) system. The programme demonstrates that HEDs are not only viable, but essential for a modernised combat vehicle fleet that can respond to evolving threats and be capable of conducting Multi-Domain Operations.

Working with QinetiQ, our designs have completed digital engineering and extensive lab tests, and the project is demonstrating that this innovative technology has matured to a point where we can modify an existing platform family to increase capabilities in acceleration, range, and on-board power. During a late summer Bradley HED demonstration, Army personnel commented on how "amazingly quiet" the vehicle was and emphasised how "powerful" it is to have the ability to watch silently for hours at a time, or move quietly into position to achieve a mission.

HED architecture offers these and numerous other military capability and operational benefits, as well as supporting the US government to reach its net zero objectives.

Synthetic training for tomorrow's armed forces

Our training teams are using their insight into operational training, while leveraging innovations from the gaming industry, to create a military metaverse that will train the armed forces of tomorrow.

We are working with companies such as Hadean, as well as virtual reality and artificial intelligence specialists VRAI, to deliver a synthetic environment alternative to large-scale military exercises. Our collaboration will help us work alongside military forces across the world to deliver more secure, affordable and sustainable ways to equip them with the skills they need on the frontline.

This work builds on our prior experience of virtual training in the UK. In 2022, we supported the Typhoon Force flying 6,336 synthetic missions, which would have burned 34,380 tonnes of fuel, releasing 107,600 tonnes of CO_2, had the missions been flown live.

Factory of the Future

In Lancashire, UK, we continue to drive efficiencies and cost savings through our industry 4.0 Factory of the Future. Last year, we manufactured a representative fast jet fuselage to demonstrate how we could potentially halve the time it takes to deliver Tempest, in comparison to previous programmes.

More than 50 partners – from SMEs specialising in data management to university research centres – collaborated on the project. They brought unparalleled pace and new technologies to the process, helping to deliver the level of accuracy needed in combat air production whilst at the same time reducing waste.

Advances in digital manufacturing delivered through Factory of the Future remove the need for fixed, bespoke tooling and jigs. Instead, robots can be reconfigured as required to switch from the production of a large-scale fighter aircraft to a smaller-scale UAV, for example. This removes the need to produce bespoke facilities and fittings for every production requirement and therefore the materials that this would require. Advanced manufacturing technologies such as additive manufacturing also mean that we are creating less waste as a by-product compared to traditional subtractive methods.

Filtering on the move

BAE Systems fitted both HMS Tamar and HMS Spey with Selective Catalytic Reduction exhaust systems when we built the vessels on the River Clyde in Glasgow. This made us compliant with the latest Nitrogen Oxides (NOx) emission limits across Emission Control Areas, which cover North America, the Baltic Sea and beyond.

The innovative systems, supplied and supported by Blunox Technology, reduce the vessels' overall NOx emissions by 90–95%, depending on the exhaust temperature and engine load. Exhaust soot discharge is also reduced by up to 40%, making the Royal Navy's Offshore Patrol Vessels more environmentally friendly while out on operations.

HMS Tamar and HMS Spey can be used to perform a variety of roles by the Royal Navy such as intercepting drug traffickers, protecting UK territorial waters, and providing humanitarian assistance in the wake of a disaster.

Creating opportunity for people and communities

We are focused on inspiring and developing a diverse workforce and making a positive social and economic contribution to our communities.

Why is this important to BAE Systems?

Our people are the core of our ability to deliver for our customers – today and in the future. We must retain, attract and develop the very best talent and, in order to do that, we continue to build a culture that is inclusive and supportive. We want all of our employees to reach their full potential and feel valued for their contribution. We are focused on maintaining our position as a leading employer of choice, particularly in the areas essential to our business of engineering, manufacturing, science and technology.

The work done by our people helps to build stronger nations and enables growth in economies and local communities, through employment and national and local supply chains. We play a vital role in many of the communities where we operate, a significant responsibility in which we take great pride.

Our aims

Inclusive attractive workplaces

- Diversity, equity and inclusion are key enablers to recruiting and retaining the best talent, driving innovation and creating a workplace environment where employees are valued.
- We have set an ambition to be recognised as a leading employer in defence and security for valuing diversity, equity and inclusion and we also aim to be representative of gender and ethnicity in the localities in which we operate.

Career-long learning

- We have award-winning early career and skills programmes in markets such as the UK and Australia. We are now developing and expanding our approach to career-long learning, through which we will continue to invest in our employees throughout their careers. We intend to create a culture of learning and development at all career stages.

Support for our communities

- We aim to build and nurture mutually beneficial relationships between our business, our people and stakeholders to deliver a positive social impact in the communities where we operate. Engaging with our communities as well as supporting and caring for them is an essential part of our business.

Our contribution to the UN Sustainable Development Goals (SDGs)

4 QUALITY EDUCATION | 5 GENDER EQUALITY | 8 DECENT WORK AND ECONOMIC GROWTH

Protecting our environment where we work

Platforms & Services employees at the York, Pennsylvania facility planted over 700 trees and shrubs on site to create a new riparian buffer. The volunteer event was organised to celebrate Earth Day in collaboration with Alliance for the Chesapeake Bay – a non-profit organisation dedicated to protecting the Chesapeake Bay and its tributaries.

While supporting the Group's goal of achieving net zero greenhouse gas emissions (Scope 1 and 2) by 2030, the nearly three-acre riparian buffer provides several additional benefits: protecting local waterways from runoff pollution, streambank erosion, and flooding; offering a new habitat to native plants and animals; and, once the trees mature, the shade will provide a cooler environment to local aquatic wildlife.

Investing in our people

Progress in 2022

Maintaining a diverse pipeline of talent and critical skills is key to fulfilling our future customer requirements. Our people strategy is designed to support our aim to retain, attract and develop the very best talent and is delivered through:

- robust succession planning;
- targeted recruitment;
- focused talent management;
- a culture of inclusivity, learning and development; and
- competitive employee value proposition.

This is underpinned by our People policies, guidance and support tools focused on enabling our leaders and enhancing the employee experience. Our People policies lay the foundations and our people manager expectations highlight the responsibilities of our leaders, which includes to lead with authenticity, foster a safe and inclusive culture, develop our people and reward them accordingly, enable teams to perform, and establish and share direction and our long-term vision.

This commitment is embedded through our governance structure. The Group Human Resources (HR) Director reports directly to the Chief Executive and chairs a Global HR Council, ensuring alignment between our strategy, policy and delivery.

Our dedicated employee communications team systematically provides employees with information on all matters that impact them. We consult with our employees and their representatives regularly and on a wide variety of topics. Their views are taken into account in our decision-making processes on matters that affect their interests. We also encourage employees' involvement in company performance through an employee share scheme.

Recruitment and skills

In 2022, we focused our efforts on recruiting and retaining a diverse workforce set against a backdrop of growth in demand across our business and a buoyant employment market. In the UK, we identified the need for more than 5,000 experienced hires as well as just under 1,800 early careers hires. We focused on attracting people with the skills that are required to support our key programmes including engineering, project management and operations roles.

Our ability to retain and recruit people with appropriate talent and skills is a principal risk (see page 123) and we continue to take a range of actions to mitigate the risk.

In the UK, our award-winning early career and skills programmes supported around 4,500 young people in training in 2022:

- 1,073 new apprentices started at BAE Systems in 2022 and 1,460 are forecast for 2023;
- 706 graduates and undergraduates started in 2022 and 1,276 are forecast for 2023;
- around 77 young people completed placements at BAE Systems as part of the Movement to Work initiative and the UK Government's Kickstart programme; and
- our 2022 partnership with Code First Girls led to 15 of the participants joining the Company as junior software engineers.

We also launched a new Sustainability Apprenticeship scheme with Cranfield University. The first cohort of nine started the apprenticeship in March 2022, and a second cohort of up to eight apprentices will follow in March 2023. The new and unique programme will play a key role in building a network of sustainability champions across the Group who will help to drive progress on our sustainability agenda.

In Australia, 75 apprentices and 101 graduates are in training (2021/22 cohorts), and in the Kingdom of Saudi Arabia, 94 trainees, students and graduates joined our early years careers programmes during 2022.

As we build Hunter Class frigates in Australia, our award-winning digital diploma for our naval shipbuilding workforce continues. In 2022, we launched an initiative to increase the number of women participating in the digital diploma course delivered in partnership with Flinders University. We also invested in a number of new Science, Technology, Engineering, and Mathematics (STEM) initiatives to influence diversity outcomes throughout the education pipeline.

Our degree apprenticeship model has been supported at federal level and in several Australian states. We are currently

Code First Girls partnership

In May 2022, Digital Intelligence announced its partnership with Code First Girls, one of the largest providers of free coding courses for women in the UK, to sponsor its CFGdegree programme.

The 13-week, industry-approved course offers career pathways into a variety of technology roles to help encourage more women into STEM careers. BAE Systems sponsored a CFGdegree course between May and September 2022 which enabled 15 female students to develop the skills they need to start a career in software engineering.

The CFGdegree training was delivered by Code First Girls, with mentoring support and guest lectures provided by BAE Systems. When the students graduated, they were offered the option of being fast-tracked into a BAE Systems graduate recruitment scheme, which in 2022 resulted in 15 of them joining us as junior software engineers.

in discussion with Australian universities and are hopeful that in the next few years we will be able to offer systems engineering apprenticeships in partnership with a local Australian university.

This year we have also started work on a new software engineering degree apprenticeship with the University of South Australia and a group of ten other employers.

In the Kingdom of Saudi Arabia, we offer aircraft maintenance apprenticeships and have built a very successful skills partnership with Saudi Development Training at a state-of-the-art facility near Riyadh. We have also created a project management curriculum in partnership with the Alfaisal University, the Saudi National Advanced Apprenticeship Programme.

Despite the evolving demands in the job market, the Inc. business had a strong year in terms of staffing. In total we filled approximately 8,150 jobs, which reflects pre-pandemic hiring levels. We saw a 26% increase in the number of early career hires and an 8% increase in the number of former employees returning to the Group. All of this activity resulted in a net headcount increase.

Part of the success in the early career hiring is attributable to the enterprise LEAP intern programme, which also grew in 2022. This programme is in its fourth year and continues to draw students from around the US to participate in primarily technical internships, while also being offered a variety of networking and development opportunities. Additionally, our Platforms & Services sector leveraged a successful welder apprenticeship programme to develop the talent needed to meet current production demands.

Ways of working

We continued to embed new ways of working across the Group in 2022. The nature of our business requires a significant on-site presence in many locations but, recognising the change in working practices that occurred during the COVID-19 pandemic and the need to remain an attractive employer, we have continued our strong focus on hybrid working.

In our US-based business, we are vigilant in delivering for our customers and do so with more than 15% of our employees working a hybrid work schedule. This allows the flexibility to meet individual employee needs, while also remaining focused on achieving our mission. To ensure our people managers are equipped to lead others in a hybrid working environment, a series of hybrid leadership workshops and helpful tools were deployed in 2022.

BAE Systems wins Employer of the Year

BAE Systems has focused on helping young people to launch their careers with us, including programmes for those not currently in education, employment or training (NEETs). Our contribution in this area was recognised at the Movement to Work (MtW) Social Mobility Awards in 2022, where we were proud to be awarded ‘Employer of the Year’.

Since becoming a founding member of the MtW programme in partnership with the Prince’s Trust, we have had around 700 young people complete placements, with 1 in 3.5 of those being offered further employment at BAE Systems. Out of the 60+ cohorts we’ve welcomed so far in England and Scotland, there has been a 91% retention rate on our programmes.

At the awards ceremony, three of our people were shortlisted as ‘Rising Stars’ for making a positive impact on their MtW placements.

Our HR organisation has evolved with the establishment of an ‘Employee Experience’ team, responsible for analysing insights from employee feedback and translating these into actions for our HR teams and line leaders. We have also introduced a Chief Operating Officer role in the HR organisation who is focused on ensuring key business priorities are implemented consistently across the business.

During the year, we commenced a process of HR policy modernisation which has included establishing and agreeing a standard approach for developing HR policies, provisions, process and guidance. This approach is designed to enable our HR strategy and support our desired employee value proposition and employee experience, while ensuring robust controls for our key people risks and enabling greater HR process efficiencies.

BAE Systems is currently in the process of exploring concepts for a new Global Digital Academy, which would offer both virtual and face-to-face training. We are starting by identifying the key priority digital skills needed.

In response to the changing talent market, the Inc. business refreshed its employee value proposition with a focus on attracting and retaining a diverse workforce. In addition, we launched Employer of Choice initiatives that include more family-friendly employee health and wellness benefits for implementation in 2023.

Supporting our employees

We recognise the strain the economic climate is placing on our workforce and have implemented a number of specific measures to help address this, in addition to our ongoing commitments and existing support mechanisms.

In the UK, national-level pay negotiations took place with the Group’s UK recognised Trade Unions during the first half of 2022. A deal was reached, in principle, which was then put to a ballot with the Trade Unions’ members who voted overwhelmingly in favour of acceptance. As part of that two-year deal, those covered by collective bargaining received a 6.75% salary increase for 2022 and we have agreed a 6% salary increase for 2023 which came into effect in January 2023. This pay deal, which has been applied to approximately 27,000 manual and professional staff across the UK, will help address the increased cost of living, whilst respecting affordability for the Group and our customers.

We also made two £1,000 payments to approximately 34,000 eligible UK employees to help address the increased cost of living.

We have structures in place to work with Trades Union representatives in our local markets, where it is appropriate and legally acceptable.

- Of our UK workforce, 72% are covered by collective bargaining agreements.
- Approximately 55% of the UK workforce are Trades Union members.
- In the US, approximately 12% of the workforce is covered by a collective bargaining agreement.
- In Australia, approximately 20% of the workforce is covered by a collective bargaining agreement.

In the UK, BAE Systems received accreditation as a Real Living Wage employer in 2021 and we continue to uphold our commitments in this regard for our own employees and those working on our sites.

To address critical talent retention, the Inc. team executed a targeted review of employees identified with critical skills to deliver off-cycle salary increases that were meaningful and intended to improve market position in order to retain these key employees. In addition to these targeted increases, the team completed an assessment to extend the eligibility for short- and long-term incentive plan participation to align with market practices.

Our priorities for the year ahead

In 2023 we will focus our work around three global strategic priorities:

- Enable business growth through our people. This will include providing the business with the right people and skills in the right place and at the right time. We will operationalise an employee experience that retains and attracts the best people and improve the enablers to support the movement of our people across the organisation seamlessly.
- Foster an inclusive environment where people thrive. We will create a continuous learning and performance culture that enables our people to develop at every life and career stage. We will advance diversity and our culture of belonging.
- Drive HR operational excellence by optimising HR technology to drive process efficiency and enhance user experience, as well as investing in HR capability, engagement and functional excellence.

Disaster relief

Following Russia's invasion of Ukraine, alongside a Company donation, we launched a number of internal fundraising campaigns, with a promise to match all employee donations with Company funds. With a Company donation of £100,000 and a significant amount raised by employees in the US and matched by funds from BAE Systems, Inc., more than $400,000 was provided to the American Red Cross Ukraine Humanitarian Relief Effort campaign. A further £100,000 was contributed to British-Ukrainian Aid thanks to fundraising efforts by our UK employees and Company-matched funding. In addition, our Digital Intelligence team donated 100 new laptops to local charities in Poland, to help children fleeing the conflict to stay connected and continue their education.

Last year, colleagues in Australia and Malaysia were affected by severe flooding, with many of those communities losing their homes to rising rainfall. BAE Systems gave £10,000 to the Malaysian Red Crescent to support flood relief efforts, with our Digital Intelligence employees giving more than £4,000 directly to colleagues affected. In Australia, our Company contributed A$25,000 through GIVIT, which distributed funds to where they were needed during the floods.

In the US, 2022 was marked by wildfires, storms and flooding. To help recover from these, employees made donations to our US Employee Relief Fund, which provides grants to colleagues who experience significant financial hardships as a result of Presidentially Declared Disasters. In late September, we also activated the Immediate Response Program to provide assistance to employees and their families in the extensive wake of Hurricane Ian.

The generous contributions from our employees, combined with Company-matched funding, are making a positive difference. From assisting the people of Ukraine who were forced to flee their homes with very little, to supporting recovery efforts in the aftermath of extreme weather crises, we're committed to supporting our communities.

Supporting our communities

Progress in 2022

During 2022, we contributed £11,504,152[1] to local, national and international causes, working with charities and not-for-profit organisations through our community investment programmes. This includes charitable sponsorships, donations, employee fundraising and volunteering. We have key criteria, where measurable impact can be demonstrated, and these are:

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

In 2022, the demand for the services of many of our charity partners increased alongside an increase in the resources they require to deliver those services. That's why it was important to us to deliver on our commitments to our charity partners and identify new opportunities to support important services in the communities in which we live and work.

Building on the local community initiatives we supported last year, we increased our support to over 40 foodbanks local to our sites in the UK with the aim of helping those most in need. We established a new partnership with Magic Breakfast in the UK, to provide a £100,000 donation to help more than 200,000 disadvantaged school children across our communities manage the risk of hunger and focus on their education.

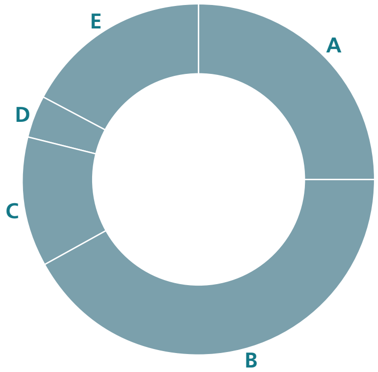
In support of our sustainability agenda we established projects focused on regenerating the environment, including planting 1,400 trees in the UK during 2022.

The impact of our support to local communities was increased through the efforts of our employees, with large-scale fundraising activities returning to our sites. Initiatives such as the 'runway' mile took place at our Warton and Samlesbury sites in Lancashire, UK, with hundreds of employees helping to raise funds for the Trussell Trust, which provides emergency food and support to people locked in poverty. Company-matched funding continued to be offered in support of a number of fundraising projects, encouraging further donations from our employees.

1. Deloitte have provided independent limited assurance in accordance with the International Standard for Assurance Engagements 3000 (ISAE 3000) issued by the International Auditing and Assurance Standards Board (IAASB) over the selected metrics identified with a [1]. Deloitte's full unqualified assurance opinion, which includes details of the selected metrics assured, can be found at baesystems.com/annual-report

To see our Basis of Reporting 2022 visit baesystems.com/annual-report

Community investment by type



A	Armed forces	25%
B	Education	42%
C	Community	12%
D	Heritage	4%
E	Other	17%

We increased our levels of in-kind support through more skills-based volunteering from our employees. An example is the strategic partnership between our Digital Intelligence business and Child Exploitation and Online Protection Command to provide pro-bono support through the knowledge and expertise of our employees in online protection. Mentoring and coaching services were also delivered by our employees to Recruit for Spouses, with our involvement helping the organisation to deliver a 608% increase in military spouses finding gainful employment.

Our focus on supporting armed forces, veterans and their family units is extremely important to us. In support of this, in 2022, we became a Foundation Partner of Legacy Australia. This provides support to the Legacy Australia Grants Fund, which helps the partners, children and widows of current and former serving personnel. We also saw our own veterans' networks and Employee Resource Groups in our markets play an integral part in armed forces focused fundraising, such as during the annual remembrance period.

To see our Basis of Reporting 2022 visit baesystems.com/annual-report

Innovating for impact for US veterans

Our Electronic Systems Tech Power: Innovating for Impact Program brings together university engineering students, employee mentors, and veteran-serving non-profit organisations in the US to design and create meaningful, adaptive technology solutions that support veterans with routine, recreational and work activities.

This programme leverages undergraduate engineering students' and BAE Systems mentors' expertise to apply their skills towards human-centred, real-world projects that benefit veterans. BAE Systems is collaborating with two national non-profit organisations, Adaptive Adventures and America's VetDogs, to include nearly 50 BAE Systems mentors and more than 80 undergraduate students from top US university engineering programmes.

On one project, a US Army veteran needed help managing her battle with post-traumatic stress disorder (PTSD). The Innovating for Impact Program team of Binghamton University engineering students in New York, BAE Systems engineers, and America's VetDogs representatives worked together to create a nightlight that her service dog can activate that allows the veteran to sleep better at night. In another project, Prairie View A&M University engineering students in Texas and BAE Systems mentors helped a veteran with PTSD by developing a wearable device prototype that senses biometrics and sends a vibration signal to the veteran's service dog, who can then alert the veteran to the early signs of a PTSD episode.

BAE Systems is proud to support non-profit organisations that assist military members and their families, as well as those that encourage the advancement of Science, Technology, Engineering, and Mathematics (STEM). The Innovating for Impact Program illustrates the intersection of these pillars, harnessing the passion and expertise of students and Company mentors to help solve real-world, impact-driven assignments for veterans.

Recognising the importance of delivering a positive social impact in our local communities, we continued our varied and comprehensive programme of education-focused activities to drive engagement in young people around STEM subjects and careers. Hundreds of our employees volunteered thousands of hours in support of STEM ambassador programmes in our different markets.

In the Kingdom of Saudi Arabia, we continued our support for education programmes. We reached a five-year milestone for our University Collaboration Programme which provided an opportunity to engage with thousands of students around the Kingdom through lectures and seminars, as well as presenting graduate project awards, in partnership with six universities around the Kingdom of Saudi Arabia. In 2022, we also restarted our STEM Ambassador programme after a COVID hiatus, delivering two STEM workshops to two schools in the Kingdom of Saudi Arabia.

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

Our priorities for the year ahead

- In 2023, we will continue to support our partners in the communities in which we live and work, collaborating to deliver sustainable, long-term benefits.
- We also aim to identify new partners and opportunities that have the potential to deliver greater social impact.
- Our focus on the delivery of skills and education initiatives across our markets will continue, as we provide funding as well as the support of our employees to high-quality STEM-focused projects.
- We aim to increase skills-based volunteering and our level of in-kind support, including to projects which help maintain the environment in which our communities are based.
- We will continue to deliver a varied programme of support to the armed forces, veterans and their families.

Unclaimed asset programme

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

In 2021, a number of potential projects suitable for the funding were identified and approved via the Company Community Investment process. Throughout 2022, several further projects were identified and approved, meaning that the majority of the £3.6m funds have now been allocated.

Governance process and management of the funds

To ensure the appropriate allocation of funds, it was agreed that projects would be approved using the Group's current Community Investment governance process. All unclaimed asset-funded proposals have also been reviewed and approved by the Global Community Investment Committee.

How projects have been identified

Businesses were asked to identify projects and initiatives to support and to apply for approval. In addition to current Community Investment governance rules, the following additional criteria were applied:

- focus on addressing an identified social need and/or contribute to social causes linked to our core business;
- funding at a level that will make a significant impact; and
- have a measurable impact.

Overview of projects funded in 2022

Opportunities for Indigenous girls and young women (Australia)

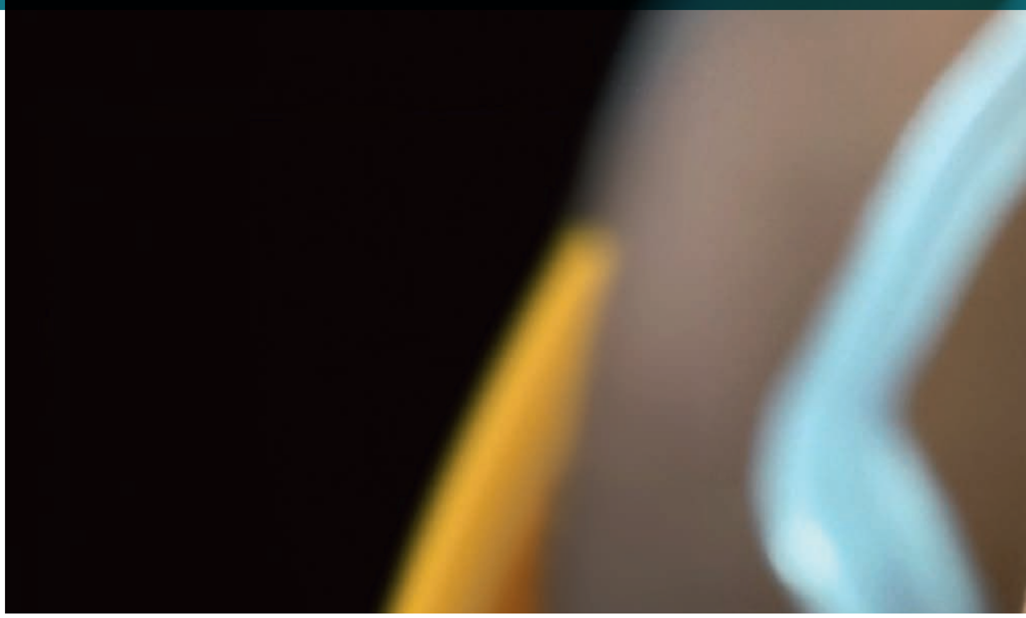
As part of our work with Stars Foundation, we help Indigenous girls and young women to stay in school and move into paid work or further study. As well as financial support, we have provided work experience and site tours to showcase the exciting STEM careers available to students.

STEM and virtual reality in schools (Australia)

We collaborated with the City of Playford's Northern Sound System on a programme called 'CnVRG'. The programme involves primary and secondary schools co-designing a virtual reality experience to bring STEM learning to life. The challenge develops problem-solving skills through teamwork and helps to prepare them for the jobs that may arise from future technological advances.

RBLI Centenary Village (UK)

We donated £100,000 to the Royal British Legion Industries' Centenary Village project through the unclaimed asset programme. Our donation is set to benefit hundreds of disadvantaged veterans every year for the next 100 years, providing homes and welfare support to former military women and men and their families. Last year, we also pledged our support to the charity's 'move on' care pathway model, which helps progress homeless veterans from the charity's emergency accommodation into its more independent housing.



Success through partnering

Collaborating and working with our suppliers and strategic partners is key to our success and delivering against our sustainability aspirations.

Why is this important to BAE Systems?

Our success as a business relies on the resilience of our supply chain. It is vital that we collaborate and partner with suppliers to deliver the capability our customers need and to support our suppliers in addressing challenges including in respect of the products and services they supply to us.

By working together with our supply chain we can accelerate our sustainability programmes which benefits us, our customers and wider society.

We have communicated our sustainability ambitions for suppliers, including within our Supplier Principles, and will be engaging with them to understand their own sustainability ambitions. Our Supplier Principles cover supplier workplace/employee business practices and wider sustainability issues.

We value diversity across our supply chain, as it brings creativity of thought, innovation and agility which helps us to create the best-in-class products and services.

Our suppliers face different drivers, priorities and challenges across the markets in which they operate.

Our relationships with suppliers are often long-lasting due to the complexity of our products and their long lifecycles, so it is critical that our suppliers share our values and our approach to sustainable business. By effectively partnering with our suppliers we are also able to leverage opportunities to deliver a positive social impact in the communities where our suppliers operate.

Our aims

Sustainable supply chain

- Build long-term relationships with supply chain partners to deliver mutual benefit.

Shared values

- Engage supply chain partners in our sustainability ambitions to collaborate on issues and accelerate progress.

Social value

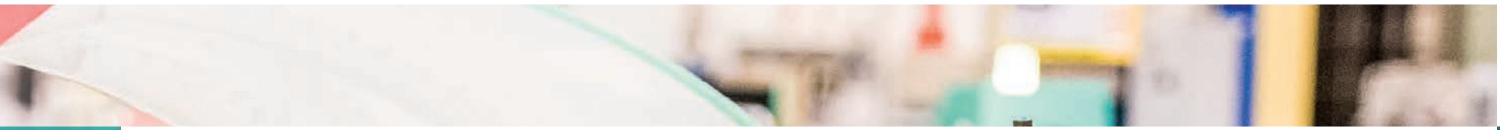
- Continue to develop a diverse supply chain that supports innovation and agility.

Decarbonising Scope 3

- Engage with our suppliers to support our decarbonisation strategy.

Our contribution to the UN Sustainable Development Goals (SDGs)

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
12 RESPONSIBLE CONSUMPTION AND PRODUCTION
17 PARTNERSHIPS FOR THE GOALS



Getting leaner and greener

Our Supply Chain team ran a sustainable project with colleagues who build major units for the F-35 programme. One of their aims was to reduce and control the wastage produced during the complex manufacturing process.

An area they tackled is the use of temporary fasteners, which secure parts of the aircraft in a non-permanent way and are integral to the build process. Working collaboratively, they were able to stem the loss of temporary fasteners and improve available volumes of them, suitable for re-use. By working closely with the customer, they were also able to deploy a more resilient process that enabled recycling of the fasteners back through the supply chain and into our assembly site.

These changes resulted in a c.34% reduction in total CO_2 emissions associated with the production and transport of temporary fasteners between 2021 and 2022 (from 1,017kg to less than 350kg one year later). The emissions saved are the equivalent of driving an articulated truck 504 miles, or 17 trips between our two largest Lancashire sites. In addition, by recycling more temporary fasteners, we use around 75% fewer single-use plastic delivery bags and we help to reduce the requirement for virgin raw material.

Partner 2 Win for success

Achieving our mission to protect those who protect us depends on the extended enterprise of our supply chain, from large corporations to small businesses. We are stronger when we leverage the power of collaboration with our suppliers to successfully deliver enhanced value for our customers while also providing products that meet their needs and support their missions.

Launched in 2017, the Partner 2 Win programme is designed to achieve operational excellence and eliminate defects in the supply chain by raising the bar of performance expectations to meet the demands of current and future customers with utmost integrity and an unwavering focus on continuous improvement.

Since the programme's inception, the Electronic Systems and Platforms & Services sectors have recognised best-in-class performance among their suppliers for achieving on-time delivery and quality standards to meet customer requirements during an annual Supplier Symposium and Awards event.

The programme has resulted in strengthened relationships with suppliers and improved collective performance in delivering the highest quality products and advancing breakthrough technologies. In 2022, Electronic Systems honoured 12 Suppliers of the Year and 106 gold, silver and bronze Partner 2 Win medallists; and the Platforms & Services Combat Mission Systems business awarded a total of 25 Supplier of the Year awards and 34 Partner 2 Win medals for their performance over the previous year. We're proud of the progress we've made to establish a strong supply base, recognising that when we partner effectively, we all win.

Sustainable supply chain

Partnering is key to our success. We aim to build long-term relationships with our supply chain partners, building on trust and collaboration to drive strategic mutual benefit. By working together we can collectively respond to business challenges and deliver innovative products and services. This shared approach not only benefits our customers, but makes a positive contribution to wider industry and communities in which we operate.

We are developing our Sustainable Procurement Strategy. This strategy will set out our long-term sustainable procurement ambitions, including a roadmap detailing how we will achieve them. Supplier engagement is central to this strategy, as we need to understand our supply chain partners' ambitions and commitments and how we can move forwards together.

Shared values

This year we updated our Supplier Principles to better align with our sustainability ambitions. This strengthened set of Supplier Principles demonstrates our commitment towards building a more robust and sustainable supply chain. By engaging with supply chain partners on our sustainability ambitions, many of whom already have their own sustainability strategy in place, we can collaborate on key sustainability issues and accelerate progress.

We have engaged suppliers on our updated Principles and undertaken assurance activity, covering more than 30% of global spend.

Social value

We value a diverse supply chain, as it drives innovation and agility, whilst positively impacting the communities in which our suppliers operate.

In the UK, we have been supporting the Government's SME Action Plan, which sets out how we can improve the engagement we have with SMEs and focuses on procurement models that are easier to navigate. Our commitments include:

- increasing SME spend at tier 1 and lower tiers;
- widening engagement with and championing on behalf of SMEs;
- paying SMEs promptly and on time; and
- supporting smaller businesses in the defence supply chain through the implementation of the industry-wide Hellios SME Portal (launched with UK Ministry of Defence at the Farnborough International Airshow in 2022).

We have also been asked by the UK Defence Suppliers Forum Executive Group to be the industry co-chair of the new DSF SME Champions Working Group that will bring together the industry's SME Champions to collaborate on delivery of the UK Government's SME Action Plan.

Decarbonising Scope 3

We have set a decarbonisation ambition that will drive efficiency, innovation and collaboration across our value chain. We recognise that our supply chain emissions are many times those of our Scope 1 and 2 emissions (see page 52) and it is critical that we partner and collaborate with our suppliers to reduce supply chain emissions by 2050 (Scope 3 emissions). To that end, we look forward to working with suppliers to understand where they are on their own decarbonisation journey.

Supporting small to medium enterprises

As a prime defence contractor, we volunteered to lead the Defence Supplier Forum working group in the UK to create the Hellios SME Portal – a new, free platform offering SMEs greater opportunity to promote their capabilities and access the defence market.

We did this because we recognise the importance of having SMEs in our supply chain; they often bring agility, diverse thinking and creative innovation that can grow our defence capabilities. This enables us to help protect what really matters – our nation's security – and it can also support new jobs in regional clusters across the UK.

Our work towards the digital portal directly supports the ambitions of the Ministry of Defence's SME Action Plan published in early 2022. The plan focuses on how best to support smaller businesses in the defence supply chain.

Small business subcontracting

In the US, we are committed to small business utilisation, with approximately 40% of our supply chain spending placed with small businesses. We recognise that our small business partners contribute to our innovation, support our customers, create jobs, and improve the overall health of the US economy. We work diligently to identify and collaborate with small businesses that bring value to our customers – small, disadvantaged, woman-owned, HUBZone, veteran, and service-disabled veteran-owned small businesses. Additionally, we collaborate with AbilityOne companies and historically black colleges and universities/minority institutes whenever possible.

Employees at Barrow-in-Furness, Cumbria, UK.

Our future Brightstars

Our Submarines site at Barrow-in-Furness, UK, offers fantastic career opportunities for hundreds of young people growing up in and around the area. To enable them to take those opportunities, we deliver a range of programmes and initiatives that help them to develop their employability skills, confidence and aspirations.

One of the key programmes delivered is Brightstars, a local initiative that provides an opportunity for young people from around eight primary schools to work with local businesses, to help them develop key skills such as creativity, innovation and problem solving. We fund up to seven of our suppliers to take part, and we also encourage local SMEs and our own employees – ranging from apprentices to management – to participate in the project.

The companies involved not only get the opportunity to inspire future talent and network with other local businesses, but also to give their employees a chance to develop their skills further and gain a much greater understanding of the communities in which they work.

Our commitment to compliance with our BAE Systems, Inc. Small Business Policy and sector subcontracting plans is underscored by the sponsorship and oversight provided by the BAE Systems, Inc. Procurement Council. Our culture of inclusion and history of small business utilisation supports long-term relationships with diverse businesses in all socio-economic categories. We are active in the small business community at the national, regional, and local levels. BAE Systems Small Business Professionals also serve on committees and in leadership positions in several organisations that advocate for diverse suppliers. We serve on panels, moderate workshops to encourage small business development and provide funding for minority business development programmes. Additionally, we regularly sponsor, exhibit, and participate in matchmaking events to identify qualified small businesses that can provide capabilities and innovation to support our customers' needs. Our commitment to meeting our small business goals and supporting small businesses is a constant in our overall business practice.

Our priorities for the year ahead

- Develop our supply chain decarbonisation strategy.
- Progress our supply chain engagement programme.

Our foundations

Safety, health & wellbeing

The safety, health and wellbeing of our employees is an enduring priority.

Our strong safety culture has many different facets, and a dominant one is the commitment of our leadership to keeping our people safe. We strive continually to improve the safety of our people.

The importance of mental health and wellbeing was put into sharp focus during the pandemic, and we are continuing to strengthen our efforts in supporting our employees in these areas.

Our approach to safety

We operate a number of industrial sites and our manufacturing activities present a range of risks. These include work in confined spaces, machinery operation, working at height, and slips, trips and falls among others. Our 2022 safety performance showed a small improvement in recordable and major injuries from 2021.

We monitor and aim to eliminate, mitigate and manage workplace safety risks. Our approach to identifying and assessing safety risks is embedded within our approach to risk management (see page 116).

We are focused on continually improving standards and this aim is embedded in our Safety Policy. We have a number of programmes focused on improving the safety of our employees and we ensure those employees exposed to identified or known hazards have the appropriate protective equipment. We continually monitor our operations to ensure our safety efforts are aligned to the working environment.

To demonstrate our commitment to safety and drive performance, the Board continued to prioritise safety through the inclusion of a safety objective in executive remuneration. Safety is set as a qualifier to the overall non-financial element of the executive bonus (see page 180). Line managers are incentivised to achieve the desired safety culture and additional personal objectives are identified through the Performance Development Review process. We use a Recordable Accident Rate[1] process as a key performance indicator to assess workplace safety improvements and this is used to determine an element of executive bonus.

Progress in 2022

During 2022, we focused on employee safety training. In the UK and Australia, this included deploying our Managing Safety, Health and Environment (SHE) training, aimed at first-line managers to allow them to understand their role in SHE and piloting our Leading SHE training aimed at more senior leaders. The training will be deployed in the Kingdom of Saudi Arabia in 2023. We also undertook a pilot of our new SHE data platform that will improve our analytics capabilities and enhance our safety processes, such as incident investigation, to reduce risks. With the pilot phase complete, the platform will be rolled out across the business in 2023.

Our training programme was supported by the launch of high-profile employee engagement campaigns on safety including one entitled 'Shift of the Day' which takes a fresh approach designed to capture attention. These campaigns aim to deliver critical safety messages to employees.

In 2022, improvements in safety and diversity were underpins to the non-financial element of the executive bonus. The requirements for safety and diversity improvements were met and progress continues to be made.

Employee health and wellbeing

The importance of our employees' health and wellbeing rose to the fore during the COVID-19 pandemic and remains a priority. We anticipate that it will continue to be important through 2023, as the cost of living crisis and its potential wide range of impacts continue. Our wellbeing programmes support employees in both their work and personal responsibilities.

We continue to promote mental health awareness programmes across the organisation and have worked diligently this year to increase our communications and engagement channels along with introducing training for employees to raise awareness of the importance of mental wellbeing. We have also raised wellbeing and mental health with our middle management, highlighting its importance to the business and providing our managers with guidance on how to support themselves and colleagues.

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

2022	485
2021	496

Major injuries recorded[2] BONUS

2022	32
2021	33

BONUS

The award of the executive directors' bonuses is dependent upon achievement of improvements in both safety and diversity (see page 181).

2. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes, and controls are in place to collate, validate and report this data. Based on the procedures and the evidence obtained, nothing has come to its attention that indicates the disclosures have not been properly prepared in accordance with such systems, processes, and controls.

We promote discussion and awareness on some challenging topics including family loss, stress and depression. Our Employee Resource Groups (ERGs) and employee communications programmes highlight these topics and help direct employees to sources of support and assistance.

Through our Employee Assistance Programmes, our employees can access physical and mental health advice and support for themselves and family members. This support is available via phone, website and specialist apps and is available 24 hours a day, 365 days of the year. We have also continued to provide a digital platform to empower employees to take a proactive and preventative approach to mental health and wellbeing.

We continue to train Mental Health First Aiders and this year were proud to be accredited as a Menopause Friendly Employer for the first time.

Our Reward & Benefit arrangements available to employees also include Private Medical Insurance, Healthcare Cash Plans, discounts to gyms and other health improvement activities. We have partnered with Cancer Research UK to deliver a range of information and live webinars on cancer, focusing on the risk factors related to our employee demographics and location such as smoking, obesity and alcohol. We have also offered free flu vaccinations to all UK employees.

1. We define recordable injuries in line with the US Occupational Health and Safety Administration reporting standard.

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Our occupational health provision delivers a number of services that contribute to the management of health risks in the workplace. Occupational hygiene and health hazard risk assessments inform health surveillance programmes that are an essential part of our health and safety management system. Services are accredited to the appropriate level, based on the geographic location. Employees access these services through referral systems or as part of a cyclical approach. Reporting back to the business then informs risk management processes.

BAE Systems, Inc. continued its implementation of the Safety Maturity Matrix (SMM) process – an audit process to help sites manage risk and drive culture. This SMM process resulted in 53 self-assessments, 11 verification audits and four training events during the year. In addition, Inc. leveraged the Serious Injury/Fatality risk identification process to drive increased focus on proactively managing and eliminating risks with higher potential for significant injury.

In support of employee mental health, the Inc. Resilience Hub website created during the pandemic continues to be maintained to offer employees help with managing stress, building time into their days for self-care, locating resources for child care and setting physical, financial, and wellbeing goals as well as working towards them. In addition, the Employee Assistance Programme was enhanced to include more behavioural health resources and access to concierge support for finding and scheduling mental health provider appointments, with new programmes and digital resources added to help employees build resilience and improve their mental outlook.

Our priorities for the year ahead

- Full deployment of our SHE reporting environment.
- Continued focus on safety training in the UK, Kingdom of Saudi Arabia and Australia.
- Promoting leadership and employee engagement in safety activities to raise awareness and drive a learning organisation.
- Proactively identify and mitigate more substantial risks through the Serious Injury/Fatality risk potential identification process.
- Continuing to put in place ways to support the general wellbeing of our employees.

Help from Henpicked

We are committed to supporting employees when it comes to menopause. With three in four women experiencing a wide range of symptoms, most of our employees are touched by menopause – if not directly themselves, then as partners, sons and daughters, friends, colleagues or line managers.

That is why, in the UK, we partnered with menopause experts, Henpicked, to raise awareness of it and provide support. Last year, more than 1,000 of our people attended one of their webinars to find out more and 300+ employees voluntarily completed further e-learning also provided by Henpicked. This was in addition to resources, articles and blogs that we shared on our Employee App, which have been read by around 5,000 colleagues.

Last year we were shortlisted as finalists for three menopause-related awards. We won the ‘Best Diversity Campaign’ award in recognition of how we are supporting our employees experiencing the menopause from a physical, mental health and wellbeing perspective, and for our openness and training at work. We were also successfully accredited as a ‘Menopause Friendly Employer’.

Diversity, equity & inclusion

Diversity, equity and inclusion are key enablers to recruiting the best talent, driving innovation and creating a workplace environment where employees are enabled to bring their whole selves to work every day.

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

We recognise the challenges of increasing diversity in the engineering sector but, through our schools and early careers programme, we are proactively increasing diversity in our pipeline and seeking opportunities to bring in talent from a wider segment of society. Resourcing talent development and succession planning remain key for us across all markets. We are making steady progress on gender diversity and our Executive Committee now includes an increased number of women and ethnic minority representation.

Throughout 2022, we prioritised initiatives around recruitment and retention of diverse talent, ensuring they are embedded into our processes. This work will continue through 2023 as we look to create a more inclusive working environment, where everyone feels a sense of belonging.

The Group is committed to giving open, full and fair consideration to applications for employment from disabled people and people with health conditions or impairments who meet the requirements for roles. We also ensure training opportunities and appropriate accessibility are available to all. We firmly believe that the inclusion of all of our people is vital to the success of our business.

Our commitment to disability inclusion and accessibility in the workplace is illustrated by our pledge to support The Valuable 500 campaign and in 2022 we became one of the founding members of Neurodiversity in Business.

Our ambitions are supported by a range of targets:

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

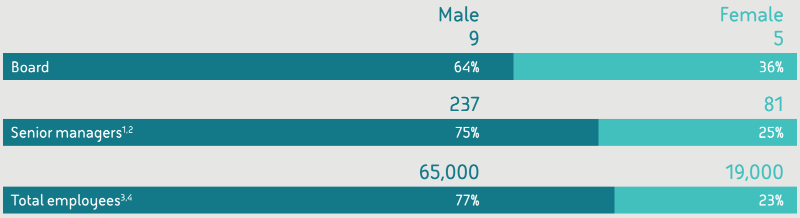
Progress in 2022

From May 2023, we are on track to meet the new Financial Conduct Authority (FCA) Board diversity targets including a female chair and a 40% gender mix with one member from an ethnic minority background.

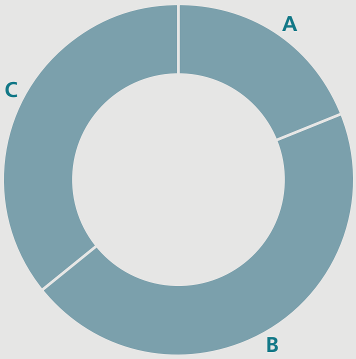
Our ERGs play an important role in promoting an inclusive and attractive workplace. They provide visible leadership and direct engagement with a range of affinity groups, to ensure employees feel that their differences are valued and represented. Our ERGs are also vital in raising awareness and educating those who may not directly relate to their focus area, but wish to support as an ally.

In the UK, this is supported by 18 different pledges and commitments to external charters, including veterans, LGBTQ+, mental health, disability and social mobility. Also in the UK, we have six core ERGs: Enabled (disability); GEN (gender); Mindset (wellbeing); VetNet (veterans); Embrace (cultural diversity) and OutLink UK (LGBTQ+).

Gender diversity



Age diversity[3,4,5]



A	Under 30 years	16,000	19%
B	30–50 years	38,000	45%
C	Over 50 years	30,000	36%

Gender pay gap

We have published our sixth annual gender pay gap report in line with UK regulations. For 2022, the average gender pay gap for our UK workforce was 8.6% (2021 8.7%) which is 6.3 percentage points lower than the current UK national average of 14.9%. We rely on employing large numbers of employees with STEM qualifications and we, like other companies, face challenges recruiting women with these qualifications because there are significantly fewer women who study and work in these fields. As a result, a greater proportion of our workforce and our senior leadership population are men and this is a major factor in our gender pay gap. We continue to work hard to improve our gender balance and remain steadfast in our commitment to delivering the plans we have in place to increase the number of women in BAE Systems and support the progression of women into senior executive positions.

1. Senior managers are defined as employees (excluding executive directors) who have responsibility for planning, directing or controlling the activities of the Group or a strategically significant part of the Group and/or who are directors of subsidiary companies.
2. Executive Committee (excluding executive directors) and their direct reports.
3. Excluding share of equity accounted investments and rounded to the nearest thousand employees.
4. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes, and controls are in place to collate, validate and report this data. Based on the procedures and the evidence obtained, nothing has come to its attention that indicates the disclosures have not been properly prepared in accordance with such systems, processes, and controls.
5. The age diversity split has been amended this year to align with external reporting requirements.

In BAE Systems, Inc. we have continued our support through the broader Multicultural Network and its eight US ERGs. In addition, an executive-level Diversity, Equity and Inclusion (DEI) Council was formed to drive execution of Inc.-wide actions.

Stand-out UK initiatives delivered in 2022 have included:

- A nationwide engineering roadshow for schools with themes specifically for girls. This is supported by 800 employee STEM Learning Ambassadors.
- An engineering badge partnership with Girl Guiding North West which has been completed by more than 23,000 girls.
- Career sponsorship programmes for women at all levels.
- Leadership development opportunities in inclusive recruitment guidelines and senior leadership specific inclusion workshops.
- Making free sanitary products available across the majority of sites, with the remaining being actioned in 2023.
- Achieving Menopause Friendly Employer accreditation.

Across BAE Systems, Inc., accountability for diversity, equity and inclusion continues to be driven through the Inclusive Leader Goal assigned to all people managers across the organisation. Building on the prior success, the 2022 goal included requirements for leaders to check in on the wellbeing of their employees, demonstrate inclusive behaviours to enable a safe and productive team environment, conduct team dialogues about DEI themes, and discuss career aspirations and development opportunities with all of their employees. As a result, employees' sense of belonging improved – as reported through the Inc.-wide Inclusion Index survey – and representation of women and people of colour in leadership roles continued to increase in 2022 as well.

Our priorities for the year ahead

As we move into 2023, we will increase our focus on inclusion and belonging which will in turn contribute to a more diverse workforce. Our Accelerating Our Inclusion action plan describes targeted activity to drive this.

- Mandated Inclusion training will be assigned to managers and leaders with in-depth topic area knowledge, as well as leadership content on meaningful conversations and creating inclusive team cultures and Leadership toolkits.
- Inclusion training will be assigned to all UK employees and a refreshed approach to employee engagement though recognisable content across all of our sites and digital platforms.
- We will continue to empower our ERGs and expand the awareness of them, and the role they play, in our Inclusion workstreams, through targeted, measurable and impactful activity.
- We will look to gain a deeper understanding of employee sentiment through various methods – enhancing our qualitative and quantitative data to drive our agenda for 2023 and beyond.

To see our Basis of Reporting 2022 visit baesystems.com/annual-report

Product trading, quality & safety

Product trading

The defence industry is subject to strict regulatory controls. We maintain stringent internal controls that govern what we sell and to whom. To identify responsible trading risks our Product Trading Policy requires an evaluation on all products and services and trading activities. The process ensures that in addition to a commercial assessment, consideration is always given to wider ESG concerns.

Our Product Trading Policy and Responsible Trading Principles help us to make informed decisions about the business opportunities we pursue in accordance with our values.

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

Product safety and quality

We are responsible for ensuring that the products we deliver both conform to their design and achieve a certain level of safety and quality, each as agreed with our customer. We do this by complying with our product safety and quality policies and processes. A product is any goods or services, including intellectual property, developed or traded by BAE Systems. This could be physical such as a platform or sub-system, non-physical such as software or a design licence, or a service, such as maintenance or support. Our policies and practices apply throughout a product's lifecycle, and may extend beyond the formal end of a project or programme.

Environmental impact management

We are committed to high standards of environmental management, including addressing our climate-related impacts. Our global Environment Policy outlines the processes to achieve this. All sites operate an environmental management system (EMS) and the ten largest sites (accounting for 54% of our emissions) operate an EMS certified to ISO[1] 14001, with the aim of reducing their energy consumption and, in turn, direct and indirect greenhouse gas emissions. See page 40 for information on how we are managing our environmental impacts and addressing climate change.

Accountability & transparency and Robust ethics & governance

Ethics and compliance

Robust governance remains at the core of our business and is a foundation of our sustainability agenda. We are committed to ethical and responsible behaviour in all aspects of what we do. Our industry is amongst the most highly regulated of any sector, and we always strive to comply with and often exceed the requirements of applicable laws and regulations.

Our Operational Framework sets out our approach as well as the policies, processes and standards to which we adhere, which apply everywhere we operate. Our Code of Conduct and 'Supplier Principles – Guidance for Responsible Business' outline expectations for all our employees and partners.

Anti-corruption programme

We support our employees in understanding the vital role they have to play in ensuring that we maintain the high standards of ethical conduct that our customers, shareholders, partners and colleagues expect. We have a zero tolerance policy regarding corruption in all its forms.

Our anti-corruption programme is designed to ensure adherence to all relevant legal and regulatory requirements recognising the bribery and corruption risks that are faced by the Company (see the Laws and regulations principal risk on page 125). The programme also provides our employees with practical guidance, helps them to understand what is expected of them and creates an environment in which they feel they can confidently, and confidentially if needed, ask questions and raise issues and concerns.

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

We drive improvements in the programme annually to ensure it continues to meet best practice. Our anti-corruption programme also includes our Code of Conduct and ethics training.

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

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

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

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

1. International Organization for Standardization.

Employee ethics programme

Our global Code of Conduct lays out the standards and behaviours that are expected of all employees. It guides them in acting responsibly and ethically in everything they do and outlines the ways in which they can seek help and guidance. Our Code is supported by a training and engagement programme to empower them to make ethical decisions. All employees are required to complete ethics training annually alongside e-learning programmes of role-specific training, for example, export controls.

In 2022, 98.4% of our employees completed our ethics training, with the majority of those who did not complete it being employees on secondment, maternity leave, sick leave or other long-term absence. These employees will complete their training on their return to the business.

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

Raising an ethics concern

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

During 2022, we received 1,196 enquiries, an increase of 0.6% compared to 2021.

Of the 1,196 enquiries received, 613 (51%) required investigation, 42% of which were substantiated. The top five categories for investigation were: employee conduct, accounting charge practices, employee relations, management practices, and safety, health and environment. Of the 613 investigations for 2022, 522 were closed and 91 remain open. These will be closed out during 2023.

To see our Basis of Reporting 2022 visit baesystems.com/annual-report

14 ethics enquiries were received about our suppliers. Seven enquiries required investigation, six were substantiated.

60% of ethics enquiries came from the US. The number of ethics reports varies by region. Factors influencing this include the number of individuals working in that region and the cultural propensity of individuals from that region to utilise Speak Up mechanisms.

We value openness, and strive to create a culture where people feel they can speak up freely. Our main metric is the number of enquiries made, and more specifically the number of enquiries per 1,000 employees. We also measure the proportion of requests for guidance compared to reports requiring investigation, anonymity rate and contacts made directly to one of our 311 Ethics Officers (one for every 349 employees) across our business. In 2022, our anonymity rate was 26% compared to 35% from 2021, well below the benchmark rate of 50%[1].

43% of reports were made directly to Ethics Officers in 2022 – we encourage this route for making reports, as it allows for an immediate response by someone familiar with the local situation. However, we are pleased that employees are using the options available to report issues or obtain guidance, whether they choose to do so anonymously or otherwise.

Total ethics enquiries[2,3]

2022	1,196
2021	1,189

Anonymity rate

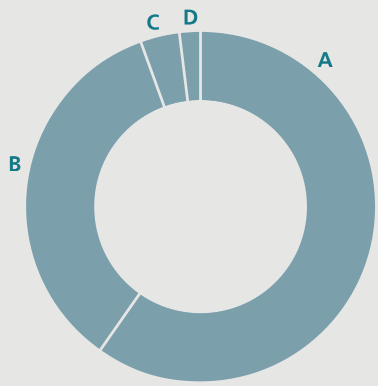
26%

(2021 35%)

Dismissals for reasons relating to unethical behaviour[2]

2022	243
2021	281

2022 ethics enquiries by region



A	US	717
B	UK	415
C	Kingdom of Saudi Arabia	44
D	Australia	20

2022 ethics enquiries by type[2]

1	583
2	140
3	11
4	18
5	223
6	103
7	2
8	65
9	12
10	19
11	10
12	9
13	1

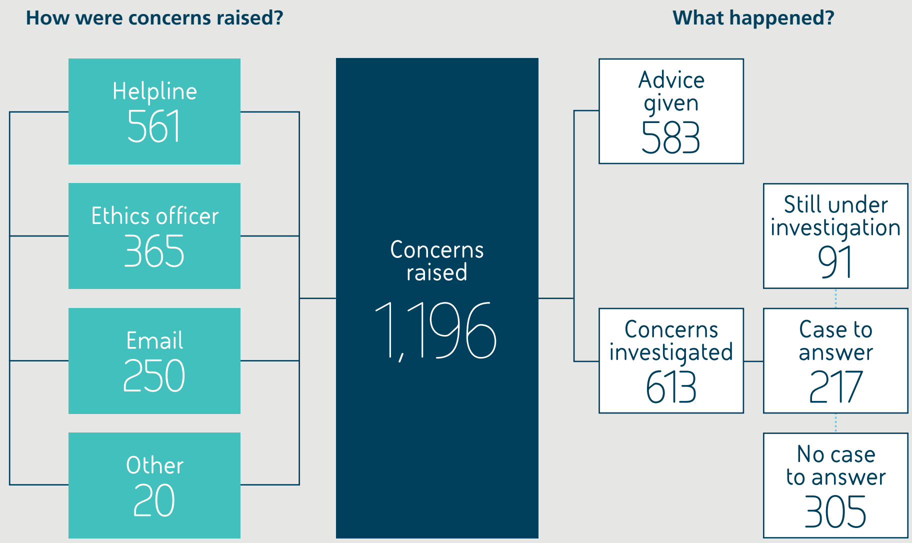
1 Enquiries that led to guidance and advice

Enquiries that led to investigations

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

1. Navex 2022 anonymity benchmark.
2. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes, and controls are in place to collate, validate and report this data. Based on the procedures and the evidence obtained, nothing has come to its attention that indicates the disclosures have not been properly prepared in accordance with such systems, processes, and controls.
3. Our US business uses the Helpline as a mechanism for people to declare a conflict of interest (e.g. a family member also working at BAE Systems, or a second job) – these are not reports of inappropriate behaviour or requests for guidance, but a simple logging process. 2021 reports data has been restated to reflect the removal of those cases in our US businesses which were the formal declarations of conflicts of interest, bringing our US business in line with the Group.

How our Ethics Helpline has been used



In 2022, 243 employees were dismissed due to misconduct, which may include breaches of the Code. The majority of the 14% decrease from 2021 occurred in our US business, and whilst there is no specific event or circumstance that primarily contributed to this decrease, it shows that employees are complying with the Code and related policies on proper workplace conduct.

Improving industry standards

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

We take a proactive leadership role in our engagement with the defence industry, governments, NGOs and other interested parties to develop initiatives that will address the key ethical issues affecting our industry. For example, we take leadership positions with industry ethics groups such as the International Forum on Business Ethical Conduct and the US Defense Industry Initiative. We also regularly interact and support the Institute of Business Ethics and Ethics & Compliance Institute, and are proactive members of both the Aerospace and Defence Industries of Europe and the Aerospace, Defence, Security and Space trade associations.

Community investment

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

Our policy does not allow payments to third-party fundraisers or individuals, and is focused on ensuring the charitable organisation receives funding directly.

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

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

We use the Business for Societal Impact Framework methodology to define the value of our support and its impact on our community partners, in comparison with our peers and other organisations. The total value of our community investment programme donations is externally assured every year. All community investment-related expenditure and any associated employee fundraising is reported through an online system which is subject to annual validation checks.

Human rights

We are committed to respecting and upholding human rights wherever we operate, in respect of activities under the full, direct control of the Group. Our employees, our suppliers and business partners are all expected to adopt high standards of ethical behaviour. We are committed to conducting business responsibly and to maintaining and improving systems and processes to minimise the risk of slavery and human trafficking in our business or supply chain.

Our human rights statement outlines our approach to responsible business behaviour, including in relation to anti-corruption, the environment, as well as our workplace, supply chain, local communities and products.

Our approach to human rights constitutes:

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

Our Code of Conduct and other global policies and processes mandated under the Operational Framework, together with our supporting principles and guidance, support our commitment to human rights and are regularly reviewed.

Our 'Supplier Principles – Guidance for Responsible Business' communicate the human rights principles we expect of our suppliers (see page 78). In 2022, we published updated Supplier Principles. We engage suppliers on our Supplier Principles during the supplier evaluation stage and undertake assurance activity as part of ongoing supplier management assessments.

In the UK and Australia, we have modern slavery working groups to progress actions to review and strengthen how modern slavery and human trafficking risk is identified, assessed and managed across our business. We publish our annual responses to the UK and Australian Modern Slavery Acts, and a statement in response to the California Transparency in Supply Chains Act on our website.

Our approach to identifying and assessing human rights risks is embedded within our approach to risk management (see page 116).

Cyber security

Cyberspace is an increasingly contested environment with criminals, hacktivists and sub-threshold activity from nation states being a significant threat. As a major defence, aerospace and security company, it is critical that our Group networks, as well as the products and services we sell, are cyber resilient and the intellectual property and confidential information held and processed on them is appropriately secured.

Our governance model and organisational structure (through the Chief Technology and Information Officer) is designed to facilitate close alignment between the Group's strategy and the resulting engineering, technology, and digital and cyber security strategies. Our digital and cyber security strategies identify trust in our business and our products as a fundamental enabler to meeting our Group strategy.

The cyber security risk is constantly reviewed and an agile, proactive, approach to mitigating the risk is taken. We do this by efficiently leveraging our core internal capabilities in cyber security, including our specialist threat intelligence service, to maintain a managed risk position as we digitally transform and the threat landscape evolves.

Our internal Cyber Security Standards for Company networks are aligned to the National Institute of Standards and Technology framework and controls and a formal, three layers of defence, assurance programme is operated to check adherence to Group standards and customer requirements, which is reviewed both internally and externally. Additionally, many of our networks are formally accredited by our government customers.

To further increase our cyber resilience, our Security Operations Centres in the UK and the US perform continual protective monitoring of our core networks. In the event of a cyber incident, we have a Cyber Incident Response plan which feeds into the Group's crisis management plan if required. Regular exercises are conducted across the business to test the Cyber Incident Response plan including up to the Executive Committee.

Education and awareness to embed a strong cyber security culture across the Group is another vital part of our activities. We take a holistic approach providing training coupled with events and activities to drive better engagement and learning outcomes. We strive for the training to be relatable, both on a professional and personal level, so that hybrid working employees maintain a strong sense of cyber awareness whether at home or in the office. Employees are subject to mandatory training which, depending on their role, covers cyber security, physical security, document marking, security of export-controlled information, and personal data protection. As many cyber attacks still involve email, we run a programme of phishing exercises for all email users across the enterprise. There is a global shortage of skills in cyber security and we actively work with a variety of groups including the National Cyber Security Centre's Cyber First programme for young people in the UK to increase the size and diversity of the cyber workforce.

Responsible supply chain

Our ambition is to be responsible and sustainable (see page 70) across our global business. We cannot achieve this alone, therefore it is important that we collaborate and partner with suppliers to make a positive business impact over the long term. We spent £11.5bn with more than 21,000 directly contracted suppliers worldwide.

Our supply chain management starts with our Global Procurement Policy which defines the requirements to be implemented by each of our sectors for the establishment of procurement control and the management of supplier-related risk. Our Global Procurement Policy requires our sectors to communicate our 'Supplier Principles – Guidance for Responsible Business' to our suppliers (see page 70). During the second half of the year, we commenced an annual risk-based assurance activity to test our suppliers' adoption of these principles and to identify any risk areas that required investigation and/or mitigation. We completed this assurance activity with suppliers representing more than 30% of our global spend.

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

Supplier due diligence

Risk-based due diligence and audit activity is undertaken for all third parties with whom we engage, whether supplier, adviser, potential joint venture partner, acquisition opportunity or other third party. Where required, this may include establishing the identity of the third party in terms of beneficial ownership and gathering of sufficient information to assess relevant bribery and corruption risks. At the contracting stage, we stipulate our expectation that suppliers embrace our standards on ethical behaviour, including those set out in our Supplier Principles.

Once a supplier has been approved and a contract has been executed we continue to actively manage and monitor that supplier. This includes managing any significant changes in our relationship with the supplier. A global Supply Chain Central Risk Intelligence hub has been established to collect and share new risk intelligence associated with suppliers, as well as category, cyber security, political and ethical information that may affect our business. Weekly global supply chain disruption meetings are held with senior procurement leaders to ensure the latest risk data is appropriately shared. Proactively managing suppliers and sharing appropriate data allows procurement to develop risk-mitigating strategies, helping to reduce the risk of supply chain disruptions.

We conduct supply chain risk assessments and work with suppliers to address any identified key risks to their businesses and supply to our programmes which would include risk associated with the supply of critical materials. Therefore, critical materials are considered as part of a broader corporate approach to monitoring supply chain risk. The challenge of limited or sole source supplies of raw materials remains, due to the nature of some of the products manufactured by the Group, which are often of a unique specification, and frequently supplied at low volumes. To address this, we have a multi-faceted risk management programme that seeks to: aggregate risk across the enterprise using proactive intelligence; manage continuity of supply; and illuminate lower-level supply chain tiers to help us to understand the relationships within our supply chain.

We pay specific attention to single- and sole-source critical goods and services procured through the supply chain, to ensure that the risk is fully understood and adequate contingency and risk mitigation plans are in place and can be enacted if required to manage programme delivery. For example, after identifying a category risk associated with semiconductor chip shortages and increasing semiconductor chip demands, we developed and implemented a risk mitigation plan that has reduced the supply chain risk across our Group programmes.

The external supply chain environment is very dynamic, with both lead-time and availability challenges, but also pricing pressures, including from inflationary increases in labour, energy and other key materials. We continue to monitor these risks. In many cases, the Group benefits from long-term programme positions and incumbencies with more stable forward visibility for long-lead items allowing us to continue to actively manage supplier lead times against demand requirements.

Conflict minerals

We expect our suppliers to provide products made from materials, including constituent minerals that are sourced responsibly, and to support efforts to eradicate the use of any minerals which directly or indirectly finance or benefit armed groups that are perpetrators of serious human rights abuses.

Reporting, disclosure and assurance

We report on progress of our sustainability agenda within our Annual Report and online: baesystems.com/sustainability

Materiality

During 2022, we continued to address the material ESG issues that were identified during our 2021 materiality assessment where we engaged with internal and external stakeholders regarding material sustainable issues for the Group. This materiality process confirmed that the Group is addressing and managing, via its sustainability agenda, the material ESG issues. We will review re-running this assessment during 2023.

We also continued our work to identify and understand material climate-related risks and opportunities.

Our approach to UN Sustainable Development Goals

We continue to support the UN Sustainable Development Goals (SDGs) and remain committed to driving progress on specific goals that are aligned to our sustainability agenda. Specific goals are highlighted on pages 40 to 68. The SDGs provide a framework for development and address the challenges that the global population faces from tackling climate change and environmental risks through to managing societal needs and building economic growth. For more information on SDGs please go to: baesystems.com/sustainability

Assurance of data

External assurance of greenhouse gas emissions (page 52), energy (page 52) and community (page 64) data is provided by Deloitte LLP.

Deloitte statement

Deloitte has provided independent limited assurance in accordance with the International Standard for Assurance Engagements 3000 (ISAE 3000) and Assurance Engagements on Greenhouse Gas Statements (ISAE 3410) issued by the International Auditing and Assurance Standards Board (IAASB) over the selected metrics identified on pages 52 and 64. Deloitte's full unqualified assurance opinion, which includes details of the selected metrics assured, can be found at baesystems.com/annual-report

Non-financial and sustainability information statement

The above 'Sustainability' section (pages 38 to 79) constitutes the Non-Financial and Sustainability Information Statement as required by the Companies Act 2006 as amended, together with the 'Our Stakeholders', 'Work of the Board', 'Our Business Model' and Risk sections listed in the table below, which are incorporated in this Non-Financial and Sustainability Information Statement by reference:

Topic	Our principles, policies and standards that govern our approach	Where to find information in this report
Environmental matters and climate-related disclosures	– Environmental policy – Carbon Reduction plan	Page 40 Sustainability – Addressing climate risks (TCFD) Page 72 Sustainability – Our foundations
Employees	– Our People policy – Health and Safety policy – Communications policy – Code of Conduct – Personal Data Protection policy	Page 32 Our stakeholders Page 34 The work of the Board Page 72 Sustainability – Our foundations
Respect for human rights	– Code of Conduct – Human Rights Statement	Page 72 Sustainability – Our foundations
Social matters	– Community Investment policy – Commercial policy – Lobbying, Political Donations and other Political Activity policy – Dignity and Respect Standards, in support of our global diversity & inclusion vision – Supplier Principles – Guidance for Responsible Business	Page 32 Our stakeholders Page 34 The work of the Board Page 72 Sustainability – Our foundations Page 151 Environmental, Social and Governance Committee report
Anti-bribery and corruption	– Gift and hospitality policy – Finance policy – Conflicts of Interest policy – Facilitation payments policy	Page 72 Sustainability – Our foundations
Description of principal risks relating to topics mentioned above	– Risk Management policy	Page 116 Risk – How we manage risk
Description of business model		Page 18 Our business model
Non-financial key performance indicators		Page 72 Recordable Accident Rate

All our policy summaries can be found on our website: baesystems.com/en/sustainability/governance/oversight/policy-summaries

Our financial review

We have delivered strong financial performance with top-line growth, margin expansion and high cash conversion. Our record order intake of £37bn increases our order backlog to £59bn, positioning us well for the future.

Our financial and operational performance has strengthened, our diverse portfolio is delivering and we carry this momentum into 2023 and beyond.

Brad Greve
Group Finance Director

2022 financial highlights

Full-year performance

Operationally, the business delivered a strong performance enabling us to report growth in sales, underlying earnings per share (EPS) and free cash flow.

The reported results benefited from a significant foreign exchange tailwind as the US dollar rate averaged $1.24:£1 compared to $1.38:£1 last year.

It was a significant year for orders, with strong demand delivering a record order intake of £37bn and order backlog increased to £59bn.

On a constant currency basis, we delivered sales growth of 4.4% and, while there were supply chain disruptions and inflation headwinds, the quality of programme execution drove strong returns, resulting in 5.5% underlying EBIT growth and a 20 basis point expansion in return on sales which reached 10.7%. Underlying EPS of 55.5p was up 9.5%, reflecting the underlying EBIT growth and the impact of the share buyback programme.

Free cash flow exceeded expectations at £1,950m, driven by strong programme delivery across our operations and a number of orders providing higher than expected advance cash payments. Three-year free cash flow (2020–2022) totalled £5.2bn[1], outperforming the guidance of 'in excess of £4bn'.

In support of our growth outlook, we increased our capital expenditure and self-funded R&D.

We also increased cash returns to our shareholders through the dividend and buyback programmes. Reflecting the in-year performance and the outlook for the business we have proposed a 7.6% increase in our full-year dividend.

The pension position improved in the year. The International Accounting Standard (IAS) 19 balance sheet position is in surplus compared with a deficit last year driven predominantly by the move in corporate bond rates. We completed the UK triennial pension review in the first half of the year and I am pleased to report that on a technical provisions basis, the UK schemes are fully funded.

2023 guidance

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

With a strong year behind us, we look forward to another year of good top-line growth with increased return on sales and good delivery against our rolling cash targets. Our guidance uses the same exchange rate we averaged in 2022 of $1.24:£1.

Sales for the Group are expected to increase between 3% to 5%, with growth across all sectors.

Underlying EBIT is expected to improve by 4% to 6%, as we see scope for increased return on sales.

We expect underlying EPS to increase 5% to 7%, as the underlying EBIT improvements and benefit of a lower share count from the buyback programme, will be offset by a higher expected tax rate of 21%, driven by the UK corporation tax rate increase.

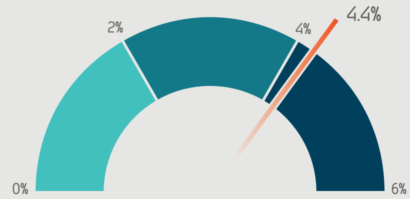
Free cash flow in 2023 is expected to be greater than £1.2bn. As mentioned, cash advances received in 2022 will start to unwind as we build out programmes. We will also have higher capital expenditure to fund the improving long-term growth outlook.

In respect of our three-year free cash flow guides, we have increased our 2021–2023 and 2022–2024 guides by £0.5bn, and set our new three-year guide for 2023–2025 at between £4bn and £5bn.

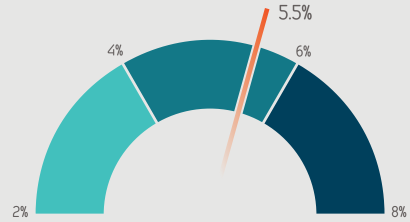
Group guidance can be found on pages 90 to 91.

2022 full-year performance against guidance

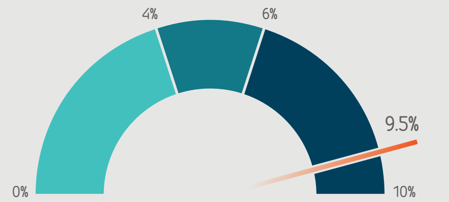
Sales growth



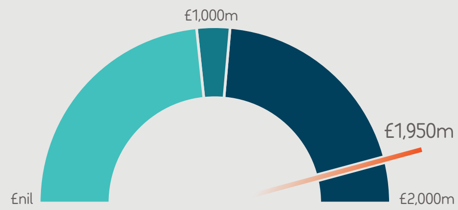
Underlying EBIT



Underlying earnings per share

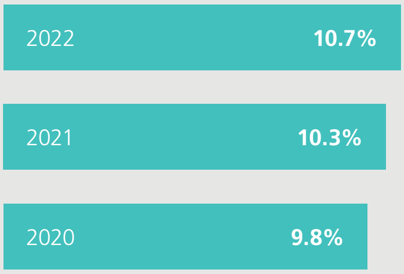


Free cash flow



2022 guidance range

Compared to guidance provided at an exchange rate of $1.38:£1



Return on sales has increased 20 basis points (on a constant currency basis)

This has been delivered by focusing on:

- strong operational performance allowing for risk retirement;
- closer supply chain focus and supplier relationships;
- proactive portfolio actions; and
- business efficiency initiatives.

1. This is before a £1bn UK pension scheme contribution in 2020.

Financial performance metrics

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

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

BONUS
75% of the UK executive directors' annual bonuses are based on the achievement of financial KPIs (see page 179).

Financial performance measures defined by the Group

Sales KPI

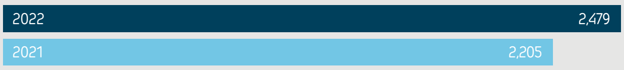
£23,256m 4% growth[1]

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

Purpose
Enables management to monitor the revenue of both the Group's own subsidiaries as well as its strategically important equity accounted investments, to ensure programme performance is understood and in line with expectations.

Underlying EBIT KPI

£2,479m 5% growth[1]

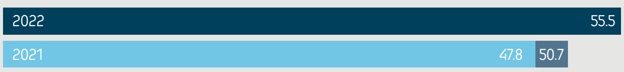


Definition
Operating profit excluding amortisation of programme, customer-related and other intangible assets (see note 8), impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBIT) and adjusting items[2]. The exclusion of amortisation of acquisition-related intangible assets is to allow consistent comparability internally and externally between our businesses, regardless of whether they have been grown organically or via acquisition.

Purpose
Provides a measure of operating profitability, excluding one-off events or adjusting items that are not considered to be part of the ongoing operational transactions of the business, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.

Underlying earnings per share[3] BONUS KPI

55.5p 9% growth[1]



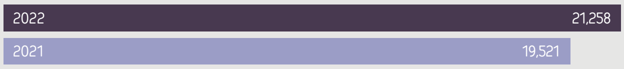
Definition
Profit for the year attributable to shareholders, excluding post-tax impact of amortisation of programme, customer-related and other intangible assets, impairment of intangible assets, non-cash finance movements on pension, other investments and financial derivatives, and adjusting items[2] attributable to shareholders, being underlying earnings, divided by number of shares as defined for Basic EPS in accordance with IAS 33 Earnings per Share.

Purpose
Provides a measure of the Group's underlying performance, which enables management to compare the profitability of the Group's recurring operations over time.

Financial performance measures derived from IFRS

Revenue

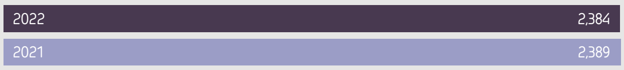
£21,258m 9% growth



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

Operating profit

£2,384m Stable



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

Basic earnings per share

51.1p 7% decrease

Definition
Basic earnings per share in accordance with IAS 33 Earnings per Share.

Financial performance measures defined by the Group

Free cash flow

KPI

£1,950m

£86m higher

Definition
Operating business cash flow less net interest paid and taxation.

Purpose
Provides a measure of cash generated by the Group's operations after servicing debt and tax obligations, available for use in line with the Group's capital allocation policy.

Order backlog

£58.9bn

£14.9bn increase

Definition
Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.

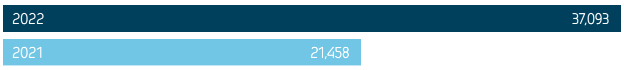
Purpose
Supports future years' sales performance of subsidiaries and equity accounted investments.

Order intake

BONUS KPI

£37,093m

£15,635m increase



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

Purpose
Allows management to monitor the order intake of the Group's own subsidiaries as well as its strategically important equity accounted investments, providing insight into future years' sales performance.

Net debt (excluding lease liabilities)

BONUS KPI

£(2,023)m

£137m decrease

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

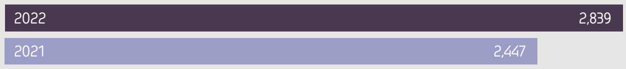
Purpose
Allows management to monitor indebtedness of the Group, to ensure the Group's capital structure is appropriate and capital allocation policy decisions are suitably informed.

Financial performance measures derived from IFRS

Net cash flow from operating activities

£2,839m

£392m higher

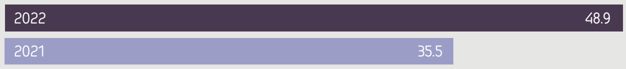


Definition
Net cash flow from operating activities in accordance with IAS 7 Statement of Cash Flows.

Order book

£48.9bn

£13.4bn increase



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

Group's share of net post-employment benefits surplus/(deficit)

£0.6bn

£2.7bn improvement

Definition
Net IAS 19 Employee Benefits surplus/(deficit), excluding amounts allocated to equity accounted investments.

Dividend per share

27.0p

7.6% growth

Definition
Interim dividends paid and final dividend proposed per share.

1. Growth rates for Sales, Underlying EBIT and Underlying EPS are on a constant currency basis (i.e. current year compared with prior year translated at current year exchange rates). All other growth rates and year-on-year movements are on a reported currency basis.
2. Adjusting items are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying business performance. Adjusting items were referred to as non-recurring items in the prior year. No change has been made to the definition of these items, but the name has been changed to reflect that some categories of items could be considered recurring in nature. The Group's definition of adjusting items includes profit or loss on business transactions, the impact of substantively enacted tax rate changes, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-retirement benefit schemes, and other items which management has determined as not being relevant to an understanding of the Group's underlying business performance. Note 1 to the Group accounts includes more information on those items reported as adjusting in the year.
3. Growth rate disclosed excludes the impact of the 2021 one-off tax benefit of £94m in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company Regime and the impact of the UK tax rate adjustment (see note 6). For 2021, Underlying EPS of 47.8p is shown excluding the one-off tax benefit and of 50.7p including the one-off tax benefit.

Income statement

Sales increased by £2.0bn to £23.3bn (2021 £21.3bn), a 4% increase on a constant currency basis[1] or 9% on a reported basis.

Revenue increased by £1.7bn, 9%, to £21.3bn (2021 £19.5bn).

Underlying EBIT increased to £2,479m (2021 £2,205m), giving a return on sales of 10.7% (2021 10.3%). Excluding the impact of exchange translation, the increase was 5%. On a reported basis this was 12%.

Operating profit remained stable at £2,384m (2021 £2,389m) with the one-off gains in 2021 on the sale of Advanced Electronics Company (£132m) and the Filton and Broughton sites (£182m) offset by the gain on sale of the financial crime detection business (£94m) and underlying growth in 2022.

Adjusting items in 2022 reflect a gain of £91m, comprising a £94m gain on the disposal of the financial crime detection business in Digital Intelligence and a £13m gain related to past service cost on the pension scheme, offset by £16m of costs related to current and historical business transactions. The credit of £350m in 2021 comprised a £182m gain in HQ on the sale of the Filton and Broughton sites, a £132m gain on disposal of the Advanced Electronics Company and £26m on disposal of a business in our Electronic Systems segment, and a net £10m gain relating to historical acquisitions.

Amortisation of programme, customer-related and other intangible assets was £110m (2021 £86m), the increase being driven by amortisation charges from businesses acquired during 2022 and a full year of cost from those acquired in 2021.

Impairment of intangible assets in 2022 was £1m (2021 £15m).

Net finance costs were £395m (2021 £279m). The underlying interest expense[2] including share of equity accounted investments, and excluding pension accounting and fair value and foreign exchange adjustments on financial instruments and investments, was £246m (2021 £241m). Net interest expense on the Group's pension surplus/(deficit), including equity accounted investments, was £38m (2021 £67m).

Income statement

Financial performance measures as defined by the Group[2]		2022 £m	2021 £m
Sales	KPI	**23,256**	21,310
Underlying EBIT	KPI	**2,479**	2,205
Return on sales		**10.7%**	10.3%

Financial performance measures derived from IFRS	£m	£m
Revenue	**21,258**	19,521
Operating profit	**2,384**	2,389
Return on revenue	**11.2%**	12.2%

Reconciliation of sales to revenue		£m	£m
Sales	KPI	**23,256**	21,310
Deduct Group's share of revenue of equity accounted investments		**(3,342)**	(2,979)
Add Subsidiaries' revenue from equity accounted investments		**1,344**	1,190
Revenue		**21,258**	19,521

Reconciliation of underlying EBIT to operating profit		£m	£m
Underlying EBIT	KPI	**2,479**	2,205
Adjusting items		**91**	350
Amortisation of programme, customer-related and other intangible assets		**(110)**	(86)
Impairment of intangible assets		**(1)**	(15)
Financial expense of equity accounted investments		**(25)**	(27)
Taxation expense of equity accounted investments		**(50)**	(38)
Operating profit		**2,384**	2,389
Net finance costs		**(395)**	(279)
Taxation expense		**(315)**	(198)
Profit for the year		**1,674**	1,912

Exchange rates

Average	2022	2021
£/$	**1.236**	1.376
£/€	**1.173**	1.163
£/A$	**1.778**	1.832

Sensitivity analysis

Estimated impact on sales of a five cent movement in the average exchange rate	£m
$	**400**
€	**55**
A$	**25**

1. Current year compared with prior year translated at current year exchange rates.
2. The purpose and definitions of non-GAAP measures are provided in the Financial glossary on page 302.

Taxation expense, including equity accounted investments, of £365m reflects the Group's underlying effective tax rate for the year of 19% adjusted for the impact of the UK tax rate adjustment. The 2021 charge of £236m reflected the Group's underlying effective tax rate for the year of 18%, plus the tax charge on adjusting items, less the impact of a one-off tax benefit of £94m in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime and the impact of the UK tax rate adjustment (see note 6).

The calculation of the underlying effective tax rate is shown in note 6 to the Group accounts on page 240.

Earnings per share

Underlying earnings per share for the year increased by 9%, excluding the impact of exchange translation, to 55.5p (2021 47.8p excluding the one-off tax benefit).

Basic earnings per share was 51.1p (2021 55.2p). The decrease being due to the lower gains on the adjusting items in 2022, and the one-off tax benefit in 2021, partially offset by the benefit of the share buybacks.

Orders

Order intake[2] increased by £15,635m to £37,093m (2021 £21,458m). Our US-managed businesses had a book-to-bill[3] ratio of more than one.

Order backlog[2] increased by £14.9bn to £58.9bn (2021 £44.0bn).

Order book[4] increased by £13.4bn to £48.9bn (2021 £35.5bn).

Earnings per share

Financial performance measures as defined by the Group[1]		2022	2021
Underlying earnings (excluding the 2021 one-off tax benefit)		**£1,728m**	£1,523m
Underlying earnings per share (excluding the 2021 one-off tax benefit)	KPI	**55.5p**	47.8p
Underlying earnings (including the 2021 one-off tax benefit)		**£1,728m**	£1,617m
Underlying earnings per share (including the 2021 one-off tax benefit)		**55.5p**	50.7p

Financial performance measures derived from IFRS	2022	2021
Profit for the year attributable to equity shareholders	**£1,591m**	£1,758m
Basic earnings per share	**51.1p**	55.2p

Reconciliation of underlying earnings to profit for the year attributable to equity shareholders	£m	£m
Underlying earnings (excluding the 2021 one-off tax benefit)	**1,728**	1,523
Adjusting items, post tax	**94**	279
Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles, post tax	**(90)**	(84)
Net interest expense on post-employment benefit obligations, post tax	**(31)**	(55)
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**(110)**	1
One-off tax benefit (2021)	**–**	94
Profit for the year attributable to equity shareholders	**1,591**	1,758
Non-controlling interests	**83**	154
Profit for the year	**1,674**	1,912

Orders

Financial performance measures as defined by the Group[1]		2022	2021
Order intake[2]	KPI	**£37,093m**	£21,458m
Order backlog[2]		**£58.9bn**	£44.0bn

Financial performance measures derived from IFRS		
Order book[4]	**£48.9bn**	£35.5bn

1. The purpose and definitions of non-GAAP measures are provided in the Financial glossary on page 302.
2. Including share of equity accounted investments.
3. Ratio of Order intake to Sales.
4. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.

Cash flow

Free cash flow[1] was £1,950m (2021 £1,864m), after shareholder returns of £1,590m (2021 £1,145m). The strong performance this year was driven by continued good operational performance and working capital management.

Net cash inflow from operating activities was £2,839m (2021 £2,447m). The inflow reflects operational business performance, and working capital management.

Taxation payments were £365m (2021 £234m).

Net capital expenditure and financial investment was £519m (2021 £209m), increasing mainly as a result of the proceeds from the Filton and Broughton sites offsetting the expenditure in 2021.

Dividends received from equity accounted investments amounted to £94m (2021 £57m).

Cash flows in respect of acquisitions and disposals comprises a net outflow of £38m. This was primarily due to the cash outflow on the acquisition of Bohemia Interactive Simulations of £146m, being offset by the cash received on the sale of the Financial Services business of £101m. The cash inflow in 2021 in respect of **acquisitions and disposals** of £185m was primarily in relation to the divestment of the Advanced Electronics Company.

Equity dividends paid in 2022 represents the 2021 final dividend (£480m) and the 2022 interim dividend (£322m).

Share buybacks saw an outflow of £788m in the year. The full 2021 programme of £500m completed in February 2022, of which £130m was spent in 2022. In July, a further three-year, £1.5bn share buyback programme was announced. During the year, payments of £658m were made towards share buybacks in relation to this three-year programme.

Dividends paid to non-controlling interests were £166m (2021 £202m), primarily reflecting payments made by our partially-owned subsidiaries in the Kingdom of Saudi Arabia.

There was a **net cash inflow from derivative financial instruments** of £328m (2021 £88m net outflow), arising from rolling hedges relating to balances within the Group's subsidiaries and equity accounted investments.

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

Cash flow

Financial performance measures as defined by the Group		2022 £m	2021 £m
Free cash flow	KPI	**1,950**	1,864
Financial performance measures derived from IFRS		**£m**	£m
Net cash flow from operating activities		**2,839**	2,447
Reconciliation from free cash flow to net cash flow from operating activities		**£m**	£m
Free cash flow	KPI	**1,950**	1,864
Add back Interest paid, net of interest received		**237**	224
Add back Taxation		**365**	234
Operating business cash flow[1]	KPI	**2,552**	2,322
Add back Net capital expenditure and financial investment		**519**	209
Add back Principal element of lease payments and receipts		**227**	207
Deduct Dividends received from equity accounted investments		**(94)**	(57)
Deduct Taxation		**(365)**	(234)
Net cash flow from operating activities		**2,839**	2,447
Net capital expenditure and financial investment		**(519)**	(209)
Principal element of finance lease receipts		**9**	10
Dividends received from equity accounted investments		**94**	57
Interest received		**32**	23
Acquisitions and disposals		**(38)**	185
Net cash flow from investing activities		**(422)**	66
Interest paid		**(269)**	(247)
Equity dividends paid		**(802)**	(777)
Purchase of own shares		**(788)**	(368)
Partial disposal of shareholding in subsidiary undertaking		**–**	28
Dividends paid to non-controlling interests		**(166)**	(202)
Principal element of lease payments		**(236)**	(217)
Cash inflow from derivative financial instruments (excluding cash flow hedges)		**533**	61
Cash outflow from derivative financial instruments (excluding cash flow hedges)		**(205)**	(149)
Movement in cash collateral		**–**	(18)
Net cash flow from loans		**(400)**	(367)
Net cash flow from financing activities		**(2,333)**	(2,256)
Net increase in cash and cash equivalents		**84**	257
Add back Net cash flow from loans		**400**	367
Foreign exchange translation		**(478)**	(50)
Other non-cash movements		**131**	(16)
Decrease in net debt (excluding lease liabilities)		**137**	558
Opening net debt (excluding lease liabilities)		**(2,160)**	(2,718)
Net debt (excluding lease liabilities)	KPI	**(2,023)**	(2,160)

Pages 282 and 284
Notes 28 and 30 to the Group accounts

1. The purpose and definitions of non-GAAP measures are provided in the Financial glossary on page 302.

Balance sheet

Intangible assets of £12.6bn is an increase of £0.9bn on the prior year, driven by the impact of the Group's US dollar-denominated goodwill.

Property, plant and equipment, right-of-use assets and investment property is £4.7bn (2021 £4.0bn), an increase of £0.7bn, driven by the Group's US dollar-denominated assets.

Equity accounted investments and other investments is £886m (2021 £630m).

The **Group's share of the net IAS 19 post-employment benefits surplus** was £0.6bn (2021 £2.1bn deficit), net of a 35% withholding tax of £0.7bn. The shift to a pension surplus was driven by changes in discount rate and inflation assumptions following completion of the triennial review. The major movements in the net surplus are shown in the bridge chart on this page. Details of the Group's post-employment benefits schemes are provided in note 25 to the Group accounts on page 267.

In aggregate, there was a £0.4bn decrease in **working capital**.

Lease liabilities are £1.6bn (2021 £1.3bn).

The Group's **net debt (excluding lease liabilities)** at 31 December 2022 was £2,023m, a net decrease of £137m from the position at the start of the year. This is primarily a result of strong Free cash flow performance, partially offset by increased shareholder returns through dividends and share buybacks. The maturity of the Group's borrowings is shown in the chart on this page.

Cash and cash equivalents of £3,107m (2021 £2,917m) are held primarily for the repayment of debt securities, pension funding when required, payment of the 2022 final dividend, funding of further share buybacks under the £1.5bn programme announced in July 2022, and management of working capital.

Balance sheet

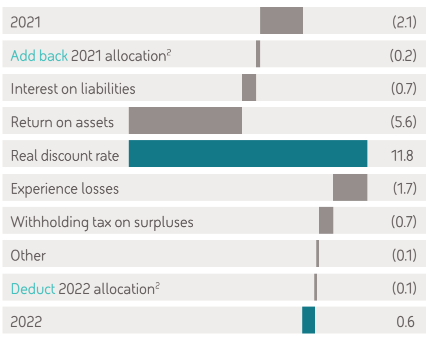
Summarised balance sheet		2022 £m	2021 £m
Intangible assets		**12,644**	11,716
Property, plant and equipment, right-of-use assets and investment property[1]		**4,723**	4,010
Equity accounted investments and other investments		**886**	630
Working capital[1]		**(4,119)**	(3,740)
Lease liabilities		**(1,582)**	(1,252)
Group's share of net IAS 19 post-employment benefits surplus/(deficit)		**646**	(2,124)
Net tax assets and liabilities		**363**	589
Net other financial assets and liabilities		**(138)**	(1)
Net debt (excluding lease liabilities)	KPI	**(2,023)**	(2,160)
Net assets		**11,400**	7,668

Components of net debt (excluding lease liabilities)		£m	£m
Cash and cash equivalents		**3,107**	2,917
Debt-related derivative financial instruments (net)		**112**	(16)
Loans – non-current		**(5,189)**	(4,604)
Loans and overdrafts – current		**(53)**	(457)
Net debt (excluding lease liabilities)	KPI	**(2,023)**	(2,160)

Exchange rates

Year end	2022	2021
£/$	**1.203**	1.354
£/€	**1.127**	1.191
£/A$	**1.773**	1.863

Accounting net pension surplus – bridge (£bn)



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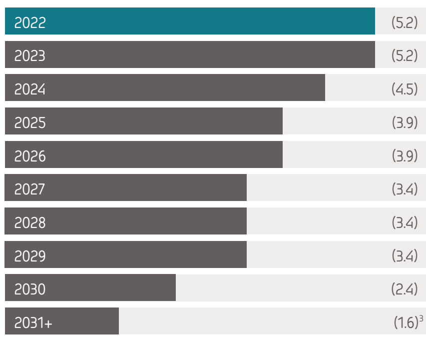
Note 25 to the Group accounts

Maturity of the Group's borrowings (£bn)



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Note 22 to the Group accounts

1. Funding received from the UK government for property, plant and equipment at Barrow-in-Furness, UK, was previously reported against the associated assets in property, plant and equipment, right-of-use assets and investment property. Within the current year, these have been re-presented to match the presentation in the consolidated balance sheet to be presented in working capital. The prior year funding of £806m has been re-presented to reflect this change.
2. Amounts allocated to equity accounted investments.
3. Repayable in 2041 (£0.3bn), 2044 (£0.5bn) and 2050 (£0.8bn).

Accounting policies

Key sources of estimation uncertainty

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise their judgement in the process of applying the Group's accounting policies. The Group therefore needs to consider a range of estimates and assumptions in the application of its accounting policies and management's assessment of the carrying values of assets and liabilities. In the event that these estimates or assumptions prove to be incorrect, there may be an adjustment to the carrying values of assets and liabilities within the next year. Potential areas of the Group's financial statements which could be materially impacted may include, but are not limited to:

Revenue and profit recognition
Revenue £21,258m (year ended 31 December 2022)
See note 1 to the Group accounts

Post-employment benefit obligations
Group's share of the net IAS 19 post-employment scheme surplus, net of withholding tax, £0.6bn (at 31 December 2022)
See note 25 to the Group accounts

Page 222
Key sources of estimation uncertainty

Changes in accounting policies

No new or amended standards which became applicable for the year ended 31 December 2022 had a material impact on the Group or required the Group to change its accounting policies.

From 1 January 2023, IFRS 17 Insurance Contracts becomes effective for the Group. This is not expected to have a material impact.

Capital

Objectives

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

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

Policies

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

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

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

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Note 27 to the Group accounts

Dividends and share buyback

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

The Board has recommended a final dividend of 16.6p per share making a total of 27.0p per share in respect of the year ended 31 December 2022. At this level, the annual dividend is covered approximately two times by underlying earnings. Subject to shareholder approval at the 2023 Annual General Meeting, the dividend will be paid on 1 June 2023 to holders of ordinary shares registered on 21 April 2023. The ex-dividend date is 20 April 2023.

At 31 December 2022, the Company had retained earnings of £3.2bn (2021 £2.8bn), the non-distributable portion of which is £955m (2021 £875m) (see page 294). Total external dividends relating to the year ended 31 December 2022 are £833m (2021 £797m). The 2022 dividends consist of the interim dividend paid during the year in respect of the first half of 2022 of £322m (2021 £316m) and the final dividend proposed of approximately £511m (2021 £481m), although the final payment is likely to be lower as a result of the impact of share buybacks. On an annual basis, the Company receives dividends from its subsidiaries to increase its distributable reserves and, accordingly, the Company expects to have sufficient distributable reserves to support its dividend policy.

The Group's dividend policy is underpinned by its viability and going concern statements (see page 127).

Treasury

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

Objectives/policies

Net debt (excluding lease liabilities)

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

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

Interest rates

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

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

Liquidity

Maintain adequate undrawn committed borrowing facilities.

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

Monitor and control counterparty credit risk and credit limit utilisation.

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

Currency

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

- All material firm transactional exposures are hedged.
- The Group does not hedge the translation effect of exchange rate movements on:
  (a) the income statements or balance sheets of foreign subsidiaries; and
  (b) equity accounted investments it regards as long-term investments.

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Note 15 to the Group accounts

Tax strategy

The Group's tax strategy is to:

- ensure compliance with all applicable tax laws and regulations; and
- manage the Group's tax expense in a way that is consistent with its values and its legal obligations in all relevant jurisdictions.

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

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

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

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

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

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

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

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Note 6 to the Group accounts

Guidance for 2023

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

The guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for 2022 are provided in our financial review on pages 84 to 89.

Group guidance

With a strong year behind us, we look forward to continued top-line growth with increased return on sales and good free cash delivery against our rolling targets. Guidance is provided on the basis of an exchange rate of $1.24:£1, which is in line with the actual 2022 exchange rate, therefore guidance is the same for both reported and constant exchange rates.

Sales
expected to increase in the range of

3% to 5%

2022: £23,256m

Underlying EBIT
expected to increase in the range of

4% to 6%

2022: £2,479m

Underlying EPS
expected to increase in the range of

5% to 7%

2022: 55.5p

Free cash flow target for 2023

>£1.2bn

2022: £1,950m

Underlying finance costs
c.£260m

Effective tax rate
c.21%

Non-controlling interests
c.£70m

Sensitivity to foreign exchange rates: the Group operates in a number of currencies, the most significant of which is the US dollar. As a guide, a 5 cent movement in the £/$ exchange rate will impact Sales by c.£400m, Underlying EBIT by c.£55m and Underlying EPS by c.1p.

Segmental guidance

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

Year ended 31 December 2023	**Expected sales**	**Expected Return on sales[1]**
Electronic Systems	Up 4% to 6%	16% to 17%
Platforms & Services	Up 2% to 4%	9% to 10%
Air	Up 1% to 3%	11% to 12%
Maritime	Up 3% to 5%	8% to 9%
Cyber & Intelligence	Up 2% to 4%	8% to 9%

1. Underlying EBIT as percentage of Sales.

In 2023, HQ underlying EBIT is expected to be broadly similar to 2022 (expense of £122m).

Three-year free cash flow guidance

	Actual		Forecast		
	2021	2022	2023	2024	2025
2021–2023 in excess of £5bn previously in excess of £4.5bn	£1,864m	£1,950m	>£1.2bn		
2022–2024 in excess of £4.5bn previously in excess of £4bn		£1,950m	>£1.2bn		
2023–2025 range of £4bn–£5bn (New guidance)			>£1.2bn		

New guidance for the three-year period from 2023–2025 has been issued, with free cash flow for the period expected to be between £4bn and £5bn. Existing guidance, in place for both the 2021–2023 and 2022–2024 periods, has also been upgraded.

Next-generation fighter aircraft
The UK, Italy and Japan will work together with a shared ambition to develop a next-generation fighter aircraft under a new Global Combat Air Programme (GCAP). This is an artist's impression of how the Tempest aircraft could look.

Segmental review

The Group reports its performance through six reporting segments.

Financial performance measures

Year ended 31 December 2022	Sales £m	Underlying EBIT £m	Return on sales %	Operating business cash flow £m	Order intake[1] £m	Order backlog[1] £bn	Revenue £m	Operating profit £m	Return on revenue %	Net cash flow from operating activities £m	Order book £bn
	As defined by the Group						Derived from IFRS				
	KPI	KPI		KPI	KPI						
Electronic Systems											
Page 94	5,057	838	16.6	650	5,444	8.1	5,057	747	14.8	860	6.7
Platforms & Services											
Page 98	3,688	326	8.8	525	5,719	8.1	3,598	322	8.9	633	7.7
Air											
Page 102	7,698	849	11.0	1,140	14,042	24.4	6,286	809	12.9	1,202	17.4
Maritime											
Page 106	4,598	356	7.7	235	9,716	17.2	4,484	352	7.9	418	16.6
Cyber & Intelligence											
Page 110	2,205	232	10.5	154	2,443	2.1	2,205	291	13.2	191	1.4
HQ[2]	420	(122)		(152)	426	–	10	(137)		(100)	–
Deduct Intra-group	(410)				(697)	(1.0)	(382)				(0.9)
Deduct Taxation[3]										(365)	
Total	**23,256**	**2,479**	**10.7**	**2,552[4]**	**37,093**	**58.9**	**21,258**	**2,384**	**11.2**	**2,839**	**48.9**

We use financial performance measures as defined by the Group to monitor the underlying financial performance of the Group's reporting segments, and the definitions and purposes of these alternative performance measures are provided in Financial performance metrics on pages 82 to 83. Reconciliations from these measures to the financial performance measures derived from IFRS are provided in Our financial review on pages 84 to 89.

1. Including share of equity accounted investments.
2. HQ comprises the Group's head office activities, together with a 49% interest in Air Astana.
3. Taxation is managed on a Group-wide basis.
4. At a Group level, the key cash flow metric is Free cash flow (see Financial performance metrics on page 83). In 2022, Free cash flow was £1,950m (2021 £1,864m).

Electronic Systems

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

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

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

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

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

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

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

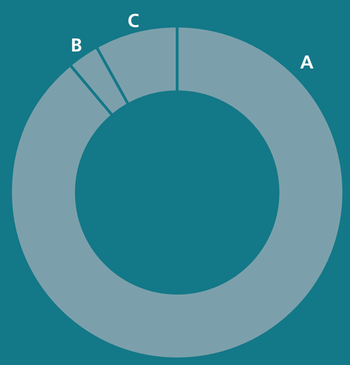
Employees[1]

16,900

Sales

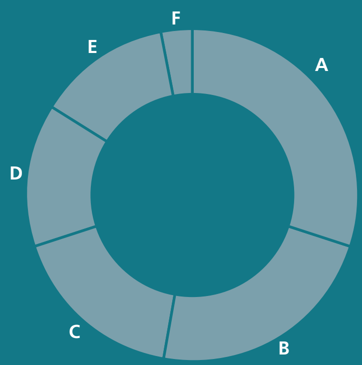
£5,057m

Sales by domain (%)



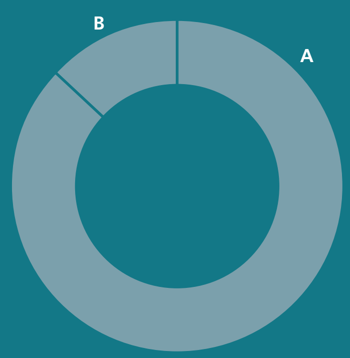
A	Air	89%
B	Maritime	3%
C	Land	8%

Sales by line of business (%)



A	Electronic Combat	30%
B	C4ISR Systems	23%
C	Precision Strike & Sensing	17%
D	Countermeasure & Electromagnetic Attack	14%
E	Controls & Avionics	13%
F	Power & Propulsion	3%

Sales analysis: Defence and commercial (%)



A	Defence	87%
B	Commercial	13%

Operational and strategic key points

– Opened state-of-the-art facilities in Manchester, New Hampshire; Cedar Rapids, Iowa; and Austin, Texas.
– Cumulatively more than 1,200 electronic warfare systems delivered on F-35 programme.
– Deliveries continue of next-generation EW Eagle Passive Active Warning Survivability System to support upgrade of US Air Force F-15 platform and testing on F-15E and F-15EX test aircraft.
– Selected to design, test and supply energy management components for GE Aviation's megawatt class hybrid electric propulsion system supporting NASA's Electrified Powertrain Flight Demonstration project.
– The Long-Range Precision Guidance Kit programme reached a critical benchmark with the successful completion of its structural survivability test in the US Army's Extended Range Cannon Artillery.
– Delivered the 3,000th Multi-functional Information Distribution System Joint Tactical Radio System through our Data Link Solutions joint venture with Collins Aerospace.

Financial performance

Financial performance measures as defined by the Group

		2022	2021
Sales	KPI	£5,057m	£4,491m
Underlying EBIT	KPI	£838m	£766m
Return on sales		16.6%	17.1%
Operating business cash flow	KPI	£650m	£774m
Order intake[1]	KPI	£5,444m	£4,923m
Order backlog[1]		£8.1bn	£7.2bn

Financial performance measures derived from IFRS

	2022	2021
Revenue	£5,057m	£4,491m
Operating profit	£747m	£715m
Return on revenue	14.8%	15.9%
Cash flow from operating activities	£860m	£951m
Order book	£6.7bn	£5.7bn

– Results reflect the impact of the global shortage of microelectronics, as well as labour and staffing shortages within the operations and supply chain.
– Despite these challenges, sales grew by 2%[2], driven by growth in the Electronic Combat Solutions business.
– Return on sales of 16.6% was in line with 2022 guidance, and steady on a constant currency basis.
– Operating business cash flow has decreased due to the timing of programme executions.
– Key orders secured on C4ISR, Electronic Combat and Precision Strike & Sensing Solutions.
– Expect supply chain pressures to continue to ease in the near term, to allow enhanced growth and margin performance.

1. Including share of equity accounted investments.
2. Constant currency basis.

Operational performance

Electronic Combat Solutions

The F-35 Lightning II programme is delivering on Lot 15 electronic warfare (EW) systems and has delivered a cumulative total of over 1,200 EW systems. We are also supporting the Block 4 modernisation efforts under multiple contracts worth over $957m (£796m), and operating on our next Performance-Based Logistics contract worth $290m (£241m) to provide critical sustainment support for the F-35 EW system.

Under a contract from Boeing, we continue to deliver our next-generation EW Eagle Passive Active Warning Survivability System (EPAWSS) to support the upgrade of the US Air Force F-15 platform and testing on F-15E and F-15EX test aircraft. In July, EPAWSS modifications began on two operational US Air Force F-15Es and work began on the $36m (£30m) low-rate initial production phase two contract.

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

We are also under contract to supply the Digital Electronic Warfare System on new and existing F-15 aircraft for multiple international customers with a value of $91m (£76m).

On Long Range Anti-Ship Missile (LRASM) we began delivering on Lot 4 in November. This marked the first delivery of the new LRASM 1.1 configuration developed under the completed Diminishing Material Sources contracts.

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

Countermeasure & Electromagnetic Attack Solutions

Our Limited Interim Missile Warning System programme received $62m (£52m) in US Army funding for the fourth production lot order, bringing production lot order totals to $250m (£208m).

The Compass Call programme is executing contracts valued at more than $1bn (£0.8bn), focused on the cross-decking of prime mission equipment to the new EC-37B aircraft while sustaining and upgrading the existing EC-130H fleet. We successfully tested third-party applications on Compass Call's Small Adaptive Bank of Electronic Resources (SABER) technology, enabling fielding of SABER on the EC-130H. We delivered key components for the US Air Force's first EC-37B Compass Call aircraft, which is targeted to initially field in 2024, and have started sustainment preparation.

We received approximately $14m (£12m) for the Smart D2™ technology as part of the US Navy's ALE-47 Common Carriage programme, representing the first purchase of the technology by the Department of Defense. Smart D2™ technology increases expendable payload capacity, incorporates a smart stores communication interface and enables the future replacement of key elements without replacing an aircraft's entire ALE-47 system to support real-time updates to next-generation countermeasures.

Precision Strike & Sensing Solutions

The APKWS® guidance kit programme continues to execute production under an Indefinite Delivery, Indefinite Quantity contract, with awards worth over $48m (£40m) received in the year. Multiple test events in 2022 demonstrated new capabilities, proving enhanced capabilities in support of US and allied forces' precision strike missions.

The Long-Range Precision Guidance Kit programme reached a critical benchmark with the successful completion of its structural survivability test in the US Army's Extended Range Cannon Artillery, securing funding for further development and bringing the total contract value to $99m (£82m).

The Terminal High Altitude Area Defense (THAAD) seeker programme provides the THAAD interceptor with critical targeting capability to defeat ballistic missile threats against the US and our allies. The programme is currently in full-rate production, with a follow-on order worth $209m (£174m). To keep pace with the evolving threat, BAE Systems has an ongoing effort valued at $150m (£125m) to design and prototype the next-generation THAAD infrared seekers.

We continue to execute a contract with Space Systems Command to develop an M-Code Increment II Miniature Serial Interface GPS receiver for ground-embedded applications with next-generation Application Specific Integrated Circuit technology valued at more than $278m (£231m).

C4ISR Systems

We are executing key programmes that provide full spectrum communications to meet customer needs for information sharing to support joint all-domain command and control. We have completed a system requirements review for the Airborne High Frequency Radio Modernization programme awarded in early 2022, and we have delivered the 3,000th Multi-functional Information Distribution System Joint Tactical Radio System through our Data Link Solutions Joint Venture with Collins Aerospace.

To bring our disruptive technology to the space domain, we are performing on the agreement to launch an experimental satellite. We continue to deliver radiation-hardened electronics to support space programmes of national importance, such as the James Webb Space Telescope, and are developing the next generation of radiation-hardened Application Specific Integrated Circuit libraries.

We transitioned our Mobility Air Forces Automated Flight Planning Service operations to Cloud One to align with the US Air Force's transformation objectives, providing increased storage, computing, processing flexibility and faster software upgrades.

Controls & Avionics Solutions

Airline traffic and business travel continue to improve, resulting in returning demand for Original Equipment Manufacturer deliveries and aftermarket services.

The business remains focused on supporting Boeing's aircraft deliveries and developing the integrated flight control electronics and remote electronic units for the new Boeing 777X aircraft, with the 777X flight control system performing as expected during flight testing.

Our full-authority digital engine controls, offered through the FADEC International and FADEC Alliance (joint ventures), continue to perform well across our portfolio. The business, through FADEC Alliance, is supporting CFM International's Revolutionary Innovation for Sustainable Engines programme by maturing new technologies that will enable a reduction in both fuel consumption and emissions. On the military side, GE achieved a successful First Engine to Test milestone in June, with our T901 FADEC.

We are engaged in developing the energy storage systems and controls for all-electric aircraft, particularly in the emerging air mobility segment. Specifically, we are executing the design, test and supply of advanced battery packs for GE Aviation's megawatt class hybrid electric propulsion system in support of NASA's Electrified Powertrain Flight Demonstration project. In October, Supernal selected BAE Systems to define the architecture of a lightweight, fly-by-wire system for its autonomous-capable aircraft.

Deliveries of F-35 vehicle management computers and active inceptor systems have successfully ramped up, and we supported the first US Depot stand-up. We continue to advance our autonomous control technologies through successful crewed–uncrewed teaming flight tests under a US Department of Defense programme. Separately, our development of an advanced vehicle control system for the UK's Dreadnought submarine programme remains on plan.

Power & Propulsion Solutions

As the global transit industry accelerates efforts to decarbonise, interest grows for our low and zero emission propulsion solutions. This year, US-based bus manufacturers Hometown Manufacturing and ElDorado National both chose our latest Gen3 electric drive technology to power their zero emission vehicles. Hometown Manufacturing will power their battery electric trolley buses and ElDorado National will power both hydrogen fuel cell electric buses and battery electric buses with Gen3 products. Also using our Gen3 electric drive system, Nova Bus continues to win battery electric bus bids in cities such as New York and Houston in the US, as well as Halifax, Nova Scotia in Canada.

Our new Gen3 power electronics incorporate advanced materials enabling smaller, lighter, more efficient systems with modular and scalable components. The flexibility of our systems increases our ability to address a broader range of markets, such as heavy-duty vocational vehicles and maritime vessels. Global fast ferry manufacturer, Green City Ferries, selected our Gen3 electric drive systems to power both their zero emission hydrogen fuel cell and battery electric ferries and Glas Ocean Electric chose our systems to power fishing fleets in North America and the Caribbean.

Looking forward

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

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Looking forward by segment

Platforms & Services

Platforms & Services, with operations in the US, UK and Sweden, manufactures and upgrades combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair, and the management and operation of government-owned munitions facilities.

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

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

US Ship Repair is a major provider of non-nuclear ship repair, modernisation, overhaul and conversions to the US Navy and other government and commercial maritime customers across three US sites on the Atlantic and Pacific coasts.

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

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

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

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

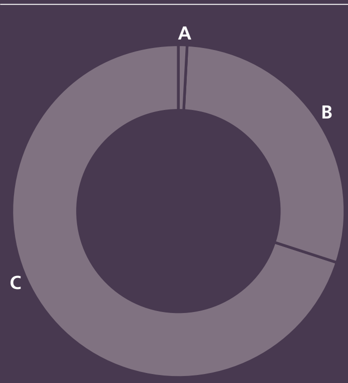
Employees[1]

12,200

Sales

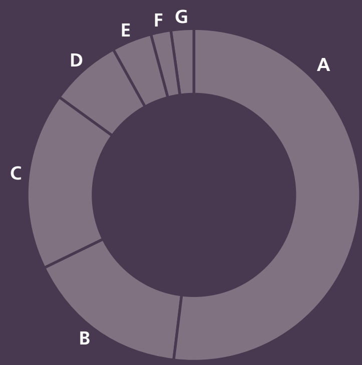
£3,688m

Sales by domain (%)



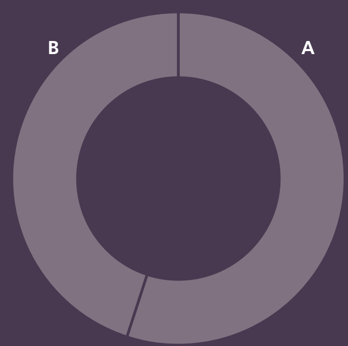
A	Air	1%
B	Maritime	29%
C	Land	70%

Sales by line of business (%)



A	Combat Mission Systems	52%
B	Ordnance Systems	16%
C	US Ship Repair	17%
D	BAE Systems Hägglunds	7%
E	BAE Systems Bofors	4%
F	Weapon Systems UK	2%
G	FNSS	2%

Sales analysis: Platforms and services (%)



A	Platforms	55%
B	Services	45%

Operational and strategic key points

- Significant increase in order intake, largely driven by the Hägglunds business.
- US Army selected the BAE Systems Beowulf for its Cold Weather All-Terrain Vehicle (CATV) programme to replace the Small Unit Support Vehicles, with a contract estimated to be worth up to $278m (£231m) for 110 vehicles.
- Submitted a proposal for the design concept phase for the US Army's Optionally Manned Fighting Vehicle programme.
- Our US shipyards marked continued performance improvements and secured $1.2bn (£1.0bn) in ship modernisation and repair orders.
- Received a five-year contract extension for Ordnance Systems Radford operations through to 2026 and a one-year extension through to 2024 for the Holston facility and supply contracts.
- Contract received worth $1.4bn (£1.2bn) to supply 152 CV9035 infantry fighting vehicles to replace the Slovakian Army's infantry fighting vehicle fleet.
- Czech government selected CV90 to replace its infantry fighting vehicle fleet. Contract expected in first half of 2023.

Financial performance

Financial performance measures as defined by the Group

		2022	2021
Sales	KPI	£3,688m	£3,395m
Underlying EBIT	KPI	£326m	£259m
Return on sales		8.8%	7.6%
Operating business cash flow	KPI	£525m	£287m
Order intake[1]	KPI	£5,719m	£3,236m
Order backlog[1]		£8.1bn	£5.6bn

Financial performance measures derived from IFRS

	2022	2021
Revenue	£3,598m	£3,318m
Operating profit	£322m	£252m
Return on revenue	8.9%	7.6%
Cash flow from operating activities	£633m	£351m
Order book	£7.7bn	£5.3bn

- Sales remained steady on a constant currency basis, as guided for the year.
- Return on sales increased to 8.8%, as the impacts from the COVID-19 pandemic began to abate in 2022.
- The increase in operating business cash reflects timing of customer advances, primarily from orders in the Hägglunds business.

1. Including share of equity accounted investments.

Operational performance

Combat Mission Systems

Combat Mission Systems is achieving consistent production throughput, at heightened volumes, across multiple programmes. Investments in facilities and new manufacturing technologies, including automation and robotic welding, are delivering positive returns as the business moves to full-rate production across a number of platforms.

We delivered Amphibious Combat Vehicles (ACVs) to the US Marine Corps under low-rate initial production (LRIP) contracts totalling approximately $600m (£499m) for 116 vehicles. This completed the LRIP phase, and we transitioned to delivery on three full-rate production contracts for an additional 185 vehicles at a value of $973m (£809m). We received a $35m (£29m) contract for the design and development of a new ACV recovery variant in March, an $88m (£73m) contract in August to build three ACV-30 Production Representative Test Vehicles (PRTVs) and are working on additional variants. The new amphibious swim facility at York is now operational. In addition, we delivered an advanced Command, Control, Communication and Computers/Uncrewed Aerial Systems (ACV C4/UAS) variant of the ACV to the US Marine Corps, which will evaluate it as a capable, cost-effective Government-Off-The-Shelf solution for the Advanced Reconnaissance Vehicle programme.

On the US Army's Armored Multi-Purpose Vehicle (AMPV) programme, we have received LRIP contracts worth $1.3bn (£1.1bn). Deliveries of the five variants continued in 2022 in accordance with the December 2021 schedule. We are also working under a July 2021 contract worth up to $600m (£499m) for AMPV System Technical Support. We expect to receive a full-rate production contract for the AMPV programme in the first half of 2023. In support of this production award, the US Department of Defense has indicated its intention to procure over 100 additional AMPV vehicles to replace the 200 in-service M113 armoured personnel carriers provided to Ukraine.

On the M109A7 programme contracts worth a total of $1.5bn (£1.2bn), all 133 LRIP vehicles and over 300 full-rate production vehicles have been delivered. We are now executing on fiscal year 2020 and 2021 full-rate production contracts totalling $750m (£624m) for 176 vehicles, including a $299m (£249m) contract received in June. We have also received early order material awards totalling $24m (£20m) for fiscal year 2022 full-rate production.

Work on the Bradley family of vehicles continues, and we received a five-year $383m (£318m) contract from the US Army to perform technical and sustainment support services for its fleet of Bradley Fighting Vehicles and M993 Multiple Launch Rocket System carriers. We continue the contract to upgrade Bradley vehicles to the A4 configuration valued at $809m (£673m) for 459 vehicles and spares. We are working on a five-year follow-on production contract to add about $258m (£215m) for 80 vehicles through 2023, with quantities to be determined for the remaining four years.

We are executing on a $32m (£27m) prototype contract received in 2020 from the US Army's Rapid Capabilities and Critical Technologies Office to integrate a hybrid electric drive system onto Bradley Fighting Vehicles.

We continue to produce and sustain the US Army's M88 recovery vehicles under previously awarded contracts, and develop next-generation M88A3 prototypes under a $336m (£279m) contract.

In November 2022, we submitted a competitive proposal for the design and prototype phase for the US Army's Optionally Manned Fighting Vehicle programme.

We are producing Mk 41 Vertical Launching System (VLS) missile canisters for the US Navy under awards totalling $433m (£360m), with a total potential value of more than $624m (£519m). We are also working on a $164m (£136m), five-year contract as the Navy's design agent for missile canisters and the mechanical portion of the VLS.

Ordnance Systems

We continue to operate and modernise the US Army's Radford and Holston ammunition plants under a total of $1.5bn (£1.2bn) in modernisation contracts. The Army awarded a five-year contract extension, through December 2026, for Radford operations; and a one-year contract extension, through December 2024, for the current Holston Army Ammunition Plant facility and supply contracts.

At Holston, modernisation activities continue, including the construction of a Weak Acetic Acid Recovery Plant, and the design, construction and commissioning of new production facilities. Contracts totalling $211m (£175m) were awarded in the year for energetics facilities at Holston.

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

US Ship Repair

During the year, we received contracts with a cumulative value of $1.2bn (£1.0bn) for maintenance and modernisation across our Jacksonville, Florida; Norfolk, Virginia; and San Diego, California shipyards.

The US Ship Repair business continues to conduct modernisation and maintenance activities for the US Navy's non-nuclear fleet. Our shipyards were impacted by delayed starts to ship repair contracts due to operational naval tasking, coupled with delays to pending contract awards and higher than usual levels of customer-added work to existing contracts. Our investments in operational excellence and additional resources are delivering benefits as we address several challenged ship modernisation programmes.

BAE Systems Hägglunds

To accommodate significant new orders received over the past 24 months, the business continues to expand its workforce and facilities.

The US Army selected our Beowulf unarmoured all-terrain vehicle and we received a contract worth up to $278m (£231m) for 110 Cold Weather All-Terrain Vehicles. The Beowulf will replace the original BV206 Small Unit Support Vehicles.

The team is executing on a contract to upgrade and extend the life of the Netherlands CV9035 fleet, including the integration of an Active Protection System, anti-tank guided-missile system, and the addition of rubber band tracks to increase effectiveness. In addition, we continue to conduct mid-life upgrades on the Dutch CV90 fleet under a contract worth more than $500m (£416m), which includes the development and testing of a new turret. The first newly upgraded CV90 was unveiled in October 2022, at our facility in northern Sweden.

In March 2022, we received a new contract to equip 20 CV90s with the Mjölner mortar system for Sweden, following the delivery of the first 40 systems on time, at cost and to quality. We have secured a $90m (£75m) contract to develop two new CV90 variants for the Swedish Army as part of the ongoing RENO programme.

While our work continues to extend the life of 186 Swiss Army CV90s to 2040, the first four of 20 CV90 vehicles for Norway were delivered on time and at cost in May under a contract exceeding $50m (£42m). We also received a seven-year contract in January for support, sustainment and readiness of 144 Norwegian CV90s. We also continue to upgrade and extend the life of CV90s in the Finnish Army fleet under an ongoing contract.

Slovakia and the Czech Republic selected CV90 in separate evaluations to replace their legacy infantry fighting vehicle fleets. Both contracts are supported by overarching government-to-government agreements with the Swedish government. Contract negotiations with the Government of Slovakia have completed and a contract was signed on 12 December at a value of $1.4bn (£1.2bn) for 152 CV9035 infantry fighting vehicles. We expect the contract negotiations with the Czech Republic to culminate in the first half of 2023.

The business is also working under contract from Sweden for 127 BvS10s worth approximately $200m (£166m), as well as sustaining and maintaining readiness to various customers of the BvS10 and CV90 fleets.

In December, Sweden, Germany, and the United Kingdom announced they have signed an agreement with BAE Systems to purchase 436 BvS10 all-terrain vehicles under a joint procurement in support of Arctic operations for the Collaborative All-Terrain Vehicle (CATV) programme, which could grow to a total of more than 10,000 all-terrain vehicles in the next 10 years. Sweden is procuring an additional 40 BvS10s in a separate contract, valued at approximately $50m (£42m).

BAE Systems Bofors

The 24 additional ARCHER systems for Sweden have been delivered, and we continue a number of ARCHER pursuits in our home and export markets. ARCHER was selected as one of two systems under consideration by the Swiss government for its future artillery system.

We are under multiple export contracts to deliver 40Mk4 and 57Mk3 naval gun systems, including five 57Mk3s and ten 40Mk4s for the UK Royal Navy's Type 31 frigates, as well as 12 40Mk4s to the Belgian and Dutch navies, and new 57mm (Mk110) gun systems to the US Navy and Coast Guard.

Weapon Systems UK

Production of 145 M777s for the Indian Army was completed in December, with all guns delivered to India under a $542m (£451m) Foreign Military Sales contract. In light of recent global events, we have received a number of inquiries about the availability of future M777 systems, as well as spare parts and support. In conjunction with the US Government, we are evaluating potential options to restart production.

FNSS

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

Multiple contracts for the Turkish Armed Forces worth in excess of €700m (£621m) are progressing. These include contracts for assault amphibious vehicles, weapons carriers and special purpose 8x8 and 6x6 vehicles. In December 2022, a follow-on contract was signed to modernise a further 52 armoured combat vehicles for the Turkish Armed Forces, in addition to the 133 armoured combat vehicles already delivered or in production.

Looking forward

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

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Looking forward by segment

Air

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

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

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

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

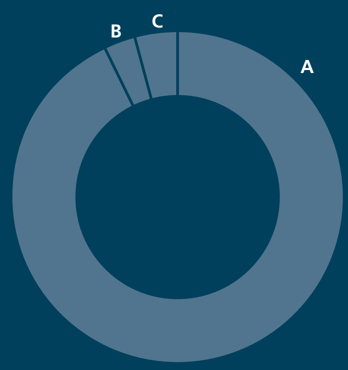
Employees[1]

24,400

Sales

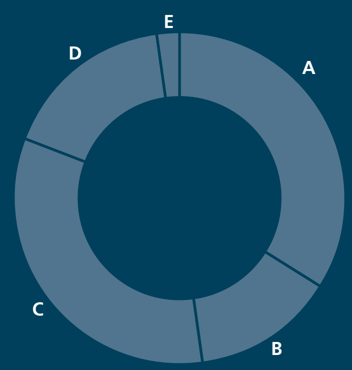
£7,698m

Sales by domain (%)



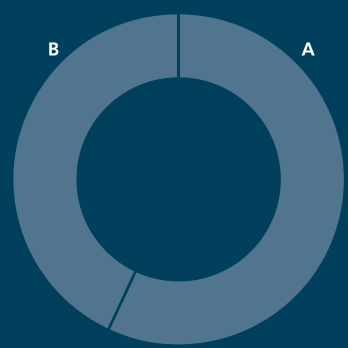
A	Air	93%
B	Maritime	3%
B	Land	4%

Sales by line of business (%)



A	European and International Markets	34%
B	US Programmes	14%
C	Kingdom of Saudi Arabia	33%
D	MBDA	17%
E	FCAS	2%

Sales analysis: Platforms and services (%)



A	Platforms	57%
B	Services	43%

Operational and strategic key points

- Excellent progress on Tempest – the governments of the UK, Japan and Italy announced a new Global Combat Air Programme (GCAP), which will bring together the Tempest and F-X programmes.
- Qatar Typhoon and Hawk programme is progressing well, with all nine Hawk aircraft accepted by the customer and eight Typhoon aircraft now delivered and in service with the Qatar Emiri Air Force.
- Work continues on the Typhoon programme and the production programme has been extended following the award of 20 further aircraft for Spain during the year, for which BAE Systems supplies major units.
- 11-year contract signed to continue to support the Royal Air Force's fleet of Hawk fast jet trainer and Royal Air Force Aerobatic Team aircraft.
- F-35 rear fuselage production continued at full-rate levels, with 150 assemblies completed in the year.
- During the year, the Saudi British Defence Co-operation Programme was renewed for another five-year term.
- All 22 Hawk aircraft have now been completed and have entered into service with the Royal Saudi Air Force.

Financial performance

Financial performance measures as defined by the Group

		2022	2021[3]
Sales	KPI	**£7,698m**	£7,449m
Underlying EBIT	KPI	**£849m**	£772m
Return on sales		**11.0%**	10.4%
Operating business cash flow	KPI	**£1,140m**	£548m
Order intake[1]	KPI	**£14,042m**	£5,695m
Order backlog[1]		**£24.4bn**	£17.8bn

Financial performance measures derived from IFRS

	2022	2021[3]
Revenue	**£6,286m**	£6,041m
Operating profit	**£809m**	£849m
Return on revenue	**12.9%**	14.1%
Cash flow from operating activities	**£1,202m**	£638m
Order book	**£17.4bn**	£12.2bn

- Sales growth of 3%[2] following delivery of Typhoon fighters for Qatar, Germany and other customers and delivery of F-35 aft fuselage tail sections during the year.
- Return on sales of 11.0%, reflects an increase in underlying EBIT of 7%[2].
- The increase in operating business cash flow reflects timing of customer advances and down payments.
- Order intake secured in the year includes the renewal of a major portion of our Saudi Support business, as well as multiple export orders in MBDA.

1. Including share of equity accounted investments.
2. Constant currency basis.
3. From 1 January 2022, the BAE Systems Australia Business transitioned from the Air sector to the Maritime sector. Comparative segmental financial information for 2021 has been re-presented to reflect the new business structure.

Operational performance

European and International Markets

Activity on the 24 Typhoon and nine Hawk aircraft and associated support and training contract for the State of Qatar continues to progress in accordance with our contractual milestones. All nine Hawk aircraft have been accepted by the customer and delivered to RAF Leeming, in line with the agreement to base the Qatari Hawk aircraft in the UK. Deliveries of Typhoon aircraft commenced in the second half of the year, with eight Typhoon aircraft delivered ahead of the 2022 FIFA World Cup and in service with the Qatar Emiri Air Force.

The final five major units were delivered during the year under the Kuwait Typhoon contract, secured by Italian Eurofighter partner Leonardo.

During the year, BAE Systems received an order for our workshare valued at in excess of £0.5bn for an additional 20 aircraft for the Spanish Air Force. Our Major Unit production on this contract has been combined with the £1.3bn order received in 2020 for 38 aircraft to replace Germany's original Typhoon Tranche 1 fleet. The first three front fuselage units are contracted to complete in 2023, and in total 22 major units have now commenced assembly.

During the year, the Group secured an 11-year follow-on contract valued at £0.6bn to continue support to the Royal Air Force's fleet of Hawk fast jet trainer and Royal Air Force Aerobatic Team aircraft.

Alongside this, the ten-year partnership arrangement for support to the Royal Air Force's Typhoon fleet continues to deliver the contracted flying hours.

Following initial entry into service of the export standard electronically scanned European Common Radar in late 2021 further deliveries were made through 2022. Development continues on the radar variants for the UK, German, Italian and Spanish Air Forces. During the year, the Group received further funding of £684m for development of the Typhoon weapon system and sensors, as part of the Partner Nations' commitment to the continual advancement of the Typhoon platform.

Future Combat Air System

The Tempest technology maturation programme is progressing well, and work continues to plan on the contract received in 2021 for the Future Combat Air System Concept & Assessment Phase. Working with national and international industry partners and the UK Ministry of Defence, this contract enables the development of a range of digital concepts, embedding new tools and techniques to design, evaluate and shape the final design and capability requirements of Tempest. During the second half of the year, the UK government confirmed plans for the UK to lead the development of a new flying combat air demonstrator, set to fly within the next five years, and has confirmed its commitment to an international coalition with Japan and Italy, under the Global Combat Air Programme.

US Programmes

F-35 rear fuselage manufacturing continued at full-rate production through 2022 with 150 rear fuselage assemblies completed during the year, in line with the programmes for Lot 14, 15 and 16 contracts. This production rate is expected to continue into 2023.

Following the award in 2021 of a five-year contract for F-35 sustainment services to December 2025, we continue to provide services for both the UK and US customers in support of key F-35 sustainment activities.

Kingdom of Saudi Arabia

In the Kingdom of Saudi Arabia, the In-Kingdom Industrial Participation programme continues to make good progress consistent with our long-term strategy, while satisfying and supporting the Saudi Arabian government's National Transformation Plan and Vision 2030. Our in-Kingdom Saudi employee base shows 78% Saudisation, and 90% of our in-Kingdom female employees are Saudi nationals. We also continue the development of our footprint across the Kingdom, with demonstrable contributions to our local communities.

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

The previous five-year contract to provide Salam Typhoon support services to the Royal Saudi Air Force (RSAF) completed at the end of 2022. An interim agreement for the continuation of this service has been reached with the RSAF, and discussions are ongoing for us to continue to support the RSAF Typhoon fleet for a further five years. A full contract is expected to be agreed during 2023.

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

Following the completion of the previous five-year SBDCP funding arrangement on 31 December 2021, agreement has been reached with the Saudi Arabian government for the Group to continue to provide these services for a further five years through to 31 December 2026, and contracts to this effect were entered into during the second half of 2022.

All 22 Hawk aircraft assembled in-Kingdom have now been completed and have entered into service with the RSAF.

We continue to review our portfolio of interests in a number of industrial companies in the Kingdom of Saudi Arabia, whilst exploring new business opportunities in the marketplace and through our Kingdom Partner Companies to collaborate with key local partners and deliver further In-Kingdom Industrial Participation. We remain aligned to the Kingdom's National Transformation Plan and Vision 2030 requirements.

Future programmes

The Group continues to invest in promising new technologies, including through a number of industry collaborations related to the exploration and development of Air Electric Products. BAE Systems is one of a consortium of investors in the Eve Urban Air Mobility electric vertical take-off and landing (eVTOL) company, aimed at developing zero emission Air Vehicles. This investment led to further cooperation with Embraer S.A., resulting in the signing of a memorandum of understanding setting out an intent to create a commercial partnership to develop a defence variant of the Eve eVTOL aircraft.

Beyond Eve, BAE Systems has also established collaborative relationships in respect of Electric Products with UK-based Malloy Aeronautics, aiming to develop the T-650 Uncrewed Air Vehicle, and with Pipistrel Aircraft who have the first European Union Aviation Safety Agency certified light aircraft, Velis Electro.

MBDA

After winning a number of key domestic and export orders in 2021, MBDA has had continued success in 2022 and is well placed to benefit from increased defence spending in a number of European countries along with further International opportunities.

Domestic market orders have been received in 2022. Italy has awarded a GBAD contract for Launchers and Common Anti-Air Modular Missiles Extended Range and a Development contract amendment for Teseo Mk2 Evolved.

Significant export market orders have been received in 2022. Aligned with the Rafale platform sales, MBDA has been awarded an air weapons package from the UAE and a further air weapons package for Greece. Following the Naval Group Intervention Frigate platform sale in Greece, MBDA has been awarded a Naval Based Air Defence weapons package for the frigates. A number of International customers have also awarded customer support contracts on their asset inventories. With European countries recognising the importance of sovereign capabilities in the missile sector and re-evaluating their needs, Poland has accelerated its ground-based air defence campaign, awarding MBDA an order for GBAD Launchers and Common Anti-Air Modular Missiles.

Despite supply chain pressure in the aftermath of the pandemic, and as a result of the Ukraine crisis, MBDA is maintaining production across its product range. Progress continues across a number of assessment and development phase programmes including Future Cruise and Anti-Ship Weapon; MICA Next Generation, Spear Capability 3 and Aster Block 1 New Technology.

Looking forward

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

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Looking forward by segment

Maritime

Maritime comprises the Group's UK-based maritime and land activities, as well as the Group's Australian business.

Maritime programmes include the construction of seven Astute Class submarines for the Royal Navy, as well as the design and production of the Royal Navy's four Dreadnought Class submarines and eight Type 26 frigates. Additionally, the Maritime portfolio includes in-service support, including the delivery of training services and supporting the operation of HM Naval Base Portsmouth on behalf of the UK Ministry of Defence and the design and manufacture of combat systems, torpedoes and radars.

Land UK's munitions business designs, develops and manufactures a comprehensive range of munitions products serving a number of customers including its main customer, the UK Ministry of Defence. Rheinmetall BAE Systems Land (RBSL) – BAE Systems' joint venture with Rheinmetall – is a UK-based business specialising in the design, manufacture and support of military vehicles used by the British Army and international customers. Land UK also develops and manufactures cased-telescoped weapons through its CTA International joint venture.

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

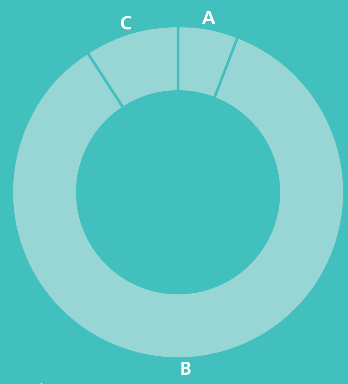
Employees[1]

24,200

Sales

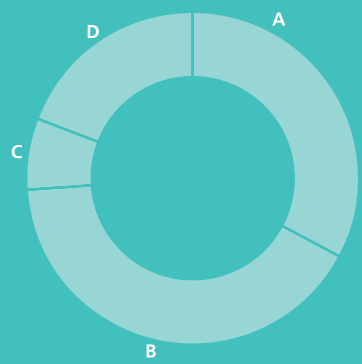
£4,598m

Sales by domain (%)



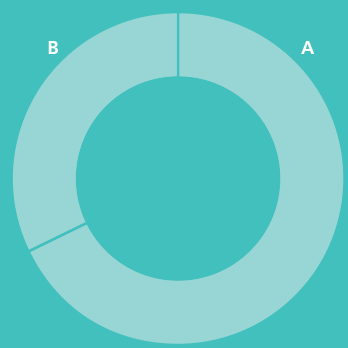
A	Air	6%
B	Maritime	85%
C	Land	9%

Sales by line of business (%)



A	Naval Ships	33%
B	Submarines	41%
C	Land UK	7%
D	Australia	19%

Sales analysis: Platforms and services (%)



A	Platforms	68%
B	Services	32%

Operational and strategic key points

- The UK Ministry of Defence awarded a £4.2bn contract to BAE Systems to manufacture the next five City Class Type 26 frigates for the Royal Navy in Glasgow.
- First City Class Type 26 Frigate entered the water and is being outfitted at Scotstoun shipyard in Glasgow.
- £3.4bn of further contract funding awarded as part of Delivery Phase 3 for the Dreadnought programme.
- The fifth Astute Class submarine, HMS Anson, exited our Barrow shipyard to commence sea trials in February 2023. The remaining two submarines, Agamemnon and Agincourt, are at advanced stages of construction.
- Construction of the first two Dreadnought Class submarines is well advanced and, in September 2022, build activities commenced on the third of class submarine. A formal steel cut ceremony for the third boat was held in Barrow on 9 February 2023.
- RBSL's multi-million pound investment in its Telford manufacturing site completed in 2022, with manufacturing activities due to commence in 2023.
- A$1.5bn (£0.8bn) extended 'In Service Support' contract for the Hawk aircraft commenced in 2022 for the Royal Australian Air Force.

Financial performance

Financial performance measures as defined by the Group

		2022	2021[2]
Sales	KPI	**£4,598m**	£4,169m
Underlying EBIT	KPI	**£356m**	£351m
Return on sales		**7.7%**	8.4%
Operating business cash flow	KPI	**£235m**	£374m
Order intake[1]	KPI	**£9,716m**	£5,688m
Order backlog[1]		**£17.2bn**	£12.1bn

Financial performance measures derived from IFRS

	2022	2021[2]
Revenue	**£4,484m**	£4,093m
Operating profit	**£352m**	£347m
Return on revenue	**7.9%**	8.5%
Cash flow from operating activities	**£418m**	£534m
Order book	**£16.6bn**	£11.6bn

- Sales grew by 10%[3], driven by significant milestones being achieved on major submarine and ship programmes during the year.
- Margin reflects high volume of Dreadnought sales, and increased Company-funded R&D expenditure.
- Operating cash flow reflects the unwind of customer advances in UK Munitions.
- Significant orders were secured in the year, including further contract funding for the next phase of Dreadnought and the build of five further City Class Type 26 frigates for the Royal Navy.

1. Including share of equity accounted investments.
2. On 1 January 2022, our BAE Systems Australia business transitioned from the Air sector to the Maritime sector. Comparative segmental financial information has been re-presented to reflect the new business structure.
3. Constant currency basis.

Operational performance

Naval Ships

The Type 26 programme continues to progress with construction underway on the first three City Class Type 26 frigates. The first City Class Type 26, HMS Glasgow, entered the water for the first time in December 2022 and has transitioned to our Scotstoun shipyard where further outfit, test and commissioning is underway. HMS Cardiff progressed through her unit erect programme following the installation of her gearbox and propulsion motors in 2022 in preparation for roll-out and block integration in 2023. HMS Belfast continues to progress after entering manufacture in June 2021. In November, the UK Ministry of Defence awarded a £4.2bn contract to BAE Systems to manufacture the next five City Class Type 26 frigates for the Royal Navy in Glasgow. The steel cut ceremony for the first ship from this order is expected to take place in the first half of 2023.

We have committed c.£300m investment to better enable us to deliver on our customer commitments and secure the long-term future for complex warship shipbuilding in Glasgow. Key investments include a new ship assembly hall in the Govan yard, a new multi-function panel line and a new Applied Shipbuilding Academy in Scotstoun. We are also making significant investments to digitalise manufacturing operations, giving colleagues working across our yards dynamic access to data and information.

The Canadian Surface Combatant programme continues to progress under the Definition Phase Contract where BAE Systems has responsibility for Warship Design, and is now moving into the Functional Design stage, having held the Preliminary Design Review in December 2022. Work is also progressing on the Support Services subcontract, which is a four-year framework agreement to provide technical assistance to Irving Shipbuilding Inc., through intellectual property licensing, and the provision of consultancy services to help upskill its workforce ahead of cutting steel on the first ship.

Our Combat Systems business continues to provide the combat system capabilities across the Carrier Strike Group whilst achieving an average of 99.75% equipment availability for the fleet. The business has now opened a collaboration centre at the Maritime Integration and Support Centre (MISC) in Portsmouth which provides space, capability and mentoring for SMEs, academia and global technology companies to co-develop new solutions for our customers, exploiting existing and emerging digital capabilities.

Submarines

Our Submarines business is a member of the Dreadnought Alliance and continues to work alongside the Submarine Delivery Agency and Rolls-Royce to deliver the replacement for the Royal Navy's Vanguard Class, which carries the UK's nuclear deterrent. Four Dreadnought Class submarines will be built at our site in Barrow, with the first of these due to enter operational service in the early 2030s.

Construction of the first two Dreadnought Class submarines is well advanced and, in September 2022, build activities commenced on the third of class submarine. A formal steel cut ceremony for the third boat was held in Barrow on 9 February 2023. The value of the programme to the Group to date is £11.2bn, with additional contract funding of £3.4bn received in 2022 as part of Delivery Phase 3 (DP3). DP3 will see the first of class submarine, Dreadnought, exit our Barrow site to begin sea trials.

The fifth Astute, HMS Anson, exited our Barrow shipyard to commence sea trials in February 2023. The remaining two submarines, Agamemnon and Agincourt, are at advanced stages of construction in Barrow.

Early design and mobilisation activities continue on the Submersible Ship Nuclear Replacement (SSNR) programme, which will deliver a replacement for the Astute class.

Maritime Services

Our Maritime Services business has successfully delivered continued support to the UK Ministry of Defence and the Royal Navy at HM Naval Base Portsmouth. Service delivery under the Ministry of Defence's Future Maritime Support Programme (FMSP) came into effect on 1 October 2021, and will continue until at least September 2026.

Under the FMSP Ship Engineering Management and Delivery contract, we continued to maintain, repair, upgrade and prepare the Portsmouth flotilla. This includes support to the aircraft carriers, destroyers, frigates and minehunters based in Portsmouth.

We continued to support the Royal Navy's Batch 2 Offshore Patrol Vessels around the globe with our teams deployed to North America, the Caribbean, the South Atlantic and the Indo-Pacific regions during the period.

The Type 45 Power Improvement Project (PIP) is progressing and the first ship, HMS Dauntless, successfully completed her programme during the year. PIP embodiment work on HMS Daring in Birkenhead was also completed in the year, and HMS Dragon's upgrade is being conducted alongside a deep maintenance upkeep in Portsmouth.

In our Underwater Weapons business, the Torpedo Repair and Maintenance contract for in-service support to the UK's Royal Navy continues to perform well. The £270m Spearfish heavyweight torpedo upgrade programme, delivered for the UK Ministry of Defence and Royal Navy, continues to produce modification kits for weapon conversion as part of the production phase which commenced in 2021.

Land UK

Our munitions business has recently transitioned between munitions supply contracts, with the UK Ministry of Defence. A number of activities have been undertaken to close out the Munitions Acquisition, the Supply Solution (MASS) contract and plans enacted for the launch of the Next Generation Munitions Solution (NGMS) contract, which superseded the MASS contract. This contract is effective from 1 January 2023, and details the supply of munitions for the next 15 years.

The £90m NGMS investment programme is advancing at pace, with £20m of this committed to updating and expanding manufacturing equipment and infrastructure. A new state-of the-art automated machining line has been installed at our munitions plant in Washington, Tyne and Wear and a new Tube Vent Electrics manufacturing plant at Radway Green in Cheshire launched in the final quarter of 2022. This secured an additional sovereign capability for this UK Ministry of Defence component, that was last produced in the UK ten years ago. Similarly, at Glascoed in Monmouthshire, a new manufacturing facility for 40mm cased telescoped ammunition was finalised in 2022.

RBSL's multi-million pound investment in its Telford manufacturing site completed in 2022, with manufacturing activities starting in early 2023. The Challenger 3 Demonstration Phase is progressing in line with the programme plan, with work on the first eight prototypes underway. The Boxer programme is progressing with technology transfer proceeding as planned. Supply Chain activities for both programmes are proceeding well with notable focus on securing UK supply chain resilience.

Australia

Australia's current geopolitical climate has brought about a sharpened focus on the defence market. BAE Systems Australia is well placed to be a strong partner to the Australian Government through focused and disciplined delivery on major programmes such as the Hunter Frigate and the Jindalee Operational Radar Network (JORN), and is well positioned to support future needs driven by the AUKUS alliance.

The Hunter Class Frigate programme is progressing strongly with the fifth and final prototype block being manufactured at the world-class Osborne digital shipyard in South Australia, ahead of cutting steel on the first schedule protection blocks for Ship 1 in 2023.

In the Maritime Sustainment business, the Group secured a six-year contract, expected to be worth c.A$155m (£87m), to optimise the capability of the Hobart Class Destroyers in October 2022.

BAE Systems Australia's participation in the sustainment and upgrade of the fleet on eight ANZAC class frigates at our Henderson facility continued at pace delivering HMAS Toowoomba to the Royal Australian Navy for sea trials in 2022.

In December, a four-year extension to the Warship Management Alliance Agreement was agreed which will see completion of the current capability uplifts on all ANZAC class frigates and preparation for the next programme of upgrade under the Future Maritime Sustainment Model.

In the aerospace sector, the A$1.5bn (£0.8bn) extended 'In Service Support' contract for the Hawk aircraft commenced in 2022 and will see BAE Systems Australia provide this Lead In Fighter training capability until at least 2031. The contract includes software and hardware upgrades and new engines for the 33-strong fleet, which will align the aircraft with the UK Royal Air Force's T2 Hawk.

Aircraft sustainment activity continues to ramp up, aligned to the expansion of the Australian F-35 Joint Strike Fighter fleet. Australia is committed to a fleet of 72 aircraft and is on track to have received all by the end of 2023.

The JORN programme upgrade is being delivered against a revised schedule. Technology developed at the Group's Edinburgh Parks facility has been successfully demonstrated to the customer and is being integrated to enhance and sustain the network which is a key defence capability to protect Australia's northern approaches.

BAE Systems Australia's Research and Development business, Red Ochre LABS, is supporting the development of bespoke sovereign capabilities for the Australian customer in autonomous systems, high-frequency systems and electronic warfare. Emerging and disruptive technologies are being applied to deliver complex solutions including common autonomous architectures, uncrewed ground vehicles equipped with an artificial intelligence capability, and market-leading electronic support measures.

Looking forward

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

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Looking forward by segment

Cyber & Intelligence

Cyber & Intelligence comprises the US-based Intelligence & Security business and UK-headquartered Digital Intelligence business, and covers the Group's cyber security, and secure government activities.

Intelligence & Security comprises the three US-based businesses.

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

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

Intelligence Solutions provides innovative mission-enabling solutions and services to intelligence and federal/civilian agencies, as well as the provision of cost-effective synthetic training and simulation software products and components for global defence applications.

Digital Intelligence provides cyber, intelligence and security expertise to help protect nations, businesses and citizens. Our services, solutions and products span customers in law enforcement, national security, central government and government enterprises, critical national infrastructure, telecommunications, military and space.

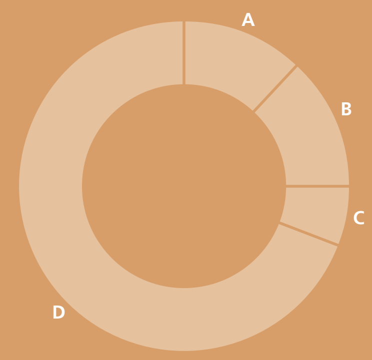
Employees[1]

10,500

Sales

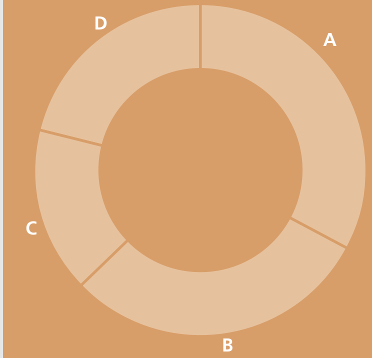
£2,205m

Sales by domain (%)



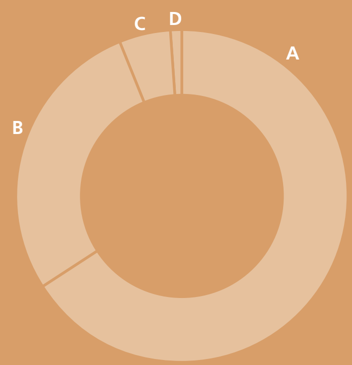
A	Air	12%
B	Maritime	13%
C	Land	6%
D	Cyber	69%

Sales by business (%)

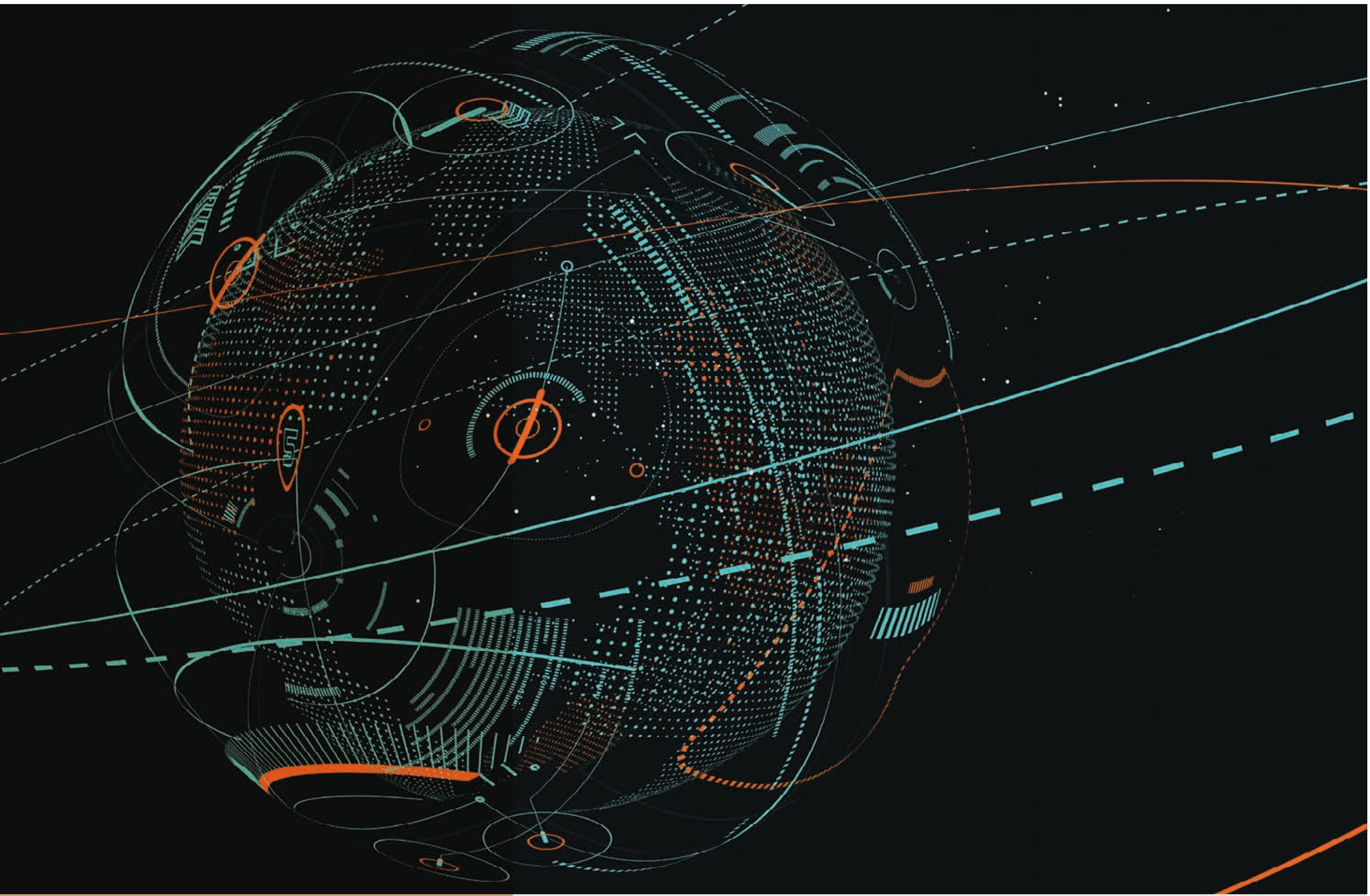


A	Digital Intelligence	33%
	Intelligence & Security:	
B	Intelligence Solutions	30%
C	Air Force Solutions	16%
D	Integrated Defense Solutions	21%

Sales by line of business (%)



A	US government	66%
B	UK and other governments	28%
C	Commercial	5%
D	Other	1%



Operational and strategic key points

Intelligence & Security

- Won a $699m (£581m) contract for operations, maintenance, and management services for the US Army's Defense Supercomputing Resources Center.
- Awarded one of the prime positions on a multi-award $300m (£249m) Indefinite Delivery, Indefinite Quantity contract to support critical mission operations for a government customer.
- Multiple additional contract awards, including a $143m (£119m) five-year contract from the US Navy to support the integration of mission equipment, combat systems, and computer programmes for the Surface Combat Systems Center.
- Completed the acquisition of Bohemia Interactive Simulations (BISim), which has been fully integrated into BAE Systems and continues to provide cutting-edge virtual training for allied militaries, including the $9m (£7m) DVS2 contract from the UK Ministry of Defence.

Digital Intelligence

- Strong order intake and revenue growth.
- Continued integration and growth of the acquired In-Space Missions business.
- In October 2022, the business completed the sale of the financial crime detection business.

Financial performance

Financial performance measures as defined by the Group

		2022	2021[2]
Sales	KPI	£2,205m	£1,923m
Underlying EBIT	KPI	£232m	£179m
Return on sales		10.5%	9.3%
Operating business cash flow	KPI	£154m	£201m
Order intake[1]	KPI	£2,443m	£2,034m
Order backlog[1]		£2.1bn	£1.8bn

Financial performance measures derived from IFRS

	2022	2021[2]
Revenue	£2,205m	£1,923m
Operating profit	£291m	£177m
Return on revenue	13.2%	9.2%
Cash flow from operating activities	£191m	£233m
Order book	£1.4bn	£1.2bn

- Sales increased by 7%[3] on a constant currency basis, with the US Intelligence & Security business benefitting from the acquisition of BISim during the year.
- Return on sales increased to 10.5%, reflecting better workforce utilisation and efficiencies.
- Multiple contract awards secured in the year, across both the Digital Intelligence business and the US Intelligence and Security business.
- Digital intelligence ended the year with a book-to-bill[4] ratio of 1.2.

1. Including share of equity accounted investments.
2. From 1 January 2022, the Group established a new Digital Intelligence business, bringing together our non-US digital and data capabilities for our customers. The new Digital Intelligence business is reported within the Cyber & Intelligence segment. Comparative segmental financial information for 2021 has been re-presented to reflect the new business structure.
3. Constant currency basis.
4. Ratio of Order intake to Sales.

Operational performance

Intelligence & Security

Air & Space Force Solutions

On the US Air Force Intercontinental Ballistic Missile Integration Support Contractor (ISC 1.0) programme, we continue to provide programme management, systems engineering, integration and testing, sustainment and cyber defence support, with cumulative funding approaching the previously increased $1.3bn (£1.1bn) contractual ceiling. In late June 2022, the Air Force awarded the recompete of the programme to BAE Systems under an 18-year ISC 2.0 contract with a ceiling value of $12bn (£10bn). The award was protested, and following the Government Accountability Office (GAO) ISC 2.0 protest sustainment decision issued in mid-October, all 2.0 transition activities were put on hold. The Air Force intends to take corrective action to address the GAO issues and we continue to support the ISC programme under a contract extension received in January 2023.

We were awarded a $15m (£12m) Indefinite Delivery, Indefinite Quantity contract by the Naval Air Warfare Aircraft Division to integrate the C-27J into the US Coast Guard's (USCG) Medium Range Surveillance Aircraft Fleet. The aircraft will help the USCG to fulfil its maritime patrol, drug and migrant interdiction, disaster response, and search and rescue missions more effectively.

In the year, the business successfully completed multiple prototype tests of its Multiple Object Tracking Radar, a mobile instrumentation radar, demonstrating its ability to meet critical performance parameters – range, transportability, accuracy, and beacon tracking – that other radars of comparable cost, size, weight and power cannot.

Integrated Defense Solutions

We continue to perform on the five-year, $478m (£397m) sole-source contract to support weapon systems on board the US Ohio and UK Vanguard Class submarines, as well as the future US Columbia Class and UK Dreadnought Class submarines.

The US Army awarded a $699m (£581m), five-year contract for Defense Supercomputing Resource Center operations, maintenance, and management services. Under this contract, we are providing technical support to advance high-performance computer services, capabilities, and infrastructure across five sites in the US.

We were awarded a $143m (£119m), five-year contract from the US Navy to continue to support the integration of mission equipment, combat systems, and computer programmes for the Surface Combat Systems Center in Wallops Island, Virginia. These mission-essential systems are used across the fleet for all current and future cruiser, destroyer, and amphibious ship modernisation initiatives.

Intelligence Solutions

We continue to execute on a $506m (£421m) contract to provide industry-leading and multi-disciplinary analytic support capabilities supporting first responders, war fighters and policy makers. These tailored analytic services span a multitude of mission specifications and operating environments. Services include, but are not limited to: source discovery and collection, time-dominant and long-term analytic assessments, cartographic production, and multi-media content generation.

We were awarded one of the prime positions on a multi-award $300m (£249m) Indefinite Delivery, Indefinite Quantity contract to support critical mission operations for a government customer.

A government agency awarded us two contracts to support the customer's IT environment at their site in Washington, DC. In September 2022, we were awarded a seven-year, $137m (£114m) contract to provide 365/24/7 Network Operations support; and in October 2022, we were awarded another seven-year, $108m (£90m) contract to continue to support the integration of commercial off-the-shelf and government off-the-shelf applications.

In March 2022, we completed the acquisition of BISim, a global software developer of simulation and training solutions for military organisations around the world (see note 35 to the Group accounts on page 288 for more details).

Digital Intelligence

The business performed well in 2022, increasing order backlog and delivering revenue and profit growth in line with expectations through a period of reorganisation.

Programme execution continues to be strong and well controlled across all areas, supporting underlying margin growth. Operating costs continue to be tightly controlled with investment expenditure being prioritised to deliver future growth.

The National Security business has continued to grow order backlog and revenue through investing in skills and capability that support long-term customer strategic aims.

The International Government business has successfully delivered a number of key programmes to existing customers during the year. Bidding activity in new markets is beginning to pick up, as a result of easing of travel restrictions during the year.

The UK Central Government business has renewed various key programmes across the Foreign, Commonwealth and Development Office, UK Border Force and Health sectors. The team also signed a framework contract for £40m, which secures a key Home Office programme for the next three years.

Within our Defence & Space business unit, we have formed an integrated team bringing together expertise from BAE Systems and In-Space Missions to develop Azalea, a cluster of highly resilient satellites which are capable of gathering, analysing and communicating Synthetic Aperture Radar, optical and radio frequency signals.

Within our Digital Defence Services business, demand for both product and service solutions remains high. Strong delivery performance in C5ISR has helped strengthen margins, and investment in developing space products, in collaboration with In-Space Missions, remains a key area of focus. The business continues to invest in future talent through development academies to address national labour and skills shortages.

On 28 October 2022, the sale of the financial crime detection business was completed. Further details can be found in note 20 to the Group accounts on page 263.

Looking forward

Forward-looking information for the Cyber & Intelligence reporting segment is provided later in this report.

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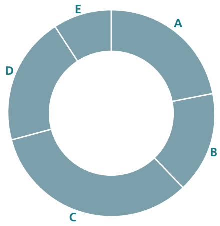
Looking forward by segment

Looking forward by segment

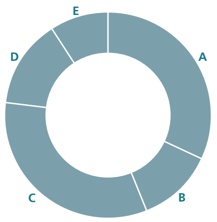
BAE Systems' reporting segments, Electronic Systems, Platforms & Services, Air, Maritime and Cyber & Intelligence, align with the strategic direction of the Group.

2022 Sales[1]



A	Electronic Systems	22%
B	Platforms & Services	16%
C	Air	33%
D	Maritime	20%
E	Cyber & Intelligence	9%

2022 Underlying EBIT[1]



A	Electronic Systems	32%
B	Platforms & Services	12%
C	Air	33%
D	Maritime	14%
E	Cyber & Intelligence	9%

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

Electronic Systems is well positioned for growth in the medium term as it continues to address current and evolving US defence priority programmes from its strong franchise positions, which are supported by a long-standing programme of research and development. The sector's focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities for US and international customers, and it expects to benefit by applying innovative technology solutions to meet defence customers' existing and changing requirements, building on its significant roles on F-35 Lightning II, F-15 upgrade, M-Code GPS upgrades and classified programmes, as well as a number of precision weapon products. Over the longer term, the sector is poised to leverage its technology strengths in emerging areas of demand such as precision weaponry, space resilience, hyper-velocity projectiles and autonomous platforms. With our electric drive propulsion capabilities, we continue to address the need for low and zero emission technology across an increasing number of civil platforms, with opportunities to migrate these technologies to the defence arena.

The commercial aviation market was negatively impacted by the pandemic, and, whilst a recovery in air travel continues to develop, it is expected to take several years to reach previous demand levels. With the positive outlook for the sector, we continue to invest in our people, R&D and in new facilities, a number of which opened in 2022.

Platforms & Services, with operations in the US, UK and Sweden, manufactures and upgrades combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair, and the management and operation of government-owned munitions facilities.

Combat Mission Systems is underpinned by a strong order backlog and incumbencies on key franchise programmes, to include the US Army's Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer, Bradley upgrade programmes, M88 HERCULES recovery vehicle, and the US Marine Corps' Amphibious Combat Vehicle. This US vehicle portfolio is augmented by the CV90 and BvS10 domestic and export programmes from BAE Systems Hägglunds and artillery systems from BAE Systems Bofors, and the FNSS joint venture continues to execute on its order book of both Turkish and international orders. These long-term contracts, franchise positions and the renewed demand environment for land systems make the combat vehicle and artillery product lines well placed for growth in the medium term.

In the maritime domain, the sector has a strong position on naval gun and missile launch programmes, as well as US Navy ship repair activities where the business has invested in capitalised infrastructure and its facilities in key home ports. The business remains well aligned to the US Navy's operational strategy and fleet projections.

The Group remains a leading provider of gun systems and precision strike capabilities and, in the complex ordnance manufacturing business, continues to manage and operate the US Army's Radford and Holston munitions facilities.

1. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 302.

Page 20
Our markets

Page 82
Financial performance metrics

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

Future Typhoon production and support sales are underpinned by existing contracts. Discussions continue in relation to potential further contract awards for Typhoon. Production of rear fuselage assemblies for the F-35 has reached full-rate levels and is expected to be sustained at these current levels. The business plays a significant role in the F-35 sustainment programme in support of Lockheed Martin and support volumes should increase as the number of jets in service continues to increase. The GCAP agreement with Japan and Italy is fundamental to meeting the goals set out in the UK government's Combat Air Strategy and represents a significant step forward for the Air sector in ensuring we have a sustainable long-term combat aircraft manufacturing capability.

Kingdom of Saudi Arabia

In the Kingdom of Saudi Arabia, the In-Kingdom Industrial Participation programme continues to make good progress consistent with our long-term strategy, as well as the Saudi Arabian government's National Transformation Plan and Vision 2030. Our in-Kingdom support business is expected to remain stable, underpinned by the recent renewal of the Saudi British Defence Co-operation Programme, a key long-standing contract, for another five years, and negotiations with the Salam Project Office, to agree Phase 4 of the Typhoon Support Solution Service, which remain ongoing and which we expect to conclude during the course of 2023.

MBDA

MBDA has a strong order backlog supporting future years' sales. Development programmes continue to improve the long-term capabilities of the business in air, land and sea domains.

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

Maritime

The outlook is positive based on long-term contracted positions and with a number of UK, Australian and international opportunities to further this outlook. Within Submarines, the business is executing on two long-term programmes. On the Astute Class programme, the fifth of class exited our Barrow shipyard to commence sea trials in February 2023 and the two remaining boats are in build. On the Dreadnought programme, manufacturing activities continue on the first three boats of a four-boat programme. Investment continues in the facilities at our Barrow shipyard in order to provide the capabilities to deliver these long-term programmes through the decade and beyond. In shipbuilding, sales are underpinned by the manufacture of Type 26 frigates. The through-life support of UK surface ship platforms provides a sustainable business in technical services and mid-life upgrades.

Land UK

Future work will be underpinned by existing in-service support contracts and the contracted workshare on the Mechanised Infantry Vehicle (Boxer) and Challenger 3 Main Battle Tank programmes. Munitions supply from 2023 will be delivered under the 15-year Next Generation Munitions Solution and volumes are expected to increase in the coming years given the elevated threat requirements.

Australia

The Australian business has long-term sustainment and upgrade activities in maritime, air, wide-area surveillance, missile defence and electronic systems. It has expanded into ship design and production on the Hunter Class Frigate programme, which will drive growth in the coming years and is pursuing a number of further opportunities.

Cyber & Intelligence comprises the US-based Intelligence & Security business and UK-headquartered Digital Intelligence business, and covers the Group's cyber security and secure government activities.

Intelligence & Security

The outlook for the US government services sector is robust with the opportunity for mid-term growth. Market conditions remain highly competitive and continue to evolve in response to shifting government priorities. The US business remains well positioned and will continue to leverage its established market positions and reputation for reliable and adaptable performance to meet customer demands for innovative, cost-effective and cyber-hardened solutions to pursue both recompete contracts and new business across its portfolio of system integration, sustainment and modernisation solutions for military and intelligence customers. The addition in 2022 of Bohemia Interactive Simulations positions the business well to enhance and grow its synthetic training operations to the US military and its allies.

Digital Intelligence

In 2022, we formed a new operating business, BAE Systems Digital Intelligence, bringing together many of our world-leading digital transformation, cyber security, complex data analysis, and communication and information capabilities from across the Group. This activity will enable even closer collaboration across the Group to help our customers operate successfully, safely and efficiently in the digital world, and in time bring a greater range of capabilities to our customers.

How we manage risk

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

Board

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

Risk is considered on a regular basis at Board and Board committee meetings and the Board reviews risk (including emerging risk) as part of its business planning and annual strategy review process. This provides the Board with an appreciation of the key risks within the business and oversight of how they are being managed.

The Board delegates oversight of certain risk management activities to the Audit and Environmental, Social and Governance Committees.

Audit Committee

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

Environmental, Social and Governance Committee

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

Approach

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

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

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

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

The Board has conducted a review of the effectiveness of the Group's systems of risk management and internal control processes, including financial, operational and compliance controls and risk management systems, in accordance with the UK Corporate Governance Code. The Group has developed a system of internal controls that was in place throughout 2022 and to the date of this report.

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

Financial and non-financial risks

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

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

Process

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

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

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

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

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

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

Risks can develop and evolve over time and their potential likelihood and impact may vary over time in response to events. These may include emerging risks, which are considered through the above existing processes, or through the Group's business planning and annual strategy review process.

Executive Committee

The key financial and non-financial risks identified by the sectors and Group functions from the risk assessment processes are collated into a report for review by the Executive Committee. In addition, the Group's business planning and annual strategy review process considers longer-term emerging risks and opportunities. The Executive Committee reviews these reports and presentations to identify those issues where the cumulative risk, or possible reputational impacts, could be significant. These reports and presentations are shared with the Board.

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

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

Principal and emerging risks

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

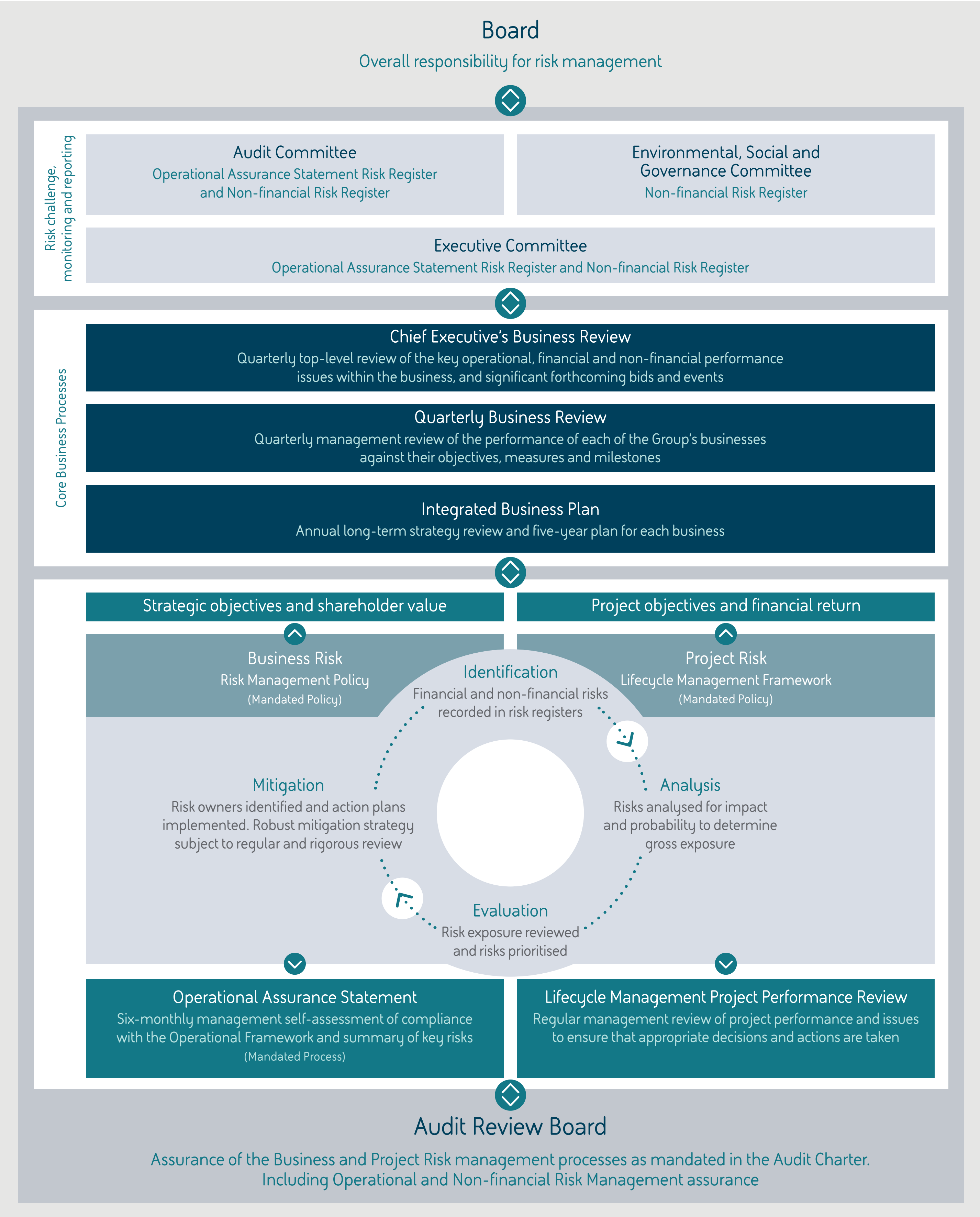
Principal risks include those that would threaten the Group's business model, future performance, solvency, liquidity or reputation. Risks have been identified as principal based on the likelihood of occurrence, the potential impact on the Group and the timescale over which they might occur. The principal risks, together with details of how they are being mitigated and managed, are detailed on pages 119 to 125.

The directors have considered the relevance of the risks of climate change and transition risks associated with the Group's net zero greenhouse gas emissions targets when preparing and signing off the Group's accounts.

Page 118
Our risk management framework

Page 119
Our principal risks

Our risk management framework



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See the Group's Operational Framework for definitions of policies, processes and reviews

Our principal risks

Risks are identified based on the likelihood of occurrence, the potential impact on the Group and the timescale over which they might occur. The Group's principal risks are identified below together with a description of how we mitigate those risks. The risks estimated as more significant to the Group (as at the date of this Strategic Report) are placed at the top end of the list[1].

Key links to strategy

1. Sustain and grow our defence business
2. Continue to grow our business in adjacent markets
3. Develop and expand our international business
4. Inspire and develop a diverse workforce to drive success
5. Enhance financial performance and deliver sustainable growth in shareholder value
6. Advance and integrate our sustainability agenda

Page 16
Our strategic framework

Government customers, defence spending and terms of trade

The Group's largest customers are governments. The Group is dependent on government defence spending, and the timing and terms of trade of government contracts.

Key links to strategy: 1 2 3 5

Description	Impact	Mitigation
In 2022, 95% of the Group's sales were defence-related. Defence spending by governments can fluctuate depending on change of government policy, other political considerations, budgetary constraints, specific threats and movements in the international oil price. There have been constraints on government expenditure in a number of the Group's principal markets.	Lower defence spending by the Group's major customers could have a material adverse effect on the Group's future results and financial condition.	The business is geographically spread across the US, UK and international defence markets. The diverse product and services portfolio is marketed across a range of defence markets. Many of the countries in which we operate either have announced increases or are making plans to increase spending to address the elevated threat environment. Whilst global economic and fiscal pressures weigh on governments, the commitment to defence in our major markets remains robust. Our principal markets – the UK, US, Kingdom of Saudi Arabia and Australia – have a significant and sustained commitment to defence and security – see Our markets on pages 20 to 23 of this Annual Report. BAE Systems benefits from a large order backlog, with established positions on long-term programmes in our principal markets. BAE Systems also has a portfolio of commercial businesses, including commercial avionics.
The Group has long-standing relationships and security arrangements with a number of its government customers, including its three largest customers, the governments of the US, UK and the Kingdom of Saudi Arabia, and their agencies. It is important that these relationships and arrangements are maintained. In the defence and security industries, governments can typically modify contracts for their convenience or terminate them at short notice. Most long-term US government contracts, for example, are funded annually or incrementally and are subject to cancellation if funding appropriations for subsequent periods are not made. Governments also from time to time review their terms of trade and underlying policies and seek to impose such new terms and policies when entering into new contracts. The Group's performance on its contracts with some government customers is subject to financial audits and other reviews which can result in adjustments to prices and costs.	Deterioration in the Group's principal government relationships resulting in the failure to obtain contracts or expected funding appropriations, adverse changes in the terms of its arrangements with those customers or their agencies, or the termination of contracts could have a material adverse effect on the Group's future results and financial condition.	BAE Systems has established strong and enduring relationships in its principal markets and is recognised as playing a key role in the industrial capability of each of the countries in which it operates. Government customers have sophisticated procurement and security organisations with which the Group has long-standing relationships with well-established and understood terms of business. In the event of a customer terminating a contract for convenience, the Group would typically be paid for work done and commitments made at the time of termination.
The Group's profits and cash flows are dependent, to a significant extent, on the timing of, or failure to receive, award of defence contracts and the profile of cash receipts on its contracts.	Amounts receivable under the Group's defence contracts can be substantial and, therefore, the timing of, or failure to receive, awards and associated cash advances and milestone payments could materially affect the Group's profits and cash flows for the periods affected, thereby reducing cash available to meet the Group's cash allocation priorities, potentially resulting in the need to arrange external funding and impacting its investment grade credit rating.	The Group's balance sheet continues to be managed conservatively in line with its policy to retain an investment-grade credit rating and to ensure operating flexibility. The Group monitors a rolling forecast of its liquidity requirements to ensure that there is sufficient cash to meet its operational needs and maintain adequate headroom.

1. The ranking and evaluation of risks as at the date of this Strategic Report should not be relied upon as a guide to their future ranking and evaluation.

International markets

The Group operates in international markets.

Key links to strategy

1 2 3 4 5 6

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

Contract risk, execution and supply chain

The Group has many contracts, including a small number of large contracts and fixed-price contracts, and is dependent upon component availability, subcontractor performance and key suppliers.

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
In 2022, 51% of the Group's sales were generated by its 16 largest programmes. At 31 December 2022, the Group had ten programmes with order backlog in excess of £1bn. A significant portion of the Group's revenue is derived from fixed-price contracts. Actual costs may exceed the projected costs, including assumptions on future rates of inflation, on which the fixed prices are agreed and, since these contracts can extend over many years, it can be difficult to predict the ultimate outturn costs. It is important that the Group maintains a culture in which it delivers on its projects within tight tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner.	The inability of the Group to deliver on its contractual commitments, the loss, expiration, suspension, cancellation or termination of any one of its large contracts or its failure to anticipate technical problems or estimate accurately and control costs on fixed-price contracts could have a material adverse effect on the Group's future results and financial condition.	Contract-related risks and uncertainties are managed under the Group's mandated Lifecycle Management process. A leadership development programme for project directors continues to be deployed across the Group, covering the leadership competencies required to manage complex projects containing significant levels of risk and uncertainty. A significant proportion of the Group's largest contracts are with the UK Ministry of Defence. In the UK, development programmes are normally contracted with appropriate levels of risk being initially held by the customer and contract structures are used to mitigate risk on production programmes, including where the customer and contractor share cost savings and overruns against target prices. The Group has a well-balanced spread of programmes and significant defence order backlog which provides portfolio resiliency and forward visibility. The Group has limited exposure to fixed-price design and development activity which is in general more risk intensive than fixed-price production activity. Robust bid preparation and approvals processes are well established throughout the Group, with decisions required to be taken at the appropriate level in line with clear delegations of authority.
The Group is dependent upon the delivery of materials by suppliers and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, on satisfactory commercial terms and in full compliance with applicable terms and conditions. The external supply chain environment is very dynamic at this time, with both lead-time and availability issues, but also pricing pressures, including from inflationary increases in labour, energy and other key materials.	Some of the Group's suppliers or subcontractors may be impacted by the economic environment (including inflationary pressures) which could impair their ability to meet their obligations to the Group and to supply on satisfactory commercial terms. In some instances, the Group is dependent on one or a limited number of suppliers. If any of these suppliers or subcontractors fail to meet the Group's needs, the Group may not, in the short term, have readily available alternatives, thereby impacting its ability to complete its customer obligations satisfactorily and in a timely manner. The above events could have a negative impact on the Group's future results of operations and financial condition.	The Group's procurement function is responsible for establishing and managing end-to-end integrated supplier arrangements, in partnership with the programmes they support. The Executive Committee continues to monitor this risk. In many cases, the Group benefits from long-term programme positions and incumbencies with more stable forward visibility for long-lead items allowing the Group to continue to actively manage supplier lead times against demand requirements. The Group seeks to manage the inflation risk through its contracting arrangements on many of its major programmes, effective cost management and improved efficiency of the Group's own operations and through its long-term supplier agreements.

Cyber security

The Group could be negatively impacted by threats to the security of its information technology and operational technology systems.

Key links to strategy

1 2 3 4 5 6

Description

Cyberspace is an increasingly contested environment with criminals, hacktivists and sub-threshold activity from nation states being a significant threat. The cyber security threats faced by the Group include: the potential for business disruptions due to an attack impacting the availability of its information technology and operational technology infrastructure and systems; unlawful attempts to gain access to both the Group's proprietary or classified information and that of its customers, partners and suppliers; and the potential for business disruptions and loss or compromise of classified, proprietary or personal information through an attack on the Group's supply chain.

Impact

Failure to combat these risks effectively could disrupt business operations, compromise the security of the Group's products and services, erode the Group's competitive advantage, harm staff and negatively impact the Group's reputation among its customers and the public, resulting in a negative impact on the Group's future results and financial condition.

Mitigation

As a major defence, aerospace and security company, it is critical that our Group networks, as well as the products and services we sell, are cyber resilient and the intellectual property and confidential information held and processed on them is appropriately secured.

Our governance model and organisational structure (through the Chief Technology and Information Officer and Group Security Director) is designed to facilitate close alignment between company strategy and the resulting engineering, technology, and digital and cyber security strategies.

The cyber security risk is constantly reviewed and an agile, proactive, approach to mitigating the risk is taken. We do this by efficiently leveraging our core internal capabilities in cyber security, including our specialist threat intelligence service, to maintain a managed risk position as we digitally transform and the threat landscape evolves.

Our suppliers, direct and indirect, are vital contributors to our business. Many hold significant amounts of intellectual property and confidential information on behalf of both the Group and its customers and so, to mitigate the cyber security risk they pose, we include cyber security-related obligations in our contracts with relevant suppliers.

We purchase cyber insurance; however, as with all insurance, it does not provide full cover against all potential loss scenarios.

Our internal Cyber Security Standards for Company networks are aligned to the National Institute of Standards and Technology framework and controls and a formal, three layers of defence, assurance programme is operated to check adherence to Company standards and customer requirements, which is reviewed both internally and externally. Additionally, many of our networks are formally accredited by our government customers.

To further increase our cyber resilience, our Security Operations Centres in the UK and the US perform continual protective monitoring of our core networks. The Cyber Incident Response plan feeds into the Group's crisis management plan and regular exercises are conducted across the business to test the Cyber Incident Response plan, including up to the Executive Committee.

Education and awareness to embed a strong cyber security culture across the Group is another vital part of our activities. We take a holistic approach providing training coupled with events and activities to drive better engagement and learning outcomes. We strive for the training to be relatable, both on a professional and personal level, so that hybrid working employees maintain a strong sense of cyber awareness whether at home or in the office. Employees are subject to mandatory training which, depending on role, covers cyber security, physical security, document marking, security of export-controlled information, and personal data protection. As many cyber attacks still involve email, we run a programme of phishing exercises for all email users across the enterprise.

Competition in international markets

The Group's business is subject to significant competition in international markets.

Key links to strategy

1 2 3 4 5 6

Description

The Group's business plan depends upon its ability to win and contract for high-quality new programmes, an increasing number of which are expected to be in markets outside the US and UK.

The Group is dependent upon US and UK government support in relation to a number of its business opportunities in export markets.

Impact

The Group's business and future results may be adversely impacted if it is unable to compete adequately and obtain new business in the markets in which it operates.

Mitigation

The Group has an international, multi-market presence, a balanced portfolio of businesses, leading capabilities and a track record of delivery on its commitments to its customers.

The Group continues to invest in research and development, and to reduce its cost base and improve efficiencies, to remain competitive.

In the UK, export contracts can be structured on a government-to-government basis and government support can also involve military training, ministerial support for promotional activities and financial support through UK Export Finance. In the US, most of the Group's defence export sales are delivered through the Foreign Military Sales process, under which the importing government contracts with the US government.

People

The Group's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills.

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
Delivery of the Group's strategy and business plan is dependent on its ability to compete to recruit and retain people with appropriate talent and skills, including those with innovative technological capabilities. The Group's business plan is targeting an increasing level of business in international export markets outside the US and UK. It is important that the Group recruits and retains management with the necessary international skills and experience in the relevant jurisdictions.	The loss of key employees or inability to attract the appropriate people on a timely basis could adversely impact the Group's ability to deliver its strategy, meet the business plan and, accordingly, have a negative impact on the Group's future results and financial condition.	The Group recognises that its employees are key to delivering its strategy and business plan, and focuses on developing the existing workforce and hiring talented people to meet current and future requirements. The Group has well-established graduate recruitment and apprenticeship programmes and, in order to maximise the contribution that its workforce can make to the performance of the business, has an effective through-career capability development programme. In order to seek to maximise its talent pool, the Group is committed to creating a diverse and inclusive environment for its employees.

Outbreak of contagious diseases

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

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
There has been a COVID-19 pandemic across the world and governments have taken a number of steps to mitigate the impact of this pandemic. Many people have contracted the disease across the world and many deaths have occurred. Although there has been an effective roll-out of vaccination programmes in certain countries, it is still not clear how enduring the long-term impact of the pandemic will be. A further outbreak of a contagious disease could occur.	Contagious diseases, and the measures taken to control them, can have an adverse effect on the Group's business, financial condition and results of operations. Areas of the Group's business that could be impacted include a decrease in spending by the Group's major defence and commercial customers; an increase in taxation by governments; the failure to obtain awards for defence and commercial contracts; the failure of suppliers to deliver parts to the Group; the requirement for the Group or its suppliers to reduce site operational levels or close sites; the inability of the Group to meet contractual delivery requirements on time; the inability to adequately staff and manage the business; and an increase in the cost or lack of availability of funding. If the Group were unable to obtain appropriate funding, it could be forced to make reductions in spending, seek to extend payment terms with suppliers and/or suspend or curtail planned programmes. Any of the above could have a material adverse effect on the Group's business, financial condition and results of operations.	The Group's experience in dealing with the COVID-19 pandemic will assist it in dealing with further outbreaks of contagious diseases. This includes the use of safe working practices and the effective use of home working. In the COVID-19 pandemic, support for the defence industry from the governments in our key markets has been strong around prioritisation of capabilities, cash flows, recognising the need to maintain a strong supply chain and working collaboratively to maintain critical defence and security programmes.

Pension funding

An aggregate funding deficit could arise in the Group's defined benefit pension schemes.

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
The latest triennial actuarial valuations of the Group's UK defined benefit pensions schemes showed as at their respective dates that there is no funding deficit in any of those schemes on a technical provisions basis. A funding deficit could arise or be adversely affected by changes in a number of factors, including investment returns and members' anticipated longevity.	An increase in pension scheme liabilities or reduction in pension scheme assets could result in a pension scheme deficit which may require the Group to make deficit contributions to these schemes, thereby reducing cash available to meet the Group's other cash allocation priorities.	In the UK, new employees have been offered membership of defined contribution rather than defined benefit schemes since April 2012 and, in the US, employees have not accrued salary-related benefits in defined benefit schemes since January 2013. The investment strategy in place across the UK and US schemes aims to ensure that the pension scheme assets are invested such that they match the cash flows needed to meet the pension liabilities, thereby reducing the risk of a deficit arising. Across the UK schemes there are a number of longevity risk management strategies in place. The Company and Trustee agreed to carry out a triennial actuarial funding valuation as at 31 March 2021 of the Group's largest UK defined benefit pension scheme. In June 2022, that valuation was agreed with the Trustee after consultation with The Pensions Regulator in the UK. The latest triennial actuarial valuations of that scheme and of the Group's other smaller UK defined benefit pensions schemes showed as at their respective dates that there is no funding deficit in any of those pension schemes on a technical provisions basis.

Climate change and the environment

The Group may be impacted by environmental factors, including those relating to climate change.

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
The Group is subject to comprehensive environmental laws and regulations in each of the countries in which it operates, including those relating to the impacts of climate change. Such laws and regulations impose standards with respect to air emissions, wastewater discharges, the use, handling and storage of hazardous materials and waste, remediation of soil and groundwater contamination and the prevention of pollution. Increasingly, environmental legislation is seeking to encourage a reduction in greenhouse gas emissions. The Group may also be impacted by environmental factors, including physical risks arising from climate change, such as extreme weather events, for example flooding and storms, and scarcity of water and other resources. The Group may also be impacted by climate change transition risks resulting from the process of adjusting to a low carbon economy. Associated with this are potential risks around our ability to attract and retain future talent, energy-related taxes and the increased costs of compliance with energy-related schemes.	Environmental factors, including those relating to climate change, have the potential to materially impact our business and operations. Increasing changes in environmental laws and regulations can expose the Company to increasing capital and operating costs associated with compliance, remediation and protection of the environment. Breaches of such laws and regulations can result in substantial costs, including fines, penalties or other sanctions, investigations and clean-up costs, and third-party claims for property damage or personal injury as well as the termination of permits. Extreme weather events can impact our operational sites as well of those of our suppliers. The shift to a low carbon economy has the potential to increase the cost of business as the Group transitions to lower-emissions technologies and deals with the disposal of its legacy assets.	We have set ourselves the target of achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030 and working towards a net zero value chain by 2050. Climate and environment risk is embedded with our approach to risk management via our business and project risk registers. Climate-related physical and transition risks have been identified and assessed as part of our decarbonisation strategy. BAE Systems uses analytical tools to apply natural catastrophe classifications to its sites worldwide. This has informed our strategy as to where to target a programme of specific flood, windstorm and earthquake assessments of our sites and implement the subsequent risk reduction recommendations. During 2022, we further developed our understanding of climate-related risks and opportunities, conducting scenario analysis of material risks so that we could understand potential unmitigated risks and our business readiness to mitigate any such risks.

Laws and regulations

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

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
The Group operates in a highly regulated environment across many jurisdictions and is subject, without limitation, to regulations relating to import-export controls, money laundering, false accounting, anti-bribery and anti-boycott provisions. It is important that the Group maintains a culture in which it focuses on embedding responsible business behaviours and that all employees act in accordance with the requirements of the Group's policies, including the Code of Conduct, at all times. Export restrictions could become more stringent and political factors or changing international circumstances could result in the Group being unable to obtain or maintain necessary export licences.	Failure by the Group, or its sales representatives, marketing advisers or others acting on its behalf, to comply with these regulations could result in fines and penalties and/or the suspension or debarment of the Group from government contracts or the suspension of the Group's export privileges, which could have a material adverse effect on the Group. Reduced access to export markets could have a material adverse effect on the Group's future results and financial condition.	BAE Systems has a well-established legal and regulatory compliance structure aimed at ensuring adherence to regulatory requirements and identifying restrictions that could adversely impact the Group's activities. Internal and external market risk assessments form an important element of ongoing corporate development and training processes. A uniform global policy and process for the appointment of advisers engaged in business development is in effect. BAE Systems continues to reinforce its ethics programme globally, driving the right behaviours by supporting employees in making ethical decisions and embedding responsible business practices.

Acquisitions

The anticipated benefits of acquisitions may not be achieved.

Key links to strategy

1 2 3 4 5 6

Description	Impact	Mitigation
BAE Systems considers investment in value-enhancing acquisitions where market conditions are right and where they deliver on its strategy. Whether BAE Systems realises the anticipated benefits from these transactions depends upon the successful integration of the acquired businesses as well as their post-acquisition performance in the markets in which they operate.	The diversion of management attention to integration efforts and the performance of the acquired businesses below expectations could adversely affect BAE Systems' business and create the risk of impairments arising on goodwill and other intangible assets.	The Group has established policies in place to manage the acquisition process, monitor the integration and performance of acquired businesses, and identify potential impairments.

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

Viability statement

As required by the provisions of the UK Corporate Governance Code 2018, the Board has undertaken an assessment of the future prospects of the Group, taking into account the Group's current position and principal risks.

This assessment considered both the Group's long-term prospects and also its ability to continue in operation and meet its liabilities as they fall due over its five-year business planning period.

The viability assessment period

The Directors have assessed the viability of the Group over a five-year period. This is considered the most appropriate period for the assessment as it is consistent with the Group's five-year business planning cycle.

Analysis of business prospects

The Board has considered the long-term prospects of the Group based on our strategy, markets and business plan as outlined on pages 16 to 37 of this report. In its strategic review of the Group, the Board recognised the importance of certain factors that underpin its long-term prospects and viability. In summary, these are:

- a diverse portfolio of businesses based on well-established market positions, providing both complex, high-technology products and programmes, and differentiated technical services and support. In 2022, 40% of Group sales were product/programme related and 60% services and support;
- a geographically diverse business with a high proportion of sales to governments and other major prime defence contractors. In 2022, 35% of sales were to the US Department of Defense, 22% to the UK Ministry of Defence and 11% to the Kingdom of Saudi Arabia Ministry of Defence and Aviation. The Group's robust order backlog continues to provide a strong foundation for further market diversity and growth;
- long-term visibility of sales and future sale prospects through a substantial order backlog and incumbent positions on major defence programmes; and
- market positions underpinned by a highly skilled workforce, intellectual property assets and proprietary know-how, which are safeguarded and developed for the future by customer- and Group-funded investment. Such investment is focused on a well-developed understanding of future technologies and the threat environment shaping the long-term defence and aerospace market.

Assessment

The Board's assessment of the Group's prospects was informed by the following business processes:

Risk management process – the Group has developed a structured approach to the management of risk (see above) and principal and emerging risks identified are considered as part of the Board's annual review of the Integrated Business Plan.

The Board recognises that the principal risks identified on pages 119 to 125 could impact the future viability of the Group, and has undertaken more detailed scenario analysis in relation to specific risks that are considered most likely to have a more immediate and severe financial impact on the Group.

The viability assessment has taken into account reasonably plausible, but severe, downside scenarios related to these risks and assessed the impact on the future cash flows, profitability, financial covenants, solvency and liquidity of the Group.

Integrated Business Plan (IBP) – the IBP represents a common process with standard outputs and requirements that produces an integrated strategic and business plan for the Group and also for each of its businesses over the following five years. The use of a five-year period provides a robust planning tool against which long-term decisions can be made concerning, amongst other things, strategic priorities, addressing the Group's stated net zero target and climate-related risks and opportunities, funding requirements (including commitments to Group pension schemes), returns made to shareholders, capital expenditure and resource planning. Longer-term strategic inputs also form part of the IBP process and, where activity is required to meet such long-term priorities, this is provided for in the plan.

The detailed plan is reviewed each year by the Board as part of its strategy review process. Once approved by the Board, the IBP provides the basis for setting all detailed financial budgets and strategic actions across the businesses, and is subsequently used by the Board to monitor performance.

Liquidity and solvency analysis – the Group's liquidity is underpinned by an undrawn committed Revolving Credit Facility of £2bn contracted to April 2025, and is available to meet general corporate funding requirements. The Board regularly reviews an analysis based on the financial output from the IBP, looking at the forecast working capital requirements, cash flow, and committed borrowing and other funding facilities available to the Group over the five-year period covered by the IBP. This analysis includes 'stress testing' of the Group's liquidity and solvency under severe, but plausible, scenarios as developed from the IBP, including the following:

- the Group being unable to access debt markets to renew term debt facilities;
- an unfavourable change to the terms of trade the Group enjoys with certain principal customers; and
- the loss of a major export market.

The scenarios tested included the impact of multiple adverse factors.

Conclusion

In undertaking its review of the IBP in 2022, the Board considered the prospects of the Group over the five-year period covered by the process. On the basis of this and other matters considered and reviewed by the Board, the Board has reasonable expectations that the Group will be able to continue in operation and meet its liabilities as they fall due over the following five years. It is recognised that such future assessments are subject to a level of uncertainty that increases with time and, therefore, future outcomes cannot be guaranteed or predicted with certainty. Also, this assessment was made recognising the principal risks that could have an impact on the future performance of the Group (see pages 119 to 125).

Going concern statement

Accounting standards require that directors satisfy themselves that it is reasonable for them to conclude whether it is appropriate to prepare financial statements on a going concern basis and the Code requires that, if appropriate, this report includes a statement to that effect. Following review, the directors have concluded that it is appropriate to adopt the going concern basis for these financial statements and have not identified any material uncertainties concerning the Group's ability to do so in the 12-month period from the date of approving them.

For this reason, they continue to adopt the going concern basis in preparing the accounts.

Strategic report

The Strategic report was approved by the Board of directors on 22 February 2023.

David Parkes
Company Secretary

Governance at a glance

The Board of directors

The Company is led by the Board of directors. Its role is to promote the long-term sustainable success of the Company, generating value for shareholders and contributing to wider society.

Page 34
The work of the Board

Contents

The purpose of the Committee is to ensure effective succession planning for the Board, and to oversee the development of a diverse pipeline of succession, taking into account a balance of skills, experience and knowledge.

Nominations Committee report

Page 140

The purpose of the Committee is to monitor the integrity of the financial and narrative statements of the Group, monitor and review the effectiveness of internal controls and oversee the relationship with the external auditor.

Audit Committee report

Page 145

The purpose of the Committee is to assist the Board in promoting the long-term sustainable success of the Group with regard to environmental, social and governance matters.

Environmental, Social and Governance Committee report

Page 151

The purpose of the Committee is to promote the success of the Group through the effective oversight of the application of science, engineering, and technology and the successful exploitation of its intellectual property and know-how in pursuit of its business and commercial goals.

Innovation and Technology Committee report

Page 157

The purpose of the Committee is to set policies for Executive remuneration that are designed to promote long-term sustainable success aligned to the Group's values and successful delivery of its long-term strategy.

Remuneration Committee report

Page 160

Chairman's governance letter

> Good governance practice has to be embedded into the culture of a company and be a natural part of corporate life.
>
> **Sir Roger Carr**
> Chairman

Dear Shareholders

As in past years, I will use this introduction to the Governance reports to highlight a few key governance themes concerning the work of the Board and its committees.

As a UK listed company our governance is based on the successful UK model of a unitary board applying the principles of the UK Corporate Governance Code – and I am pleased to report that we are also compliant with its provisions (see page 138). Whilst we are a UK company, our governance structure respects and helps uphold the special arrangements in place to protect the national security interests of our government customers. These arrangements are of great value to us. They are an essential part of our ability to be both a successful international company and, at the same time, a valued and trusted part of our government customers' sovereign defence and security interests.

Whilst being a British company, we operate internationally. Notably, we have a significant presence in the US, which is by far the largest defence market, and the US Department of Defense is our largest customer. We are one of the largest international defence companies – as such, we are well placed to support our national government customers in maintaining and developing the international relationships that are a vital part of global defence and security structures.

The composition of the Board mirrors the balance between national and international aspects of our governance structure. A majority of directors and the Chief Executive are UK nationals (as required by the UK's Special Share arrangements) but there is also a significant international presence on the Board. Consistent with the special arrangements in place to protect US national security, that includes the President and Chief Executive Officer of our US operation. His membership of the Board is an important part of our corporate governance arrangements and of great value to the Company and its stakeholders.

The US President and Chief Executive Officer role can only be performed by a locally based US national but, because of his position on the Board, we do look to apply UK governance requirements when structuring the remuneration package for the role. In dealing with the renewal of our Directors' remuneration policy at this year's AGM, the Remuneration Committee has considered at some length how we deal with that role in terms of reward, which is an important consideration in our being able to sustain this unique, and highly beneficial, arrangement in the long term. It has required the Committee to balance UK governance norms against the remuneration standards for a US executive role that is only comparable with the local US market. The Chair of our Remuneration Committee, Nicole Piasecki, provides more detail on this matter in her report on pages 160 to 164.

We have recently completed a review of the fees paid to the non-executive directors – the first such review in three years. It was agreed that the basic fee should be increased by 4%. In order to recognise more fully the time commitments and responsibilities involved, we also agreed an additional fee payable for membership of board committees (except the Nominations Committee). Further details of the non-executive director fee review can be found on page 176.

In recent years, there has been a good deal of emphasis on a director's duties but that has often been focused on decision-making and rather less on Board oversight of operational performance, which I believe is equally important. As a Board we exercise operational oversight at all of our regular scheduled meetings but we also require independent oversight, which is why boards have committees, and audit committees in particular. The Chair of our Audit Committee, Stephen Pearce, provides details of the Committee's activities in his report on pages 145 to 150. The Committee has also been monitoring the significant changes we expect to the audit, risk and internal control provisions in the Code and also the proposed changes to the audit market, and will ensure we are well placed to implement these when necessary.

The need for independent oversight is also a key factor in the growing trend for boards to establish Environmental, Social and Governance (ESG) committees. Our ESG Committee has been a core part of our governance structure for over a decade. During that time, we have always structured its activities and responsibilities so that they are similar to those of the Audit Committee. That link is evident in the two committees holding an annual joint meeting to bring wider oversight of the effectiveness of our risk and internal controls processes and also review the capabilities and annual work programme for our internal audit function. The level and importance of ESG reporting has grown significantly in recent years and it has been encouraging to see how the ESG Committee has been working with the Audit Committee to develop a wider understanding of risk, including climate-related risk and its reporting and assurance.

Last year, our Innovation and Technology Committee (ITC) completed its first full year of operation, it having been formed in July 2021. We wanted this committee to focus on how we innovate and develop new technology, something that is critical to our long-term success. By forming a committee of the Board we were looking to gain a more direct insight and deeper understanding of this important matter. Dr Ewan Kirk, the Chair of the ITC, has provided more detail of the committee's activities in his report on pages 157 to 159. I am pleased that the committee took the decision to hold most of its meetings at operational sites, which has allowed it to engage with employees and understand at first hand the workplace culture that is essential to the fostering of innovation. That was also true for the Board as a whole in 2022, when, freed from the restrictions of the COVID pandemic, all directors were able to visit our sites and engage directly with the workforce.

The key activity undertaken by our Nominations Committee last year was to identify my successor. In line with good governance requirement, our Senior Independent Director, Chris Grigg, chaired and led the committee throughout that process. He engaged closely with all his non-executive director colleagues in agreeing a profile for the role that incorporated, among other things, the required skills, knowledge and experience we were looking for in this appointment. The succession planning process started in good time, which allowed the Committee to undertake a comprehensive and considered search. I am pleased that we were able to conclude this matter successfully with the appointment of Cressida Hogg as a non-executive director and Chair designate.

To provide continuity of experience and knowledge on the Board following my forthcoming retirement, Chris Grigg will remain a non-executive director of the Company until no later than the end of the year.

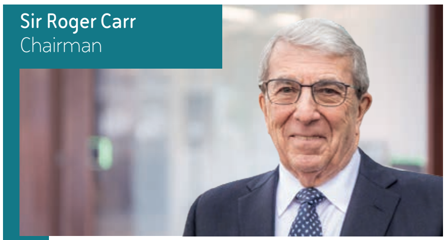
Last year, the Company continued to perform strongly. That was clear to the Board last November when it completed its annual strategy review and approved the business plan for the next five years. However, regardless of operational performance, good governance practice has to be embedded into the culture of a company and be a natural part of corporate life. By setting the right tone at the top of the company and leadership setting clear expectations on behaviours and actions, the intrinsic culture of a company helps steer the right course through good times and bad.

This is my last annual report to shareholders before I retire at this year's AGM. I am sure the Board, led by the new Chair, will remain diligent in its oversight and leadership of the Company and ensure its governance keeps pace with best practice and the expectations of our shareholders and other stakeholders.

Sir Roger Carr
Chairman

Board of directors

Sir Roger Carr
Chairman



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

Skills, competence and experience

Sir Roger was appointed Chairman in 2014, having joined the Board in 2013 as Chair Designate. He is an experienced company chairman with a wealth of knowledge gained across a number of business sectors. With over two decades of boardroom experience, Sir Roger has a deep understanding of good stewardship, corporate governance and the enablers of board effectiveness.

Sir Roger is a Senior Advisor to KKR, a non-executive director of Wella International Operations S.a.r.l. (a company majority-owned by KKR), Chairman of the English National Ballet and Vice President of the Royal Navy and Royal Marines Charity.

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

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

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

Committee membership

Chair of Nominations Committee.

Dr Charles Woodburn
Chief Executive

Appointed to the Board: 2016 **Nationality:** UK

Skills, competence and experience

Charles joined BAE Systems in May 2016 as Chief Operating Officer and became Chief Executive on 1 July 2017.

He is an experienced business leader with over 26 years' experience in the defence and aerospace, and oil and gas industries. Prior to joining the Company in 2016, he was Chief Executive Officer of Expro Group, before which he spent 15 years with Schlumberger Limited holding a number of senior management positions in Asia, Australia, Europe and the US. Charles is a trustee and Chair of the charity Movement to Work. He is a Fellow of the Royal Academy of Engineering.

Brad Greve
Group Finance Director

Appointed to the Board: 2020 **Nationality:** US

Skills, competence and experience

Brad joined BAE Systems in 2019 as Group Finance Director Designate and joined the Board on 1 April 2020.

He is a highly experienced executive with deep financial and operational management experience, gained during a 30-year career in international engineering and technology businesses. Prior to joining the Company he held a number of senior executive roles in Schlumberger, undertaking roles in Europe, Africa, South America and the US.

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

Appointed to the Board: 2020 **Nationality:** US

Skills, competence and experience

Tom was appointed to the Board on 1 April 2020, and serves as President and Chief Executive Officer of BAE Systems, Inc. Throughout his career, Tom has led complex organisations responsible for fulfilling critical and technologically challenging missions. Before becoming President and Chief Operating Officer of BAE Systems, Inc., he had a 24-year career in various senior roles within BAE Systems, Inc.

Prior to his senior leadership appointments, Tom managed various organisations and programmes for Sanders, a Lockheed Martin company, until it was acquired by BAE Systems in 2000. Earlier in his career, he held a variety of engineering and programme management positions with General Electric and TASC.

Tom is a member of the Executive committee of the Aerospace Industries Association.

Cressida Hogg CBE
Chair Designate and non-executive director

N.

Appointed to the Board: 2022 **Nationality:** UK

Skills, competence and experience

Cressida is currently Chairman of the Board of Land Securities Group PLC (Landsec), a position she has held since 2018, having served as a non-executive of the company since 2014. She will be retiring from the Landsec board on 16 May 2023.

Cressida is also a non-executive director of London Stock Exchange Group plc, where she is the Senior Independent Director and chairs its Remuneration Committee. She has previously enjoyed a long executive career, spent largely with 3i Group, during which she developed a deep understanding of large, long-term infrastructure projects and businesses, gaining international experience whilst working in various countries including the US, Canada, India, Australia and the Middle East.

Committee membership

Nominations Committee.

Nick Anderson
Non-executive director

E.I.N.

Appointed to the Board: 2020 **Nationality:** UK

Skills, competence and experience

As Group Chief Executive of a FTSE 100 industrial engineering company, Nick has a strong record of leading and growing global businesses. His knowledge and experience, particularly in leading international engineering and manufacturing operations, are a particular asset to the Board.

Since being appointed Group Chief Executive of Spirax-Sarco Engineering plc in January 2014, Nick has overseen the successful global growth of Spirax-Sarco Engineering, which serves customers in 130 countries worldwide. Prior to his roles at Spirax-Sarco Engineering, he was Vice-President of John Crane Asia Pacific and President of John Crane Latin America.

Committee membership

Environmental, Social and Governance Committee, Innovation and Technology Committee and Nominations Committee.

Crystal E Ashby
Non-executive director

E.N.

Appointed to the Board: 2021 **Nationality:** US

Skills, competence and experience

Crystal has held various senior leadership roles within the energy and healthcare sectors and has considerable expertise in government affairs, legal and regulatory matters. She is currently the Executive Vice President and Chief People Officer of the US health insurance company, Independence Health Group.

In her executive career, Crystal held various senior leadership roles during a long career with BP America Inc., culminating with her appointment as Executive Vice President of Government and Public Affairs and Strategic University Partnerships and membership of its Americas Leadership Team. She is an Independent Director on the Board of Texas Reliability Entity, Inc. and serves on the Engineering Dean's Leadership Advisory Board at the University of Michigan. She is a National Association of Corporate Directors Fellow and a member of the International Women's Forum and American Bar Association.

Committee membership

Environmental, Social and Governance Committee and Nominations Committee.

Dame Elizabeth Corley CBE
Non-executive director

A.I.N.R.

Appointed to the Board: 2016 **Nationality:** UK

Skills, competence and experience

Dame Elizabeth brings a wealth of investor, governance and boardroom experience to the Board. She is the Chair of Schroders plc and a former non-executive director of Pearson plc and Morgan Stanley Inc. She chairs the board of the Impact Investment Institute, having previously chaired the industry Taskforce on Social Impact Investing for the UK government. She served as Chief Executive Officer of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016. Prior to that, she worked for Merrill Lynch Investment Managers.

Elizabeth is active in representing the investment industry and developing standards within it. She is a member of the CFA Future of Finance Advisory Council, the AQR Institute of Asset Management at the London Business School, the Committee of 200 and the 300 Club.

Elizabeth is also an acclaimed writer, a Fellow of the Royal Society for the encouragement of Arts, Manufactures and Commerce and a trustee of the British Museum.

Committee membership

Audit Committee, Innovation and Technology Committee, Nominations Committee and Remuneration Committee.

Dr Jane Griffiths
Non-executive director

E N.

Appointed to the Board: 2020 **Nationality:** UK

Skills, competence and experience

Jane has experience in leading high technology businesses and international corporate leadership. She is Chair of Redx Pharma Plc, an AIM listed company, Chair of Theramex and a non-executive director of Johnson Matthey. In her executive career with Johnson & Johnson, she held various executive positions and led its Corporate Citizen Trust in EMEA and sponsored its Women's Leadership Initiative.

Jane previously had been Company Group Chair of Janssen EMEA, Johnson & Johnson's research-based pharmaceutical arm, where she was sponsor of Janssen's Global Pharmaceuticals Sustainability Council. She is a former Chair of the European Federation of Pharmaceutical Industries and Associations, past Chair of the PhRMA Europe Committee and former member of the Corporate Advisory Board of the UK government-backed 'Your Life' campaign, aimed at encouraging more people to study STEM subjects.

Committee membership

Chair of Environmental, Social and Governance Committee and member of Nominations Committee.

Chris Grigg CBE
Non-executive director and Senior Independent Director

A.N.R.

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

Skills, competence and experience

Chris is Chair of the UK Infrastructure Bank and Chair of Evelyn Partners. He has held a range of leadership roles including Chief Executive of Barclays Commercial Bank and, most recently, Chief Executive of The British Land Company PLC, a position he held for over 11 years. He brings extensive public company and business leadership experience to the Board.

He has more than 30 years' experience in the banking and real estate industries. Prior to joining British Land, he was Chief Executive of Barclays Commercial Bank. Before that, he was a partner at Goldman Sachs. Chris is a former member of the executive board of the European Public Real Estate Association and the board of the British Property Federation.

Committee membership

Audit Committee, Nominations Committee and Remuneration Committee.

Dr Ewan Kirk
Non-executive director

I N.

Appointed to the Board: 2021 **Nationality:** UK

Skills, competence and experience

Ewan has extensive experience in commercialising data science and quantitative analysis. He has led multiple ventures to identify, apply and leverage technology and mathematics research in both business and philanthropy.

In 2006, he founded Cantab Capital Partners, a science-driven investment management firm, which was acquired by GAM Investments in 2016 and is one of the top-performing quantitative investment companies in the UK. Prior to founding Cantab, Ewan was Partner and Head of Quantitative Strategies Group at Goldman Sachs.

He is Chair of the Isaac Newton Institute for Mathematical Sciences, Chairman of DeepTech Labs, a UK-based venture capital fund that invests in deep technology businesses, and Co-Chair of the Turner Kirk Trust. Ewan holds a PhD in General Relativity from the University of Southampton, a MASt in Mathematics from Queen's College, Cambridge, and a BSc in Natural Philosophy and Astronomy from the University of Glasgow.

Committee membership

Chair of Innovation and Technology Committee and member of Nominations Committee.

Stephen Pearce
Non-executive director

A N.

Appointed to the Board: 2019 **Nationality:** AU

Skills, competence and experience

Stephen has more than 20 years' experience as a director of public companies and over 30 years of financial and commercial experience in the mining, oil and gas, and utilities industries. He is currently Finance Director of Anglo American plc, a role he has held since April 2017, and a non-executive director of its majority-owned subsidiary, DeBeers.

He previously served as CFO and as an executive director of Fortescue Metals Group Limited from 2010 to 2016. He is a Fellow of the Institute of Chartered Accountants, a Fellow of the Governance Institute of Australia and a Member of the Australian Institute of Company Directors.

Committee membership

Chair of Audit Committee and member of Nominations Committee.

Nicole Piasecki
Non-executive director

E.I.N. **R**

Appointed to the Board: 2019 **Nationality:** US

Skills, competence and experience

Nicole has extensive experience gained from executive positions within the aerospace industry and leadership of multi-functional teams. She previously held a number of engineering, sales, marketing and business strategy roles during her 25-year career with the Boeing Company, including Vice President and General Manager of the Propulsion Systems Division and Vice President of Business Development & Strategic Integration for Boeing's commercial aircraft business, and President of Boeing Japan.

She is Executive Chairman of VEA Aviation Inc., Chair of the Board of Trustees of Seattle University and a director of Howmet Aerospace Inc. and Weyerhaeuser Company. Nicole formerly served on the Federal Aviation Authority's Management Advisory Board, the US Department of Transportation's Future of Aviation Advisory Committee and the Federal Reserve Bank of San Francisco's Seattle branch.

Committee membership

Chair of Remuneration Committee and member of Environmental, Social and Governance Committee, Innovation and Technology Committee and Nominations Committee.

Mark Sedwill
Baron Sedwill of Sherborne
GCMG, FRGS
Non-executive director

E.N.

Appointed to the Board: 2022 **Nationality:** UK

Skills, competence and experience

During a long career serving the UK government, Lord Sedwill held a wide range of national security and diplomatic roles in the UK and overseas. In his final decade in public service, he was British Ambassador and NATO Representative in Afghanistan, Foreign Office Political Director and Home Office Permanent Secretary, culminating in his appointments as National Security Adviser (2017 to 2020) and Cabinet Secretary (2018 to 2020). Earlier in his career, he held diplomatic and security posts, serving in Egypt, Syria, Jordan, Cyprus and Pakistan.

He is a senior adviser and Supervisory Board member of Rothschild & Co, and the Senior Independent Director and Senior Deputy Chair of Lloyd's of London. He is also the Chairman of the Atlantic Future Forum and a member of the UK Parliament's House of Lords. Lord Sedwill is a Fellow of the Royal Geographical Society and of the Institute of Directors. He is President of the Special Forces Club.

Committee membership

Environmental, Social and Governance Committee and Nominations Committee.

Membership and attendance

	Board meetings	Committee membership	Audit Committee	Environmental, Social and Governance Committee	Innovation and Technology Committee	Nominations Committee	Remuneration Committee
Sir Roger Carr[1]	8/8	**N**	–	–	–	5/5	–
Nick Anderson	8/8	E.I.N.	–	5/5	2/2	5/5	–
Crystal E Ashby	7/8[2]	E.N.	–	5/5	–	5/5	–
Dame Elizabeth Corley	8/8	A.I.N.R.	5/5	–	1/1[3]	5/5	7/7
Dame Carolyn Fairbairn[4]	3/3	I.N.R.	–	–	0/1[2]	1/1	3/3
Jane Griffiths	8/8	**E** N.	–	5/5	–	5/5	–
Chris Grigg	8/8	A.N.R.	4/4	3/3[5]	–	5/5	7/7
Cressida Hogg[6]	2/2	N.	–	–	–	–	–
Ewan Kirk	5/5	**I** N.	–	–	2/2	5/5	–
Stephen Pearce	8/8	**A** N.	5/5	–	–	5/5	–
Nicole Piasecki	8/8	E.I.N. **R**	–	5/5	2/2	5/5	4/4
Lord Sedwill[6]	2/2	E.N.	–	1/1	–	–	–
Ian Tyler[4]	3/3	A.N.R.	1/1	–	–	2/2	3/3
Charles Woodburn Chief Executive	7/8[7]		–	–	–	–	–
Brad Greve Group Finance Director	8/8		–	–	–	–	–
Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.	8/8		–	–	–	–	–

1. Sir Roger Carr joined the Board in October 2013 and was appointed as Chairman in February 2014.
2. Attendance impacted by personal matters.
3. Appointed to the Committee in May 2022.
4. Retired from the Board on 5 May 2022.
5. Stepped down from the Committee on 1 July 2022.
6. Appointed on 1 November 2022.
7. Could not attend due to customer meeting.

Chairman

Executive director

Non-executive director

C Committee chair
A. Audit Committee
E. Environmental, Social and Governance Committee
I. Innovation and Technology Committee
N. Nominations Committee
R. Remuneration Committee

The average length of appointment of non-executive members of the Board (as at 31 December 2022) was three years and nine months.

The average length of appointment of executive members of the Board (as at 31 December 2022) was four years.

Governance framework

This is the structure through which we manage the Group including the Board division of responsibilities.

The Board

Role of the Board

The Board is responsible for promoting the long-term sustainable success of the Company, generating value for shareholders, while having regard to its other stakeholders and the impact of its operations on the environment and the communities in which we operate. See page 34 for more information on the work of the Board.

The Board agrees the Company's purpose, values and standards of behaviour expected of all employees, satisfying itself that these and the culture of the business are aligned. The Board also sets the Group's strategy, oversees and monitors internal controls, risk management and the Company's governance framework. Our robust governance framework, the operational framework, is agreed by the Board and sets out how we do business.

Purpose

The Company's purpose (see page 1) recognises that we serve, supply and protect those who serve and protect us, and that we have important wider stakeholder responsibilities that the Board has regard to in its decision-making. The Board monitors our strategy, behaviours and culture and their alignment with our purpose.

Culture

Our culture is to be performance driven and values led. The Board is responsible for ensuring that culture is aligned with our purpose, values and strategy.

Strategy

Our strategy (see page 16) is comprised of five key long-term focus areas aligned with our vision and mission. Agreed annually by the Board, it is an important part of how it promotes the long-term sustainable success of the Company.

Board engagement with stakeholders

In considering and engaging with stakeholders, the directors act in accordance with Section 172 of the Companies Act. The work of the Board during the year is detailed in pages 34 to 37.

Board composition

The Board consists of executive and independent non-executive directors, plus a non-executive chairman who was independent in accordance with the UK Corporate Governance Code on his appointment. There is a clear division in the roles and responsibilities of the executive and non-executive directors and between the Chairman and Chief Executive which are detailed in our Board Charter (available on the Company's website).

Chairman

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

Senior Independent Director

Acts as a sounding board for the Chairman and also as an intermediary for the other directors as necessary. Annually, or on other occasions as necessary, leading the non-executive directors in appraising the Chairman's performance, and providing feedback.

Chief Executive

Responsible for the development and delivery of the strategy agreed by the Board. Developing for the Board's approval, appropriate values and standards to drive the required behaviours and by leading by personal example with regards to company culture.

Company Secretary

Ensuring that Board procedures are complied with and advising the Board on all governance matters. Also supports the Board by ensuring that it has the policies, processes, information, time and resources it needs in order to function effectively.

Principal committees

The Board has established principal committees which focus on particular areas, as set out below. The chair of each committee reports to the Board on the committee's activities after each meeting.

Executive and other committees

Operational Framework

Agreed annually by the Board, the Operational Framework is a comprehensive statement of mandated governance requirements and delegated responsibilities. The UK Corporate Governance Code's (the Code) principles are embedded within the Operational Framework, and its policies and processes underpin all the disclosures made by the Board pursuant to the Code's provisions.

Our Operational Framework provides a stable foundation from which to deliver our strategy, improve our Group performance and continue to develop our culture.

It is mandatory across all wholly-owned entities and details our organisation, governance framework, core business practices and delegated authorities.

Internal controls

Core Business Processes
This describes the reporting and reviews mandated by the Operational Framework, which provide upwards visibility of project and business performance.

Operational Assurance
A process through which line and functional leaders respectively confirm twice yearly that their businesses and functions are compliant with the Operational Framework.

Internal Audit
Assesses the effectiveness of internal controls through a programme of reviews based on a continuous assessment of business risk across the Group.

We take pride in managing our operations effectively and responsibly

Responsible Trading Principles
How we conduct business is fundamental to the success of our Company and we mandate a principles-based approach to our business activity. We do not compromise on the way we conduct business, and consistency of this approach is key in defining our reputation.

Product Safety Policy
We set out principles which describe our approach to product safety to reduce the risk of unintentional harm to people, property and the environment. They apply throughout the life of the Product and throughout the supply chain.

Workplace and Operational Environment
Our people management expectations are clearly communicated to all employees and set out within our People Policy. We have a zero tolerance policy regarding corruption and every member of our workforce is aware of their role in ensuring we maintain high standards of ethical conduct. Pages 75 to 77 provide further detail about our anti-corruption programme.

The safety and wellbeing of our employees is paramount and our high standards for Health and Safety management provide a common framework to guide our workforce and further information can be found on page 72.

We use our expertise to reduce our global environmental impacts and to develop products and services for our customers which reduce their impacts on the environment. Our climate transition strategy and impact on the environment including; greenhouse gas emissions, efficient use of resources, land use and biodiversity, and the environmental impact of the Group's supply chain is overseen by the Environmental, Social and Governance Committee.

We are committed to ensuring that IT systems and services are used in a manner which promotes effective communication and working practices within the organisation and to preventing damage to its business or reputation through misuse of those systems.

With the support of our Internal Audit team, our IT assurance and governance programme developed to support the effective management of cyber risks.

Suppliers
The Group depends upon its suppliers to provide fully compliant, cost-effective equipment, goods, services and solutions, which are an integral part of the world-class products required by our customers, and also support the effective operations of our Businesses and the Group's standards of business conduct. Our supply chain management and Supplier Principles – Guidance for Responsible Business (the Supplier Principles) are focused on high achievement of our standards. Our supplier contracts contain anti-corruption and anti-bribery provisions and stipulate the expectation to compliance, meet our standards on ethical business conduct and Supplier Principles, including safety, environment and human rights.

Product Trading Policy
Underpins all of our business activity and is applied to all Company products, trading, and throughout the product lifecycle. The Policy is used to reflect the Company's standards of integrity and help us to thoroughly evaluate the opportunities we pursue.

Risk Management Policy
We set clear requirements for the management and reporting of financial and non-financial risks in support of the delivery of our strategy. Project risks are managed through our Lifecycle Management Framework.

Core Business Processes
Our Integrated Business Plan (IBP) represents a common process with standard outputs and requirements that produces an integrated strategic and business plan for the Group and also for each of its businesses over the following five years. The IBP is reviewed each year by the Board as part of its strategy review process. Once approved, the IBP provides the basis for setting all detailed financial budgets and strategic actions across the businesses, and is subsequently used by the Board to monitor performance.

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

Lifecycle Management (LCM) Framework describes our approach to the assurance of Projects. LCM is integral to the successful execution of the Group's projects and programmes. Its application provides progressive risk-based assurance throughout the Lifecycle to aid decisions, supporting delivery of Projects to achieve customer satisfaction, schedule and financial requirements.

The purpose of the Mergers, Acquisitions and Disposals process is to provide a structured approach to managing the Acquisitions, strategic Joint Ventures and Disposals. It forms a part of our Strategy and Planning framework in order to support the delivery of the IBP.

National Security Arrangements
The Group is subject to various national security requirements which are an important part of how we operate as a defence company and meet the needs of our customers. Due to the nature of its activities, the UK government holds a Special Share in the Company, ensuring that the Company cannot be non-British controlled. We also have a Special Security Agreement with the US Department of Defense addressing national security matters relating to the ownership and control of our US defence businesses. Through the Special Security Agreement, our governance structure is augmented by the BAE Systems, Inc. board, which is populated by leading figures formerly from the US government and military and intelligence communities.

Similarly, our Australian operations are subject to an Overarching Deed with the Commonwealth of Australia which protects national security and other interests, and allows the Group to own and manage certain Australian defence-related industrial assets. These national security arrangements are an important part of our governance.

Applying the UK Corporate Governance Code Principles

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

	Principles	Reference
Section 1 – Board leadership and Company purpose		
A.	We have an effective and entrepreneurial Board that promotes the long-term sustainable success of the Company, generates value for shareholders and contributes to wider society.	Page 64 Supporting our communities Page 88 Dividends paid and capital allocation policy objectives Page 144 Annual Board evaluation
B.	The Board has established the Company's purpose, values and strategy, and satisfied itself that these and its culture are aligned. All directors are required to act with integrity, lead by example and promote the culture they wish to see for the Company.	Page 1 Our purpose Page 16 Our strategic framework Page 75 Sustainability / Our foundations / Robust ethics & governance Page 134 Governance framework Page 151 Environmental, Social and Governance Committee report
C.	Through the Company's integrated strategic planning process the Board has agreed annual and long-term strategic and financial objectives for the Company. The integrated nature of the planning process will help ensure that the necessary resources are in place to meet those objectives. The Board regularly reviews progress against the plan. The Company has a comprehensive controls structure that enables risk to be assessed and managed.	Page 18 Our business model Page 135 Governance framework – Operational Assurance Statement – Integrated Business Planning – Lifecycle Management Policy
D.	In order for the Company to meet its responsibilities to shareholders and stakeholders, the directors have established a number of means through which it is able to engage with them in order to better understand their views and expectations.	Page 32 Our stakeholders Page 34 The work of the Board Page 151 Environmental, Social and Governance Committee report
E.	The Board looks to ensure that workforce policies and practices are consistent with our values and support our long-term sustainable growth. All members of our workforce are able to raise any matters of concern through our Ethics Helpline or with a local Ethics Officer.	Page 1 Our purpose Page 16 Our strategic framework Page 60 Sustainability / Our key themes / Creating opportunity for people and communities
Section 2 – Division of responsibilities		
F.	The Chairman leads the Board and is responsible for the overall effectiveness of the Board in directing the Company. In doing so he seeks to demonstrate objective judgement and promotes a culture of openness and debate within the boardroom. The directors are provided with accurate, timely and clear information, to facilitate open and constructive board relations.	Page 134 Governance framework Page 144 Annual Board evaluation
G.	The Board comprises the Chairman, three executive directors and ten non-executive directors. There is a clear division in the roles and responsibilities of the executive and non-executive directors and between the Chairman and Chief Executive which are detailed in our Board Charter (available on the Company's website).	Page 129 Chairman's governance letter Page 134 Governance framework
H.	The non-executive directors have committed to having sufficient time to meet their responsibilities. The non-executive directors provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.	Page 134 Governance framework Page 138 Governance disclosures Page 139 Board information
I.	The Company Secretary supports the Board in ensuring the directors have the correct policies, processes, information and time in order to function effectively and efficiently.	Page 134 Governance framework Page 144 Board performance evaluation

Principles		Reference
Section 3 – Composition, succession and evaluation		
J.	The Nominations Committee undertakes a formal, rigorous and transparent approach to succession planning for Board appointments. The Board oversees the development and implementation of succession plans for directors and senior management. Appointments and succession plans are based on merit and objective criteria, whilst also promoting diversity in all forms.	Page 139 Board information Page 140 Nominations Committee report
K.	The directors look to maintain a good combination of skills, experience and knowledge on the Board and on its committees. Succession plans take into consideration the lengths of service of directors and the need to regularly refresh Board membership.	Page 129 Chairman's governance letter Page 139 Board information Page 140 Nominations Committee report
L.	The Board annual performance evaluation undertaken by the Board in 2022 considered its composition, diversity and how effectively members worked together to achieve objectives. The evaluation included an assessment of the effectiveness of individual members.	Page 140 Nominations Committee report Page 144 Annual Board evaluation
Section 4 – Audit, risk and internal control		
M.	The Board through its Audit Committee has established formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and the work they undertake assists the Board in satisfying itself as to the integrity of financial and narrative statements.	Page 145 Audit Committee report
N.	As detailed in these reports, the directors confirm they consider the 2022 Annual Report and financial statements taken as a whole to be fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.	Page 210 Directors' responsibility statement
O.	The Board has established procedures to manage risks. It also oversees the internal control frameworks and determines the nature and extent of the principal risks the Company is willing to take in order to achieve its long-term strategic objectives.	Page 118 Our risk management framework Page 119 Our principal risks Page 134 Governance framework
Section 5 – Remuneration		
P.	The policies and practices of the Remuneration Committee have been designed to support our strategy and promote the long-term sustainable success of the Company. Executive remuneration is aligned to Company purpose and values and is linked to the successful delivery of our long-term strategy.	Page 160 Remuneration Committee report Page 165 Annual remuneration report
Q.	The Remuneration Committee has a formal and transparent procedure for developing policy on executive remuneration and also for determining the remuneration of directors and senior management. Directors are not involved in determining their own remuneration outcome.	Page 160 Remuneration Committee report Page 190 Directors' remuneration policy
R.	The Remuneration Committee has the ability to exercise its discretion and independent judgement when agreeing remuneration outcomes. When exercising such discretion it will take into account Company and individual performance, and also wider circumstances.	Page 160 Remuneration Committee report

Compliance with the UK Corporate Governance Code provisions

The Company is subject to the principles and provisions of the UK Corporate Governance Code 2018 (the Code), a copy of which is available at frc.org.uk. The Company was compliant with the provisions of the Code throughout 2022, with the exception of Provision 38 concerning pension contribution rates for executive directors. Following a change to the Chief Executive's pension contribution arrangements (see below), the Company currently complies with the provisions of the Code. The following statements are made in compliance with the Code.

Executive director pension arrangements

In compliance with Provision 38 of the Code, last year the Remuneration Committee agreed that the Chief Executive's pension contribution should be reduced such that with effect from 1 December 2022 it would be set at a value equal to the weighted average contribution rate of the UK active pension scheme members (see Remuneration Committee report, page 166). That adjustment was made and consequently the Company is currently compliant with all the Code's provisions.

Risk management and internal control statement

The Board is responsible for the Group's risk management and internal control systems. It has delegated responsibility for reviewing in detail the effectiveness of these systems to the Audit Committee, which reports to the Board on its findings so that all directors can take a view on the matter.

An overview of the processes used to identify, evaluate and manage the principal risks can be found on pages 116 to 125. These processes are an integral part of our governance framework, and the Operational Framework, details of which can be found on page 135. The Operational Framework mandates the Operational Assurance Statement (OAS) process, which is owned by the Group's Internal Audit function and is one of the principal processes used by the Board in monitoring the effectiveness of control systems.

The OAS process has been designed to provide assurance with regard to compliance with the policies and processes mandated by the Operational Framework. It is a key element of the Group's governance and is formed of two parts: a self-assessment by businesses and functions of compliance with the Operational Framework; and a report showing their assessment of key risks. Twice a year, the line leaders for our business and the heads of our functions are required to critically analyse compliance relative to a scoring framework, which sets clear standards against which compliance must be assessed. Line and functional leaders are required to assure themselves of the level of compliance for a business, and submit as required supporting information and data to provide evidence of compliance.

The output from the OAS process is reviewed by (and subject to challenge from) the Internal Audit function relative to its understanding of matters within particular businesses. In addition, the OAS risk management process requires that twice-yearly the risks identified in each of the businesses are reported against a set risk framework. The output from the OAS process is provided to the Board and is reviewed in detail by the Audit and ESG committees. The report to the directors on the output from the OAS process provides granular graphical and narrative analysis of compliance against the requirements of the Operational Framework, and as such is an important part of how the Board monitors and reviews the Company's risk management and internal control systems. Further details of the Board's monitoring and review process can be found in the Audit Committee report on page 145.

The risk management and internal control systems detailed in the Operational Framework were in place throughout the year and the Board, having reviewed their effectiveness, believes they accord with the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

Viability statement and going concern

As required by the provisions of the Code, the Board has undertaken an assessment of the future prospects of the Group, taking into account the Group's current position and principal risks. This assessment considered both the Group's long-term prospects and also its ability to continue in operation and meet its liabilities as they fall due over its five-year business planning period. This can be found on page 126 of the Strategic report.

Directors

In compliance with the Code, all directors are subject to annual re-election by shareholders. The Board considers all of the non-executive directors (except the Chairman) named on pages 131 to 133 of this report to be independent for the purposes of the Code. The Chairman was also independent on appointment.

Prior to making Board appointments, the Board considers other demands on an individual's time to ensure that, following appointment, directors have sufficient time to meet their Board responsibilities.

Non-executive directors are required to seek prior approval before taking on additional external appointments. The Board also considers whether there are any matters that could have a bearing on a non-executive director's independence pursuant to Provision 10 of the Code. The following disclosure is made on these matters:

Dame Elizabeth Corley

Dame Elizabeth Corley, a non-executive director, was appointed a non-executive director and Chair designate of Schroders plc on 1 September 2021. Schroders are a shareholder in the Company, holding approximately 0.4% of the total share voting rights as at the date of this report. Consequently, an assessment was undertaken prior to her appointment to assess whether this relationship could have a bearing on her independence for the purpose of Provision 10 of the Code. It was agreed that the number of shares held by Schroders was not sufficiently material to have a bearing on her independence. The Company was also made aware of steps that have been taken by Schroders to avoid a conflict of interest with regard to any shares it may hold in BAE Systems plc.

Chris Grigg

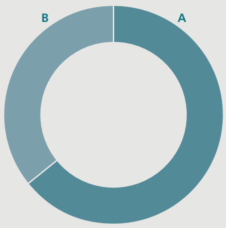
Chris Grigg was appointed a non-executive director of the Company in July 2013 and his service on the Board therefore exceeded nine years during 2022. In accordance with Provision 10 of the Code, the Board believes his independence has not been impaired because of his having served for a relatively short period in excess of nine years.

As Senior Independent Director, he led the Nominations Committee last year in the search activity that resulted in Cressida Hogg's appointment to the Board as a non-executive director and Chair designate. It has been agreed that Mr Grigg will remain a non-executive director of the Company until no later than the end of 2023. With an experienced Chairman retiring at the Company's AGM in May, this short extension to his terms of office will help preserve the level of knowledge and experience on the Board and help support a successful transition in the leadership of the Board. During the second half of the year, the Board will appoint a new Senior Independent Director to succeed Mr Grigg in that role.

Board and Executive Committee diversity information

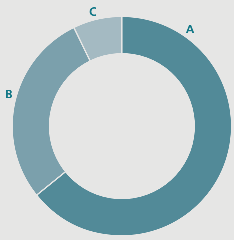
Board information

Gender



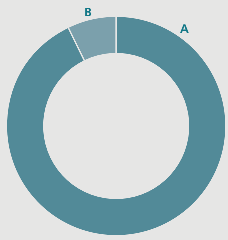
A	Male	9
B	Female	5

Nationality



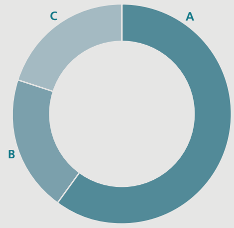
A	UK	9
B	US	4
C	Australia	1

Ethnicity



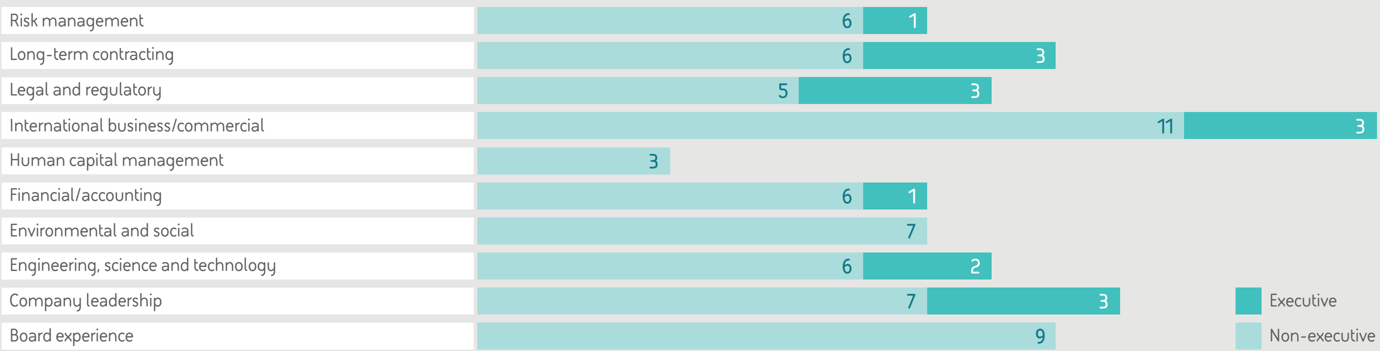
A	White	13
B	Black	1

Tenure
(independent non-executive directors)



A	Up to three years	6
B	Over three and up to six years	2
C	Over six years	2

Skills and experience



Board and Executive Committee diversity

In accordance with Listing Rule 9.8.6(9) of the FCA's Listing Rules, these tables set out details of the diversity of the individuals on the Board and Executive Committee at 31 December 2022.

There are 14 Executive Committee members (including the Chief Executive, President and Chief Executive Officer of BAE Systems, Inc. and the Group Finance Director, who are also executive directors) and 14 directors of the Board. The Company Secretary is included in the calculation of executive management.

The data was obtained on a voluntary self-reported basis. Participants were invited to complete a survey through a secure electronic portal, wherein they were asked to confirm their sex and gender identity, and ethnic background. The descriptive categories of sex, gender and ethnic background set out in the survey, were taken verbatim from Listing Rule 9.8.6(9), and therefore correspond precisely with the tables.

Sex and gender identity

	Number of Board members	Percentage of the Board	Number of senior positions on the Board (CEO, CFO, SID and Chair)	Number in executive management	Percentage of executive management
Men	9	64%	4	11	73%
Women	5	36%	–	4	27%
Other categories	–	–	–	–	–
Not specified/ prefer not to say	–	–	–	–	–

Ethnic background

	Number of Board members	Percentage of the Board	Number of senior positions on the Board (CEO, CFO, SID and Chair)	Number in executive management	Percentage of executive management
White British or other White (including minority-white groups)	13	93%	4	14	93%
Mixed/Multiple Ethnic groups	–	–	–	1	7%
Asian/Asian British	–	–	–	–	–
Black/African/ Caribbean/Black British	1	7%	–	–	–
Other ethnic group, including Arab	–	–	–	–	–

In respect of the 2022 financial year, the Board has met the diversity targets in Listing Rule 9.8.6(9) and its Board Diversity and Inclusion Policy in relation to ethnicity. However, the targets in relation to gender diversity have not been met. The Board recognises the work it must undertake to meet those targets. From the Company's AGM in May this year, we anticipate the only target it will not have met will be with regard to Board membership gender diversity. Following the AGM, it is anticipated that women will comprise 38.4% of Board membership, slightly short of the 40% target. There have been no changes in the composition of the Board or Executive Committee in the intervening period between the year end and the signing of this Annual Report.

Nominations Committee report

Sir Roger Carr
Chair

Members:

Nick Anderson
Crystal E Ashby
Dame Elizabeth Corley
Jane Griffiths
Chris Grigg
Cressida Hogg
Ewan Kirk
Stephen Pearce
Nicole Piasecki
Lord Sedwill

Dear Shareholders

At the start of 2022, the Nominations Committee had three key objectives for the year, which were:

- continue to drive the executive succession planning process to ensure that we have visibility of those high potential executives that will be available, in due course, to succeed the three executive directors currently on the Board;
- complete the search for a suitable candidate to succeed me as Chair of the Company when I retire in May this year; and
- identify candidates to succeed the non-executive directors that were approaching the end of their final terms of office.

When dealing with all of the above, the Committee was clear that it would continue to be guided by its policy on diversity and inclusion. We see diversity as a key attribute to Board effectiveness and therefore we aim to maintain a diverse membership, including, among other attributes, an appropriate balance of nationalities, gender, ethnicity, skills, knowledge, experience, cognitive and personal strengths. At the beginning of a selection process for Board appointments, the Committee considers the blend of skills and experience required to maintain an effective Board. Further information on the skills and experience of the Board can be found on page 139.

I will deal with each of our objectives below but first, by way of context, I will provide details of the national security considerations that inevitably have a bearing on much that the Committee does in managing Board succession.

National security

Government national security requirements are an essential part of being a defence company. They shape our governance and are an important factor in the Committee's deliberation on Board appointments.

For our largest government customers, the Company is an important part of their defence industrial base, providing sovereign defence capability that is a key element of their national security. Consequently, there are certain specific nationality requirements with which we must comply.

Even when there are no specific job-related nationality requirements, we have to consider carefully whether a role could be discharged effectively given the general application of national security restrictions in our businesses.

The UK government holds a Special Share in the Company specifically to ensure that it remains UK controlled. In addition to restricting the percentage of shares that may be held by a non-UK shareholder, the Special Share requires that the Chief Executive must be a UK national (and also places certain restrictions on the nationality of the Chair) and that a majority of all directors must be UK nationals. Operational roles such as those running our UK businesses are effectively restricted, in most part, to individuals with higher-level UK security clearances. Whereas, we are less restricted with Group functional positions, e.g. Finance, HR, Corporate Communications, etc.

With regard to our US business, the regulatory requirements governing its ownership and the level of individual national security clearances required to discharge the role mean that the President and Chief Executive Officer of our principal US operating company, BAE Systems, Inc., has to be a US citizen. That is also the case for members of the senior executive team in the US.

Executive succession

The decisions made by the Committee on executive director appointments in recent years have been a critical enabler for the strong performance that the executive team, headed by Charles Woodburn, has helped to deliver. Managing future leadership succession has remained a high priority for the Board and the Committee – I am aware from my frequent engagement with our largest shareholders that they too recognise the importance of this.

An Enterprise Talent Review, undertaken by the Board in September last year, helped inform the work the Committee undertook subsequently in reviewing detailed succession plans for the most senior executive roles. That review was facilitated by a data-driven analysis of succession plans for the 14 senior executives (three being executive directors) that currently comprise the membership of the Executive Committee. The plans cover individuals judged to have the potential to be appointed to one of the EC roles at future dates but may be up to two jobs away from being ready for that at present. A total of 66 individuals were identified in the 2022 plans, a slight increase from the previous year. As you would expect, the plans are dynamic and individuals may be added, moved within the plan or removed. Senior executives are required to engage actively in developing and retaining these highly talented individuals, and do so in line with our diversity, equity and inclusion goals.

In summary, the key points from our Enterprise Talent Review were:

Strengths

- Executive Committee gender balance increased to 29% (from 8% in 2021).
- The emerging talent pipeline almost doubled from 19 individuals to 37.
- 28% of the successor pipeline executives have less than five years' service – evidencing improved awareness of high-potential individuals and agility in career development management.

Challenges

- Growing the pool of female talent in mid-level management grades.
- Retention of key individuals identified in succession plans.
- Increasing the number of executives voluntarily providing us with information on their ethnicity.

As part of the Enterprise Talent Review, we were pleased to see progress being made in increasing the level of gender diversity within our executive populations. In the executive succession pipeline leading to the Executive Committee and the Board, we have seen a higher level of gender diversity (38%) compared with that of our senior executive population (24.3%). In terms of data analysis, ethnicity reporting remains a challenge and we require more employees to inform us of their ethnicity, on a self-identified basis, to complement the range of activities underway to realise our diversity, equity and inclusion objectives.

During 2022, the Committee undertook a detailed review of executive succession plans, focused on the three current Board-level roles: Chief Executive, Group Finance Director and the President and Chief Executive Officer of BAE Systems, Inc.

The Committee welcomed the fact that the succession plans for these roles have continued to mature. In particular, we saw good evidence of how we are managing the careers of key individuals to ensure that they have focused development plans, and that their current roles provide ample scope for them to grow as leaders and further demonstrate the potential to take on Board-level positions.

Chair succession

When I retire at this year's AGM, I will have served as Chairman for just over nine years, the maximum term permitted in accordance with the UK Corporate Governance Code. The search for my successor began in 2021 and was undertaken in strict compliance with Code requirements and governance best practice. Therefore, I did not participate in the Committee's meetings when it was dealing with the matter. The search activity was undertaken by the Committee, led by our Senior Independent Director, Chris Grigg.

The Committee appointed the search consultants Spencer Stuart (who provide other recruitment and executive succession planning services to the Company) to identify suitable candidates for the Chair role. Spencer Stuart undertook a series of interviews with the members of the Committee to develop and agree a profile for the search, including the skills, experience and knowledge required by candidates. As part of the search the Committee also considered diversity (see Board Diversity & Inclusion Policy on page 142) and nationality requirements concerning the composition of the Board (see above).

I am delighted that, at the end of July last year, the Board formally approved the Committee's clear and unanimous nomination of Cressida Hogg, and appointed her a non-executive director and Chair designate with effect from November 2022. She will succeed me with effect from the close of our AGM in May.

Cressida brings a strong combination of business and boardroom experience to our Board. She currently chairs the board of Land Securities Group PLC and is the Senior Non-executive Director of London Stock Exchange Group plc. Previously, she had a long executive career, largely with 3i Group, during which she developed a deep understanding of large, long-term infrastructure projects and businesses, whilst working in various parts of the world, including the US, Canada, India, Australia and the Middle East.

Chair appointment process

Scope

Considered the key skills, attributes and experience required for the Chair role, particularly in reference to boardroom dynamics, the Committee's Board Diversity & Inclusion policy (see page 142) and nationality requirements concerning the composition of the Board.

Engage

Engaged the services of Spencer Stuart, independent search consultants (who have previously provided other recruitment and executive succession planning services to the Company) to identify suitable candidates for the Chair role. Spencer Stuart undertook a series of interviews with the members of the Committee to develop and agree a profile for the search, including the skills, experience and knowledge required by candidates.

Interview

Reviewed candidate profiles against the pre-determined criteria, and invited a shortlist of prospective candidates to interview. All Board members had the opportunity to meet with shortlisted prospective candidates.

Nomination

A unanimous nomination was received.

Board Diversity & Inclusion Policy

This policy sets out the approach to diversity and inclusion in respect of the Board of directors of BAE Systems plc.

Diversity and Inclusion

We are committed to maintaining a diverse and inclusive Board. As a company, we value diversity and are committed to creating a diverse and inclusive working environment for our employees, in which colleagues from any background can fulfil their potential. This is reflected in our clear purpose, values and the behaviours that guide our culture.

The Board understands that diversity is a key attribute to its effectiveness. We aim to maintain a diverse Board, including an appropriate balance of nationalities, gender, ethnicity, skills, knowledge, experience and personal strengths.

Board Composition

The Nominations Committee (the Committee), on behalf of the Board, undertakes a formal, rigorous and transparent approach to succession planning for director appointments. The Committee oversees the development and implementation of succession plans for directors and senior managers.

Appointments and succession plans are based on merit and objective criteria, reflecting the skills, knowledge and experience needed to ensure we have a well-rounded, diverse and effective Board. In the case of non-executive directors, other relevant matters are also taken into account, such as independence and the ability to fulfil time commitments.

Due to the nature of its activities, the UK government holds a Special Share in the Company, ensuring that the Company cannot be non-British controlled. The Special Share also includes provisions requiring that a majority of the directors on the Board are British nationals and the roles of Chairman and Chief Executive are also subject to UK nationality restrictions.

The Committee shall aim to comply with the following targets in respect of Board membership:

- At least 40% of Board members shall be women (including those identifying as women).
- At least one of the four senior Board positions (Chair, Chief Executive Officer, Senior Independent Director, Chief Financial Officer) shall be a woman (or identifying as a woman).
- At least one member of the Board shall be from an ethnic minority background (as referenced in categories recommended by the UK's Office for National Statistics).

In line with UK regulatory requirements, the Committee shall report in the Company's annual report on compliance with the above targets.

The Board and Committee will maintain oversight of the range of activities the Company is pursuing aimed at increasing the diversity of our workforce – including the executive pipeline that is essential for executive directors' succession planning. In addition, when the Committee engages search consultants we will use their services to help identify a diverse range of potential non-executive director candidates and, where necessary, to help with executive directors' succession requirements.

Reporting

The Committee will ensure that there is continued appropriate and meaningful disclosure in the Company's annual report against the matters set out in this policy.

Non-executive directors

At the beginning of last year, Ian Tyler retired having served on the Board as a non-executive director for nine years. He made an excellent contribution to the Board, chairing both the Corporate Responsibility and Remuneration committees.

During the year, Dame Carolyn Fairbairn also stood down as a non-executive director. Her decision to stand down after a relatively short period on the Board was taken following her acceptance of a new role as Chair of Mencap, an appointment that was of particular personal importance to her.

I am pleased that, as part of the non-executive succession planning objectives set by the Committee at the beginning of the year, we were able to appoint Lord Sedwill to the Board at the beginning of November. He enjoyed an outstanding career working for the UK government at the most senior levels, before retiring from public service in September 2020. His career covered a wide range of national security and diplomatic roles in the UK and overseas. With his depth of knowledge and experience, Mark brings a well-informed geopolitical and economic perspective to the Board as well as experience in leading large and complex organisations.

Lord Sedwill's appointment to the Board was made over two years after he had retired from public service in September 2020. As such, he joined after the post-employment period covered by the UK Government's Business Appointment Rules for Civil Servants. Notwithstanding that, he received written confirmation that the UK government did not have any concerns regarding his appointment.

Generally, the Committee appoints search consultants to assist in identifying candidates for appointment to the Board. However, given the roles he held during his long government career, Lord Sedwill is a well-known public figure. Consequently, the Committee did not employ search consultants or use advertising to assist in identifying him as an individual with the necessary experience, skills and knowledge for appointment to the Board.

Non-executive director induction

As part of the induction programme, Cressida Hogg and Lord Sedwill met with senior executives to better understand the operating context of the business. The below provides an overview of the conversations and the persons who they met with.

Topic	Met with
Purpose, strategy, competitive landscape, customer and broader stakeholder context	Chief Executive, President and Chief Executive Officer of BAE Systems, Inc.
Financial performance, investor insights	Group Finance Director, Group Financial Controller, Group Tax Director, Group Investor Relations Director
Sectoral overviews	Managing Director of each Business
Legal and regulatory environment, Special Security Agreement	Group General Counsel
Risk and Assurance	Internal Audit Director, Group Financial Controller
Employees, Safety, Health and Environment	Group HR Director, Group ESG, Culture & Business Transformation Director

Board diversity

At the end of last year, I reported that we had met the targets set by the Hampton-Alexander and Parker reviews concerning gender and ethnic diversity respectively. The successor to that review, the FTSE Women Leaders Review, has now adopted new voluntary minimum targets of increasing the level of women on boards and leadership teams to 40%, and also for one of the chair, senior independent director, chief executive or finance director roles to be held by a woman by the end of 2025. These new gender-based targets and the board ethnicity target, set previously by the Parker Review, are consistent with the targets adopted by the Financial Conduct Authority (FCA) in its new regulations on gender and ethnicity reporting.

During the year, the Committee reviewed and updated its policy on Board diversity and inclusion to reflect the progress made over the last few years, and also evolving stakeholder expectation as evidenced by the FTSE Women Leaders Review and the FCA's regulations. Our revised policy is shown opposite. You can see that we have adopted a gender target of 40% and a goal of at least one of the four key board positions being held by a woman.

Whilst we are not required to report against the new FCA regulations until next year, the Board has decided to do so on a voluntary basis, using 31 December 2022 as the reference date for this reporting (see page 139 for our disclosures using the standardised numerical table on diversity).

At present, women comprise 36% of the Board's membership; when I retire in May that will increase to 38%. With the appointment of Cressida Hogg as my successor, a woman will occupy one of the principal Board positions. We also continue to meet our objectives on ethnic diversity.

With regard to diversity, equity and inclusion in our senior leadership population, we have seen the number of women on the Executive Committee increasing to 4, 29% of the membership. Gender diversity is greater in the wider group formed of those executives reporting directly to an Executive Committee member, standing currently at 38%. For the combined Executive Committee, Company Secretary and their direct reports the level of gender diversity is 37%.

As a Company, we have set an ambition to be recognised as the leading employer in defence and security for valuing diversity, equity and inclusion, and to be representative of the localities in which we operate in terms of gender and ethnicity. This ambition and the range of actions being taken to achieve it (see page 73) is shaping the leadership pipeline that ultimately leads to the Board. It is work in progress but the Board is encouraged by the progress to date in increasing the level of gender diversity in our executive succession plans.

We recognise that further work is required in terms of ethnic diversity and the Company continues to evolve its inclusive practices in order to attract and retain diverse talent. To be in a position to report authoritatively on progress in increasing ethnic diversity across the countries we operate, we require voluntary self-identification disclosures from employees. Data privacy regulations differ across the territories in which we operate and, in certain countries, we are limited or unable to solicit, hold or use data regarding protected and personal characteristics. Whilst we continue to work towards creating an inclusive organisation, collecting diversity data and therefore monitoring and reporting on the improvements in ethnic diversity below the level of the Executive Committee is challenging.

Board evaluation

The performance of the Board, its committees and individual directors was undertaken by an external facilitator, Independent Board Evaluation, at the beginning of last year. A number of actions were identified in the evaluation, and I can report the following in respect of the work we have undertaken this year to address these:

- **Succession planning** – as reported above, we have focused on executive succession planning and continue to make progress on this matter.
- **Culture** – the Board specifically considered culture during the year, including feedback received from employees on a range of matters. This is reported more fully on page 35.
- **Strategy** – the formation of the Innovation and Technology Committee (see page 157) has helped the Board develop its understanding of the key attributes and technologies required for our long-term success. Its approach has been to meet at our sites and engage with employees on how we organised to identify and develop technology in support of our strategic objectives. We are pleased with the contribution that this new committee has made, and after this positive start we look forward to it developing its activities further in future years.
- **Employee engagement** – the Board and ESG Committee were successful in increasing the level of employee engagement they were able to undertake during 2022. Further details of this can be found on pages 151 to 153.
- **Induction** – two new non-executive directors joined at the end of the year and their induction programmes are underway. With travel no longer restricted by COVID-19 regulations, these programmes include visits to the Company's principal sites in the UK and US. In addition, Board members visited a number of sites in 2022, which provided an opportunity for the directors that had joined in the previous two years to meet employees and learn more about the Company.

Concluding comments

As I shall be retiring from the Board at this year's AGM, this is my last report to shareholders on the activities of the Nominations Committee. When I took on the role of Chairman back in 2014, I expanded the membership of the Nominations Committee to comprise all of the non-executive directors, as I believe that the group of directors charged with managing succession to a board needs to be as wide as possible. Therefore, a large part of the Board's membership has been engaged in identifying and meeting potential candidates for appointment.

I would like to thank members of the Committee, past and present, for the manner in which they engaged in the nomination process – all recognising how critical that is to any successful board and the overall success of the Company. Decisions on the executive leadership are particularly challenging. They require the non-executives on the Committee to exercise critical judgement and be bold in appointing candidates that can lead and take the Company forward. The success of the Company in recent years is, in part, due to the Committee showing those qualities.

Succession planning is an ongoing process. Those that have the good fortune to serve on boards recognise that they have their entrances – and ultimately their exits. I wish the Committee well in its future deliberations.

Sir Roger Carr
Chair of the Nominations Committee

The Nominations Committee's year

March — Committee; May — Committee; June — Committee; July — Committee; September — Committee

March

Committee (Farnborough, UK)

- Reviewed Board composition and the membership of its Committees.
- Discussed the ongoing Chair search and reviewed a shortlist of candidates.

May

Committee (Videoconference)

- Discussed the ongoing Chair search.
- Discussed the ongoing search for a non-executive director.

June

Committee (Virginia, US)

- Discussed the ongoing Chair search.

July

Committee (Videoconference)

- Discussed the outcome of the Chair search and made a nomination to the Board.

September

Committee (Boston, US)

- Reviewed succession plans for executive directors and members of the Executive Committee.
- Reviewed the Board Diversity and Inclusion Policy, in light of the FCA's Policy Statement (PS22/3).

Board evaluation 2022/23

Period of evaluation

The evaluation was conducted at the end of 2022, with feedback and review taking place at a Board meeting held on 22 February 2023.

Evaluation process

The process was internally evaluated using a questionnaire developed by the Company using best practice guidance, including the Financial Reporting Council's Guidance on Board effectiveness.

Questions covered the performance of the Board, its committees and individual directors.

The evaluation covered a range of matters, including the following:

Board

- Strategy oversight and implementation
- Market and technology awareness and understanding
- Risk management
- Composition of the Board – skills, diversity, experience and knowledge
- Engagement with shareholders and other stakeholders
- Board focus and priorities, use of time
- Quality of papers and presentations
- Access to management
- Succession planning, for Board membership and senior management

Board Committees

- Information and resources available to members
- Support and engagement with executive management
- Quality and extent of matters covered by committees
- Quality of papers and presentations

Feedback

A report on the survey, as it applied to the Board, was provided to directors ahead of the Board meeting held on 22 February 2023. The principal findings and recommendations for the evaluation were discussed at the meeting and a number of resulting actions agreed (see below). Reports were also provided to each of the Committees on the finding of the evaluation as it applied to them. The Chairman will provide feedback from the evaluation to individual directors.

Key Resulting Actions

Succession planning – we will continue to focus on executive succession and development activity to ensure the Company has a strong and diverse pipeline of candidates for all senior executive roles, and those at Board level in particular.

Skills and training – the Board will set aside time to update directors on key ESG-related matters, including training on climate change.

Stakeholder engagement – further opportunities will be arranged for directors to engage directly with stakeholders, including customers and employees.

2022 Board evaluation, overview of self-assessment areas of focus:

- Strategic oversight
- Board composition and dynamics
- Board meetings and materials
- Risk management oversight
- Executive support and engagement
- Committees
- Chair and individual directors

Audit Committee report

Stephen Pearce
Chair

Members:
Dame Elizabeth Corley
Chris Grigg

Dear Shareholders

I am pleased to present the Audit Committee report for the year ended 31 December 2022. This report is intended to provide you with an insight into key areas we considered, together with how the Committee has assisted the Board in fulfilling its responsibilities. The Committee monitors the Group's internal control environment and the integrity of financial reporting. Additionally, we challenge the management teams and the external auditor on a number of areas, including key accounting judgements and control matters. The Committee's Terms of Reference are available on the Company's website.

Overview and Committee composition

Our biographies and Board information on pages 132 to 133 provide a summary of our skills and our experience, which highlights that all Committee members have the necessary skills, and financial literacy, to effectively discharge our duties as a Committee.

After each Committee meeting, I report to the Board on the Committee's activities, the key matters discussed and present any recommendations to the Board. The Committee met six times during the year and had five formal meetings. After four of the formal meetings, we met privately with the External Auditor and the Internal Audit Director.

During the year, the membership of the Committee changed. We welcomed Chris Grigg to the Committee and said goodbye to Ian Tyler, who stepped down from the Board at the conclusion of the 2022 AGM. I would like to thank Ian for his valued contribution over many years.

In addition to members of the Audit Committee, our meetings are routinely attended by the Chairman of the Board, the Chief Executive, the Group Finance Director, the Group General Counsel, the Internal Audit Director, the Group Financial Controller, the Senior Audit Partner and other senior members of the External Audit team from our auditors, Deloitte LLP. In addition, other senior executives are invited to attend meetings, as required to provide the Committee with a deeper level of insight on relevant matters.

An outline of the work that we have undertaken in the last 12 months can be found on page 150 and, during this report, I will give an overview of some of our discussions.

Audit, corporate reporting and corporate governance reform

We discussed the key themes from the government's response to the BEIS white paper on 'Restoring Trust in Audit and Corporate Governance', with the management team to understand the preparation the Group was undertaking in order to be ready for the implementation of the reforms.

During the year, we heard from the Group Finance Director on the progress of a programme designed to enhance the effectiveness of the Group's Finance function. The first phase, introducing a revised functional design, has been implemented to enhance the capability of the function, and create more efficient infrastructure and processes. Certain of these changes have been made to ensure we are well placed to deal with the BEIS requirements. We noted, in particular, the evolution to a three lines of defence model for financial assurance, which would broaden the coverage and depth of the review of financial risks.

We will continue to monitor the preparatory activities during 2023, and next year we will provide further detail as to the scope and impact of these reforms on the Group, its assurance processes and financial reporting.

External audit

Following a tender process Deloitte LLP was appointed as the Company's external auditor at the 2018 Annual General Meeting and has just completed the fifth year of its first five-year cycle. John Adam, the audit partner responsible for the Group's audit since 2018, will rotate off the audit following the completion of the 2022 audit. The Committee has agreed with Deloitte that Claire Faulkner, a suitably experienced audit partner, will succeed him.

During the year, we approved the external audit plan as proposed by Deloitte. As part of the plan, we agreed the scope and level of materiality and discussed with Deloitte the areas that it had identified as key risks and other particular areas of focus.

The scope of work agreed was largely consistent with the prior year, and included consideration of the impact of climate change throughout the financial statements and the enhancement of disclosures for TCFD reporting. The Maritime Services, Ship Repair and Holston and Radford US businesses were added to the audit scope, and the Hägglunds and Weapons

UK Competition and Markets Authority Audit Order

The Company has complied with the Statutory Audit Services Order issued by the UK Competition and Markets Authority for the financial year ended 31 December 2022.

UK businesses were removed. This periodic rotation of certain businesses, in and out of scope, ensures sufficient coverage across the Group.

Auditor independence

The Committee oversees the relationship with the external auditor and is responsible for assessing its effectiveness. It also approves its terms of engagement, fees and monitors the auditor's independence and objectivity.

We review the relationship with the external auditors on a regular basis, including consideration as to when it would be appropriate to complete a competitive tender process for the role, in line with the Competition and Markets Authority order concerning the frequency and governance of tenders for the appointment of the external auditor. The Committee considers that Deloitte is effective in its role as auditor. The scope and output of our annual review of the external auditor's independence and effectiveness is discussed below.

In view of this, and having considered the continued objectivity, independence and effectiveness of the auditors, the Committee considers it to be in the best interests of the Company's shareholders for Deloitte LLP to remain as external auditors for the upcoming financial year. We will continue to monitor this position, taking into account the effectiveness and independence of the auditors and the best interests of shareholders, and will ensure that an audit tender is conducted no later than the 2028 financial year.

Non-audit services policy

The Committee has a formal policy on non-audit services. This was reviewed during the year, to ensure that it remains fit for purpose and aligned to the FRC's 2019 Revised Ethical Standard of Permitted Audit-Related and Non-Audit Services. The policy governs the engagement of the auditor to provide non-audit services. It also prohibits certain activities from being undertaken by the auditor and places restrictions on the employment of former employees of the auditor.

The policy permits the provision of Audit-Related Services and Permitted Non-Audit Services up to limits that are pre-approved by the Committee, with specific Committee approval required beyond such limits. Such approvals are kept to a minimum and relate to work which, by its nature, is most appropriately carried out by the auditor.

A copy of the policy is available on the Company's website. Details of fees payable to the auditor are set out on page 236. The 2022 non-audit fees for Deloitte represented 5% of the audit fee. The principal non-audit services provided by Deloitte during the year relate to the half-year review and ESG assurance work, which has been undertaken by Deloitte for the first time this year.

Internal control and risk

The Group's Risk Management and Internal Control Framework are designed to manage rather than eliminate the risk of failure to achieve its strategic objectives. It can only therefore provide reasonable and not absolute assurance against material misstatement or loss. Detailed information in respect of the Group's internal controls and risk management systems is provided on pages 116 to 125.

The Committee monitors the Group's risk management and internal control systems, including their effectiveness, on behalf of the Board and provides feedback to the Board on these matters. In considering the effectiveness of internal controls, the Committee received and discussed reports from the Group Financial Controller, Internal Audit Director and the External Auditor.

With the easing of COVID-19 restrictions, external assurance providers, the Group's own assurance teams and Internal Audit teams were able to work on site when undertaking assurance activities during the year. Areas of assurance focus included: financial controls; IT and cyber security; Joint Venture management; export control; supply chain resilience; safety; and environmental targets.

Assessing the effectiveness of External Audit

Who we surveyed to inform our assessment on the effectiveness of the Group's External Auditor

Senior Finance Executives

Internal Audit Director

What we surveyed

Partners & Audit Teams

Planning Scope & Execution

Communication & Reporting

Challenge & Insight

Outcome

The Committee noted that the output of the review was broadly positive and consistent with prior years. Participants felt that the external auditor provided robust and constructive challenge and overall delivered an effective audit. A key area of focus in 2023 would be the continuity of audit teams as a result of partner rotation, and changes to audit personnel. Effective handovers were key in ensuring that audit quality and the knowledge of the Group's business and risks were maintained.

On the basis of the review following the 2022 year-end audit, the Committee has proposed to the Board that it recommends that shareholders support the re-appointment of Deloitte LLP at the 2023 AGM.

The six-monthly Operational Assurance Statement (OAS) provides the basis for our review of the effectiveness of internal controls and risk management. The OAS returns, comprised of submissions by each business or function, are amalgamated to create the foundation for the assessment of financial and non-financial risks. These risks are reviewed by the Executive Committee and the Group Audit Review Board, following which, an assessment is made on the probability of the risks arising and potential impact to the Group's five-year Integrated Business Plan (IBP). Specific responsibility for managing each identified risk is allocated to a member of the Executive Committee.

We also received reports from the internal and external auditors on control areas. During the year, we discussed the process, outputs and improvement actions relating to cyber and IT, financial, programme management and project accounting controls testing. Areas of specific focus have included the following:

- **General financial controls** – the continuing importance of a robust finance control environment, particularly in the light of the Audit and Corporate Governance Reform changes, is recognised with benchmarking of assurance practices underway.
- **Lifecycle Management (LCM)** – the bedrock of our programme execution and management, LCM is integral to the successful execution of the Group's projects and programmes, and of particular importance in the early identification of programme risk and the determination of profit recognition or provisioning which tend to be areas where judgement is required to be exercised. At the current time, when the Group has several large programmes in relatively early stages, adherence to LCM methodology is vital to ensure timely delivery and margins at target or better.
- **General IT controls** – the importance of a strong IT control environment is acknowledged and remediation is a key focus where testing has identified that improvement is required.
- **Cyber risk** – we continue to monitor the developments in IT and cyber security and associated regulatory and legislative compliance. The Chief Information Security Officer attended a Committee meeting to give an assessment on the Group's cyber security standards, and provide an update on the work underway to evolve cyber security processes, and the associated assurance processes to monitor this evolution.
- **Export control compliance** – throughout the year, the Group General Counsel updated the Committee on developments in export licensing and export control compliance matters and enhancements to existing procedures. Additionally, the Chief Counsel Compliance and Regulation provided a thorough overview of the Company's compliance with the various export control regimes in the territories in which it operates.

These reports together allowed the Committee to monitor, review and assess the effectiveness of the Group's risk management and internal control systems in context of the total landscape of risks and the Group's strategy. The Board and the Committee have determined that the most significant risks, as measured through potential impact and probability, are those shown as the Company's Principal Risks that can be found on pages 119 to 125. In relation to the risk horizon, the Group Finance Director provided an overview of potential and emerging risks which are monitored through the Group's risk radar. These processes are a key component of the Group's governance framework (page 134) and provided key context for the Committee's consideration of the directors' Viability statement.

Internal Audit

Internal Audit plays an important role in the Group's governance framework through its objective and independent review of the effectiveness and efficiency of internal control systems. The scope and authority of the Internal Audit function is defined within its charter which is approved annually by the Committee.

Committee meetings are attended by the Internal Audit Director and the VP Internal Audit, Inc. During the year under review, in addition to the private meetings we hold with the Internal Audit Director without management present, the Committee held a separate session with the Internal Audit Director and the external auditor.

Assessing the effectiveness of Internal Audit

Who we surveyed to inform our assessment on the effectiveness of the Internal Audit function

Executive Team | Sector Leadership | Audit Review Board Chairs | Audit Committee members

What we surveyed

Role of Internal Audit | People & Processes | Executive & Reporting | Value-add

Outcome

The Committee reviewed all the feedback provided by survey participants and was pleased with the positive nature of the comments, wherein participants noted the integral role and value-adding services of the Internal Audit function. The responses highlighted the following areas of development which we will review during next year's survey: bolstering the Internal Audit function ESG assurance expertise; exploring opportunities to refine and evolve the focus of Audit Review Boards; continuing to build relationships with subject matter experts to provide fuller context to audit recommendations.

During this session, we discussed:

- the demarcation of roles and responsibilities of the Audit and ESG committees in respect of ESG assurance and data;
- the importance of accurate and clear ESG reporting and the requisite processes for ESG horizon scanning;
- the evolving threat to cyber systems and associated regulatory expectations; and
- the government's response to the BEIS white paper on 'Restoring Trust in Audit and Corporate Governance'.

The Internal Audit Director provides regular reports to the Committee on the assessment of the Group's risk management activities, internal controls and corporate governance framework. These reports provide an overview of the work undertaken in the period under review, individual reports on audits conducted, progress against the agreed Internal Audit plans and, in the case of any control failures, progress of remediation plans. We also review the outputs of the twice-yearly OAS process.

The Internal Audit programme is driven primarily by the Group's strategy and the Company's assessment of key risks. The programme is agreed jointly by the Audit and ESG Committees. The programme encompasses financial and non-financial risks, and the programme allows for dynamic recalibration, which provides Internal Audit with the flexibility to address emerging risks and business requirements. One of the objectives for the Internal Audit function is to provide assurance that ethical business conduct and an appropriate culture exists, and is being fostered to support the executive management in matters that could lead to operational and/or reputational risk, so that risks are minimised.

The 2022 assurance programme covered a broad range of assurance areas including: Financial Control Framework Audits; effectiveness of the Operational Framework; risk register findings; OAS outputs; ESG matters; change programmes; and Joint Ventures.

The effectiveness of the Internal Audit function is monitored regularly by a variety of inputs including: the quality and content of ongoing Internal Audit reports received; our formal and informal interaction with the Internal Audit Director; an annual evaluation, assessing the function's effectiveness; and the six-monthly OAS outputs that provide a summary of the progress against the Internal Audit programme.

The responses from the 2022 Internal Audit evaluation raised no significant issues and were consistent with prior years, with participants noting the integral role of Internal Audit and recognising that the Internal Audit function added value to the business. An outline of the process and results is shown above.

Environmental, Social and Governance (ESG) data

We recognise that with the increased disclosure of ESG, and particularly climate-related data, there are increasing demands for greater assurance in areas of narrative and non-financial reporting. In recognition of this, I worked with Dr Jane Griffiths (ESG Committee Chair), the Internal Audit Director and the Climate Resilience & Environment Director, to clarify the role of the Audit Committee and the role of the ESG Committee, in relation to the oversight of assurance and implementation activities. This is a fast-evolving area which requires the appropriate infrastructure and data to allow for both Committees to effectively discharge their duties in this regard.

We agreed that the Audit Committee would maintain oversight of the internal and external assurance processes in regard to ESG data, and the ESG Committee would monitor the progress and implementation of the Company's ambitions against the ESG metrics. This approach will allow both Committees to seek comfort in the robustness of the assurance processes that underpin the provision of TCFD requirements along with other elements of ESG and non-financial reporting. Our annual joint Audit and ESG Committee meeting will allow us to assess the effectiveness of this approach. The Audit Committee will continue to be well placed to make an assessment on whether the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable, and provides the requisite information to allow stakeholders to assess the Group's position and performance, business model and strategy.

Working alongside the ESG Committee, we asked the executive team to undertake an exercise to codify the sources and assurance activities which were undertaken in relation to the ESG disclosures published within the Group's Annual Report. The output of this was an Annual Report assurance map which provided us an overview of the data disclosed within the Annual Report and the data sources; how verification was sought over the data sets; and the internal or external parties that provide assurance over the data. The assurance map is intended to be a dynamic document reviewed at least annually and updated in line with regulatory or statutory changes.

Climate-related disclosures

Climate-related disclosures were an area of continued focus of the Audit and ESG Committees. During the year, we reviewed the context and requirements of the TCFD and the Group's compliance against the reporting requirements.

The Committee welcomed the enhancement made to support improvements in climate subject matter command, evaluation of risks and opportunities, and climate reporting.

The Committee is in agreement that climate-related transition and physical risks could cause impairment and changes to expected credit loss and that, although we have judged there to be no material impact on the Group's consolidated financial statements for the year ended 31 December 2022, close monitoring must continue. Work to address climate-related data limitations and to build accurate modelling of the financial impact of climate-related risks is continuing and we believe will deliver improvements to disclosure quality in respect of future years.

Financial statements

The Committee reviews all significant issues concerning the financial statements which include the going concern and viability statements.

In considering the Group's Annual Report, the Committee assessed whether the report was fair, balanced and understandable and also whether it provided the information necessary for shareholders to assess the Group's position and performance, business model and strategy. In making this assessment, we considered the robust input and review processes undertaken as part of the drafting of the Annual Report. We also examined disclosures during the year, discussed with senior management, and

How we ensure that the Group's Annual Report, taken as a whole, is fair, balanced and understandable and provides information necessary for shareholders to assess the Group's position and performance, business model and strategy

The process is:

– comprehensive guidance issued to all the contributors at operational level;

– a verification process dealing with the factual content of the reports;

– comprehensive reviews undertaken at different levels in the Group that aim to ensure consistency and overall balance; and

– comprehensive review by the directors and the Executive Committee.

confirmed matters that representations had been substantiated, and reviewed internal control reports.

We received early sight of the draft Annual Report and Accounts, in advance of final review and sign-off by the Board. This allowed us to review the consistency of the narrative disclosures and financial statements. It has also provided opportunity to consider the reporting of climate risks and opportunities. After careful review and consideration of all relevant information, the Committee was satisfied that, taken as a whole, the 2022 Annual Report and Accounts was considered to be fair, balanced and understandable and it affirmed that view to the Board.

The Committee agreed the parameters of, and subsequently reviewed a report providing support for, the going concern statement (see page 127) and the statement on the Board's assessment of the prospects of the Group (see the viability statement on page 126) over the five-year period used in the Integrated Business Plan (IBP). The Committee considered the period covered by the viability statement, and whilst a number of companies have elected to use a three-year horizon, we continue to be of the view that a five-year period remains the most appropriate timespan for this Group given our business planning cycle and the long-term nature of a number of our programmes.

In assessing going concern and viability, the Committee has considered cash flow projections and timings, which include assumptions, as far as they can be made, in respect of inflation and climate change. Such analysis included related sensitivity analysis and stress testing scenarios and borrowing facilities available to the Company. Other related issues such as credit ratings were also considered.

In line with regulatory guidance, the potential impact of the Ukraine war on liquidity and cash management (including related covenants) has been considered.

In addition to the going concern and viability statement reviews, the principal matters we considered concerning the 2022 financial statements were:

Recognition of revenue, profit and provisioning

The estimation of contract margin and the level of revenue and profit to recognise in a single accounting period requires the exercise of management judgement. The Committee reviewed key estimates and judgements applied in determining the financial status of the more significant programmes, including Type 26 frigate and US Land programmes.

Pensions

Accounting for pensions and other post-employment benefits involves making estimates when measuring the Group's retirement benefit obligations. These estimates require assumptions to be made about uncertain events, such as discount rates, inflation rates and longevity. As at 2022 year end and following recent changes in discount rates and inflation assumptions, a number of the Group pension schemes are in an accounting surplus. The Group has recognised the surpluses on the basis that the future economic benefits are unconditionally available to the Group. These have been recognised after deducting a 35% withholding tax, which would be levied prior to the future refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the Group. We have reviewed this presentation and concluded this estimate is appropriate based on the Group's ability to access its defined benefit surpluses.

We reviewed the methodology used to allocate a proportion of the net post-employment benefit surpluses to equity accounted investments and concluded that this continues to be appropriate with reference to agreement between the Company and the retirement benefit schemes. We also considered the disclosures in respect of the sensitivity of the surplus to changes in these key assumptions (see note 25 to the Group accounts on pages 267 to 277).

Goodwill

Impairment testing of goodwill on the balance sheet is underpinned by the value of the future prospects of the related business, which have to be estimated. Within the year, the Group restructured part of its operations and, as a result, changed the level at which goodwill is monitored. We considered this alongside the level of goodwill held on the Group's balance sheet and whether, given the future prospects of the acquired businesses, the value of goodwill held on the balance sheet remains appropriate.

No goodwill impairments were judged to be required as a result of this review. The methodology for impairment testing used by the Group is set out in note 8 to the Group accounts on pages 243 to 245, including disclosures on Cash-Generating Units and their assumptions.

Taxation

Computation of the Group's tax expense and liability, the provisioning for potential tax liabilities and the level of deferred tax asset recognition are underpinned by management judgement and estimation of the amounts that could be payable.

Whilst tax policy is ultimately a matter for the Board's determination, we reviewed the Group's tax strategy as set out on page 89. Twice during the year, we reviewed the Group's tax charge and tax provisions, and discussed these with the Group Tax Director.

Alternative Performance Measures (APMs)

The Group monitors the underlying performance measures of the Group using APMs, as a mechanism to support the year-on-year business performance and cash generations, and to enhance management's planning and decision-making on the allocation of resources.

One such measure is underlying EBIT, which provides a measure of operating profitability, excluding one-off events or transactions that are not considered to be part of the ongoing operational transactions of the business. This provides management with a more comparable position with which to monitor the performance of recurring operations over time.

During the year, management reviewed the disclosure of reconciling items as 'non-recurring' in the calculation of underlying EBIT. As some of the items could be considered recurring in nature, and in order to provide more clarity as to the nature of these items, the disclosure has been amended to describe the items as 'adjusting'. A financial glossary is included in the Annual Report to provide a composite explanation of APM content, and the respective prominence given to IFRS measures and APMs has been considered.

Priorities for the year ahead

We await the outcome of the Financial Reporting Council's consultation on Audit Committee minimum standards and the implementation of regulatory standards to address the BEIS response in respect of the corporate governance and audit reforms. The Committee will review its processes and implement changes to its operations, as may be required. We will also monitor the Group's implementation of any required changes resulting from the reforms.

Stephen Pearce
Chair of the Audit Committee

The Audit Committee's year

February — June — July — October — December

February	June	July	October	December
Committee	Committee	Committee	Committee	Committee
			Meeting	

February

Committee (Videoconference)

- Reviewed the financial statements and specific disclosures, including viability and going concern, for recommendation to the Board.
- Received a presentation from the Group Financial Controller and Group Treasurer in respect of work supporting the viability and going concern statements.
- Considered the accounting, financial control and audit issues reported by the external auditor that flowed from the audit work.
- Reviewed the effectiveness of the external audit process.
- Received a report from the Group Tax Director.
- Reviewed external auditor independence and nature and value of non-audit services.

Joint session with the Environmental, Social and Governance Committee:

- Considered output from the six-monthly OAS review.
- Reviewed the procedures and outputs for the identification, assessment and reporting of risk.
- Agreed final iteration of the 2022 Internal Audit programme.
- Considered development of ESG-related disclosures, including climate change and TCFD reporting requirements.

June

Committee (Washington DC, US)

- Agreed the 2022 external audit plan and scope.
- Reviewed external auditor independence.
- Agreed external audit engagement letter and fee.
- Considered any emerging accounting issues prior to the half year.
- Received a presentation from VP, Internal Audit, for the US businesses.
- Reviewed the Non-Audit Services Policy.
- Reviewed the nature and value of non-audit services.
- Received an update on the Finance team modernisation plans from the Group Finance Director.
- Agreed external audit partner successors for the US and UK/RoW businesses.

July

Committee (Videoconference)

- Reviewed the financial statements and specific disclosures, including going concern, for recommendation to the Board.
- Received a presentation from the Group Financial Controller and Group Treasurer in respect of work supporting the going concern statement, together with an update on viability.
- Considered the accounting, financial control and audit issues reported by the external auditor that flowed from the half-year review work.
- Received a report from the Group Tax Director.
- Considered output from the six-monthly OAS review.
- Reviewed the procedures and outputs for the identification, assessment and reporting of risk.
- Reviewed external auditor independence and the nature and value of non-audit services.

October

Committee (Videoconference)

- Received a presentation from the Group General Counsel on the governance and operation of Group Joint Venture companies.

Meeting (London, UK)

- Informal meeting with the Internal Audit Director and external auditor to discuss a range of issues as detailed above on page 145.

December

Committee (Videoconference)

- Considered any emerging accounting issues prior to the year end.
- Considered the external auditor's controls report.
- Considered output of the Internal Audit Director's report.
- Received a report on export control compliance from the Chief Counsel Export Control and Compliance.
- Discussed the approach to ESG assurance and endorsed the ESG assurance map.
- Reviewed the risk radar.
- Received a report on cyber security standards from the Chief Information Security Officer.
- Set the parameters for work supporting the viability and going concern statements.
- Received technical accounting and financial reporting updates.
- Discussed the first iteration of the 2023 Internal Audit programme.
- Reviewed the Internal Audit Charter.
- Discussed the outcome of the Internal Audit function effectiveness review.
- Reviewed external auditor independence and the nature and value of non-audit services.

The Committee holds a quarterly session with the Internal Audit Director and external auditor without management present. The Audit Committee Chair also meets with the Group Finance Director, the Internal Audit Director and the external auditor on an ad hoc basis.

Environmental, Social and Governance Committee report

Jane Griffiths
Chair

Members:

Nick Anderson
Crystal E Ashby
Nicole Piasecki
Lord Sedwill

Dear Shareholders

I am pleased to present the Environmental, Social and Governance (ESG) Committee report for 2022.

At the Company's ESG event last October, we provided shareholders with some insight into the work of the Committee and discussed the Group's progress against its ESG ambitions. Our Committee meetings span a breadth of ESG topics but the key areas of focus in 2022, particularly in light of the cost of living challenges facing employees, the communities in which the Group operates and the wider supply chain, were:

- increasing gender and ethnic diversity;
- progress of the Group's environmental ambitions; and
- employee engagement.

Committee overview

Our individual biographies and summary of our collective experience as a Board can be found on pages 131 to 133.

The composition of the Committee has evolved to reflect changes to the Board membership during the year. Chris Grigg stepped down as a member of the Committee and we welcomed Lord Mark Sedwill to the Committee, following Dame Carolyn Fairbairn's retirement from the Board. I would like to thank Chris for his valuable and much-appreciated contribution during his tenure as a member of the Committee.

Committee meetings are attended by the Chairman of the Board, the Chief Executive, the Group Finance Director, the President and Chief Executive Officer of BAE Systems, Inc., the Group ESG, Culture & Business Transformation Director, the Group General Counsel and the Climate Resilience & Environment Director. Other senior executives are invited to attend meetings to provide the Committee with first-hand subject matter, views and expertise as required. During the year, we welcomed the creation of the Group ESG, Culture & Business Transformation Director, an Executive Committee position, that has further endorsed the commitment to delivering our ESG agenda.

The Committee met five times during the year, and after each Committee meeting I reported to the Board on the Committee's activities, key takeaways from conversations and, where relevant, offered specific recommendations.

Page 156 gives an overview of our key discussions in 2022 and this report is intended to give further context of these conversations. Further information on the role of the Committee and our Terms of Reference can be found on the Company website.

Diversity, equity and inclusion

In order to fulfil the Group's commitment to create a diverse, equitable and inclusive working environment, we regularly review the progress against various diversity metrics and inclusion indicators. It was good to see the progress made against the Group's ambition to be recognised as a leading employer in the defence and security sectors for valuing diversity and inclusion, particularly in respect of increasing the gender diversity of the Executive Committee to gender parity by 2030. Women now account for 29% of the Executive Committee and, whilst there is further work to be done to meet this ambition, there is clear momentum which sets the 'tone from the top' for the broader organisation in regard to the value of diversity and inclusivity.

During the year, we heard from the Group ESG, Culture & Business Transformation Director and the Chief Diversity, Equity and Inclusion Officer on the progress of the Group's strategy to increase diversity and foster inclusive cultures. There are three main areas of continued focus:

- inclusive and visible leadership;
- refreshed recruitment practices; and
- broader awareness and training materials.

The Group has sought to create more inclusive employment opportunities through changes in how we recruit and define roles, for example ensuring a gender-neutral approach to advertising and, where possible, offering more flexible, shared and hybrid working options. Mandatory diversity, equity and inclusion awareness e-learning training has been created and rolled out to improve managerial awareness and encourage leaders to take proactive and visible steps to foster inclusive and diverse teams. We have also been made aware of how some individual employee narratives were being used to bring the value of diversity to life; the narratives were both powerful and extremely thought provoking.

The Group's performance on diversity, equity and inclusion is a non-financial component of the annual incentive plan for senior executives. These objectives operate as a downward underpin to the incentive, reducing incentive payment if performance is not at the expected levels. We believe this demonstrates that good performance in these areas is the expectation, rather than the exception.

The Committee sets, measures and determines the level of performance achieved against these objectives and makes a recommendation to the Remuneration Committee.

In 2022, the diversity, equity and inclusion objectives were:

- for UK/RoW, increasing gender and ethnic diversity particularly within early-career employees;
- for BAE Systems, Inc., increasing the representation of employees from a minority ethnic background in mid-management roles; and
- driving inclusion through training, leadership and demonstrating inclusive behaviours.

In 2022, there was a 1% increase in the number of women in the organisation.

The executive annual incentive plan includes the following objectives for 2023:

- increase gender diversity in mid-management grades;
- for UK/RoW, increase representation of employees from minority ethnic backgrounds;
- for BAE Systems, Inc., increase representation of employees from minority ethnic backgrounds in mid-management roles; and
- drive inclusion through training, leadership and demonstrating inclusive behaviours.

Environment and climate transition

As outlined on page 124 of this Annual Report, the Group considers the potential impacts of climate change as one of its principal risks. The Board is responsible for the oversight of climate-related risks and opportunities and, as a Committee, we support the Board in monitoring the progress of the executive team in implementing an integrated, strategic approach to address climate transition risks and opportunities.

Our role is to oversee the Group's response to the impacts of the Group's activities on the environment, and its response to the potential impacts of climate change on the Group's current and future operations. Whereas the role of the Audit Committee, in respect of climate change and other ESG matters, is to oversee the assurance framework, internal controls, activities and financial planning that relates to the Group's plans. Accordingly, we work closely with the Audit Committee on these matters, particularly in respect of ESG assurance and reporting in relation to the Task Force on Climate-related Financial Disclosures (TCFD).

Members of the executive team and senior executives (as detailed above) are invited to attend all meetings of the Committee, which helps us to effectively discharge our oversight duties through regular engagement and challenge on climate transition matters. In addition to dialogue with internal colleagues, and to build on the foundations of the prior year's training, the Board received further training from PwC and an update on climate risk.

The rich conversations during the session helped to further bolster our subject command and understanding of climate risk and TCFD, and provided clarity on the next steps for the Group.

Several times during the course of the year, we heard from the Climate Resilience & Environment Director on the progress of the net zero programme, particularly in relation to the Company's own operations (Scopes 1 and 2). We learned that a Group-wide transformation and governance programme had been established and implemented within the sectors. In support of these programmes, operational models were created to include financial data, support risk assessments and identify renewable energy investment and self-generation opportunities. An exercise to homogenise data and improve the Group's rigour on data reporting had also been undertaken. As part of the Integrated Business Plan process, each sector has created roadmaps in order to make the Group's net zero ambition an integrated part of sector business planning.

We also heard from the Chief Procurement Officer and the Supply Chain Sustainability Director on the progress being undertaken in regard to the Group's supply chain.

In support of the Group's net zero ambitions, specific objectives were included in the senior executive annual incentive plan. As with the objectives regarding diversity, equity and inclusion, and safety, the Committee sets, measures and determines the level of performance achieved against these objectives and makes a recommendation to the Remuneration Committee. The 2022 environmental objectives were in regard to the creation of the net zero framework and roadmaps to achieve a reduction in Scope 1, 2 and 3 emissions in the timeframes committed by the Group. A fuller discussion on the incentive outcomes can be found in the Remuneration Committee report on pages 160 to 164.

Employee engagement framework

Hear from executives on employee matters such as safety, wellbeing, diversity and inclusion and company decisions that could impact employees.	Senior executives
Review employee sentiment and wellbeing surveys and other data sources evidencing employee views.	Operational managers
Learn from operational management teams on the practical application and impact of workforce policies.	Direct engagement
Direct engagement with groups of employees.	Data

We will continue to improve our understanding of climate transition, emerging risks and opportunities by working with external and internal subject matter experts and continue to challenge the executive team on the pace of implementation.

If approved by shareholders at the 2023 AGM, the executive long-term incentive plan will include climate change-related objectives with the aim of increasing alignment between executive performance and the creation of long-term sustainable success through the delivery of the Group's climate ambitions. Further details regarding the ESG targets in the executive long-term incentive plan may be found on page 191.

Employee voice

In accordance with Provision 5 of the UK Corporate Governance Code (the Code), the Board is required to maintain an effective mechanism to engage with the workforce. The Committee annually reviews contemporary employee engagement practices and effectiveness of the model adopted by the Group.

The Board agreed that the mechanism by which the Committee undertakes employee engagement on its behalf remains effective.

This decision rationale for this is as follows:

- engaging with employees has been a part of the Committee's activities since its inception;
- the non-executive membership of the Committee meets the same independence criteria as appointing a single non-executive director, as proposed in the Code; and
- the size and complexity of the Group's business, with 93,100[1] employees in around 40 countries, means that there are logistical and practical advantages to the role being performed by more than one director.

Employee engagement timeline

March

Location
Videoconference
Activity
Employee conversations: UK Embrace Employee Resource Group Co-Chairs
Key themes
Ethnic and cultural diversity
Those involved
ESG Committee Chair

Location
Warton and Samlesbury
Activity
Site visit and town hall
Key themes
Parental leave and ethnic diversity
Those involved
Board of directors

Location
London
Activity
Dinner with UK high-potential employees
Key themes
Talent development and UK customer insights
Those involved
Board of directors

Location
Christchurch
Activity
Site visit and informal lunch
Key themes
Talent development
Those involved
Innovation and Technology Committee

Location
Nashua
Activity
Site visit and town hall
Key themes
Leadership and Company performance
Those involved
Board of directors and BAE Systems, Inc. Board Chair

May

Location
London
Activity
Trade Union National Officers Dinner
Key themes
Impact of cost of living crisis
Those involved
Chief Executive and ESG Committee Chair

Location
Videoconference
Activity
Employee conversations: Australia Safety teams
Key themes
Improved safety culture
Those involved
ESG Committee Chair

June

Location
Washington
Activity
Dinner with Inc. high-potential employees
Key themes
Talent development and US customer insights
Those involved
Board of directors

July

Location
Videoconference
Activity
Board review on ethical business conduct
Key themes
Company culture, Ethics Officer training
Those involved
Board of directors, Group ESG, Culture & Business Transformation Director, Governance, Conduct and Sustainability Director

Location
Videoconference
Activity
Employee conversations: Kingdom of Saudi Arabia Safety teams
Key themes
Roll-out of wellbeing resources
Those involved
ESG Committee Chair

September

Location
Boston
Activity
Dinner with Inc. senior executives
Key themes
US customer insights
Those involved
Board of directors

Location
Merrimack
Activity
Site visit and informal lunch
Key themes
Talent development and higher education partnering
Those involved
Innovation and Technology Committee

Location
Boston
Activity
Board discussion on culture and review of key culture indicators
Key themes
Mental health and wellbeing, business transformation, cultural evolution and alignment with behaviours and inclusion
Those involved
Board of directors, Group HR Director and Group ESG, Culture & Business Transformation Director

1. Including share of equity accounted investments.

As global coronavirus restrictions eased and colleagues returned to offices, we were able to resume our programme of physical site visits whilst continuing to leverage technology for virtual employee engagement.

In order to ensure that the conversations and key themes are shared and discussed at the Board, I updated Board colleagues on the employee engagement activities undertaken at the mid-year and full year. This standing agenda item, coupled with the organic discussions and actions from site visits provided for a rich and deeper understanding of the matters concerning employees.

As a Board, we had the opportunity to visit various sites in our UK and US businesses and my ESG Committee colleagues, Nicole and Nick, in their roles as members of the Innovation and Technology Committee, were also able to visit further UK and US sites. We recognise that site visits and tours only provide one element of interaction with employees, so to properly gauge sentiment and culture, we supplement these site visits with open and conversational town hall sessions, informal lunches with on-site colleagues, and dinners with high-potential employees. Our town halls during site visits allowed for employees to ask questions of the Board and local management teams.

During these town hall meetings, in the UK and US, employees raised questions about parental leave, ethnic diversity and leadership development. We were pleased to be given the chance to hear these questions first-hand and witness the Chief Executive and executive teams providing clear answers on progress regarding gender and ethnic diversity, and share some of their personal experiences and stories. Following these visits, as a Board, we were able to discuss employee sentiment and reflect particularly on the progress of diversity, equity and inclusion measures and challenge the executive team on the pace of change. To support these conversations, the executive team provided the Committee with details of the diversity, equity and inclusion roadmap, that had been developed to identify the steps needed to effect change. We also undertook several deep dives on various Group-wide initiatives to create an inclusive culture, and thereby attract, retain and develop our employees, particularly in regard to gender and those from under-represented backgrounds.

In addition to the conversations held during these visits, I attended trade union dinners and had conversations with employees representing Employee Resource Groups. These included a cross-section of employees within safety teams in Australia and the Kingdom of Saudi Arabia which provided a spotlight on safety and DEI, a key area of focus for the Committee. These conversations were not attended by members of the executive team, to ensure that colleagues felt comfortable in having transparent conversations. As a result of these meetings, I was able to feed back to the Board employee suggestions on improving diversity and create a more inclusive culture, as well as improvements in wellbeing and safety culture and other areas that would benefit from further focus.

Our employee engagement framework and further details of the employee engagement activity undertaken by or on behalf of the Board are shown on pages 151 to 153.

Safety and wellbeing

At regular intervals during the year, we reviewed the global safety performance of the Group and we were pleased to see a reduction in the number of recordable injuries, compared with the prior year. The various initiatives put in place to improve safety culture and embed personal and team responsibilities within operational teams, have resulted in an overall reduction in safety incidents. In 2022, the Group had a recordable injury rate of 486 (493 in 2021) and had 32 (33 in 2021) major injuries.

Mental health and wellbeing continued to be a focus of the global safety agenda. We learned about the work of the mental health Employee Resource Groups and the work being done to address the perceived taboo of depression and anxiety. Encouraging employees to share stories and providing individual and line managerial training on how to identify signs of strained mental health, were some of the tools the Group has deployed during the year.

As in prior years, safety performance remains an underpin of the annual incentive plan for senior executives, reducing incentive payments if performance does not achieve the level expected. The Committee sets, measures and determines the level of performance achieved against the safety objectives and makes a recommendation to the Remuneration Committee.

Governance

We heard from the Group General Counsel on the application of the Group's Product Trading Policy and the Responsible Trading Principles and the evaluation process that apply to how we do business throughout the product lifecycles.

We also received presentations from the Chief Counsel, Compliance and Regulation on the global use of advisers during the year and of the application of the Advisers Policy, that helps ensure we have the necessary controls and governance in place.

ESG data assurance

At the joint ESG and Audit Committee meeting in February, we reviewed the context and requirements of the TCFD and the Group's compliance against the reporting requirements.

As a result of the increasing need to disclose ESG, and particularly climate-related data, there is a requirement for greater assurance in areas of narrative and non-financial reporting. During the year, I worked with Stephen Pearce (Audit Committee Chair), the Internal Audit Director and the Climate Resilience & Environment Director, to better articulate the role of the Committee versus that of the Audit Committee, in relation to the oversight and assurance of ESG activities and the associated data.

We agreed that the Committee would monitor the progress and implementation of the Group's ambitions against the ESG metrics and that the Audit Committee would oversee the internal and external assurance processes for ESG data. This approach reduces duplication, creates a better understanding of our roles and responsibilities and will allow for both Committees to discharge their duties in this regard effectively.

In support of this, the executive team presented an 'Annual Report assurance map', which codified sources of information and assurance activities which were undertaken in relation to ESG disclosures published within the Group's Annual Report.

Looking forward

In 2022, we invited the Investor Relations Director to provide updates on the investors' views of the Group's ESG performance. He provided an overview of the Group's approach to creating further transparency and demonstrating its responsible business credentials through better disclosures and engagement with investors and ESG indices and ratings agencies. We believe this was a worthwhile exercise and will continue to monitor investor views of the Group's ESG performance during the course of 2023.

For 2023, we have taken the decision to undertake one 'deep dive' on an E,S or G theme to ensure appropriate focus and understanding of these topics.

As we look forward to 2023, our key areas of focus remain broadly consistent with the prior year and we will continue to challenge the executive team to deliver against the Company's ambitions relating to the environment and climate change; diversity, equity and inclusion; and safety.

I would like to thank my colleagues on the Committee for their contributions during the year and I look forward to continuing this work in 2023.

Jane Griffiths
Chair of the Environmental, Social and Governance Committee

The Environmental, Social and Governance Committee's year

January Committee · February Committee → June Committee → September Committee → December Committee

January

Committee (Videoconference)

- Received an update on the Group's responsible supply chain activities.
- Received an update on global safety performance.
- Reviewed the 2021 safety and diversity, equity and inclusion performance in respect of the outcomes of the annual incentive plan.
- Agreed the 2022 objectives and annual incentive targets in respect of safety, and diversity, equity and inclusion.
- Reviewed the efficacy of our employee engagement framework.

February

Committee (London, UK)

- Received an update on the Group's environment and climate transition – net zero programme.
- Discussed the application of the Group's anti-bribery and corruption programme.
- Reviewed investor trends and sentiment in light of EU social taxonomy regulations.
- Reviewed the Group's 2022 planned ESG activities and longer-term roadmap.
- Joint meeting with the Audit Committee to review TCFD requirements, non-financial risk register and agree the 2022 Internal Audit programme.

June

Committee (Washington DC, US)

- Performed a deep dive on the Group's safety performance to date.
- Received a briefing on the progress of the Group's diversity, equity and inclusion programmes.
- Discussed the progress of the Group's environment and climate transition – net zero programme.
- Reviewed the Group's ESG priorities against investor and other stakeholder expectations.

September

Committee (Boston, US)

- Discussed the Group's lobbying activities.
- Received a briefing on the Group's approach to tackling modern slavery.
- Discussed the progress of the Group's environment and climate transition – net zero programme.
- Reviewed the Operational Assurance Statement process and the audit and assurance landscape during the year.
- Received a briefing on the progress of the Group's diversity, equity and inclusion programmes.
- Discussed the impact of the cost of living crisis on employees and the support provided to employees.

December

Committee (Videoconference)

- Received a briefing on the application of the Group's Product Trading Policy and the Group's Responsible Trading Principles.
- Received an update on the Group's use of advisers during the year and the application of the Advisers Policy.
- Undertook a deep dive into the roadmap for Scopes 1, 2 and 3 of the Group's net zero programme.
- Reviewed the 2022 safety and diversity, equity and inclusion performance in respect of the outcomes of the annual incentive plan.
- Considered the initial proposed objectives and annual incentive targets for 2023 in respect of safety, and diversity, equity and inclusion.
- Reviewed some of the Group's community and social impact activities.
- Discussed the Financial Reporting Council's report on ESG data production.
- Approved our 2023 programme of activities.

Schedule of activities in 2023

February

- Environment and climate transition – net zero
- Deep dive: diversity, equity and inclusion
- Safety and wellbeing
- Approach to ESG assurance
- Joint meeting with Audit Committee

June

- Environment and climate transition – net zero
- Deep dive: employees' and broader stakeholder views
- ESG ratings and investor landscape
- Anti-bribery and corruption
- Full Board session – Ethics helpline review

September

- Environment and climate transition – net zero
- Deep dive: waste and water management
- Deep dive: community and social value
- Operational Assurance Statement
- Advisers Policy
- Product Trading Policy and controversial weapons

December

- Environment and climate transition – net zero
- Diversity, equity and inclusion
- 2023 annual incentive objectives review
- 2024 annual incentive objectives approval
- Deep dive: responsible procurement and supply chain

Innovation and Technology Committee report

Ewan Kirk
Chair

Members:
Nick Anderson
Dame Elizabeth Corley
Nicole Piasecki

Dear Shareholders

I am pleased to introduce the report on the activities of the Innovation and Technology Committee during 2022. The Committee was established by the Board in July 2021 with the purpose of supporting the Company's future success. The Committee focuses principally on the UK business and we pay particular attention to the effective oversight of the application of science, engineering and technology, and the Group's ability to successfully exploit its intellectual property and know-how in pursuit of business and commercial goals.

One of the Group's strategic priorities is to advance and further leverage technology. To help achieve this, we are investing in key technologies, particularly electronic warfare, combat aircraft, precision weapons, cyber and the underwater battlespace. From these core areas we are building adjacent market capabilities in multi-domain networks, autonomy, low carbon and space solutions. The strategic priorities are the foundation of our discussions as a Committee. Equally, we recognise that these ambitions will only be achieved if we are able to foster an innovative culture and attract, retain and develop the best talent.

During the year, we took time to reflect on the efficacy of the Committee's operations, discussions and agenda. Unlike other Board committees, there is no precedent or guidance for a committee such as this, and the format, focus and discussions of the Committee will continue to evolve to ensure we are able to properly discharge our duties. Throughout this report, I will give some insights as to our key conversations and the activities undertaken by the Committee in the last year.

Committee context

Our individual biographies and summary of our collective experience as a Board can be found on pages 131 to 133. The composition of the Committee evolved during the year, to reflect changes to Board membership. Dame Elizabeth Corley joined the Committee in May, following Dame Carolyn Fairbairn's retirement from the Board. More details of membership and attendance at meetings can be found on page 133.

Our conversations, site visits and meetings are undertaken in recognition of national security considerations. Much of the intellectual property and know-how owned by the Group is subject to national laws and regulations. All Committee activities are undertaken in accordance with the national security requirements of the UK and other nations. We are particularly cognisant of and observe the requirements of BAE Systems, Inc.'s Special Security Agreement.

The Committee presentations, site visits and meetings allow this group of directors a closer engagement with senior executives on innovation and technology as it pertains to the fulfilment of the Group's strategic objectives. Our meetings are attended by the Chairman of the Board and members of the senior executive team: the Chief Executive, President and Chief Executive Officer of BAE Systems, Inc., Group Finance Director, Chief Technology and Information Officer (CTIO), Group General Counsel and Technology Director. Following each Committee meeting, I provide a report to the Board on our conversations, key themes and any recommendations.

The Committee met four times during the year, in March, May, September and October and had two formal meetings. Page 159 gives fuller context as to the nature of these meetings and an outline of our conversations. Our terms of reference can be found on the Company's website.

Research and Development (R&D)

In order to properly assess progress and identify areas where we as a Committee could add value, as part of each meeting, we are provided with and discuss the strategic context for each topic. This context allowed us to understand the areas in which the Group is doing well and identify areas for development, or those which may benefit from further resource, stewardship or financial investment. We were also able to develop our understanding of the Group's horizon-scanning processes and the various Technology Readiness Levels and R&D strategies associated with them.

During the year, we discussed at length the Group's strategic priorities and how they aligned with the Integrated Business Plan (IBP) process and sought to understand how, through the IBP, key technology focuses were identified. We learned how the determination of technology focus areas during the strategy process allowed engineering teams to articulate the required areas of investment, the source of funding, and whether partnerships are required to deliver the requisite outcomes.

The executive team have provided us with additional insight and context on the Group's R&D funding. The Group's overall self-funded R&D budget has grown significantly in recent years and, in our meetings, we considered the 'Seedcorn'[1] budget and portfolio as a whole, and how they support the Group and sector strategies. Page 29 discusses the R&D budget. This provided helpful context to help us understand how we support innovation and identify and fund key R&D priorities.

1. 'Seedcorn' refers to investments in very early stage and often speculative R&D projects.

Technologies

Throughout the year, we discussed five current and emerging technology focus areas (see below) that we see as being strategically important for the long-term development of the Group. We heard from the CTIO and Technology Director regarding progress in these areas:

- **Autonomy** – over the past few years, particularly in our strategy conversations, the Board has discussed the evolving nature of warfare and the shift to uncrewed and autonomous systems. It is therefore important that the Group is innovating and creating technologies that anticipate and meet customer expectations both in delivering autonomy and in countering the use of autonomous technologies.
- **Space** – in the UK, we learned of the progress with LEO satellite solutions, primarily through the In-Space Missions business we acquired in 2021 and the development of its imaging and radio signal monitoring LEO satellite (Prometheus 2); and orbit capable optical communication satellite (Titania). During our visit to Christchurch, we were able to hear from the In-Space Missions team and received live product demonstrations which conveyed the breadth of the Digital Intelligence portfolio and the skills of its employees. We also discussed the equity investment in ICEYE, a company specialising in Synthetic Aperture Radar technologies which will help to bolster the Group's space-based Intelligence, Surveillance and Reconnaissance (ISR) capabilities.

  Similarly, we noted that our US business's space strategy was focused on building on its current activities in this area and pursuing opportunities to expand its customer offering.
- **Sustainability** – in addition to the Group's own ambitions regarding climate change and its net zero ambition, we see opportunities to help our customers and others achieve their sustainability objectives through the development of decarbonisation services and products.

  We discussed the innovation, technological and engineering challenges that could result from changes in physical landscapes as a consequence of climate change, and the possible impact on military doctrine and the nature of warfare. Given the likely pace of environmental change, we noted that, in order to meet customer performance expectations, such environmental factors needed to be considered as an integral part of our product design and support plans.

  We heard from the Technology Director on the work underway to advance the efficiency of current and new products and services, through the introduction of low or zero emissions technologies and the potential longer-term revenue opportunities in these technologies. We reviewed case studies of these technologies such as can be found on pages 55 to 59.
- **Manufacturing and design** – the Technology Director also highlighted the Seedcorn investments made in 'factory of the future' developments in areas of Cobotics, 5G and digital modelling, which are being achieved through collaboration with SMEs and universities. We discussed how these improvements create efficiencies in design and cost, whilst also supporting our climate ambitions through waste reduction.
- **Multi-domain and digital integration** – the CTIO kept the Committee abreast on Project Juno – a Company programme for the development of multi-domain autonomous solutions, and also various Group-wide programmes to develop interoperable and platform agnostic, digitally integrated defence systems. During our site visits we were able to learn more about BAE Systems, Inc.'s FASTLabs business and the UK Digital Intelligence business, both of which are on the cutting edge of technological developments. The conversations highlighted the growing strategic need of our global customers for integrated full spectrum and multi-domain solutions. These discussions helped to improve our understanding of developments in Command & Control, Communications, Computers, Cyber, Intelligence, Surveillance and Reconnaissance (C5ISR) systems.

We also noted that within the Group's portfolio, there may be examples of technologies with potential adjacencies in defence. These potential adjacencies could align with strategic objectives and provided opportunities for the Group to partner with commercial companies. We understand that these opportunities require careful evaluation and discipline in order to be effective and deliver robust commercial partnerships, whilst complying with national security requirements and protecting the Group's know-how and commercial advantages. This is an area that we will continue to review over the next year.

Intellectual property

As a Committee, we recognise the ingenuity of the designs, engineering processes and technologies which are created and captured throughout the business. Whilst the Group is a market leader in terms of its capability and ability to deliver on complex programmes, we are keen to see how we can be more innovative in non-customer funded R&D opportunities. The patent portfolio has the potential to create opportunities for commercialisation. In line with our ambitions regarding market adjacencies, we discussed at length the potential for wider commercial application of certain Group intellectual property. Clearly, any such consideration of the further application of the intellectual property and know-how would be undertaken in compliance with applicable national laws, regulations and in line with our obligations to customers and partners.

To undertake a review of the Group's intellectual property catalogue and identify potential commercial advances, it was important to set guidelines for the level of available investment and clearly determine risk appetites. It is critical to properly assess requisite funding levels and the overall viability of this exercise. We recognised that the articulation of a clear technology strategy is the foundation of this exercise, and would, in turn, determine the feasibility and level of investment required to achieve broader success in this area.

Meaningful incentivisation and workplace culture are key to fostering innovation and broader thinking. During the year, we spent time considering how we can do more to foster such a culture, including how the Group encouraged employees to consider commercial application of intellectual property, and more broadly how it engages and encourages employees to generate new ideas.

At our meeting in October, the CTIO presented specific activities which would help us achieve more success in this area. In particular, we noted that a small team had been formed, within the CTIO, working closely with the central intellectual property and legal teams, as well as teams within the business units.

Innovative culture

Our culture values diversity, and rewards integrity and merit so that everyone can fulfil their potential. The Board recognises that in order to maintain long-term sustainable success, the Group must be able to attract, retain and develop engineers and business leaders who are able to drive innovation and help deliver the Group's strategic objectives.

The Group has a rich history of innovation and technology, and it continues to pursue its technological ambitions through a number of research labs which act as new technology incubators and provide new capability and solutions, whilst fostering innovative and collaborative cultures. We were able to visit one such lab, FASTLabs in the US Electronic Systems business, and further details regarding this and other site visits can be found below. We were pleased to hear about the horizon-scanning activities both within academia and the SME community which led to opportunities for collaboration on projects and fostering broader industry relationships. Additionally, we learned about the sponsoring of accelerator programmes for start-ups in the defence technology space, and the provision of support to SMEs in navigating the complexities of operating in the defence sector.

The diverse geographic footprint of the Group provides opportunities for collaboration, and strong, global collaborative relationships have been built with SMEs, peers and strategic university partners. The six strategic universities in the UK, our preferred academic partners in the US, and the two university partners in Australia focus largely on fundamental science and physics through applied technologies. These partnerships assist in assessing a broad range of technologies and as a vehicle for novel innovation challenges, whilst providing an insight to the prospective undergraduate and postgraduate talent pipeline.

All of these activities together foster innovation and strengthen relationships.

Our site visits are useful opportunities to engage with employees. We discuss culture, professional development and receive product demonstrations. As a Committee, we relished these visits and the presentations, demonstrations and conversations with colleagues added an additional lens to our strategy discussions in June and November. These conversations provided assurance concerning workplace culture; infrastructure; collaborative practices; and the effectiveness of the activities that foster innovation.

Looking ahead

At our meeting in October, we agreed specific activities with the aim of continuing to evolve the innovation culture across the Group. These activities are: creating an innovation challenge programme; better understanding intellectual property monetisation opportunities and exploring alternate intellectual property business models; and providing entrepreneur training and support.

These will be the key areas of focus of our discussions during 2023 and I will provide you with an update as to the progress of each matter in next year's annual report.

I'd like to thank my fellow Committee members for their diligent engagement and perspectives, and the executive team who continue to provide us insight and are receptive to our challenge. I'd also like to thank the employees who have enthusiastically and patiently shared appropriate and permissible insights of their work. It has been a pleasure to see such engaged colleagues and meet first-hand the skilled workforce that supports the Group in creating its sustainable and long-term success.

Ewan Kirk
Chair of the Innovation and Technology Committee

The Innovation and Technology Committee's year

March	May	September	October
Site visit Meeting	Meeting	Site visit	Meeting

March
Site visit and meeting (Christchurch, UK)
- Site visit to Christchurch, UK.
- Strategic context.
- Deep dive on the Digital Intelligence business.
- Informal lunch with various employees.
- Product demonstrations and conversations with employees.

May
Meeting (Videoconference)
- Informal meeting with the Chief Technology and Information Officer, and Technology Director, to discuss the approach to intellectual property monetisation and the sectoral innovation landscape.

September
Site visit (New Hampshire, US)
- Site visit to New Hampshire, US.
- Strategic context.
- Deep dive on FASTLabs business.
- Product demonstrations and conversations with employees.

October
Meeting (Videoconference)
- Strategic context.
- Sustainability projects.
- University partnerships.
- Review of Committee operations and key themes.

Remuneration Committee report

Nicole Piasecki
Chair

Members:
Dame Elizabeth Corley
Chris Grigg

Dear Shareholders

On behalf of the Board, I am pleased to present the Remuneration Committee's report for 2022.

It is hard to imagine a time in which pay decisions could matter more. Whether determining pay outcomes for directors or protecting employees from inflationary stress, our pay decisions need to reflect the current and future needs of the business, while respecting our values, including:

- ensuring our financial sustainability, on which our ability to produce returns for shareholders and create high-quality jobs depends;
- respecting our employees and the communities that support our ongoing operations;
- acknowledging the importance of defence capabilities that underpin national security in an increasingly volatile world;
- balancing pay continuity with a need to pivot quickly in a rapidly changing macroeconomic environment; and
- maintaining operations in countries with different approaches to the structure, amounts and conditions of pay arrangements.

In making its decisions, the Committee has been mindful of the UK Corporate Governance Code's principles in relation to remuneration – clarity, simplicity, risk, predictability, proportionality and alignment to culture. You will see evidence of this on page 173 and in the remainder of this report which describes the pay outcomes for 2022 and the proposed changes to our Directors' remuneration policy (the Policy) that will help ensure we are able to retain and attract the key talent needed to deliver our business strategy.

2022 pay outcomes for executive directors

2022 has been another strong year, with:

- top-line sales growth of over 4%;
- underlying earnings per share (EPS) growth of 9%;
- free cash flow of £1,950m, exceeding expectations;
- record annual order intake; and
- increased returns to shareholders via dividends and buyback.

75% of the annual bonus for executive directors is determined by financial performance, with the remaining 25% determined by the achievement of key strategic objectives. Financial performance measures are agreed by the Committee at the beginning of the year, with performance levels set at threshold, target and stretch in line with the Integrated Business Plan (IBP). For 2022, each of the financial measures exceeded stretch requirements. The Committee reviewed the achievement of the key strategic objectives for each executive director in 2022, considering also the safety and diversity & inclusion underpin, described in more detail on page 179. This evaluation resulted in overall bonus outcomes of c.97% of maximum for executive directors for 2022. One-third of the bonus amounts are deferred into shares for a further three years.

The performance share awards granted to executive directors in 2020 are subject to EPS and total shareholder return (TSR) performance conditions measured over a three-year performance period ended 31 December 2022, with any vested shares released up to five years after grant.

2022 key performance outcomes (extract)

	Threshold	Stretch	Actual	Vesting outcome
Annual bonus				
• Group underlying EPS	46.0p	49.6p	52.2p	100%
• Group net cash/(debt)	£(2,920)m	£(2,170)m	£(1,383)m	100%
• BAE Systems, Inc. underlying EBIT	$1,491.8m	$1,611.8m	$1,623.3m	100%
• BAE Systems, Inc. net cash/(debt)	$2,053m	$2,593m	$2,916m	100%
Long-Term Incentive Plan (LTIP)				
• Annual average EPS growth	3%	7%	8.3%	100%
• TSR against sectoral comparator group	31.5%	44.4%	63.5%	100%
• TSR against FTSE 100 comparator group	–1.0%	27.2%	63.5%	100%

No adjustments were made to the performance targets in respect of the impact of COVID-19.

Annual average EPS growth of 8.3% exceeded stretch requirement, and TSR of 63.5% was greater than the upper quintile of both the sectoral comparator group and the FTSE 100 group, resulting in the performance shares vesting at 100% of maximum. No adjustments to performance targets were made in respect of the impact of COVID-19.

Before confirming the vesting of any performance shares, the Committee considers the composition of EPS growth to ensure that any windfall profits are excluded, and any other one-off amounts are linked to genuine management endeavour, with the impact of currency exchange rate fluctuations (upwards or downwards) excluded by measuring EPS growth in constant currency.

The 2020 performance shares were granted in March 2020, adopting the standard practice of using the closing share price immediately prior to the date of grant. With volatility in global stock markets at that time due to the COVID-19 pandemic, the Committee considered if this approach may have resulted in a windfall gain for participants, and whether there should be a corresponding reduction in the number of shares vesting. In making their determination, the Committee considered share price movements in the 12-month periods before and after the March 2020 grant, and observed that there was no material difference in the grant prices between the March 2019 awards (485.0p), March 2020 awards (485.1p) and March 2021 awards (499.9p). The Committee was satisfied that the level of vesting and values for the 2020 performance shares remained appropriate in the context of the Company's underlying performance and share price history.

The share price at close on 31 December 2022 was 856.0p with that share price appreciation mostly attained during 2022. Consequently the total single figures of remuneration for executive directors include the value of the long-term incentive awards vesting in 2022 based on the three-month average year-end share price, notwithstanding that those shares will not be released in full until 2025, five years after grant.

The Committee has the ability to exercise its discretion to reduce formulaic outcomes if appropriate, but the Committee did not consider this necessary in respect of the 2022 pay outcomes. Accordingly, the Directors' remuneration policy, as approved by shareholders in 2020, operated as intended throughout 2022.

Taking care of our people

Executive management remained active in 2022 in securing our employees' services and protecting their wellbeing in a period of high inflation. In the UK, actions included:

- securing support from our UK collectively bargained employees (c.27,000 UK employees) for a two-year pay deal, comprising a 6.75% salary increase in 2022 and a 6% salary increase with effect from 1 January 2023, with two £1,000 lump sum payments, one in 2022 and one in 2023, to help with the cost of living; and
- awarding salary increases to other employees averaging 6% for 2023, with two £1,000 lump sum payments, one in 2022 and one in 2023, for our mid-level non-collectively bargained employees.

Additionally, UK employees are eligible to receive company pension contributions, life insurance, income protection, health and wellbeing support through a flexible benefits platform, access to shopping discounts, the Employee Assistance Programme, a performance-related bonus, an annual award of free shares based on Group financial performance, and the opportunity to participate in and receive free matching shares.

Actions in the US included:

- awarding average salary increases of 5% for 2023, while addressing critical talent retention with additional off-cycle salary increases; and
- extending short- and long-term incentive plan participation to align with the competitive market practices.

Remuneration policy review

It will be three years since our Directors' remuneration policy was last approved by shareholders in 2020, and therefore a new policy will be submitted for shareholder approval at the 2023 AGM.

During 2022, the Committee reviewed the approach to remuneration in the context of business strategy, investor guidelines, and the increasingly competitive external environment in which we operate. As part of its review, the Committee sought feedback from institutional investors and other stakeholders, and I am very grateful for all the responses and support received. The Committee considered various alternative approaches, and concluded that the core elements and structure of our current remuneration policy remain appropriate.

Therefore, the proposed new remuneration policy is very similar to the existing policy, except for some adjustments to bring our remuneration policy into line with the competitive market. The proposed key changes are:

- Annual bonus for the Group Finance Director to increase from 160% to 200% of salary at maximum (from 80% to 100% of salary at target), to be better aligned with the external competitive market and closer to the bonus opportunity for the other executive directors (225% of salary at maximum).
- Long-term incentive performance share awards for the President and Chief Executive Officer of BAE Systems, Inc. to increase from 298% to 440% of salary from 2023, to be brought into line with the fiercely competitive US market in which we compete for talent.

In addition, the Committee has reviewed the performance measures for the performance share awards to ensure they remain aligned to our business goals.

Group EPS, cash flow and return on capital employed (ROCE) are key drivers of share price and shareholder returns, and will have higher weightings. TSR is influenced by external factors, but to ensure the executive team is incentivised to outperform peers regardless of prevailing market conditions, TSR will remain as a performance measure with a reduced weighting. This re-weighting of performance measures enables us to introduce a specific component based on the achievement of our environmental, social and governance (ESG) ambitions in line with our previous commitment.

ESG is important for our long-term financial sustainability, and will help position us for a future in which sources of energy and their associated costs shift rapidly, and where we must demonstrate alignment to key criteria for our customers' procurement decisions. The ESG metrics will be specific and measurable, and aligned where possible to external reporting frameworks. These will focus on goals that are most relevant to our financial sustainability and over which we have the greatest ability to make a near-term and ongoing difference, including the reduction of our environmental footprint.

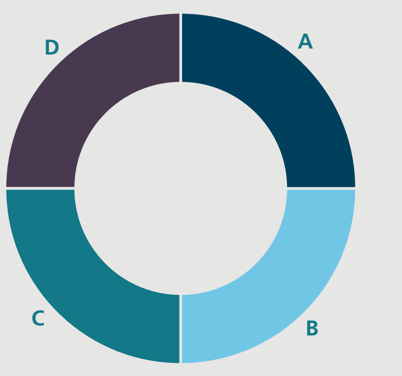
A graphic illustrating the rebalancing of Long-Term Incentive Plan (LTIP) metrics is shown overleaf.

The proposed 2023 Policy being submitted for approval at the 2023 AGM can be found on pages 190 to 205.

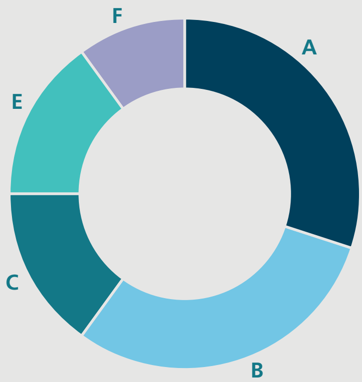
Shareholders will additionally be asked to approve the BAE Systems Long-Term Incentive Plan 2023 at the 2023 AGM, the terms of which remain substantially the same as the existing BAE Systems Long-Term Incentive Plan 2014.

Rebalancing of LTIP performance metrics

2022 Awards



Awards from 2023



		2022 %	2023 %
A	Group EPS	25	30
B	Cash flow	25	30
C	Total Shareholder Return (TSR)	25	15
D	Strategic progress • ROCE (8.3%) • Operational excellence (8.3%) • Advancing technology (8.3%)	25	–
E	Return on Capital Employed (ROCE)	–	15
F	Environmental, social and governance (ESG) metric	–	10

Executive director pay in 2023

Chief Executive

We are proposing no changes to the remuneration for Charles Woodburn, our Chief Executive, except for a 4% salary increase effective 1 January 2023. This increase is less than the average increase awarded to UK employees (6%).

In December 2022, the employer contribution to the Chief Executive's pension was reduced from 16.4% to 14% of salary, bringing it into alignment with the weighted average employer contribution rate of UK active members.

The Committee is satisfied that the Chief Executive's overall remuneration package remains appropriate.

Group Finance Director

Brad Greve was recruited on 1 September 2019 to succeed a long-serving predecessor in the Group Finance Director role. Whilst Brad had impeccable credentials as a senior financial executive in a large international business, his appointment at BAE Systems was his first as the financial head of a global PLC.

It was against this background that the Committee chose to position his reward structure at the low end of the range of his peer group with a view to adjust upwards over time according to his performance and achievement. Brad received two salary increases of 2% (1 January 2021) and 2.5% (1 January 2022) aligned to the annual pay increases across the UK workforce.

Brad has proved to be a highly effective financial leader and a material contributor to the overall growth and performance of the business. Brad has led the improvement of financial metrics across our business including capital management, balance sheet strength, pension fund arrangements, shareholder returns and programme performance metrics including margin improvement and cost controls. Additionally, his initial responsibilities have been broadened to incorporate the supply chain function, given the increasing importance of this to the performance of the business.

Throughout, Brad has also shown himself to be a clear and trusted communicator regarding the financial health of the Company with all stakeholders. In the light of his performance the Board believes that Brad has proved himself to be a highly effective and respected Group Finance Director of an important and complex FTSE 30 global company and should be rewarded accordingly at the median of his peer group.

In order to align Brad's salary with the median of the FTSE 30 peer group, his salary would need to have been increased by 17.6%. Our Remuneration Policy limits the increase in an executive director's salary to a maximum of 10% per annum.

In July 2022, the Chairman and I wrote to our major shareholders to communicate our intentions regarding the alignment of Brad's salary and we were pleased to receive overwhelming support. On 1 January 2022, Brad had received an increase of 2.5%, and from 1 August 2022 a further increase of 7.3% making a total of 10% in 2022. From 1 January 2023, Brad's salary increased by a further 9.6% to £750,150 in keeping with the median for his peer group.

It is the Committee's intention that any future salary increases will be in accordance with general company pay increases across the workforce.

As part of that same shareholder letter, we signalled our intention to seek shareholder approval for a new remuneration policy at the 2023 AGM enabling an increase in Brad's annual bonus opportunity from 160% to 200% of salary at maximum (from 80% to 100% of salary at target) to align his total package with FTSE 30 CFO median reward levels.

We are not proposing any changes to Brad's long-term incentive award levels.

President and Chief Executive Officer, BAE Systems, Inc.

Tom Arseneault, the President and Chief Executive Officer of our US subsidiary, BAE Systems, Inc., is a US national based in the US. Unusually for the US market, he is also an executive director of a UK-listed company, BAE Systems plc, an arrangement that benefits the Company and its stakeholders. In order to protect US national security, he has an enhanced level of autonomy in leading our US business which represents 44% of Group sales and is uniquely recognised as the major non US-owned defence contractor in the largest market globally. BAE Systems, Inc. is the only top ten US government defence prime contractor whose parent company is not US-domiciled. As such, we need to compete for the best Aerospace and Defence talent in the US market.

To sustain this unique and critical role in the long term, the Committee has to be responsive to market dynamics in a tight talent pool by providing our US President and Chief Executive Officer, and other US-based employees, with remuneration packages that are sufficiently attractive in the US market, while still respecting UK corporate governance requirements.

Tom received a 4% salary increase effective 1 January 2023, the same as our Chief Executive and less than the average salary increase for our US employees.

Reflective of the very competitive market in US Aerospace and Defence, we propose to increase Tom's performance share award grant from 298% to 440% of salary, subject to performance measured over three years, and vesting one-third equally after three, four and five years from grant. The Committee considers this change to be appropriate and indeed essential in light of the market situation.

No change is proposed to Tom's annual bonus arrangements or restricted share award.

These changes will enable Tom's pay to be positioned at an appropriate level for the US market, but with a longer vesting period, compulsory bonus deferral requirement and post-cessation shareholding requirement than is typical in the US, but in alignment with UK corporate governance standards.

Implementation of the Policy in 2023

A summary of the implementation of the Policy in 2023 is set out on page 166 with more detail on the performance measures and weightings for the 2023 Annual and Long-Term Incentives set out on pages 194 to 197, and 2023 Long-Term Incentive metrics on page 186.

In conclusion

I hope you find this report a clear explanation of the Committee's considerations, decisions and remuneration outcomes for 2022. Further, I hope that you will support the proposed changes to our remuneration policy at the 2023 AGM, which are designed to modernise our remuneration offering and bring it into line with the competitive market.

I cannot close without thanking both my Remuneration Committee Chair predecessor Ian Tyler who retired from the Board at last year's AGM, and our colleague and departing Board Chairman Sir Roger Carr, who has overseen and helped us navigate to the strong position that the Company is in today. Further, I give a warm welcome to our Chair designate Cressida Hogg and look forward to her contributions in steering the Company.

Finally, I would like to thank the numerous shareholders, institutional investors and other stakeholders who have helped inform and improve our remuneration policy proposals.

On behalf of the Board

Nicole Piasecki
Chair of the Remuneration Committee

The Remuneration Committee's year

January — Committee
February — Committee
May — Committee
June — Committee
September — Committee
November — Committee
December — Committee

January

Committee (Videoconference)

- Assessed outturn of 2021 strategic objectives for executive directors and Executive Committee members.
- Agreed 2022 key strategic objectives for executive directors and Executive Committee members.
- Received an update on provisional 2021 financial performance for annual and long-term incentive purposes.
- Approved remuneration package for new or existing Executive Committee members.

February

Committee (Videoconference)

- Determined 2021 bonuses against performance for executive directors and Executive Committee members for payment in March 2022.
- Approved 2021 Group All-Employee Free Share Plans payments.
- Determined vesting outcome for Spring 2019 Long-Term Incentive awards.
- Approved grant of 2022 Long-Term Incentive awards and associated performance targets for executive directors and Executive Committee members.
- Reviewed feedback from shareholder consultation.
- Approved 2021 Directors' remuneration report.

May

Committee (Videoconference)

- Reviewed feedback from shareholder consultation and May 2022 Annual General Meeting.
- Received an update on performance of in-flight long-term incentive awards.
- Agreed scope of 2023 Directors' remuneration policy (Policy) review.

June

Committee (Washington DC, US)

- Reviewed potential changes to Policy.
- Approved salary changes for Group Finance Director.
- Agreed appointment of new Remuneration Committee advisers.

September

Committee (Boston, US)

- Agreed proposed changes to Policy and approach to consult with shareholders.
- Received an external market trends update on executive remuneration.
- Reviewed progress against Executive Committee 2022 key strategic objectives.
- Approved remuneration package for new or existing Executive Committee members.
- Approved the vesting outcome of the 2019 Autumn Long-Term Incentive awards.
- Approved grant of 2022 Autumn Long-Term Incentive awards including targeted restricted shares awards to select key, critical individuals at middle management level.

November

Committee (Hampshire, UK)

- Received an update on initial shareholder engagement on proposed Policy changes.
- Approved shareholder consultation letter on proposed Policy changes.
- Received an update on broader workforce remuneration.
- Agreed approach to development of 2022 Directors' remuneration report.
- Reviewed level of executive directors' and Executive Committee members' shareholdings relative to their Minimum Shareholding Requirement.
- Approved operation of Group All-Employee Free Share Plans for 2023.
- Reviewed dilution levels and share usage under Employee Share Plans.
- Approved changes to Executive Committee members' and senior executives' remuneration packages.

December

Committee (Videoconference)

- Received an update on institutional investor guidance.
- Discussed shareholder consultation feedback to date on proposed Policy changes.
- Approved executive directors' salary increases from 1 January 2023.
- Agreed the approach, structure and financial targets for the 2023 annual incentive plan.
- Received an update on progress of 2022 key strategic objectives applicable to executive directors and Executive Committee members.
- Received an update on broader workforce remuneration.

Annual remuneration report at a glance

for the year ended 31 December 2022

Business performance and incentive outcomes in 2022

		2022 performance	2022 incentive outcome
Group underlying EPS[1]	AIP	52.2p	●
Group net cash/(debt)[1]	AIP	£(1,383)m	●
Group order intake[1]	AIP	£35.6bn	●
Average three-year diluted underlying EPS growth	LTI	57.8p	●
Three-year TSR	LTI	63.5%	●

AIP Annual Incentive Plan
LTI Long-Term Incentive

● Below threshold
● Between threshold and target
● At or above target

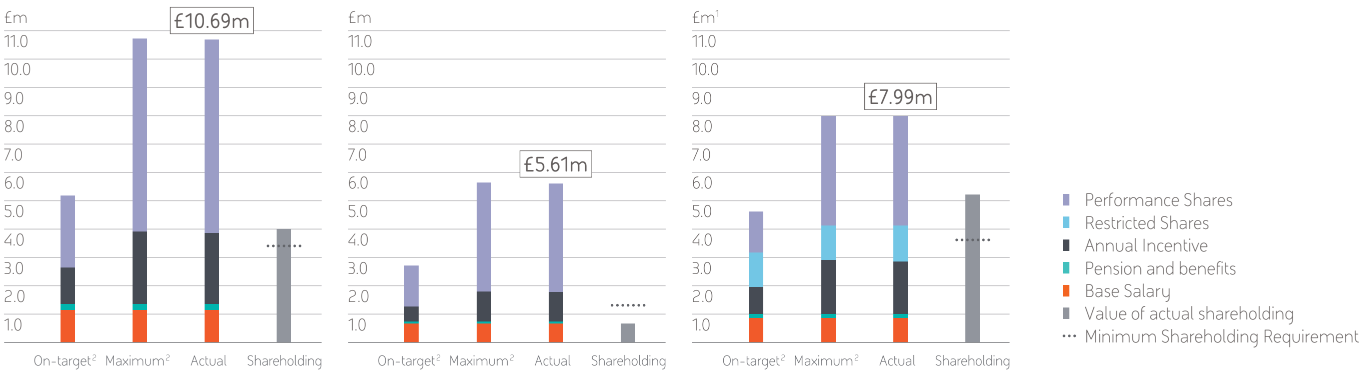
1. Adjusted to be on a comparable basis with the targets (see page 179).

Very strong operational and financial performance for 2022 resulting in the following incentive outcomes:

- 2022 annual bonus payouts for the executive directors were near to maximum; and
- Performance Shares granted in March 2020 exceeded stretch performance against both the EPS and TSR conditions and therefore 100% will vest.

Summary of executive directors' remuneration in 2022

The charts below show the 2022 actual remuneration achieved, as disclosed in the single total figure of remuneration on page 177, compared with the 2022 on-target and maximum opportunity. Also included is the value of the actual shareholding for each executive director as at 31 December 2022 compared to their Minimum Shareholding Requirement (as set out on page 187).



Charles Woodburn Chief Executive	**Brad Greve** Group Finance Director	**Tom Arseneault**[1,3] President and Chief Executive Officer of BAE Systems, Inc.

1. The figures for Tom Arseneault have been converted from US dollars to sterling.
2. On-target remuneration assumes target vesting of incentives payable in respect of the performance period with year-end 2022, whilst maximum remuneration assumes maximum vesting of incentives payable.
3. Long-term incentive figures above are based on the 2020 Performance Shares and, for Tom Arseneault, include his 2022 Restricted Shares award (as required by regulation in the single total figure of remuneration).

Consistent remuneration philosophy and strategy applicable to all our employees

The Committee has responsibility for reviewing remuneration and related policies applicable to the wider workforce and the alignment of incentives and rewards with culture, ensuring this is taken into account when setting the policy for executive remuneration. Our people are critical to ensuring the long-term sustainability of our business and our ability to deliver for our customers. With this in mind, our people strategy is designed to support our aim to attract, retain and develop the very best talent.

During 2022 various initiatives were deployed across the Group in response to challenges of post-pandemic global increases in workforce attrition and labour shortages, and the impact that the cost of living crisis is having on our employees.

In the UK, actions included:

- focused efforts on recruiting people with skills required to support our key programmes;
- supporting c.4,500 young people through our award-winning early career and skills programmes;
- upholding our commitments as a Real Living Wage employer;
- a two-year pay deal for our manual and professional population;
- increasing the reward packages for our executive population in line with grade and the market; and
- providing a broad Employee Assistance Programme to our employees and family members.

In the US, actions included:

- refreshing the employee value proposition in response to the changing talent market with a focus on attracting and retaining a diverse workforce;
- launching an 'Employer of Choice' initiative that includes more family-friendly employee health and wellness benefits for 2023;
- additional targeted salary increases to address critical talent retention concerns; and
- extending short- and long-term incentive plan participation to align with market practices.

Annual remuneration report at a glance

for the year ending 31 December 2023

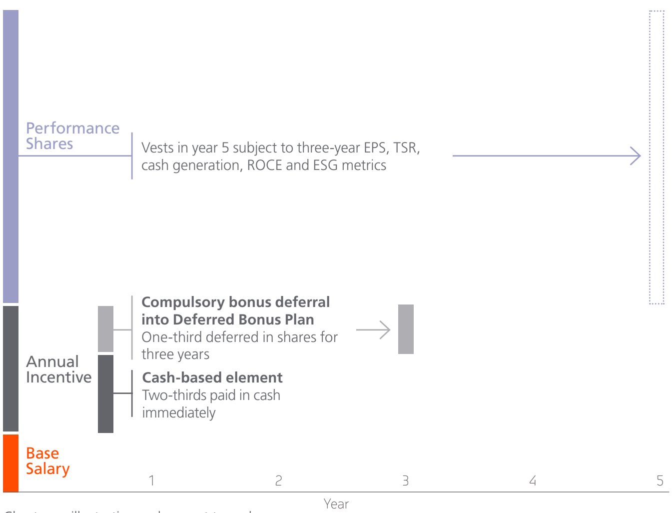
Summary of remuneration framework

The table below sets out the overall remuneration framework applicable to each of the executive directors under the 2023 Directors' remuneration policy that is subject to shareholder approval at the 2023 AGM.

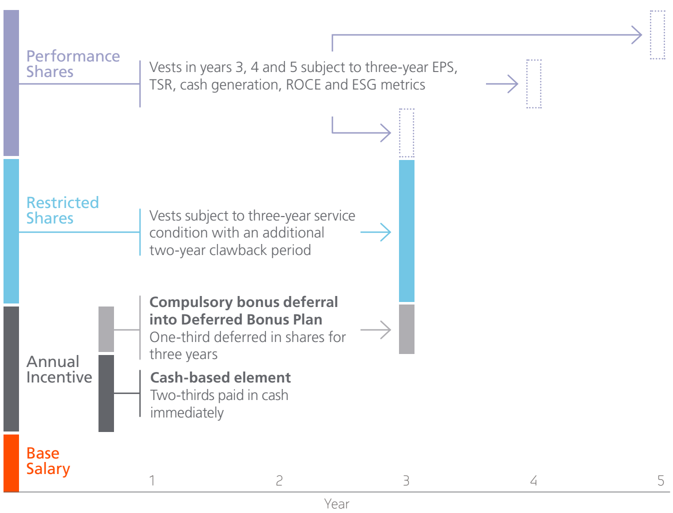
		Charles Woodburn CEO	**Brad Greve** GFD	**Tom Arseneault** President and CEO Inc.	**Purpose and link to strategy**
Base Salary (with effect from 1 January 2023)		£1,180,635	£750,150	$1,094,080	Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.
Pension and benefits		Defined contribution (14% salary[1])	Defined contribution (8% salary)	US defined benefit and Section 401(k) defined contribution[2]	Provide employment benefits and competitive post-retirement benefits to ensure overall package is market competitive.
Annual Incentive	On-target/maximum opportunity (% salary)	112.5%/225%	100%/200%	112.5%/225%	Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours, in order to deliver sustainable growth in shareholder value.
	Performance condition	75% financial (earnings, cash and order intake)/ 25% non-financial (key strategic objectives)[3]			
	Deferral into Deferred Bonus Plan	One-third compulsory deferral			Compulsory deferral into shares increases alignment with long-term shareholder interests.
Performance Shares	Grant (% salary)	370%	335%	440%	Direct financial measures based on the Key Performance Indicators (KPIs) that drive our financial ambitions for the Company, and measures linked to our key long-term strategic priorities including our sustainability agenda, aligned to the interests of our shareholders.
	Performance condition	15% relative TSR/ 30% three-year diluted underlying EPS growth/ 30% cash generation/ 15% return on capital employed/ 10% ESG metrics			
	Vesting	Three-year performance conditions, vests in year 5		Three-year performance conditions and vested shares released one-third in years 3, 4, 5	
Restricted Shares	Grant (% salary)	n/a		150%	Designed to help ensure remuneration for senior US-based executive is competitive in the local market.
	Vesting	n/a		Three-year service condition and two-year clawback period	
Minimum Shareholding Requirement	(% salary)	300%	200%	425%	Provide long-term alignment with shareholder interests.
	Post-cessation shareholding requirement (% salary)	300% for two years	200% for two years	300% for one year	

1. CEO's employer pension contribution rate is aligned to the weighted average employer contribution rate of UK active members.
2. Further detail on Tom Arseneault's pension is provided on pages 183 and 198.
3. Shared key strategic objectives include those more focused on supporting our sustainability agenda. Safety and diversity underpin applies to the non-financial element with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce.

Application of 2023 package for UK executive directors



Application of 2023 package for US executive director



Charts are illustrative and are not to scale.

Annual remuneration report

for the year ended 31 December 2022

This section details the remuneration of the executive and non-executive directors (including the Chairman) during the financial year ended 31 December 2022 and will be proposed for an advisory vote by shareholders at the 2023 Annual General Meeting (AGM).

It has been prepared on the basis prescribed in Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

UK Corporate Governance Code

Reporting against Code requirements can be found as follows:

Page 174
Strategic rationale for our directors' remuneration

Pages 167–172
Appropriateness of our remuneration

Page 173
Addressing Provision 40 factors

Page 160
Operation of our policy

Page 175
Engagement with shareholders

Page 175
Engagement with workforce

Pages 160–163
Exercise of discretion

Statement of voting

Shareholder voting on the resolutions to approve the Annual remuneration report put to the 2022 AGM and the Directors' remuneration policy put to the 2020 AGM was as follows:

Annual remuneration report

Votes for	%	Votes against	%	Total votes cast	Votes withheld (abstentions)
2,288,879,813	96.01	95,175,707	3.99	2,384,055,520	14,521,219

Directors' remuneration policy

Votes for	%	Votes against	%	Total votes cast	Votes withheld (abstentions)
2,423,919,276	97.55	60,821,405	2.45	2,484,740,681	18,848,820

The current Directors' remuneration policy approved at the 2020 AGM is available in the Investor Relations section of the Company's website: baesystems.com

The Directors' remuneration policy for approval at the 2023 AGM is detailed on pages 190 to 205.

Contents

Appropriateness of remuneration and wider context

Our reward philosophy and approach

The Committee has responsibility for reviewing remuneration and related policies applicable to the wider workforce, ensuring that this is taken into account when setting the policy for executive remuneration. As part of this, we apply a consistent remuneration philosophy and strategy to all employees across the Group. Our aim is to provide a reward package that is aligned to shareholders' interests, supports the achievement of the Company's in-year financial and strategic objectives, is competitive against the appropriate market and is consistent with our focus on our Company Behaviours and our values of Trusted, Innovative and Bold.

Across BAE Systems we continue to accelerate our performance, focusing on both what we do for our customers and how we do it. Our people strategy is designed to support our aim to attract, retain and develop the very best talent through:

- robust succession planning;
- targeted recruitment;
- focused talent management;
- culture of inclusivity, learning and development; and
- competitive employee value proposition (EVP).

We continue to ensure that our culture is inclusive and supportive and allows our employees to reach their full potential and feel valued for their contribution. This means:

- base salaries are set with reference to median of the relevant market competitive level;
- high performance and exceptional contribution are recognised through annual incentives;
- remuneration packages for leadership roles have an increased emphasis on longer-term incentives;
- providing employees with competitive and affordable post-employment benefits which reward long-term contribution and loyalty; and
- offering a competitive and cost-effective package of other benefits as part of our total reward offering.

Appropriateness of remuneration and wider context continued

As set out on page 173, the Committee considered a number of core principles in the renewal of the 2023 remuneration policy for executive directors, including how reward policy and practice compares across the wider workforce. The table below illustrates this for the different groups of employees within BAE Systems.

<table>
<tr><th></th><th>Executive directors</th><th>Executive Committee</th><th>Senior executives</th><th>Middle management</th><th>Wider workforce</th></tr>
<tr><td>Base salary</td><td colspan="4">Base salary is set based on market pay approach recognising the individual's skill, knowledge, experience levels and contribution to role.
Normally reviewed annually with increases typically in line with the wider workforce.</td><td>Base salary is either subject to negotiation with recognised trades unions and/or is set in line with market and/or performance.</td></tr>
<tr><td>Pension and benefits</td><td colspan="5">Range of employment benefits and competitive post-retirement benefits in line with relevant home market.</td></tr>
<tr><td>Short-term incentives</td><td colspan="2">Annual incentive based 75% on financial performance of our KPIs and 25% on key strategic objectives relating to the delivery of the Group's strategy, including our sustainability agenda, and the demonstration of leadership behaviours. Compulsory deferral into shares for three years.</td><td>Annual incentive based primarily on organisation performance of our KPIs and remainder on personal objectives and behaviours. Compulsory deferral into shares for three years (for the majority of UK and Rest of World executives).</td><td>Annual incentive based on organisation and individual performance.</td><td>In UK businesses, incentive typically based on business and/or individual performance.
None in US, Australia or KSA.</td></tr>
<tr><td rowspan="2">Long-term incentives</td><td colspan="5">Eligible employees may participate in and receive free matching shares in our Company Share Incentive Plan (SIP) or international equivalent.
Company rewards eligible employees with annual award of free shares, or cash equivalent, based on our Group financial performance.</td></tr>
<tr><td>Performance shares are subject to three-year performance conditions (and further holding requirements) designed to drive sustained company financial performance aligned to interests of shareholders.
Restricted shares vest subject to service condition (applicable in the US only).</td><td colspan="2">Performance shares are subject to three-year performance conditions designed to drive sustained company financial performance aligned to interests of shareholders.
Restricted shares vest subject to three-year service condition (predominantly applicable in the US).</td><td colspan="2"></td></tr>
</table>

The Committee regularly undertakes an in-depth session to build its understanding of reward arrangements applicable to the wider workforce. The Committee has continued to deepen its approach, not only due to the broader governance requirements, but because it believes that well-designed remuneration can be a tool of culture change and progressive improvement in Company performance. Such sessions provide assurance that the remuneration for the wider workforce is consistent with market trends, with regulation, and is non-discriminatory with respect to gender, ethnicity and other personal attributes not related to performance.

The Committee is provided with visibility of remuneration practices in the different sectors and geographies in which we operate and for the different populations within the wider workforce across the Company globally. These sessions have covered a range of topics including the outcome of the annual reward review throughout the workforce, reward principles and pay philosophy, annual and long-term incentive design, employee share plans and other employee benefits including pension and retirement schemes. The Committee is also periodically updated on wider employee matters such as the outcome of our UK gender pay analysis and an analysis of selected key talent such as those individuals on an Executive Committee succession plan. During 2022, the Committee was made aware of and fully supported the specific measures implemented by the Company to help the workforce in light of the challenging economic climate and increased cost of living.

Committee members, in common with other Board members, meet periodically with the wider workforce and with high-potential employees to engage with them at first hand.

The Company also receives insights from the broader employee population using an engagement survey. Further detail on engagement with employees is given on page 175.

Pay comparisons

Pay ratio of Chief Executive to UK average employee

The Committee is mindful of the relationship between Chief Executive remuneration and the remuneration of the wider BAE Systems employee population. As required by legislation, the table below provides the ratio of the Chief Executive to that of the median, 25th and 75th percentile total remuneration of full-time equivalent UK employees. We voluntarily disclosed the pay ratio on the required basis in 2018.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2022	**Option B**	**228:1**	**164:1**	**149:1**
2021	Option B	171:1	140:1	99:1
2020	Option B	121:1	103:1	89:1
2019	Option B	90:1	72:1	59:1
2018	Option B	61:1	48:1	38:1

The reporting regulations offer three calculation approaches for determining the pay ratio – Options A, B and C. The table above has been calculated using the approach determined by Option B which is deemed the most appropriate methodology for BAE Systems. Recognising that BAE Systems has more than 30,000 UK employees, operating on different human resources and payroll systems, it is not feasible to adopt Option A. The calculations for the relevant representative employees were performed as at 31 December 2022.

To ensure Option B provides a sufficiently accurate representation of the UK workforce, we have performed sensitivity analysis around the three quartiles. Our approach has been to consider the total pay and benefits for a number of employees centred around each quartile. This allows any anomalies that may arise when calculating the total pay and benefits for the full financial year (such as if an employee left part way through the year) to be adjusted or excluded. By taking an average of the remaining figures, this provides a robust representation of each quartile.

The total full-time equivalent pay and benefits for the relevant employees has been calculated based on the amount paid or receivable in respect of the relevant financial year. The calculations are on a similar basis as required for the Chief Executive's remuneration for single total figure purposes. For pension-related benefits, employer pension costs have been estimated using the employer contributions applicable to the member's pension scheme made through payroll. In respect of annual incentives, the amounts have been estimated based on the accrued expected financial outturn. No other estimates or adjustments have been used in the calculation and no remuneration items have been omitted. A minority of employees in this calculation are employed on a part-time basis and therefore their remuneration has been annualised to reflect the full-time equivalent.

Our reward framework across the Group is based on a consistent set of principles, including managing reward by reference to external competitor benchmarks (see page 168). In the case of our Chief Executive, his total remuneration comprises a significant proportion in variable pay and therefore the single figure will vary considerably depending on the level of performance against the measures which drive the Annual and Long-Term Incentive Plans. The employees in the calculation would not typically participate in any long-term incentive plans and receive a significantly higher proportion of their remuneration in the form of fixed pay. The difference in ratio at the three quartiles is consistent with our market-based approach to reward, with the ratio increasing as the Chief Executive's remuneration is compared with that of more junior employees. The overall picture presented by the ratios is consistent with our pay, reward and progression policies.

£	25th percentile	50th percentile	75th percentile
Total pay and benefits	46,998	65,014	71,679
Salary component	35,802	46,523	55,057

Relative to 2021, the pay ratio in 2022 has increased by approximately 33%, 17% and 51% at 25th, 50th and 75th percentiles respectively. The total pay and benefits figures have increased at 25th and 50th percentiles in part reflecting the actions taken by the Company to address the increased cost of living. The pay ratio has been impacted by the increase in the Chief Executive's remuneration for 2022, primarily as a result of an increase in the long-term incentive vesting outturn (100% in 2022 versus 57.9% in 2021) and share price appreciation between the grant and vesting dates.

Appropriateness of remuneration and wider context continued

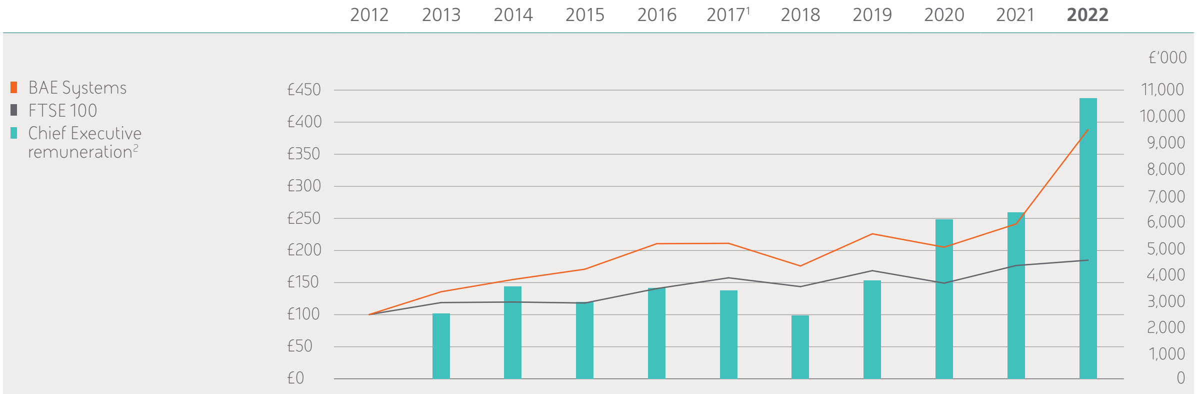
Total Shareholder Return (TSR) performance and Chief Executive pay

The graph below shows the value by 31 December 2022, on a TSR basis, of £100 invested in BAE Systems on 31 December 2012 compared with the value of £100 invested in the FTSE 100 index, including the effect of dividends. The graph additionally shows the remuneration of the Chief Executive, plotted as a bar chart on the secondary y-axis.

The FTSE 100 is considered to be an appropriate comparator for this purpose as it is a broad equity index of which BAE Systems is a constituent member and reflects the investment interests of our UK shareholder base. In addition, it forms 50% of the TSR performance measure for awards made between 2016 and 2020 and 100% of the TSR performance measure for awards made since 2021.

The chart below demonstrates the strong long-term alignment of our Chief Executive pay and the returns to our shareholders. We achieved this through the Chief Executive receiving a high proportion of his remuneration in shares and with our performance conditions being based on measures which directly support the implementation of our strategy.

Value at 31 December 2022 of £100 investment at 31 December 2012



Change in Chief Executive's remuneration over ten years

	2013	2014	2015	2016	2017[1]	2018	2019	2020	2021	**2022**
Chief Executive's single total figure (£'000)										
Charles Woodburn	–	–	–	–	1,279	2,416	3,747[3]	6,080	7,071	**10,693**
Ian King	2,499	3,519	2,929	3,463	2,086	n/a	n/a	n/a	n/a	**n/a**
	2,499	3,519	2,929	3,463	3,365	2,416	3,747[3]	6,080	7,071	**10,693**
Bonus paid as a percentage of maximum										
Charles Woodburn	–	–	–	–	75.8%	65.6%	95.6%	78.7%	97.1%	**97.5%**
Ian King	53.4%	74.3%	72.4%	82.3%	75.9%	n/a	n/a	n/a	n/a	**n/a**
LTI as a percentage of maximum vesting										
Charles Woodburn	–	–	–	–	n/a	nil	10.9%[3]	100%	57.9%	**100%**
Ian King	nil	16.8%	nil	nil	11.3%	n/a	n/a	n/a	n/a	**n/a**

1. In 2017, Charles Woodburn succeeded Ian King as Chief Executive on the latter's retirement. Ian King's remuneration is shown from the start of the 2017 until 30 June 2017 and Charles Woodburn's remuneration is shown from 1 July 2017 to the end of that year.
2. Plotted as a bar chart on the secondary y-axis.
3. Total remuneration includes the value of share plans vesting that were granted prior to appointment as Chief Executive.

Annual percentage change in directors' remuneration

The table below shows the percentage change over the year ended 31 December 2021 to the year ended 31 December 2022 and prior years in respect of directors' remuneration and average employee remuneration. As required by legislation, directors' remuneration is compared to employees of the BAE Systems plc entity on a full-time equivalent basis.

	2021/2022			2020/2021			2019/2020		
	Salary/fees % change	**Benefits[1] % change**	**Annual bonus % change**	Salary/fees % change	Benefits % change	Annual bonus % change	Salary/fees % change	Benefits % change	Annual bonus % change
Executive directors									
C N Woodburn	**+2.5**	**+56.4**	**+2.9**	+12.7	+17.7	+39.1	+6.9	–3.9	–12.1
B M Greve[2]	**+5.6**	**+79.3**	**+6.0**	+36.0	+44.2	+68.7	n/a	n/a	n/a
T A Arseneault[2]	**+15.0**	**+24.1**	**+15.8**	+27.9	+156.9	+115.4	n/a	n/a	n/a
Non-executive directors									
Sir Roger Carr	**0.0**	**0.0**	**n/a**	0.0	0.0	n/a	0.0	0.0	n/a
N J Anderson[2]	**0.0**	**–42.7**	**n/a**	+500.0	+81.0	n/a	n/a	n/a	n/a
C E Ashby[3]	**+200.0**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a
Dame Elizabeth Corley	**0.0**	**–47.6**	**n/a**	+1.5	0.0	n/a	+4.7	–100.0	n/a
Dame Carolyn Fairbairn[4]	**–58.2**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a
J V Griffiths[2]	**0.0**	**–82.2**	**n/a**	+72.5	0.0	n/a	n/a	n/a	n/a
C M Grigg	**0.0**	**n/a**	**n/a**	+7.3	0.0	n/a	+28.1	–100.0	n/a
C M Hogg[5]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a
E M Kirk[3]	**+75.8**	**+92.6**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a
S T Pearce[6]	**0.0**	**–50.0**	**n/a**	+1.1	+90.4	n/a	+133.0	–4.0	n/a
N W Piasecki[6]	**+19.2**	**n/a**	**n/a**	+1.5	–100.0	n/a	+79.5	–35.5	n/a
Lord Sedwill[5]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a	n/a	n/a	n/a
I P Tyler[4]	**–65.2**	**–8.8**	**n/a**	+1.1	+8.9	n/a	+3.6	–64.7	n/a
Average employee[7]	**+4.5**	**+4.5**	**+9.2**	+1.5	+1.5	+28.4	+2.5	+2.5	–2.0

1. Benefit figures for Crystal Ashby, Chris Grigg and Nicole Piasecki were £nil in respect of 2021; therefore the 2021/2022 benefits percentage change is shown as n/a.
2. Remuneration for Brad Greve and Tom Arseneault in respect of 2020 reflects the period from their appointment as executive directors on 1 April 2020. Remuneration for Nick Anderson and Jane Griffiths in respect of 2020 reflects their part-year from joining the Board on 1 November 2020 and 1 April 2020 respectively.
3. Remuneration for Crystal Ashby and Ewan Kirk in respect of 2021 reflects their part-year from joining the Board on 1 September 2021 and 1 June 2021 respectively.
4. Remuneration for Dame Carolyn Fairbairn and Ian Tyler for 2022 reflects their part-year prior to stepping down from the Board on 5 May 2022; for Dame Carolyn Fairbairn, prior year figures relate to her having joined the Board on 1 March 2021.
5. Remuneration for Cressida Hogg and Lord Sedwill reflects the period from their appointment as non-executive directors on 1 November 2022 (no prior year remuneration so figures are shown as n/a).
6. Remuneration for Stephen Pearce and Nicole Piasecki in respect of 2019 reflects their part-year from joining the Board on 1 June 2019.
7. Figures are provided in respect of the relevant median average employee of BAE Systems plc as determined on a full-time equivalent basis and with the annual bonus estimated on the accrued expected financial outturn in respect of 2022.

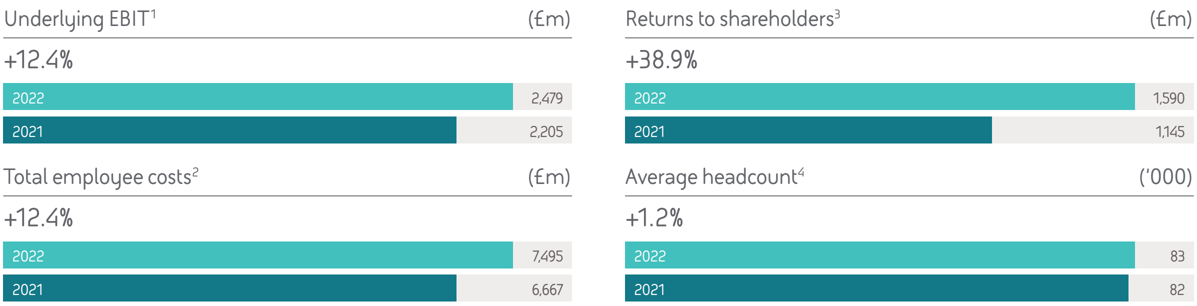
Appropriateness of remuneration and wider context continued

Gender pay

BAE Systems has published its annual gender pay gap report in line with the UK regulations. For 2022, the average (mean) gender pay gap for our UK workforce was 8.6% in favour of men (2021 8.7%), which is lower than the current UK national average of 14.9%. We rely on employing large numbers of employees with STEM qualifications and we, like other companies, face challenges recruiting women with these qualifications because there are significantly fewer women who study and work in these fields. As a result, a greater proportion of our workforce and our senior leadership population are men and this is a major factor in our gender pay gap. We continue to work hard to improve our gender balance and remain steadfast in our commitment to delivering the plans we have in place to increase the number of women in BAE Systems and support the progression of women into senior executive positions.

Relative importance of spend on pay

The following charts set out underlying EBIT[1], amounts paid in returns to shareholders, total employee costs and average headcount for the years ended 31 December 2021 and 2022. These charts have been chosen as they are most representative in assisting to understand the relative importance of spend on pay.



1. This is included as it is the Group's principal measure of operational profitability as defined in the Financial glossary on page 302.
2. After excluding the impact of exchange translation, wages and salaries increased by approximately 4.6% per employee in 2022.
3. Returns to shareholders comprise dividends to ordinary shareholders paid in the year and share buybacks in 2021 (£368m) and 2022 (£788m).
4. Excluding share of equity accounted investments. This is included for year-on-year comparison of employee headcount.

Remuneration principles

The Committee established six core principles which underpin our approach to executive remuneration. The principles are aligned to BAE Systems' strategic objectives, taking account of shareholder expectations and the remuneration factors set out in Provision 40 of the UK Corporate Governance Code (the Code). The Committee considered these principles in the renewal of our 2023 remuneration policy, whilst being mindful of the alignment and fairness of remuneration with the wider workforce. The table below shows this close alignment between the Committee's core principles and the Code's factors, including how the Committee addresses each factor.

Factor within Provision 40	How the Committee addresses the factor
Clarity Remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce.	In line with our commitment to full transparency and engagement with our shareholders on the topic of executive remuneration, the Remuneration Committee Chair engages with our major shareholders to set out the changes planned. In a year of significant change, the Remuneration Committee Chair will consult with our major shareholders to discuss and seek views on potential changes. The Company consults directly with the broader employee population on their remuneration through a variety of methods including Webex, explanatory guides hosted on the intranet, human resources or business-led briefings, and direct line manager engagement (see also page 175 for engagement on executive pay).
Simplicity Remuneration structures should avoid complexity and their rationale and operation should be easy to understand.	Simple three-part construct of salary, annual incentive and long-term incentives has been in use for a number of years. Use of a single 'umbrella' LTI plan allowing for simplicity and flexibility of design.
Risk Remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated.	Full range of design features exist within remuneration arrangements to take risks into account as follows: – malus and clawback mechanisms within annual and long-term incentives; – Remuneration Committee application of reasonable discretion to override formulaic outcomes; and – safety targets expected to be met in all circumstances, with downward underpin applying within Annual Incentive Plan (AIP) in the event of below-target performance.
Predictability The range of possible values of rewards to individual directors and any other limits or discretions should be identified and explained at the time of approving the policy.	Our remuneration policy contains the following: – maximum award levels and vesting outcomes applicable to annual and long-term incentives; and – as set out above in Risk, the Committee has the ability to apply malus, clawback and reasonableness discretion where appropriate.
Proportionality The link between individual awards, the delivery of strategy and the long-term performance of the company should be clear. Outcomes should not reward poor performance.	Performance conditions attached to annual and long-term incentive arrangements require a minimum level of performance to be achieved before any payout is made. As set out on page 174, there is a direct link between an individual's reward and their contribution to driving strategy and increasing company performance. No payment is made for poor performance. Any individual's performance that is below expectations is dealt with as part of our performance management process – any individual leaving due to performance issues would not be entitled to any incentive payments.
Alignment to culture Incentive schemes should drive behaviours consistent with company purpose, values and strategy.	As set out on page 174, there is a direct link between driving BAE Systems' strategy and an individual's reward, with incentive measures chosen as they align with the Company's shared strategic objectives. As shown on page 174, the Committee has established six core principles which underpin the philosophy and approach to executive remuneration to ensure alignment to BAE Systems' strategic objectives.

Remuneration Committee core principles

Simplicity
Clarity and simplicity of design; ease of understanding by executives and external stakeholders.

Motivational
Plans are relevant and meaningful with clear line of sight between actions and reward outcomes; metrics and targets which drive superior performance and value for shareholders.

Aligned with shareholder interests
Close alignment of reward outcomes and shareholder experience; long-term share ownership and 'skin in the game' for executives.

Globally competitive
Reward opportunity aligned to relevant competitive employment market; enabling mobility across different businesses and geographies.

Reflects ESG progress
Embedding the sustainability agenda to benefit all stakeholders; compliance and scrutiny of executive pay and fairness relative to the wider workforce.

Flexibility
Transparent and responsible application of discretion to override formulaic outcomes; ability to respond to special/unforeseen circumstances during life of binding policy.

Strategic rationale for our directors' remuneration

As detailed on page 167, the Committee's aim across the Group is to provide a reward package that is aligned to shareholders' interests, supports the achievement of the Company's in-year financial and strategic objectives, is competitive against the appropriate market and is consistent with our focus on performance and our values of Trusted, Innovative and Bold. In the context of our executive directors and senior executive population, a significant proportion of their remuneration package is performance-related, and the performance conditions applying to incentive arrangements support the delivery of the Company's strategy. The chart below shows the alignment of our incentive measures with our shared strategic objectives.

Shared strategic objectives

How our strategic objectives are measured in our incentives

	Sustain and grow our defence and security business	Continue to grow our business in adjacent markets	Develop and expand our international business	Enhance financial performance and deliver sustainable shareholder growth	Inspire and develop a diverse workforce to drive success	Advance and integrate our sustainability agenda
Annual incentive						
Earnings per share	●	●		●		
Net cash/(debt)	●			●		
Order intake	●	●	●	●		
Safety and diversity & inclusion[1]					●	●
Key strategic objectives	●	●	●	●	●	●
Long-term incentive						
Earnings per share	●	●		●		
Relative Total Shareholder Return	●	●	●	●		
Cash generation	●	●		●		
Strategic progress	●	●	●	●	●	
Return on capital employed (from 2023)	●	●	●	●		
Environmental, social and governance (from 2023)				●	●	●

1. Safety and diversity & inclusion will be applied as a downward underpin if these are not achieved at high levels expected.

The table below sets out how our executive directors' and senior executives' 2023 remuneration framework directly aligns to our strategy for 2023.

Element	Purpose and link to strategy
Base salary	Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.
Pension and benefits	Provide employment benefits and competitive post-retirement benefits to ensure overall package is market competitive.
Annual incentive	Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours, in order to deliver sustainable growth in shareholder value.
Bonus deferral	Compulsory deferral into shares increases alignment with long-term shareholder interests.
Performance shares	Direct financial measures based on the Key Performance Indicators (KPIs) that drive our financial ambitions for the Company, and measures linked to our key long-term strategic priorities including our sustainability agenda, aligned to the interests of our shareholders.
Restricted shares (predominantly in the US)	Ensure remuneration for senior US-based executives is competitive in the local market and also to assist in mitigating retention risks in respect of certain key executives.
Shareholding requirements	Provide long-term alignment with shareholder interests.

Engagement with shareholders

In line with our commitment to full transparency and engagement with our shareholders on the topic of executive remuneration, the Remuneration Committee Chair annually writes to our major shareholders and also the Institutional Shareholder Services, the Investment Association and Glass Lewis, to set out our planned remuneration changes.

During the formulation of the 2023 Policy, the Remuneration Committee Chair has engaged directly with and met our major shareholders to discuss and seek their views on potential changes. The Remuneration Chair values direct engagement with our shareholders and has made herself available for such meetings to hear their perspective on remuneration matters which has helped shape the 2023 Policy.

Engagement with workforce

The skills, capabilities and commitment of our people are critical to ensuring the long-term sustainability of our business and delivering the innovation needed to solve our customers' complex challenges. Effective engagement enables our employees to contribute to improving business performance and helps us to create an environment in which everyone is valued and can fulfil their potential.

Our values of Trusted, Innovative, and Bold and our Company Behaviours provide our employees with focus on how we create value for our stakeholders. As part of this, the Behavioural Framework is a key element of how we provide clear guidance on what we expect from our employees and stress the equal importance of what we do and how we do it. These behaviours are embedded within the personal objective setting process, as well as within development and training materials for managers and individual contributors.

In accordance with Provision 5 of the UK Corporate Governance Code (the Code), the ESG Committee undertakes workforce engagement on behalf of the Board, and Dr Jane Griffiths, Chair of the ESG Committee, provides regular updates to the Board on employee engagement. Additionally, reports from members of the executive team and our first-hand interactions with employees, allowed for discussions on various employee-related matters throughout the year. The Board engaged directly with employees through a mix of site visits, town hall Q&A sessions, informal discussions during on-site lunches, and dinners with high-potential employees. A fuller overview of the Board's engagement during the year and our employee engagement framework can be found on pages 152 to 154.

During 2022, we used a range of channels to engage with employees across the Group, including in-person and virtual meetings, briefings, conferences, toolbox talks, stand-downs and listening forums at all levels. Leaders provided regular updates through videos and podcasts, as well as attending events throughout the year. We also used digital channels including our Employee App, intranet, email and TV systems.

Employees were encouraged to share feedback and get involved in Company activities. We ran surveys and insight sessions to measure employee sentiment in the year.

Engagement has continued with trades unions in Australia and the UK and labour unions in the US.

We engaged with employees on health and safety issues through regular communications, as well as ongoing implementation or refreshment of health and safety standards to ensure compliance.

This report is the principal means through which we communicate and engage with employees on how executive remuneration aligns with that of the wider workforce. Around 53,000 of the Company's employees who are shareholders in the Company receive email communications with a direct link to this report on the Company's website and an invitation to vote on the resolutions being put to the Annual General Meeting (AGM), including those resolutions on executive remuneration. The results of employee shareholder voting on the AGM resolutions, including those relating to executive remuneration, are subsequently reported to the Board for discussion. This did not impact executive remuneration policy in 2022 as the remuneration policy was not due for renewal and is not used to seek feedback on individual outcomes.

Single total figure of remuneration

Single total figure of remuneration for the Chairman and non-executive directors (audited)

	Fees £'000		Benefits £'000		Other £'000		Total £'000		Total fixed remuneration £'000		Total variable remuneration £'000	
	2022	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021
Chairman												
Sir Roger Carr	**700**	700	**–**	–	**–**	–	**700**	700	**700**	700	**–**	–
Non-executive directors												
N J Anderson	**85**	85	**1**	2	**9**	–	**95**	87	**95**	87	**–**	–
C E Ashby[1]	**85**	28	**4**	–	**9**	9	**98**	37	**98**	37	**–**	–
Dame Elizabeth Corley	**85**	85	**1**	2	**9**	–	**95**	87	**95**	87	**–**	–
Dame Carolyn Fairbairn[2]	**30**	71	**1**	–	**–**	–	**31**	71	**31**	71	**–**	–
J V Griffiths	**110**	110	**1**	5	**9**	–	**120**	115	**120**	115	**–**	–
C M Grigg	**110**	110	**–**	–	**9**	–	**119**	110	**119**	110	**–**	–
C M Hogg[3]	**14**	n/a	**–**	n/a	**–**	n/a	**14**	n/a	**14**	n/a	**–**	n/a
E M Kirk[4]	**110**	62	**1**	1	**9**	–	**120**	63	**120**	63	**–**	–
S T Pearce	**110**	110	**1**	2	**9**	–	**120**	112	**120**	112	**–**	–
N W Piasecki	**101**	85	**6**	–	**14**	9	**121**	94	**121**	94	**–**	–
Lord Sedwill[3]	**14**	n/a	**–**	n/a	**–**	n/a	**14**	n/a	**14**	n/a	**–**	n/a
I P Tyler[5]	**38**	110	**1**	1	**–**	–	**39**	111	**39**	111	**–**	–

1. Appointed to the Board on 1 September 2021.
2. Appointed to the Board on 1 March 2021; retired from the Board on 5 May 2022.
3. Appointed to the Board on 1 November 2022.
4. Appointed to the Board on 1 June 2021.
5. Retired from the Board on 5 May 2022.

● Fixed remuneration element (Fees, Benefits, Other, Total fixed remuneration)
● Variable remuneration element (Total variable remuneration)

Chairman

The Chairman's fee is set by the Remuneration Committee.

Sir Roger Carr's fee is £700,000 per annum and will not be reviewed during the remainder of his term in office. Sir Roger is due to retire as Chairman at the close of the 2023 AGM.

Cressida Hogg will succeed Sir Roger Carr as Chair of the Company on 4 May 2023. She will receive the same fee and benefits as her predecessor. Her fee will not be reviewed further during the first 12 months of her appointment.

Non-executive directors

The non-executive directors' fees are set by the Non-Executive Directors' Fees Committee which comprises Sir Roger Carr (Committee Chair), Charles Woodburn, Tom Arseneault and Ed Gelsthorpe (Group General Counsel) who joined the Committee on 1 July 2022 and whose predecessor, Philip Bramwell, served on the Committee until his retirement on 30 June 2022.

The fee structure on a per annum basis has since April 2020 been set as follows: (i) each individual non-executive director: £85,000; (ii) additional fee for Committee chairs: £25,000; and (iii) additional fee for Senior Independent Director: £25,000. These amounts are shown in the 'Fees' column above.

A travel allowance of £4,500 per meeting is also paid on each occasion that a non-executive director's travel necessitates air travel of more than five hours (one way) to the meeting location, subject to a maximum of six travel allowances per year. These amounts are shown in the 'Other' column.

The amounts in the 'Benefits' column relate to travel expenses and subsistence.

The non-executive fee structure was reviewed in January 2023 and, in order to recognise more fully the time commitment and responsibilities involved, the following was agreed with effect from 1 April 2023:

- the fee of each individual non-executive director will increase by 4% (£3,400) per annum to £88,400;
- an additional Committee membership fee of £15,000 per annum for membership of each Committee (with the exception of the Nominations Committee) will be introduced;
- the additional fee for Committee chairs will increase to £35,000 per annum;
- the additional fee for the Senior Independent Director will increase to £35,000 per annum; and
- the travel allowance will cease.

This fee structure will be subject to periodic review.

The above table has been subject to audit.

Single total figure of remuneration for the executive directors (audited)

	Base salary £'000		Taxable benefits[1] £'000		Bonus[2] £'000		LTIP[3] £'000		Pension[4] £'000		Other[5] £'000		**Total £'000**		Total fixed remuneration £'000		Total variable remuneration £'000	
	2022	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021
C N Woodburn	**1,135**	1,108	**37**	24	**2,490**	2,420	**6,846**	3,332	**184**	186	**1**	1	**10,693**	7,071	**1,356**	1,318	**9,337**	5,753
B M Greve	**657**	622	**31**	17	**1,025**	968	**3,842**	–	**53**	50	**1**	1	**5,609**	1,658	**741**	689	**4,868**	969
T A Arseneault[6]	**851**	740	**56**	45	**1,865**	1,611	**3,869**	479	**89**	26	**1,261**	1,109	**7,991**	4,010	**996**	811	**6,995**	3,199

● Fixed remuneration element (Base salary, Taxable benefits, Pension, Total fixed remuneration)
● Variable remuneration element (Bonus, LTIP, Other, Total variable remuneration)

The above table has been subject to audit.

1. The benefits received by Charles Woodburn include the provision of a car allowance and private use of a chauffeur-driven car (2022 £25k; 2021 £22k), financial and tax advice support (2022 £6k; 2021 £nil) and provision of private medical insurance and medical benefits (2022 £6k; 2021 £1k). The benefits received by Brad Greve include the provision of a car allowance and private use of a chauffeur-driven car (2022 £19k; 2021 £16k), financial and tax advice support (2022 £6k; 2021 £nil) and provision of private medical insurance and medical benefits (2022 £6k; 2021 £1k). The benefits received by Tom Arseneault include private use of a chauffeur-driven car (2022 £14k; 2021 £8k); medical, dental and executive medical benefits (2022 £18k; 2021 £15k); insured life and disability benefits (2022 £4k; 2021 £7k); financial counselling benefit (2022 £12k; 2021 £nil); and the private use of a company aircraft (2022 £7.5k; 2021 £15k).
2. Further detail on bonus payments is provided on page 179. One-third of the net bonus paid will be deferred compulsorily into BAE Systems shares for a three-year period, without additional performance conditions.
3. This column relates to: (i) the estimated or actual value of Long-Term Incentive Plans for which the performance period ended in the relevant financial year; and (ii) the value of shares deriving from notional reinvested dividends as appropriate.

   In respect of (i), the values in the 2022 column are calculated on the basis of the three-month average share price of £8.127 as at 31 December 2022 and relate to the vesting portion (100% overall; 100% vesting on both TSR and EPS), including shares deriving from notional reinvested dividends, of the 2020 LTIP PS^{EPS}/PS^{TSR} for which the performance period ended on 31 December 2022 (see page 182 for further detail). With respect to the level of share appreciation, the Committee was satisfied that there was no risk of windfall as a result of the COVID-19 pandemic and that the level of vesting and value were appropriate (see page 182 for further detail). There has been no exercise of discretion as a result of share price appreciation or depreciation.

   An estimate of the amount of 2020 LTIP award attributable to share price appreciation is set out below.

	2020 LTIP PS £
C N Woodburn	+2,448,874
B M Greve	+1,380,109
T A Arseneault	+1,389,070

   In respect of (ii), the figure for Tom Arseneault is the value of the shares deriving from notional reinvested dividends for year 4 in respect of his 2018 Performance Share award, valued on release and pro-rated for his service as executive director since 1 April 2020 (£3k). The figure for Charles Woodburn is the value of the shares deriving from notional reinvested dividends for years 4 and 5 in respect of his 2017 Performance Share award and valued on exercise (£29k).

   As required by regulation, the estimated vesting values for the awards shown in the 2021 column (which were calculated in the 2021 Annual Report on the basis of the three-month average share price of £5.6227 as at 31 December 2021), have been adjusted to reflect the actual value on the vesting of the performance award in March 2022 based on the then share price of £7.228. The figures reported in the 2021 column in the 2021 Annual Report on the estimated basis were Charles Woodburn: £2,602k; and Tom Arseneault: £373k. The respective figures in the 2021 Total and Total variable remuneration columns have been recast accordingly. Additionally, the Chief Executive's single total figure for 2021 as referenced on pages 169 and 170 has been recast.

Single total figure of remuneration continued

4. The figures for Charles Woodburn and Brad Greve relate to a salary supplement in lieu of Company pension contributions and the added pension value received in the year from their defined contribution schemes in respect of the employer contributions.

   The figures for Tom Arseneault include company contributions paid into his Section 401(k) defined contribution arrangements. The figures for Tom Arseneault also reflect defined benefit arrangements calculated in line with the method set out in Section 229 of the Finance Act 2004 using a capitalisation factor of 20 for the life pension, a x10 factor for the ten-year pension and a x1 factor for the lump sum benefit (see page 183).

   Further detail on pensions is given on page 183.
5. This column includes (i) the value of Free Share awards under the UK all-employee Share Incentive Plan (SIP) of £628 for Charles Woodburn and Brad Greve, and their respective Matching Shares under voluntary investment in the SIP; and (ii) for Tom Arseneault, the value of the 2022 grant of Restricted Shares (£1,204k). This award formed part of Tom Arseneault's 2022 LTIP allocation but is required to be reported under 'Other' as it has no performance conditions attached. The balance of the 2022 figure (£57k) relates to the value of notional reinvested dividends in respect of his 2019 Restricted Share Plan award which vested in March 2022, the third anniversary of grant, and has been apportioned to include amounts in respect of his service as an executive director since 1 April 2020.
6. Tom Arseneault is paid in US dollars with the disclosed figures being converted into sterling at the required exchange rate. Tom Arseneault's 2022 salary reflects his 3.5% increase and the exchange rate fluctuations experienced during 2022.

There were no payments to former directors in 2022.

Implementation of our policy in the year ending 31 December 2023

For the purposes of the Companies Act 2006, the Directors' remuneration policy (the Policy) has been operating in practice since the date of its approval on 7 May 2020 at the 2020 AGM. The remuneration for 2023 will be implemented as follows:

– The salary of the Chief Executive is increased to £1,180,635 with effect from 1 January 2023.
– The salary of the Group Finance Director is increased to £750,150 with effect from 1 January 2023.
– The salary of the President and Chief Executive Officer of BAE Systems, Inc. is increased to $1,094,080 with effect from 1 January 2023.
– On 1 December 2022, the Chief Executive's employer pension contribution rate was aligned to the employer contribution rate of weighted average UK active members.
– Annual and Long-Term Incentive opportunity levels are in line with the 2023 Policy that is subject to shareholder approval at the 2023 AGM.
– Long-Term Incentive awards of Performance Shares only for UK executive directors, and Performance Shares and Restricted Shares for our US executive director.
– The performance measures and weightings for 2023 for the Annual and Long-Term Incentives are set out on page 166 with more detailed information on page 186 and pages 194 to 197. In addition, further information on rebalancing the LTIP metrics for 2023 is set out on pages 161 and 162.
– The Committee is of the view that bonus targets for the Annual Incentive are commercially sensitive and that it would be detrimental to the Company to disclose them in advance. The targets will be disclosed retrospectively after the end of the relevant financial year.

Annual bonus (audited)

Annual bonuses for the 2022 year are paid in March 2023. Annual bonus is made up of financial metrics, shared key strategic objectives relating to the delivery of the Group's strategy including objectives specifically focused on our sustainability agenda, and the demonstration of leadership behaviours. A safety and diversity underpin applies to the non-financial element, with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce. The breakdown of bonus measures, achievement and payout for each executive director is shown below. One-third of the net bonus payment is subject to compulsory deferral into BAE Systems shares for a three-year period, for which there is no additional performance condition.

Charles Woodburn Chief Executive

Measures	Weight (as a percentage of target)	Actual performance against targets set: Below	Threshold	Target	Stretch	Threshold for 2022	Target for 2022	Stretch for 2022	Actual performance[1]	Percentage of maximum opportunity
Financial										
Group underlying EPS	45.0					46.0p	48.4p	49.6p	52.2p	100%
Group net cash/(debt)	22.5					£(2,920)m	£(2,670)m	£(2,170)m	£(1,383)m	100%
Group order intake	7.5					£21.9bn	£23.1bn	£24.3bn	£35.6bn	100%
Non-financial										
Key strategic objectives	25.0					See Key strategic objectives section on page 180				90%
Safety and diversity & inclusion underpin[2]										100%
									Total bonus (as a percentage of maximum)	**97.5%**
									Amount of bonus	**£2,490,402**

Brad Greve Group Finance Director

Measures	Weight (as a percentage of target)	Actual performance against targets set: Below	Threshold	Target	Stretch	Threshold for 2022	Target for 2022	Stretch for 2022	Actual performance[1]	Percentage of maximum opportunity
Financial										
Group underlying EPS	45.0					46.0p	48.4p	49.6p	52.2p	100%
Group net cash/(debt)	22.5					£(2,920)m	£(2,670)m	£(2,170)m	£(1,383)m	100%
Group order intake	7.5					£21.9bn	£23.1bn	£24.3bn	£35.6bn	100%
Non-financial										
Key strategic objectives	25.0					See Key strategic objectives section on page 180				90%
Safety and diversity & inclusion underpin[2]										100%
									Total bonus (as a percentage of maximum)	**97.5%**
									Amount of bonus	**£1,025,243**

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

Measures	Weight (as a percentage of target)	Actual performance against targets set: Below	Threshold	Target	Stretch	Threshold for 2022	Target for 2022	Stretch for 2022	Actual performance[1]	Percentage of maximum opportunity
Financial										
Group underlying EPS	15.0					46.0p	48.4p	49.6p	52.2p	100%
Group net cash/(debt)	7.5					£(2,920)m	£(2,670)m	£(2,170)m	£(1,383)m	100%
Group order intake	2.5					£21.9bn	£23.1bn	£24.3bn	£35.6bn	100%
BAE Systems, Inc. underlying EBIT	30.0					$1,491.8m	$1,571.8m	$1,611.8m	$1,623.3m	100%
BAE Systems, Inc. net cash/(debt)	15.0					$2,053m	$2,233m	$2,593m	$2,916m	100%
BAE Systems, Inc. order intake	5.0					$10.7bn	$11.3bn	$11.9bn	$15.6bn	100%
Non-financial										
Key strategic objectives	25.0					See Key strategic objectives section on page 180				91.7%
Safety and diversity & inclusion underpin[2]										97.5%
									Total bonus (as a percentage of maximum)	**97.3%**
									Amount of bonus	**$2,304,127**

The above table has been subject to audit.

1. Adjusted to be on a comparable basis with the targets.
2. Performance in respect of the safety and diversity & inclusion underpin to the bonus was determined by the Environmental, Social and Governance Committee (whose composition is stated on page 151). In 2022, improvements in safety and diversity were underpins to the non-financial element of the executive bonus. In respect of 2022, the requirements for diversity improvements were met. Safety improvements were met at a Group level (applicable to the UK directors), but were not achieved within BAE Systems, Inc. While progress was made with some of the long-term metrics improving, especially around major injuries rates, the overall injury rate increased slightly over 2021 within BAE Systems, Inc. Given the importance of safety to our Company, it was confirmed that a reduction be applied to the non-financial element of the bonus applicable to our US director. See page 181.

Taking into consideration the overall business performance during the year, the Committee believes the bonus outturns are appropriate.

Annual bonus continued

Key strategic objectives

Achievement against key strategic objectives represents 25% of the annual bonus opportunity applicable to each of the executive directors. These objectives relate to the delivery of the Group's strategy centred on maintaining and growing our core franchises and securing growth opportunities through advancing our strategic priorities including our sustainability agenda, and demonstrating leadership behaviours. A safety and diversity underpin applies to the outturn of the non-financial element, with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce. Executive directors and Executive Committee members are collectively responsible for, and required to support, a set of shared common strategic objectives.

Charles Woodburn Chief Executive	Brad Greve Group Finance Director	Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.
Drive operational excellence **Key successes in 2022** – Nine Hawk advanced jet trainer aircraft accepted and delivered to 11 Squadron, the joint Qatar-UK Hawk squadron based at RAF Leeming, UK; joining forces with defence partners in the UK, Japan and Italy to deliver the next generation of combat air fighter jets; bringing our expertise into the development, advanced manufacture, electronic warfare systems and sustainment of the world's largest defence programme (F-35).		
– Delivered target net improved project performance margins per Group Salients. – Successful launch and roll-out of a refreshed Life Cycle Management (LCM) process to improve agility, execution and management of projects.	– Delivered target net improved project performance margins per Group Salients. – Successful launch and roll-out of a refreshed LCM process to improve agility, execution and management of projects.	– Delivered target net improved project performance margins per Group Salients. – Successful launch and roll-out of a refreshed LCM process to improve agility, execution and management of projects.
Continuously improve competitiveness and efficiency **Key successes in 2022** – Embarked on construction of a new, modern ship lift/land-level ship repair complex at our Jacksonville, Florida shipyard to improve production efficiency and increase capacity; in Lancashire, UK we continued to drive efficiencies and cost savings through our industry 4.0 Factory of the Future; worked hard to ensure continuity of supply and to proactively manage risks arising from supply chain disruptions as a result of global events.		
– Demonstrable improvement in Supply Chain Risk Management (SCRM) including improvement in risk to baseline. – Developed and implemented strategy leveraging transportation movement and spend in support of ESG, and operational excellence. – Increased enterprise organisation effectiveness and efficiency by achieving 100% transition to transactional and common shared services and delivering organisation health improvements in layers and spans of control.	– Demonstrable improvement in SCRM including improvement in risk to baseline. – Developed and implemented strategy leveraging transportation movement and spend in support of ESG, and operational excellence. – Increased enterprise organisation effectiveness and efficiency by achieving 100% transition to transactional and common shared services and delivering organisation health improvements in layers and spans of control.	– Demonstrable improvement in SCRM including improvement in SCR position. – Developed and implemented strategy leveraging transportation movement and spend in support of ESG, and operational excellence. – Reduced general and administration costs as % sales at BAE Systems, Inc.
Advance and further leverage our technology **Key successes in 2022** – Leading the design, test, evaluation and build process and bringing together new digital engineering technologies as part of Team Tempest, critical in the delivery of the UK's Future Combat Air System; completed acquisition of Bohemia Interactive Simulations (BISim) to provide cutting-edge virtual training for allied militaries; and continued integration and growth of the acquired In-Space Missions business and built satellites for DSTL, which were launched on the UK's Virgin Orbit craft, Cosmic Girl.		
– Exceeded Group integrated technology plans as set in IBP with over £300m investment. – Significant progress against agreed strategic technology growth themes of systems for multi-domain operations including: i. **Autonomy** – including release of Uncrewed Air System technology and autonomous detection capabilities; ii. **Space** – additional Low Orbit capability through In-Space Missions, our UK-based satellite company and working with third parties on Azalea, our multi-sensing satellite cluster; and iii. **Sustainability** – technology including sustainable ground power for UK Typhoons and electrifying the combat vehicle force of the future.	– Exceeded Group integrated technology plans as set in IBP with over £300m investment. – Significant progress against agreed strategic technology growth themes of systems for multi-domain operations including: i. **Autonomy** – including release of Uncrewed Air System technology and autonomous detection capabilities; ii. **Space** – additional Low Orbit capability through In-Space Missions, our UK-based satellite company and working with third parties on Azalea, our multi-sensing satellite cluster; and iii. **Sustainability** – technology including sustainable ground power for UK Typhoons and electrifying the combat vehicle force of the future.	– Significant progress against our Group integrated technology plans as set in IBP. – Significant progress against agreed strategic technology growth themes: world leader in developing, manufacturing and deploying state-of-the-art, radiation-hardened circuits for use in defence, space, intelligence, research, and commercial missions, resulting in our selection by the US Department of Defense to qualify a new generation of integrated circuit technology for use in the harsh environment of space.
Pursue and deliver growth **Key successes in 2022** – UK Ministry of Defence awarded £4.2bn contract to manufacture the next five City Class Type 26 frigates; MBDA (in which the Group has a 37.5% interest) won several export orders on air and naval platforms; won $699m contract for operations, maintenance and management services for the US Army's Defense Supercomputing Resources Center; £3.4bn of further contract funding awarded as part of Delivery Phase 3 for the Dreadnought programme; contract received worth $1.4bn (€1.34bn) to supply 152 CV9035 infantry fighting vehicles to replace the Slovakian Army's fleet; and we have signed a non-binding Memorandum of Understanding that provides a framework for negotiations to deliver CV90 combat vehicles to the Czech Republic.		
– Progressed and/or won specific key awards.	– Progressed and/or won specific key awards.	– Progressed and/or won specific key awards.

Charles Woodburn Chief Executive	Brad Greve Group Finance Director	Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.
Lead and inspire high-performance teams and individuals **Key successes in 2022** – Award-winning early career and skills programmes in markets such as the UK and Australia; focused efforts of recruiting and retaining a diverse workforce set against a backdrop of growth in demand across our business and a buoyant employment market.		
– Executive Committee pipeline and succession development with execution and tracking of development plan for potential successors. – Achieved milestones against D&I roadmap with an increase in rate of improvement in gender diversity, increasing diversity in early careers entry population and people managers participating in diversity awareness training. – Demonstrated inclusive leadership behaviours.	– Executive Committee pipeline and succession development with execution and tracking of development plan for potential successors. – Achieved milestones against D&I roadmap with an increase in rate of improvement in gender diversity, increasing diversity in early careers entry population and people managers participating in diversity awareness training. – Demonstrated inclusive leadership behaviours.	– Exceeded movement and development of Inc. SLT sponsorship participants to advance pipeline and further career opportunities. – Increased representation of women and people of colour in executive grades. – Demonstrated inclusive leadership behaviours.
Evolve, accelerate and integrate our sustainability agenda with progress across each of environment, social and governance **Key successes in 2022** – Selected to design, test and supply energy management components for GE Aviation's megawatt class hybrid electric propulsion system supporting NASA's Electrified Powertrain Flight Demonstration project; use of sustainable ground power for UK Typhoons; integrated a hybrid electric drive (HED) system onto a Bradley armoured fighting vehicle to electrify the combat vehicle force of the future; working with other companies to deliver synthetic environment training as an alternative to large-scale military exercises.		
– IBP approval of Net Zero roadmaps at Group and sector level to identify the key activities and investment required to decarbonise our operations by 2030. – Improved employee engagement and culture through quantitative, ongoing assessment of employee sentiment on key workplace issues. – Reduced overall significant Group risk rating. – Improved investor ESG ratings through improved data, progress in key ESG material areas and transparency of reporting. – Improvements against key safety indicators including regular SHE engagement tours and SHE training.	– IBP approval of Net Zero roadmaps at Group and sector level to identify the key activities and investment required to decarbonise our operations by 2030. – Improved employee engagement and culture through quantitative, ongoing assessment of employee sentiment on key workplace issues. – Reduced overall significant Group risk rating. – Improved investor ESG ratings through improved data, progress in key ESG material areas and transparency of reporting. – Improvements against key safety indicators including regular SHE engagement tours and SHE training.	– IBP approval of Net Zero roadmaps at Inc. level to identify the key activities and investment required to decarbonise our operations by 2030. – Improved employee engagement and culture through quantitative, ongoing assessment of employee sentiment on key workplace issues. – Reduced overall significant Group risk rating. – Improved investor ESG ratings through improved data, progress in key ESG material areas and transparency of reporting. – Improvements against key safety indicators including regular SHE engagement tours and SHE training.
Payout (% of maximum): **90%**	**Payout (% of maximum):** **90%**	**Payout (% of maximum):** **91.7%**
Safety and diversity & inclusion underpin: **100%**	**Safety and diversity & inclusion underpin:** **100%**	**Safety and diversity & inclusion underpin:** **97.5%**
Overall non-financial outturn: **90%**	**Overall non-financial outturn:** **90%**	**Overall non-financial outturn:** **89.4%**

In relation to the safety and diversity and inclusion underpin, the requirements for diversity improvements were met. Safety improvements were met at a Group level (applicable to the UK directors), but were not achieved within BAE Systems Inc. Given the importance of safety to our Company, it was confirmed that a reduction be applied to the non-financial element of the bonus applicable to our US director. See page 179 for further details. The shared nature of the common strategic objectives and the fact that the overall level of performance in 2022 had been strong in most areas resulted in the executive directors achieving a similar outturn.

Long-Term Incentive Plan (LTIP) performance

Annual average diluted underlying EPS growth

Outperformance of performance conditions ending on 31 December 2022	Threshold	Maximum	Actual	Percentage of maximum achieved
2022 EPS requirement	50.5p	56.0p	57.8p	
Annual average EPS growth	3%	7%	8.3%	100%

Relative TSR against comparator groups

Outperformance of performance conditions ending on 31 December 2022	Threshold	Maximum	Actual	Percentage of maximum achieved
TSR against sectoral comparator group	31.5%	44.4%	63.5%	100%
TSR against FTSE 100 comparator group	–1%	27.2%	63.5%	100%
Overall vesting against TSR				100%

2020 Performance Shares (LTIP PS)

Performance conditions: half on relative TSR against two comparator groups (with equal weighting), half on EPS growth of 3% to 7% per annum. The three-year performance period ended on 31 December 2022.

With respect to the 2020 LTIP PS TSR award, the maximum TSR performance was exceeded against both the sectoral and the FTSE 100 comparator groups and therefore the vesting level of the TSR portion of the award is 100%. In confirming this outcome, the Committee considered the secondary condition and determined that there had been a sustained improvement in the Company's underlying financial performance.

With respect to the 2020 LTIP PS EPS award, the 2019 EPS baseline for this award was based on underlying EBITA. During 2021 the Group moved to the underlying EBIT profitability measure which includes amortisation of software and development costs. The 2022 fully diluted underlying EPS, on an EBITA basis consistent with 2019 EPS is 57.8p as shown in the table above, having been adjusted to add back the amortisation of software and development costs.

In line with the Committee's agreed principles, as disclosed last year, it was agreed that constant currency should be used to ensure that the calculation of EPS is not affected by currency exchange rate fluctuations, upwards or downwards. The baseline from which performance over the three-year performance period was measured was c.1p per share higher than if an actual currency basis had been used.

In reviewing the composition of EPS growth, no one-off amounts were deemed relevant in the overall consideration of the achievement of the EPS outturn.

The Committee was therefore satisfied that the performance condition was achieved at a vesting level of 100% of the EPS portion.

In addition to the deliberations referred to above, as described on pages 160 to 161, the Committee carefully reviewed whether there was any potential windfall gains arising from the volatility in the market at the onset of the COVID-19 pandemic in March 2020. Our Remuneration Policy contains sufficient flexibility to reduce the number of awards vesting if required and the Committee attached an additional condition to the March 2020 grant to exercise discretion to ensure that the value of the awards in three years' time at vesting was appropriate.

In making its determination, the Committee considered the volatility of the Company's share price in the 12-month periods either side of the award date and observed that there was no material difference between the share prices between the March 2019 award (485.0p), March 2020 award (485.1p) and March 2021 award (499.9p).

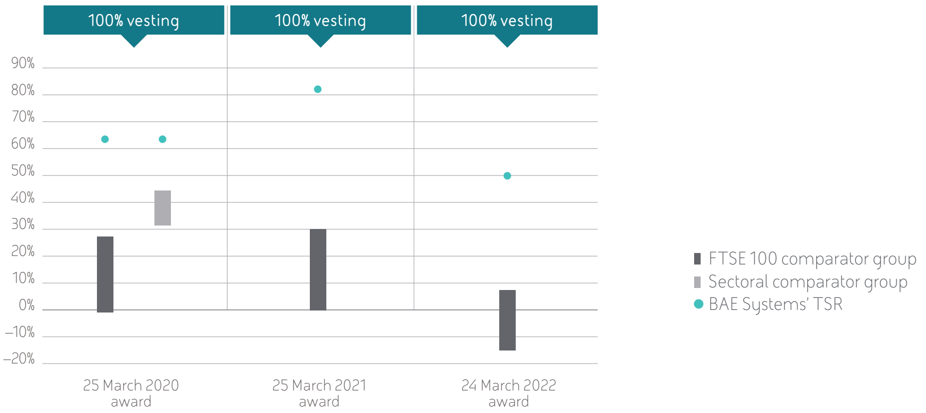
Taking these points into consideration the Committee was satisfied that there was no risk of windfall gains as a result of the COVID-19 pandemic, and the level of vesting and values were appropriate given the Company's underlying business performance over the three-year performance period and share price history.

The Committee therefore believes the vesting outturns of 100% for both the TSR and EPS portions of the 2020 awards are appropriate.

A summary of TSR performance to 31 December 2022 on outstanding TSR-related LTIP awards is illustrated in the chart below. The vesting percentage for the 25 March 2020 award is the actual vesting outturn referred to on page 182.

The grey boxes show the range of TSR required for 25% vesting to full vesting in respect of the FTSE 100 and sectoral international defence comparator groups, as appropriate, and the circles show BAE Systems' TSR. The proportion that would vest as at 31 December 2022 is shown in the boxes at the top of the chart.

TSR performance under the TSR-related awards as at 31 December 2022



Pension entitlements

Total pension entitlements (audited)

Director	Age	Normal retirement age	Accrued benefit at 1 January 2022[1] £	Accrued benefit at 31 December 2022[1] £	Figures included in the remuneration table on page 177		
					Added pension value received in the year from defined benefit scheme £	Added pension value received in the year from defined contribution scheme £	Total £
Charles Woodburn	51	65	64,928	66,229	n/a	4,000	4,000
Brad Greve	55	65	24,985	27,304	n/a	4,000	4,000
Tom Arseneault	59	65	See notes below		74,526	14,094	88,620

1. Accrued benefit for Charles Woodburn and Brad Greve is the total value of their defined contribution account, including employee contributions and investment returns.

The above table has been subject to audit.

Charles Woodburn participates in the Mercer Master Trust – BAE Systems Retirement Savings Plan (BAESRSP), which is a defined contribution arrangement. A salary supplement of £179,928 per annum was paid in 2022 in lieu of the Company contributions in excess of those permitted by the Annual Allowance (£4,000 per annum from 6 April 2020) which are paid into the BAESRSP.

Brad Greve also participates in the BAESRSP. The Company contributes the maximum into the BAESRSP arrangement as permitted by the Annual Allowance (£4,000 per annum from 6 April 2020). An 8% salary supplement is paid in lieu of the Company contributions in excess of those permitted by the Annual Allowance which are paid into the BAESRSP.

Tom Arseneault participates in US defined benefit and Section 401(k) arrangements as follows:

Arrangement	Accrued benefit at 1 January 2022	Accrued benefit at 31 December 2022
BAE Systems ERP Qualified Plan – life pension	$39,348 per annum	$39,348 per annum
BAE Systems ERP 2006 Qualified Plan – lump sum	$83,000	$84,000
12/31/2004 BRP Restoration Plan – life pension	$5,283 per annum	$5,283 per annum
2007 BRP – ten-year pension	$109,834 per annum	$101,177 per annum
Section 401(k)	$1,623,989	$1,421,754

Accrued defined benefit for Tom Arseneault is annual pension and lump sum payable at retirement prior to any reduction for early retirement. Tom Arseneault also participates in a Section 401(k) defined contribution arrangement set up for US employees in which the company will match his contributions up to a maximum contribution of 6% of salary, up to US regulatory limits (2023 $22,500; 2022 $20,500). In 2022, the company paid contributions of $16,950 into this arrangement. Accrued Section 401(k) benefit for Tom Arseneault is the total value of his Section 401(k) account including both employee and company contributions as well as investment returns.

Share interests (audited)

Scheme interests awarded during the financial year

Scheme	Type of interest	Date of grant	Number of shares	Basis of award	Face value of award[1] £	Exercise price £	Date to which performance is measured	Performance condition	Percentage of interests receivable if minimum performance achieved
Charles Woodburn									
LTIP PS[TSR]	Performance Shares/nil cost option	24.03.22	142,869	92.5% of salary	1,050,087	nil	Three years to 31.12.24	TSR/secondary financial measure	25%
LTIP PS[EFS]	Performance Shares/nil cost option	24.03.22	428,605	277.5% of salary	3,150,247	nil	Three years to 31.12.24	EFS	25%
Brad Greve									
LTIP PS[TSR]	Performance Shares/nil cost option	24.03.22	72,669	83.75% of salary	534,117	nil	Three years to 31.12.24	TSR/secondary financial measure	25%
LTIP PS[EFS]	Performance Shares/nil cost option	24.03.22	218,008	251.25% of salary	1,602,359	nil	Three years to 31.12.24	EFS	25%
Tom Arseneault									
LTIP PS[TSR]	Performance Shares	24.03.22	81,386	74.5% of salary	598,187	n/a	Three years to 31.12.24	TSR/secondary financial measure	25%
LTIP PS[EOS]	Performance Shares	24.03.22	244,156	223.5% of salary	1,794,547	n/a	Three years to 31.12.24	EOS	25%
LTIP RS	Retention	24.03.22	163,863	150% of salary	1,204,393	n/a	n/a	n/a	n/a

1. The value of the award is calculated on the date of grant by reference to the middle market quotation at the close of the preceding day.

Key: LTIP – Long-Term Incentive Plan. PS – Performance Shares. RS – Restricted Shares. TSR – Total Shareholder Return. EFS – Earnings per share, Free Cash Flow and Strategic Progress. EOS – Earnings per share, BAE Systems, Inc. Operating Cash Flow and Strategic Progress.

The performance share awards set out above have four performance conditions of EPS, TSR, cash generation and measures reflecting strategic progress with each condition equally weighted at 25%. Further detail on these performance conditions is set out on pages 185 and 186.

Note: Performance Shares and Restricted Shares – Shares under award attract notional reinvested dividends prior to vesting. Performance Shares are intended to be free share awards and for UK executive directors are structured as a nil cost option to give the participant more flexibility as to the timing of the benefit. For the US executive director, awards of Performance Shares are classified as conditional share awards (rather than share options) and are deliverable on the third, fourth and fifth anniversary of grant, subject to attainment of the performance condition. For the UK executive directors, shares vest on the fifth anniversary of grant.

The table above has been subject to audit.

Description of share plans and summary of performance conditions

Long-term incentives operate under the BAE Systems LTIP approved by shareholders at the 2014 AGM. The three main vehicles in use are Performance Shares, Restricted Shares and Share Options.

From 2018 executive directors no longer receive share option awards. Up to and including 2022, share options have been used below executive director level without performance conditions and are generally exercisable between three and ten years from grant.

Shareholders will be asked to approve the BAE Systems Long-Term Incentive Plan 2023 at the 2023 AGM, the terms of which remain substantially the same as the existing BAE Systems Long-Term Incentive Plan 2014.

LTIP Performance Shares

For 2017, shares under award vest after satisfaction of the three-year performance condition. Awards that vest are capable of being exercised in three equal tranches on a phased basis from the third, fourth and fifth anniversary of grant. Any unexercised awards will lapse on the seventh anniversary of grant. From 2018, awards to UK executive directors remain subject to the three-year performance period but will not vest until the fifth anniversary of grant and will be exercisable until the seventh anniversary of grant. For US executive directors, the awards are automatically delivered in three equal tranches at the end of years three, four and five, subject to the performance condition being achieved. Shares under award attract notional reinvested dividends prior to tranche vesting.

Existing awards granted up to and including 2020 are weighted 50% on the EPS performance condition and 50% on the TSR performance condition as set out below. The TSR sectoral comparator group is shown below.

Plan	Performance condition
LTIP PS^{EPS}	Rate of average annual diluted underlying EPS growth over the three-year performance period, with 25% vesting at 3% average growth per annum, 50% vesting at 5% average growth per annum and 100% vesting at 7% average growth per annum, with vesting on a straight-line basis between these parameters.
LTIP PS^{TSR}	The proportion of the award capable of exercise is determined by: (i) 50% of the TSR measure is on the sectoral comparator group of other international defence companies and 50% is on the companies in the FTSE 100 index. Under both the sectoral and FTSE 100 comparator groups, no shares vest if the Company's TSR is less than median TSRs achieved by the comparator group, with 25% vesting at median, 100% vesting if the Company's TSR is in the top quintile and vesting on a straight-line basis between these two parameters; and (ii) whether there has been a sustained improvement in the Company's underlying financial performance. In taking such a view, the Committee may consider (but not exclusively) the following financial metrics: net cash/debt; EBIT[1]; order book; turnover; risk; and project performance.

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure in place of the previously reported EBITA measure. Further details of this change are provided in the Financial glossary on page 302.

The TSR sectoral comparator group for awards from 2017 to 2019 comprises:

Cobham	Leonardo	SAIC
General Dynamics	Lockheed Martin	Thales
Harris Corporation	Meggitt	United Technologies
L3 Technologies	Northrop Grumman	
Leidos	Raytheon	

The TSR sectoral comparator group for awards made in 2020 comprises:

General Dynamics	Lockheed Martin	SAIC
L3 Harris Technologies	Meggitt	Thales
Leidos	Northrop Grumman	
Leonardo	Raytheon Technologies	

For awards granted in 2021 and 2022, the Company's TSR is measured against a single comparator group of the companies in the FTSE 100 index excluding BAE Systems.

For awards granted in 2021 and 2022, four performance conditions of EPS, TSR, cash generation and measures reflecting strategic progress apply with each condition equally weighted at 25%.

Plan	Performance condition
LTIP PS^{EPS}	Rate of average annual diluted underlying EPS growth over the three-year performance period, with 25% vesting at 3% average growth per annum, 50% vesting at 5% average growth per annum and 100% vesting at 7% average growth per annum, with vesting on a straight-line basis between these parameters.
LTIP PS^{TSR}	The proportion of the award capable of vesting is determined by: (i) The Company's TSR measured against a single comparator group of the companies in the FTSE 100 index. No shares vest if the Company's TSR is less than the median TSRs achieved by the comparator group, with 25% vesting at median, 100% vesting if the Company's TSR is in the top quintile and vesting on a straight-line basis between these two parameters; and (ii) whether there has been a sustained improvement in the Company's underlying financial performance. In taking such a view, the Committee may consider (but not exclusively) the following financial metrics: net cash/debt; EBIT; order book; turnover; risk; and project performance.
LTIP PS^{FCF} Applicable to UK directors only	Three-year cumulative Free Cash Flow (FCF) at a Group level, with 25% vesting at threshold, 50% vesting at target and 100% vesting at stretch, with vesting on a straight-line basis between these parameters. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year.
LTIP PS^{OCF} Applicable to US director only	Three-year Operating Cash Flow (OCF) in respect of the BAE Systems, Inc. business, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance, with vesting on a straight-line basis between these targets. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year.

Share interests continued

LTIP PS[SP]	The proportion of the award capable of vesting is determined by the following three key strategic objectives, each with equal weighting. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year. (i) **Drive operational excellence.** Focuses on the adherence to project plans of mission-critical projects. Measured by the metric of On Time Delivery, evaluated against an approved set of customer contracts, in a manner consistent with the normal course of business. Contracts are representative of each main business sector, having regard to execution risk, scale and duration. For our US executive director, On Time Delivery will be measured against BAE Systems, Inc. contracts only. The Company's robust quality and safety processes will continue to apply. Target performance achieved for equal or better than aggregated On Time Delivery three-year average. Threshold and stretch performance levels will also apply, with final vesting outturn between 0% and 100% of this element. (ii) **Continuously improve competitiveness and efficiency.** Measured by three-year Return on Capital Employed (ROCE) to support continually improving our competitiveness in order to drive profitable growth benefiting all of our stakeholders. For 2021: 25% vesting for 25bps reduction in 2023 ROCE, 50% vesting for 2023 ROCE consistent with the Integrated Business Plan (IBP) 2020 and 100% vesting for 25bps improvement in 2023 ROCE, with vesting on a straight-line basis between these parameters. For 2022: 25% vesting for 25bps reduction in ROCE compared to IBP 2021, 50% vesting for 2024 ROCE consistent with IBP 2021 and 100% vesting for 25bps improvement in ROCE compared to IBP 2021, with vesting on a straight-line basis between these parameters. (iii) **Advance and leverage our technology.** Effective programme delivery for major technology programmes will be used to measure our effectiveness at driving technology adoption. Over the three-year performance period, the selected projects will be measured against their key project milestones. The vesting outcome will be derived from the outturn of each of the projects (between 0% and 100% of this element) with final approval by the Committee.

For awards granted in 2023, the following metrics will apply:

Metric and weight	Performance condition
Earnings per share (EPS) – 30%	Rate of average annual diluted underlying EPS growth over the three-year performance period, with 25% vesting at 3% average growth per annum, 50% vesting at 5% average growth per annum and 100% vesting at 7% average growth per annum, with vesting on a straight-line basis between these parameters.
Free cash flow (FCF) – 30%	Three-year cumulative FCF at a Group level, or in the case of the US executive director, three-year operating cash flow (OCF) in respect of the BAE Systems, Inc. business. 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance, with vesting on a straight-line basis between these targets. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year.
Total shareholder return (TSR) – 15%	Determined by: (i) the Company's TSR measured against a single comparator group of the companies in the FTSE 100 index. No shares vest if the Company's TSR is less than the median TSRs achieved by the comparator group, with 25% vesting at median, 100% vesting if the Company's TSR is in the top quintile and vesting on a straight-line basis between these two parameters; and (ii) whether there has been a sustained improvement in the Company's underlying financial performance. In taking such a view, the Committee may consider (but not exclusively) the following financial metrics: net cash/debt; EBIT[1]; order book; turnover; risk; and project performance.
Return on capital employed (ROCE) – 15%	25% vesting for 25bps reduction in ROCE compared to IBP 2022, 50% vesting for 2025 ROCE consistent with IBP 2022 and 100% vesting for 25bps improvement in ROCE compared to IBP 2022, with vesting on a straight-line basis between these parameters. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year.
Environmental, social and governance (ESG) metric – 10%	Objective to reduce Group greenhouse gas (GHG) emissions (Scope 1 and 2) aligned to a science-based pathway of 1.5°C, year-on-year over ten years. Measurement over three-year performance period. 25% vesting for minimum 5% reduction, 50% vesting for 12.6% reduction and 100% vesting for 14% reduction. Vesting on a straight-line basis between these targets.

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure in place of the previously reported EBITA measure. Further details of this change are provided in the Financial glossary on page 302.

Note that in accordance with the Directors' remuneration policy, Performance Share awards granted to executive directors are subject to application of reasonableness discretion in light of other important factors in the business.

LTIP Restricted Shares

Restricted Shares are not subject to a performance condition as they are designed to help ensure remuneration for senior US executives is competitive in the local market and also to assist in mitigating retention risks in respect of certain key executives. The shares are subject only to the condition that the participant remains employed by the Group at the end of the vesting date (three years after the award date). Shares under award attract notional reinvested dividends prior to vesting. Awards made to the US executive director are subject to a further two-year clawback period after the initial three-year vesting period.

Statement of directors' shareholdings and share interests

Minimum Shareholding Requirement (MSR)

Executive directors are required to establish and maintain a minimum personal shareholding equal to a set percentage of base salary as set out in the table on page 187. Executive directors are required to achieve their Initial Value as quickly as possible, and achieve their Subsequent Value within a five-year time period. Where an executive director has not achieved their MSR, the consequence is a restriction on the number of shares that can be sold on exercise or release, until their MSR

Subsequent Value is met. Where an executive director has met less than the Initial Value (50% of their MSR), they must retain 50% of the net value (i.e. the value after the deduction of exercise/sale costs and tax) of shares acquired through the various share schemes; if they have met the Initial Value but not the Subsequent Value (i.e. between 50% and 100% of their MSR), they must retain 25% of the net value. In the event that the executive director has not met the Subsequent Value at the end of the five-year period, the Committee will set out their proposed remedial actions at that time. The Committee has discretion to increase the Initial Value and/or Subsequent Value. Shares owned beneficially by the director and his/her spouse count towards the MSR.

Where an executive director leaves employment for any reason, a post-cessation shareholding policy will apply. For UK executive directors, the policy is based on the full MSR continuing to apply for a period of two years. For US executive directors, the policy is based on 300% MSR applying for a period of one year. Executive directors will be required to sign a contract on leaving employment to ensure compliance with this policy. Any case of non-compliance would be dealt with by the Committee.

The following table sets out MSR Initial Value and Subsequent Value and actuals as at 31 December 2022:

	Initial Value	Subsequent Value	Actual
Charles Woodburn	150%	300%	353%
Brad Greve	100%	200%	102%
Tom Arseneault	212.5%	425%	613%

The actual MSR figures in the table are provided as at 31 December 2022, based on the year-end share price of £8.56.

The higher MSR values applicable to Tom Arseneault recognise the higher LTI opportunity and broader US market practice.

There are MSR requirements in place for the majority of the employee population who receive LTIPs.

There are no shareholding requirements for the Chairman or the non-executive directors.

Share interests as at 31 December 2022 (audited)

The interests of the directors who served during the year ended 31 December 2022 in the shares of BAE Systems plc, or scheme interests in relation to those shares, were as follows:

	Shares	Scheme interests: Options and awards over shares					
		Share awards with performance conditions	Share awards without performance conditions	Share options with performance conditions	Share options with performance conditions, vested but unexercised	Share options without performance conditions	Total scheme interests
Sir Roger Carr	166,549	–	–	–	–	–	–
N J Anderson	14,000	–	–	–	–	–	–
T A Arseneault	626,430	1,262,415	596,266	–	–	1,739,974	3,598,655
C E Ashby	–	–	–	–	–	–	–
Dame Elizabeth Corley	19,000	–	–	–	–	–	–
B M Greve	82,163	–	–	1,128,887	–	–	1,128,887
J V Griffiths	10,117	–	–	–	–	–	–
C M Grigg	24,555	–	–	–	–	–	–
C M Hogg[1]	–	–	–	–	–	–	–
E M Kirk	–	–	–	–	–	–	–
S T Pearce	10,000	–	–	–	–	–	–
N W Piasecki	–	–	–	–	–	–	–
Lord Sedwill[1]	–	–	–	–	–	–	–
C N Woodburn	468,600	–	–	3,115,297	–	–	3,115,297

1. Appointed to the Board on 1 November 2022.

Note: The share options without performance conditions were granted to Tom Arseneault prior to him being appointed as an executive director. These options are vested but unexercised. The related breakdown of these options is shown on page 188.

The above table has been subject to audit.

The interests of directors include those of their connected persons. Details of the share interests in options and awards held by the executive directors as at 31 December 2022 are given on page 188 together with details of options exercised in 2022.

Performance Shares granted under the LTIP are classified as share awards with performance conditions for the US executive director and as nil-cost options with performance conditions for the UK executive directors.

Since 31 December 2022, both Charles Woodburn and Brad Greve have each acquired an additional 51 shares under the Partnership and Matching Shares elements of the Share Incentive Plan so that their beneficial shareholdings at the date of this report stood at 468,651 and 82,214 respectively.

There have been no changes in the interests of the remaining directors in the shares of BAE Systems plc between 31 December 2022 and the date of this report.

Share interests continued

Breakdown of scheme interests (audited)

Charles Woodburn

Options and awards held as at 31 December 2022

	31 December 2022	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS^{TSR}	**285,227**[1]	20.03.18	nil	20.03.23
LTIP PS^{EPS}	**285,227**[1]	20.03.18	nil	20.03.23
LTIP PS^{TSR}	**55,416**[2]	20.03.19	nil	20.03.24
LTIP PS^{EPS}	**350,737**[2]	20.03.19	nil	20.03.24
LTIP PS^{TSR}	**373,737**[2]	25.03.20	nil	25.03.25
LTIP PS^{EPS}	**373,737**[2]	25.03.20	nil	25.03.25
LTIP PS^{TSR}	**204,936**[3]	25.03.21	nil	25.03.26
LTIP PS^{EFS}	**614,806**[3]	25.03.21	nil	25.03.26
LTIP PS^{TSR}	**142,869**[3]	24.03.22	nil	24.03.27
LTIP PS^{EFS}	**428,605**[3]	24.03.22	nil	24.03.27
	3,115,297			

Performance Shares – nil-cost options exercised during 2022

	Exercised during the year	Exercise price £	Date of grant	Date of exercise	Market price on exercise £
LTIP PS^{EPS}	44,301	nil	21.03.17	22.03.22	7.34

The Performance Shares nil-cost options exercised by Charles Woodburn attracted notional reinvested dividends which equated to an additional 9,214 shares on exercise of these options.

Brad Greve

Options and awards held as at 31 December 2022

	31 December 2022	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS^{TSR}	**210,626**[2]	25.03.20	nil	25.03.25
LTIP PS^{EPS}	**210,627**[2]	25.03.20	nil	25.03.25
LTIP PS^{TSR}	**104,239**[3]	25.03.21	nil	25.03.26
LTIP PS^{EFS}	**312,718**[3]	25.03.21	nil	25.03.26
LTIP PS^{TSR}	**72,669**[3]	24.03.22	nil	24.03.27
LTIP PS^{EFS}	**218,008**[3]	24.03.22	nil	24.03.27
	1,128,887			

Tom Arseneault

Options and awards held as at 31 December 2022

	31 December 2022	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS^{EPS}	**10,997**[2]	20.03.18	n/a	20.03.23
LTIP PS^{TSR}	**9,119**[2]	20.03.19	n/a	20.03.23
LTIP PS^{EPS}	**57,715**[2]	20.03.19	n/a	20.03.23
LTIP PS^{TSR}	**211,994**[2]	25.03.20	n/a	25.03.23
LTIP PS^{EPS}	**211,994**[2]	25.03.20	n/a	25.03.23
LTIP PS^{TSR}	**108,764**[3]	25.03.21	n/a	25.03.24
LTIP PS^{EOS}	**326,290**[3]	25.03.21	n/a	25.03.24
LTIP PS^{TSR}	**81,386**[3]	24.03.22	nil	24.03.25
LTIP PS^{EOS}	**244,156**[3]	24.03.22	nil	24.03.25
	1,262,415			
LTIP SO	**304,245**	26.03.14	4.12	26.03.17
LTIP SO	**258,380**	25.03.15	5.43	25.03.18
LTIP SO	**289,258**	23.03.16	4.99	23.03.19
LTIP SO	**267,026**	21.03.17	6.49	21.03.20
LTIP SO	**268,594**	20.03.18	5.82	20.03.21
LTIP SO	**352,471**	20.03.19	4.85	20.03.22
	1,739,974			
LTIP RS	**213,416**	25.03.20	n/a	25.03.23
LTIP RS	**218,987**	25.03.21	n/a	25.03.24
LTIP RS	**163,863**	24.03.22	n/a	24.03.25
	596,266			

Share Options – options exercised during 2022

	Exercised during the year	Exercise price £	Date of grant	Date of exercise	Market price on exercise £
LTIP SO	288,602	3.89	25.03.13	11.10.22	8.34

Note: The Share Options granted to Tom Arseneault between 2013 and 2019 as set out above were granted prior to him being appointed as an executive director and do not have performance conditions attached to them. Options are normally exercisable between the third and tenth anniversary of their grant. Share options granted to him from 2015 onwards are subject to a two-year clawback period after the initial three-year vesting period.

Note: As reported in the Remuneration Committee Chair's report in the 2020 Annual Report, in light of the volatility in the market during March 2020, the Committee attached an additional condition to the 2020 awards to retain the ability to exercise discretion to ensure that the value of the 2020 awards at vesting is appropriate. The outcome is reported on page 182. As reported in the Remuneration Committee Chair's report in the 2021 Annual Report, a similar condition was applied to the 2021 awards in light of volatility in the market in March 2021.

The tables above have been subject to audit.

Performance conditions for the LTIP are detailed on pages 184 to 186.

1. All shares due to vest subject to agreed terms.
2. Subject to a performance condition that has been met.
3. Subject to a performance condition that is yet to be tested.

Remuneration Committee composition and advisers

The Committee members comprise Nicole Piasecki, who joined the Committee and succeeded Ian Tyler as Chair when the latter retired from the Board at the close of the Company's AGM on 5 May 2022, Dame Elizabeth Corley and Chris Grigg. Dame Carolyn Fairbairn also served as a Committee member until she too retired from the Board with effect from the close of the Company's AGM on 5 May 2022. Committee attendance is shown on page 133. Advisers to the Remuneration Committee are shown below.

During the year under review, the Committee received material assistance and advice on remuneration policy from the Group Human Resources Director, Tania Gandamihardja, and her predecessor in this role, Karin Hoeing. Charles Woodburn in his role as Chief Executive also provided advice that was of material assistance to the Committee.

Adviser	Services provided	Appointment	Governance	Fees (in respect of services provided to the Committee)
Watson Towers Willis (WTW)	Since July 2022, independent adviser to the Committee, including attendance at Remuneration Committee meetings. Also provided information on remuneration market practice, market trends and benchmarking of the remuneration packages for the senior executive population.	Committee appointment. By the Company at the request of the Committee.	The Committee is aware that WTW provides unrelated services to the Company in the areas of benefits and pensions. The Committee is satisfied that the WTW lead adviser and team who provide remuneration advice to the Committee do not have connections with the Group, or the individual directors, that could impair their independence or objectivity. WTW is a member of the Remuneration Consultants Group (RCG) and is a signatory to the RCG's code of conduct.	£60,000 Fee basis: Fixed fee/ hourly
PricewaterhouseCoopers (PwC)	Up to June 2022, independent adviser to the Committee, including attendance at Remuneration Committee meetings. Also provided information on market practice in relation to different aspects of remuneration, market trends and benchmarking of the remuneration packages for the executive population.	Committee appointment. By the Company at the request of the Committee.	The Committee is aware that PwC provides a variety of other services to the Company, including tax and pensions advice. PwC also provides a range of consultancy services. The Committee is satisfied that the PwC LLP engagement partner and team, who provided remuneration advice to the Committee, did not have connections with the Group, or the individual directors, that could impair their independence and objectivity. PwC is a member of the Remuneration Consultants Group (RCG) and is a signatory to the RCG's code of conduct.	£38,044 Fee basis: Fixed fee/ hourly
	Provides support in relation to assessing the TSR performance updates and vesting outcomes for in-flight awards granted under the BAE Systems LTIP 2014.	By the Company.	The nature of the advice provided to the Committee is based on factual information concerning the performance of the Company's shares relative to the chosen peer group(s).	£13,500 Fee basis: Fixed fee
Linklaters	Provided legal services, principally advice regarding remuneration policy, reporting and remuneration awards.	By the Company with the approval of the Committee.	Only provides legal compliance, legal drafting and review services, and does not advise the Committee. The Committee is aware that Linklaters is one of a number of legal firms that provide legal advice and services to the Company on a range of matters. Linklaters is regulated by the Law Society.	£43,908 Fee basis: Hourly

Directors' remuneration policy

This Directors' remuneration policy (the Policy) will take effect from the conclusion of the 2023 Annual General Meeting (AGM) subject to shareholder approval at the 2023 AGM.

The Remuneration Committee (the Committee) is governed by Terms of Reference which set out its roles and responsibilities including how the Committee will be conducted and operate. These are reviewed at least annually to ensure they remain appropriate and include relevant corporate governance and other guidance. The Terms of Reference are available on the Company's website.

The Committee has appointed independent external advisers to provide material independent assistance and advice. In addition, to avoid any conflicts of interest or appearance thereof, no director is involved in deciding their own remuneration outcome with such items being discussed without their presence in the meeting.

The Committee considers the remuneration policy annually to ensure that it remains aligned with business needs and is appropriately positioned relative to the market. However, in the absence of exceptional or unexpected circumstances which may necessitate a change to the Policy, there is currently no intention to revise the Policy more frequently than every three years.

The Policy is to set base salary with reference to the relevant market-competitive level. We use target performance to estimate and benchmark the total potential reward against reward packages paid by BAE Systems' competitors. Actual total direct reward reflects the performance of the individual and the Company as a whole. The aim is to deliver an overall remuneration package for executive directors which provides an appropriate balance between short-term and long-term reward and between fixed and variable reward as described more fully below.

The Long-Term Incentive Plan provides the Committee with discretion over vesting outcomes that affect the actual level of reward payable to individuals; as explained on page 195, such discretion would only be used in exceptional circumstances and, if exercised, disclosed at the latest in the report on implementation of the Policy (i.e. the Annual remuneration report) for the year in question.

Contents

Note

References in this Policy to 'UK executive directors' are to UK-based executive directors and references to 'US executive directors' are to US-based executive directors.

Revisions compared to the policy approved at the 2020 AGM

The Committee conducted a thorough review of the Policy during 2022 against six agreed core principles of Simplicity, Motivational, Aligned with shareholder interests, Globally competitive, Flexibility, and reflects Environmental, Social and Governance progress. With an overall objective of securing top talent and rewarding sustainable long-term value creation, the Committee focused on the following areas:

- **Alignment to strategy:** The overall Policy and incentive metrics were evaluated against the Company's strategy, purpose and key priorities to ensure that the Policy remains fit for purpose. This included incorporating Environmental, Social and Governance measures into our incentives.
- **Flexibility:** In addition to having a transparent remuneration framework, it was important for the Policy to have flexibility in design construct and choice of metrics, as well as the ability for the Committee to respond to exceptional external factors.
- **Global competitiveness:** The Committee assessed the Policy against relevant markets to ensure the Company can attract and retain the key talented individuals needed to deliver the strategy.
- **Corporate governance best practice:** Throughout the review of the Policy, the Committee considered governance best practice and the views of institutional shareholders. This review considered best practice in the US as well as the UK.
- **Alignment with shareholder interests:** The Committee conducted an extensive shareholder consultation in which views were sought on the key features of the Policy focusing on any revisions. The Committee Chair engaged with our major shareholders and welcomed their feedback in formulating this Policy.

The Committee concluded that the policy approved at the 2020 AGM remains effective and is appropriately aligned to the Company's strategy and shareholders' interests. As such, the 2023 Policy remains broadly unchanged and contains no new components which were not already in the Policy approved at the 2020 AGM. The key changes proposed in the 2023 Policy, which are intended to improve flexibility and competitiveness, are:

- Group Finance Director – Annual bonus opportunity;
- President and Chief Executive Officer, BAE Systems, Inc. – Long-term incentive opportunity; and
- revisions to long-term incentive metrics.

These are referenced below with further context and commentary provided in the Remuneration Committee Chair's report on pages 160 to 163.

Salary

- The overall process for determining salary increases remains unchanged.
- In general, increases will continue to be no greater than the wider workforce.
- Salary levels will continue to consider appropriate market comparisons and for UK executive directors this will include subsets of the FTSE 100 including the FTSE 50 and FTSE 30.

Annual incentive plan (AIP)

- The overall structure of the AIP remains unchanged including the approach to determining performance metrics and the bonus deferral mechanism as the Committee believes these remain fit for purpose.
- The maximum award levels for the Chief Executive, the President and Chief Executive Officer, BAE Systems, Inc. and Chief Operating Officer are unchanged.
- The maximum award level for the Group Finance Director will be 200%, increased from 160% to fairly reflect the expansion of his managerial responsibilities and bring into line with other Group Finance Directors in the FTSE 30.
- Confirmation that non-financial metrics will continue to be based on a combination of personal performance objectives linked to our strategic objectives, safety measures, and diversity and inclusion targets. To support our focus on our sustainability agenda, specific quantifiable and appropriate Environmental, Social and Governance (ESG) metrics will be included within the non-financial key strategic objectives (KSOs) element of the AIP for 2023.

Long-Term Incentives (LTI)

- The structure of our LTI framework will remain unchanged, with UK executive directors continuing to receive Performance Shares only and US executive directors eligible to receive a mix of Performance Shares and Restricted Shares.
- There is no change to the grant levels of Performance Shares for the Chief Executive, the Group Finance Director and the Chief Operating Officer.
- For the President and Chief Executive Officer, BAE Systems, Inc. the Committee proposes to increase the Performance Share award from 298% to 440% of salary and maintain the Restricted Share award at 150% of salary.
- The Committee is acutely aware of the unique context in which our US executive director operates. The Committee has applied careful judgement to delicately balance the strategic importance of our US business, the market practice of relevant US aerospace and defence peers, and the corporate governance and best practice requirements that come with being an executive director of a UK plc.
- Having reflected on the President and Chief Executive Officer, BAE Systems, Inc.'s strong performance and successful leadership of our US business, and following a detailed review of the total remuneration package of relevant US aerospace and defence peers, the Committee determined that it was appropriate to propose an increase in the LTI opportunity.
- The Committee will maintain its ability to determine performance measures, weightings and targets for each LTI award. As part of this, and to provide greater flexibility around the most appropriate metrics and weightings, the minimum weighting of 20% being applicable to the Total Shareholder Return (TSR) metric will be removed.
- Performance Shares granted from 2023 will feature an ESG metric in line with the Committee's previous commitment.
- For 2023, the ESG metric will have a 10% weighting and is based on the reduction of Group greenhouse gas (GHG) emissions (Scope 1 and 2) aligned to a science-based pathway. TSR will have a 15% weighting; Earnings per Share and Cash Flow will each have 30% weighting; with the remaining 15% measured on Return on Capital Employed (replacing the Strategic Progress metric).

Benefits

- Modest changes to benefits including limited financial and tax advice support, executive medical for the US executive director and, for UK executive directors, the introduction of medical benefits and an increase to the car allowance.

Pension

- As previously stated, the Committee recognises the requirements of institutional investors and the UK Corporate Governance Code to align executive director pension contributions with the wider workforce level. As such, the Chief Executive's employer pension contribution rate has been reduced to the weighted average employer contribution rate of UK active members.

Recruitment

- Maximum opportunities on recruitment for incentives (excluding buyouts of existing incentives) will be subject to the maxima stated in the policy table.

Remuneration policy for other employees

- Confirmation that LTI grants below executive director level will continue to be made in line with 2023 policy, reflecting the relevant geographies and with the following differences:
  - Performance Shares will vest after three years subject to meeting the required performance conditions; and
  - share options will no longer be granted.

Non-executive directors' fees

- Subject to election as Chair at the 2023 AGM, the current Chair designate's fee will be initially set at £700,000 (consistent with the fee for the current Chair).
- Non-executive directors receive a basic fee. An additional fee is paid for committee membership (with the exception of the Nominations Committee), for those who chair a committee and/or undertake the role of Senior Independent Director.
- From April 2023, the travel allowance has been discontinued.

Consideration of employment conditions elsewhere in the Company

Further details provided in relation to building the Committee's understanding of reward arrangements applicable to the wider workforce.

Stakeholder considerations

Further details provided in relation to the Committee's engagement with shareholders on the topic of executive remuneration.

Executive directors' policy table

Base salary

Purpose and link to strategy
Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.

Operation
Salaries are reviewed annually. Business and individual performance, skills, the scope of the role and the individual's time in the role are taken into account when setting and assessing salaries, as is market data for similar roles in the relevant market comparator group.

The comparator groups for UK executive directors are comprised of subsets of the FTSE 100 including the FTSE 30 and FTSE 50. For the President and Chief Executive Officer, BAE Systems, Inc., the comparators are drawn from companies in the US aerospace and defence sectors, together with similar organisations in the general industry sector reflecting the size and geography of BAE Systems, Inc.

Maximum opportunity
When considering salary increases for the executive directors in their current roles, the Committee considers the general level of salary increase across the Group and in the relevant external market.

Actual increases for the executive directors in their current roles will generally not exceed the average percentage increase for employees as a whole, taking account of the level of movement within the relevant UK/US comparator group.

As a maximum, in exceptional circumstances (such as a material increase in job size or complexity while performing the same role, or a recently appointed executive director where the salary is positioned low against the market), the increase is not expected to exceed 10% in any single year for executive directors performing the same role. If an individual's role changes then a salary increase above 10% may be awarded in any single year to position their salary appropriately in accordance with the base salary principles described under 'Operation' above. No new executive director role will have a salary greater than the Chief Executive at that time.

Performance metrics, weighting and time period applicable
None.

Executive directors' policy table continued

Annual incentive

Purpose and link to strategy
Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours in order to deliver sustainable growth in shareholder value.

Compulsory deferral into shares increases alignment with long-term shareholder interests.

Operation
The annual incentive is driven off in-year financial performance, corporate responsibility and other non-financial objectives measured at the Group and individual level.

One-third of the total net annual incentive amount is subject to compulsory deferral for three years in BAE Systems shares without any matching.

Cash dividends are payable to the participants on the shares held during this three-year deferral period.

A malus/clawback mechanism may be applied to any bonus, and a malus mechanism may be applied to the deferred bonus shares until up to the end of the three-year deferral period, where:

- the Company is entitled to terminate employment for cause or the participant has engaged in misconduct (including breach of policy) which gives rise to other disciplinary sanction;
- the results of the Company and/or relevant business or businesses for any period have been restated or subsequently appear materially inaccurate or misleading;
- any Group company or business unit has made a material financial loss; and/or
- the measurement of any performance condition does not reflect the actual performance of the Company over the performance period.

Maximum opportunity
Chief Executive: 225% of salary.

Chief Operating Officer: 200% of salary.

Group Finance Director: 200% of salary.

President and Chief Executive Officer, BAE Systems, Inc.: 225% of salary.

The payout for on-target performance is 50% of the payout for maximum performance (which is shown as the respective maximum opportunity percentages above). In respect of the financial metrics, the payout for achieving threshold performance is 20% of the payout for maximum performance, with no payout for performance less than threshold. Payout for performance between threshold, target and maximum is calculated on a straight-line basis.

Performance metrics, weighting and time period applicable
Performance is assessed on an annual basis, using a combination of the Group's main performance indicators for the year and other objectives designed to support the Group's strategy. Metrics, which will include financial and non-financial metrics as well as the achievement of personal objectives, will be determined and weighted each year according to business priorities and may be structured as targets to be achieved, or underpins which, if not achieved, will reduce payouts. 75–80% of targets will relate to financial metrics aligned with long-term earnings and cash targets. The non-financial element will be based on a combination of personal performance objectives that provide a clear line of sight to our strategic objectives including those in relation to environmental, social and governance (ESG), safety measures, and diversity and inclusion (D&I)*.

Metrics, targets and weightings to be determined annually.

Metrics and weightings applicable in 2023:

For UK executive directors:	For US executive director:
Group EPS – 45%.	Group EPS – 15%.
Group net cash/(debt) – 22.5%.	Group net cash/(debt) – 7.5%.
Group order intake – 7.5%.	Group order intake – 2.5%.
	BAE Systems, Inc. EBIT – 30%.
	BAE Systems, Inc. net cash/(debt) – 15%.
	BAE Systems, Inc. order intake – 5%.

Key strategic objectives (KSOs) designed to support the Group's strategy and with safety and D&I applying as a downward underpin on this element – 25%.

*See notes 4 and 5 on page 199 regarding the selection and weighting of performance metrics.

All bonus payments are at the discretion of the Committee, which will be based on an assessment of the individual's personal contribution to business performance over the relevant year and leadership behaviours demonstrated in making that contribution, relative to others. See note 6 on page 199 regarding the application of the reasonableness discretion.

Long-Term Incentives (LTI)

Operation
Long-term incentives will operate under the BAE Systems Long-Term Incentive Plan which is subject to approval by shareholders at the 2023 AGM.

The size of awards granted is based on a percentage of salary, which is divided by the share price around the time of the grant to determine the number of shares subject to the award.

Dividend equivalents in respect of vested shares may be paid at the time of vesting (or exercise, in the case of options) and are not taken into account when determining individual limits.

A malus and clawback mechanism may be applied, until two years after vesting, or if sooner, the fifth anniversary of grant, or the occurrence of certain corporate events to all awards granted on or after 25 March 2015 where:
- the Company is entitled to terminate employment for cause or the participant has engaged in misconduct (including breach of policy) which gives rise to other disciplinary sanction;
- the results of the Company and/or relevant business or businesses for any period have been restated or subsequently appear materially inaccurate or misleading;
- any Group company or business unit has made a material financial loss; and/or
- the measurement of any performance condition does not reflect the actual performance of the Company over the performance period.

Awards and performance conditions can be adjusted to take account of variations of share capital and other transactions or events.

On a change of control or similar transaction, awards generally will vest to the extent performance conditions are then satisfied (if applicable) and then be pro-rated to reflect the acceleration of vesting unless the Committee decides otherwise. Alternatively, awards may be exchanged for equivalent awards over shares in the acquiring company.

The share plan rules may be amended from time to time by the Committee in certain circumstances including minor changes for administrative, tax or other regulatory purposes.

Subject to this Policy, performance conditions of awards already granted may be amended in accordance with their terms or if anything happens which causes the Committee reasonably to consider it appropriate to do so.

Maximum opportunity
Over the lifetime of this Policy, the Committee will have discretion to vary the weighting of different types of awards within the framework set out below, but the overall LTI Expected Value (EV) will remain the same (assuming the LTI EV is calculated as 50% of face value for Performance Shares and 100% of face value for Restricted Shares):
- UK executive directors' awards will consist of Performance Shares only.
- US executive directors' awards will consist of a mix of Performance Shares and Restricted Shares (with the annual grant of Restricted Shares comprising no more than 150% of salary), ensuring competitiveness of overall LTI opportunity in line with US market practice.

Performance metrics, weighting and time period applicable
The Committee will establish the targets for each measure at the start of each performance period based on Group projections and market expectations for the business. The performance conditions for previous awards are described in the Annual remuneration report.

See below in relation to Performance Shares.

In addition to the primary performance tests set out below, the Committee confirms and recognises its obligation to judge the overall reasonableness of the rewards received relative to the overall business actions and results achieved. When determining the final performance condition outcome under Performance Share awards, the Committee will have discretion over the number of awards vesting in light of other important factors in the business (reasonableness discretion). The discretion may result in vesting of awards going upwards (subject to maximum 100% vesting of awards) as well as downwards. Any factors will be properly considered as they arise and any discretion to the calculated results will be applied in a highly disciplined manner and the rationale and impact will be reported transparently.

See notes 4 and 5 on page 199 regarding the selection and weighting of performance metrics.

Executive directors' policy table continued

Long-Term Incentives – Performance Shares

Purpose and link to strategy
Direct financial measures based on the Key Performance Indicators (KPIs) that drive our financial ambitions for the Company, and measures linked to our key long-term strategic priorities including our sustainability agenda, aligned to the interests of our shareholders.

Operation
For UK executive directors, awards, typically in the form of nil-cost options, will vest subject to performance and service conditions on the fifth anniversary of grant. These will be exercisable between the fifth and tenth anniversary of grant or such shorter period as may be specified by the Committee.

For US executive directors, awards are delivered as conditional share awards. To maintain the competitiveness of the LTI offering in the US, awards will vest automatically in three equal tranches on the third, fourth and fifth anniversary of grant, subject to three-year performance conditions.

No additional holding periods apply.

Policy maximum opportunity
Award levels applicable to UK executive directors for normal annual grants are as follows:

Chief Executive: 370% of salary.

Chief Operating Officer: 350% of salary.

Group Finance Director: 335% of salary.

Award levels applicable to US executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Restricted Shares) are as follows:

President and Chief Executive Officer, BAE Systems, Inc.: 440% of salary.

The minimum value that an executive director can receive is zero on the basis of nil vesting, for example either due to the performance conditions not being achieved, or as a result of the application of reasonableness discretion that determines nil vesting of the awards.

Threshold performance under the financial performance measures is 25% of the maximum for that measure.

Performance metrics, weighting and time period applicable
Metrics and weightings for the 2023 award will be as follows (subject to the Committee's ability to adjust as set out below):

- 15% of award based on Total Shareholder Return (TSR) relative to one or more appropriate comparator groups over the three-year performance period as selected by the Committee at the time of grant:
  - Vesting for each comparator group is determined as: nil vesting if TSR ranked below median in the comparator group; 25% vesting if TSR ranked at the median; 100% vesting if TSR ranked in the upper quintile; pro-rata vesting for performance between median and upper quintile.
  - If more than one comparator group is used, vesting of the TSR portion of the award will be determined by the average of the vesting outcomes from each comparator group.
  - Award subject to a secondary financial measure as set out on pages 185 and 186.
- 30% of award based on average annual Earnings per Share (EPS) growth over the three financial years starting with that in which the award is granted, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance. Pro-rata vesting for intermediate performance between threshold, target and stretch.
- 30% of award based on three-year cumulative cash generation metric over the three financial years starting with that in which the award is granted, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance. Pro-rata vesting for intermediate performance between threshold, target and stretch.
- 15% of award based on Return on Capital Employed (ROCE) over the three financial years starting with that in which the award is granted, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance. Pro-rata vesting for intermediate performance between threshold, target and stretch.
- 10% of award based on one or more robust and measurable ESG objectives.

Note that awards granted to executive directors are subject to application of reasonableness discretion in light of other important factors in the business as described earlier.

The Committee can adjust the weighting of the performance conditions, and, if considered appropriate, may introduce an alternate performance condition aligned to the Company's strategy, or remove a performance condition set out above.

See notes 4 and 5 on page 199.

Long-Term Incentives – Restricted Shares

Purpose and link to strategy
Provide long-term reward through time-vesting awards principally in the Company's US market.

Operation
The shares are subject only to the condition that the participant remains employed by the Group on the vesting date (three years after the award date). Directors are required to retain their shares for a further two-year period, except for any shares that need to be sold to cover tax liabilities due in respect of the shares. During that time, they are subject to clawback as described above. However, this holding requirement will not apply following a change of control. These awards are not subject to a performance condition as they are designed to address competitive market practice and retention issues principally in the US. Non US-based executive directors are not eligible.

Policy maximum opportunity
Award levels applicable to US executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Restricted Shares) are as follows:

President and Chief Executive Officer, BAE Systems, Inc.: 150% of salary.

Performance metrics, weighting and time period applicable
None.

See notes 4 and 5 on page 199.

Benefits

Purpose and link to strategy
Provide employment benefits which ensure that the overall package is market competitive when these elements are taken into account.

Operation
Benefits include provision of a company car (or cash equivalent), life assurance and ill-health benefit cover which are provided directly or through membership of the Company's pension schemes, and financial and tax advice support.

The main benefits in the UK include a car allowance (currently £25,000 per annum for the Chief Executive and £20,000 per annum for the Group Finance Director), private use of a chauffeur-driven car and annual medical screening, medical benefits, financial and tax advice support, plus life assurance and ill-health benefit cover provided through membership of the Company's pension schemes.

Opportunity for UK executive directors to participate in the Share Incentive Plan, a tax approved all-employee plan.

In the US, benefits include parking and private use of a chauffeur-driven car and company aircraft, financial and tax advice support, medical, executive medical and dental benefits, and insured life and disability benefits.

Additional benefits, such as relocation assistance, may also be provided in certain circumstances if considered reasonable and appropriate by the Committee. Relocation assistance comprises reimbursement for direct items of expenditure, such as legal, estate agency, removals and temporary accommodation.

Directors' and Officers' insurance cover is also provided for all executive directors.

Maximum opportunity
Benefits are set at a level which the Committee considers to be appropriate against comparable roles in companies of similar size in the relevant market. Benefits are as reported and itemised within the single total figure shown as part of the Annual remuneration report on page 177. The maximum cost of such benefits will reflect the associated market-competitive cost of provision. Relocation assistance is based on actual costs incurred which are linked to the size and value of the property, plus a maximum relocation allowance of £2,500.

Participation limits for the Share Incentive Plan are those set by the UK tax authorities from time to time.

Performance metrics, weighting and time period applicable
None.

Executive directors' policy table continued

Pension

Purpose and link to strategy
Provide competitive post-retirement benefits or cash allowance equivalent.

Operation
The Chief Executive is a member of the Mercer Master Trust – BAE Systems Retirement Savings Plan (BAESRSP) into which the DC section of the BAE Systems Executive Pension Scheme was transferred. Recognising the requirements of institutional investors and the UK Corporate Governance Code, since 1 December 2022, the Chief Executive's employer pension contribution rate has been reduced to the weighted average employer contribution rate of UK active members. In the UK, the Company has a number of defined benefit plans which are closed to new entrants, with new hires being offered membership of the BAESRSP, a defined contribution pension scheme. Employer contribution rates for the different schemes range from 6% to approximately 50% of salary. The level of employer contribution based on a weighted average of UK active members across all schemes is approximately 14% as at 30 September 2022. Since 1 December 2022, the employer contribution to the Chief Executive's pension has been aligned to 14% of salary, being the wider workforce figure.

For any new externally appointed UK executive directors, or internally appointed UK executive directors, membership of the BAESRSP is offered as the default pension vehicle. Employer contributions are currently set at 8% of base salary for those members contributing 6% of salary, in line with that available to the wider UK workforce participating in the Company's UK defined contribution arrangements. In certain circumstances, individuals may elect instead to receive some or all of their employer contributions as a cash allowance.

Consistent with the above, the Group Finance Director is a member of the BAESRSP with employer contributions of 8% salary.

Where the Annual Allowance (AA) is exceeded, as is the case with the Chief Executive and the Group Finance Director, each individual will receive employer contributions up to the AA limit and the remaining employer contributions will be paid as a salary supplement. Where UK executive directors' pension entitlement or accrual is restricted to the Lifetime Allowance (LTA) and/or the AA, the Company may offer a salary supplement to offset the impact of these restrictions.

Any new US executive directors, whether externally appointed or internally appointed, would be offered participation in the US Section 401(k) defined contribution plan. The same provisions and features of the plan currently apply to the majority of participating active employees, with the company (i.e. employer) matching contributions up to a maximum of 6% of salary, subject to US regulatory limits. For any internally appointed US executive directors they will be able to maintain any previous pension plan arrangement on the basis that the same provisions and features of the plan align with those available to the relevant workforce.

The President and Chief Executive Officer, BAE Systems, Inc. participates in a Section 401(k) defined contribution arrangement, as detailed above, and is also a participant in the BAE Systems Employees' Retirement Plan (ERP, a qualified pension plan) and the BAE Systems 2007 Benefit Restoration Plan (BRP 2007, a non-qualified pension plan). The ERP and BRP 2007 provide for either a lump sum or annuitised payments based on the accrued values at the time of separation from employment. Annual additional accruals are currently limited to $1,000 in the ERP and $500 in the BRP 2007. The same provisions and features of the plans apply to the majority of participating active employees.

Maximum opportunity
Since 1 December 2022, the BAESRSP provides a maximum employer contribution rate for the Chief Executive of 14% of salary (in addition to employee contributions of 6% of salary), which is aligned with the wider workforce figure based on the weighted average employer contribution rate of UK active pension scheme members.

The maximum employer contribution for any new externally appointed UK executive directors, or internally appointed UK executive directors will be in line with the level available to new joiners to the wider UK workforce which is currently 8% (in addition to employee contribution of 6%) of base salary. This is the level set for the Group Finance Director.

Where UK executive directors' pension entitlement or accrual is restricted to the LTA and/or the AA, the Company may offer a salary supplement to offset the impact of these restrictions.

With limited exceptions, the US Section 401(k) defined contribution plan currently provides company (i.e. employer) matching contributions up to a maximum of 6% of base salary, subject to US statutory limits. For US executive directors who are eligible to participate in the ERP and the BRP 2007, these plans provide a cash sum or annuity at retirement equal to the present value of all prior annual accruals and credits from the initial year of service eligibility through to the present. Since the start of 2013, annual additional accruals have been set at $1,000 from the ERP and $500 from the BRP 2007.

Notes to the executive directors' policy table

Remuneration policy for other employees

1. The Company's approach to annual salary reviews is consistent across the Group, with consideration given to the scope of the role, level of experience, performance and market data for similar roles in other companies.
2. All leaders may participate in an annual bonus scheme with similar metrics to those used for the executive directors. Other employees may participate in performance-based incentive plans which vary by organisational level and with relevant metrics for the particular area of the business.
3. LTI grants may be made to the most senior managers in the business (approximately 600 individuals globally). The nature of the awards depends on the individual's location, roles and responsibilities, in particular:
   - performance conditions and targets for Performance Share grants made to participants below executive director level are made in line with those applying to executive directors with the exception of the TSR metric which does not apply;
   - for US participants below Executive Committee level, performance conditions and targets for Performance Share grants are tailored to reflect the strategic context and focus of the US business;
   - Performance Shares applicable to participants below executive director level vest on the third anniversary subject to meeting the required performance conditions;
   - Restricted Share grants are currently made to the most senior managers in the US businesses and vest after three years. Targeted awards may also be made to selected executives in UK and Rest of World with Committee approval;
   - one quarter of the total annual incentive amount is subject to compulsory deferral for three years in BAE Systems shares without any matching for the majority of UK and Rest of World participants that receive LTI grants; and
   - Minimum Shareholding Requirements are in place for the majority of individuals globally that receive LTI grants.

Performance measures and targets

4. The Committee selected the performance conditions because these are central to the Company's overall strategy and are the key metrics used by the executive directors to oversee the operation of the business. Any non-financial performance targets are determined by the Committee in consultation with the Environmental, Social and Governance Committee as appropriate.
5. The performance conditions, weightings and targets are determined annually by the Committee (within the parameters set out above), taking account of the Group's strategic objectives, the internal business plan and budgets, as well as external market expectations and general economic conditions. The Committee is of the view that the performance targets for the annual bonus are commercially sensitive and that it would be detrimental to the interests of the Company to disclose them before the start of the financial year. The targets will be disclosed retrospectively after the end of the relevant financial year.
6. Under the various scheme rules and under this Policy for the AIP and LTI, the Committee has discretion to override the formulaic outcome of performance measures if it determines that it is not reflective of underlying performance for that metric or for the business as a whole (reasonableness discretion). This discretion may apply upwards (subject to maximum 100% vesting) or downwards (subject to a minimum 0% vesting). Any factors will be properly considered as they arise and any discretion to the calculated results will be applied in a highly disciplined manner and the rationale and impact will be reported transparently.

Minimum Shareholding Requirement (MSR)

7. The Committee has agreed a policy whereby the executive directors are required to establish and maintain a minimum personal shareholding equal to a set percentage of base salary as set out in the table below. Executive directors are required to achieve their Initial Value as quickly as possible, and achieve their Subsequent Value within a five-year time period. Where an executive director has not achieved their MSR, the consequence is a restriction on the number of shares that can be sold on exercise or release, until their MSR Subsequent Value is met. Where an executive director has met less than the Initial Value (50% of their MSR), they must retain 50% of the net value (i.e. the value after deduction of exercise/sale costs and tax) of shares acquired through the various share schemes; if they have met the Initial Value but not the Subsequent Value (i.e. between 50% and 100% of their MSR), they must retain 25% of the net value. In the event that the executive director has not met the Subsequent Value at the end of the five-year period, the Committee will set out their proposed remedial actions at that time. The Committee has discretion to increase the Initial Value and/or Subsequent Value (see below). Shares owned beneficially by the director and his/her spouse count towards the MSR.

   Where an executive director leaves employment for any reason, a post-cessation shareholding policy will apply. For UK executive directors, the policy is based on the full MSR continuing to apply for a period of two years. For US executive directors, the policy is based on MSR of 300% of salary applying for a period of one year. Executive directors will be required to sign a contract on leaving employment to ensure compliance with this policy. Any case of non-compliance would be dealt with by the Committee.

   The following table sets out the MSR Initial Values and Subsequent Values for executive directors as a percentage of salary:

	Initial Value	Subsequent Value
Chief Executive	150%	300%
Chief Operating Officer	100%	200%
Group Finance Director	100%	200%
President and Chief Executive Officer, BAE Systems, Inc.	212.5%	425%

Executive directors' policy table continued

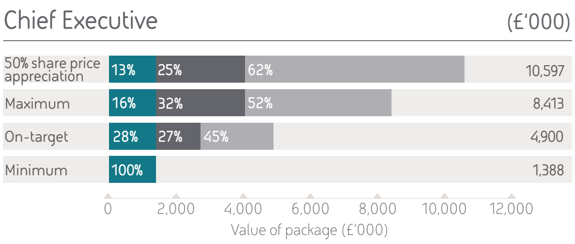
Illustration of application of remuneration policy

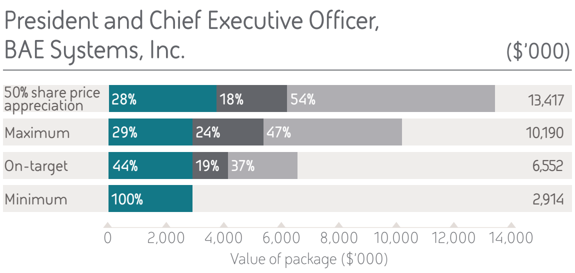
The charts below show the value of the package each of the executive directors would receive in the first year of operation of the Policy. There is currently no Chief Operating Officer in role so no chart is provided.

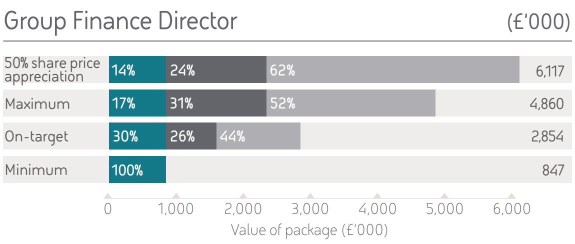
The values are based on 2023 levels for base salaries, benefits and pension and assume that the office-holders at the date of this Policy coming into effect are employed throughout the first year of operation of the Policy. Annual and long-term incentives are based on awards applying in 2023. The charts assume the following scenarios:

– minimum fixed pay includes salary, benefits and pension as provided in the single figure table on page 177 of the 2022 Annual Report and Restricted Shares award for the US executive director awarded at 150% salary (excluding share price growth);
– on-target pay assumes on-target performance is met in respect of variable elements (annual and long-term incentives);
– maximum pay assumes variable elements pay out in full; and
– 50% share price appreciation assumes all variable elements pay out in full and there is 50% gain in share price over the relevant vesting period in respect of Performance Shares and Restricted Shares awards received, and excludes dividends.

The minimum, on-target and maximum scenarios below exclude any share price appreciation and dividends.







- Fixed elements of remuneration
- Annual bonus
- Performance Shares

Non-executive directors' (NEDs) policy table

Fees

Purpose and link to strategy
To attract NEDs who have a broad range of experience and skills to provide independent judgement on issues of strategy, performance, resources and standards of conduct.

Operation
NEDs' fees are set by the Non-Executive Directors' Fees Committee.

NEDs receive a basic fee. An additional fee is paid for committee membership (with the exception of the Nominations Committee), for those who chair a committee and/or undertake the role of Senior Independent Director.

Fees are reviewed periodically, taking into account time commitment requirements and responsibility of the individual roles, and after reviewing practice in other comparable companies.

The Chair's fees are set by the Committee and are reviewed periodically, taking into account time commitment requirements and responsibility, and after reviewing practice in other comparable companies.

Maximum opportunity
Actual fee levels are disclosed in the Annual remuneration report for the relevant financial year.

The current Chairman's fee is £700,000 per annum and will not change during his remaining term of office. Sir Roger Carr is due to step down from his role as Chairman at the close of the 2023 AGM and be succeeded by the current Chair designate.

The current Chair designate's fee will be set at the same level and will not be reviewed earlier than the first anniversary of her appointment.

The aggregate cost of fees and benefits paid to NEDs (including the Chair) will not exceed an annual limit of £3.0m and the cost of fees and benefits paid to the Chair will not exceed £1.25m annually.

Performance metrics, weighting and time period applicable
None.

Benefits

Purpose and link to strategy
Reimbursement for reasonable and documented expenses incurred in the performance of duties.

Operation
NEDs are not eligible to participate in any pension benefits provided by the Company, nor do they participate in any performance-related incentives.

The Chairman is provided with a chauffeur-driven car. This may be used for non-Company business, but the cost of the benefit of such usage shall be paid by the Chairman. The current Chair designate will also be provided with a similar benefit on her appointment as Chair.

The Company reimburses travel and subsistence costs (including payment of the associated tax cost) incurred by the director or his/her spouse whilst undertaking duties on behalf of the Company that may be assessed as a benefit for tax purposes. Directors' and Officers' insurance cover is also provided for all directors.

Maximum opportunity
See the aggregate limit under 'Fees' above.

Prior commitments
For the duration of this Policy, the Company will honour any commitments made in respect of executive director and non-executive director remuneration and benefits before the date on which either: (i) the Directors' remuneration policy becomes effective; or (ii) an individual becomes a director, even where such commitments are not consistent with the policy set out in this report or prevailing at the time any such commitment was made or is fulfilled.

Recruitment

Approach to recruitment remuneration

The recruitment policy provides an appropriate framework within which to attract individuals of the required calibre to lead a company of BAE Systems' size, scale and complexity. The Committee determines the remuneration package for any appointment to an executive director position, either from within or outside BAE Systems.

Operation
The Committee will take into consideration all relevant factors, including overall total remuneration, the type of remuneration being offered and the jurisdiction from which the candidate was recruited, and will operate in order to ensure that arrangements are in the best interests of the Company and its shareholders without paying more than is necessary to secure the individual of the required calibre.

The fees and benefits applicable to the appointment of any new non-executive directors will be in accordance with the policy table on page 201.

Opportunity
The Committee seeks to align the remuneration package offered with the policy set out in the executive directors' policy table above recognising that participation under the policy above varies by geography.

On appointment as executive director, maximum opportunities for participation in the annual incentive plan and long-term incentive awards (excluding buyouts, for which see below) will be subject to the maxima stated in the policy table.

To facilitate recruitment, the Committee may additionally make awards on hiring an external candidate to 'buy out' existing incentives or, in exceptional circumstances, other elements of remuneration forfeited on leaving the previous employer. In doing so, the Committee will take account of relevant factors including any performance conditions attached to these awards, the form in which they were granted (e.g. cash or shares) and the time over which they would have vested. Buy-out awards would be capped to be no higher, on recruitment, than the expected value of those forfeited. Full details will be disclosed in the next Annual remuneration report following recruitment which will include details of the need to grant a buy-out award.

Fixed elements (base salary, retirement and other benefits)
The salary level will be set in accordance with the principles for setting base salary described in the executive directors' policy table above.

The executive director shall be eligible to participate in applicable BAE Systems' employee benefit plans in line with the agreed policy, including coverage under applicable executive and employee pension and benefit programmes in accordance with the terms and conditions of such plans, as may be amended by the Company in its sole discretion from time to time.

In the case of promotion of an existing Group employee to an executive directorship on the Board, commitments made before such promotion will continue to be honoured whether or not they are consistent with the remainder of this Policy. However, in the case of pensions for a UK-based executive director, the individual will be offered provision in line with the agreed policy on page 198 and any previous arrangement will cease (unless it complies with the policy).

Annual Incentive Plan
The appointed executive director will be eligible to earn a discretionary annual bonus in accordance with the annual incentive construct as described in the executive directors' policy table above.

The level of opportunity will be consistent with the policy disclosed in the executive directors' policy table in this report and subject to the maximums referred to therein and under 'Opportunity' above.

Long-Term Incentive Plan
The executive director will be eligible for equity awards in such amounts as the Committee may determine in its sole discretion, subject to this Policy and the rules of the Long-Term Incentive Plan.

The level of opportunity will be subject to the maximums referred to under 'Opportunity' above.

Other
For internal and external appointments, the Committee may agree that the Company will meet certain relocation expenses in accordance with the provisions described under the Benefits section of the policy table on page 197.

Service contracts and letters of appointment

Executive directors

Operation
In accordance with long-established policy, all executive directors have rolling service agreements which may be terminated in accordance with the terms of these agreements.

Dates of appointment for executive directors

Name	Date of appointment	Notice period
Charles Woodburn[1]	1 July 2017	12 months either party
Brad Greve	1 April 2020	12 months either party
Tom Arseneault[2]	1 April 2020	60 days either party

1. Appointed to the Board as Chief Operating Officer on 9 May 2016; appointed as Chief Executive with effect from 1 July 2017.
2. Tom Arseneault's contract of employment automatically renews for a one-year period from 31 December each year, unless one party gives the other at least 60 days' notice.

Notice period
The Committee's policy is that the notice periods in the service contracts of executive directors will not exceed 12 months. In exceptional circumstances, in relation to recruiting a new executive director operating in the US, the notice period may be extended to a maximum of 24 months and structured such that it reduces to no more than 12 months by no later than the end of the first complete year of service.

Change of control
No executive director has provisions in his service contract that relate to a change of control of the Company.

Chairman

Sir Roger Carr's appointment is documented in a letter of appointment and he is required to devote no fewer than two days a week to his duties as Chairman. His appointment as Chairman (which commenced on 1 February 2014) will automatically terminate if he ceases to be a director of the Company. The Company announced on 28 July 2022 that Sir Roger would retire as Chairman and director at the conclusion of the Company's 2023 Annual General Meeting (AGM) due to be held on 4 May 2023.

Chair designate

The Company announced on 28 July 2022 that Cressida Hogg would be appointed to the Board as a non-executive director with effect from 1 November 2022, and would succeed Sir Roger Carr as Chair at the conclusion of the Company's 2023 AGM due to be held on 4 May 2023. Cressida Hogg's appointment as Chair is documented in a letter of appointment and she will be required to devote no fewer than two days a week to her duties as Chair. Her appointment as Chair will automatically terminate if she ceases to be a director of the Company. Her appointment is for three years ending on 4 May 2026 unless terminated earlier in accordance with the Company's Articles of Association or by the Company or the Chair giving not less than six months' notice. The Chair's appointment is to be reviewed by the Nominations Committee prior to the end of the three-year term and the Chair may be invited to serve for an additional period.

Non-executive directors

The non-executive directors do not have service contracts but do have letters of appointment detailing the basis of their appointment. The dates of their original appointment are shown below:

Name	Date of appointment	Expiry of current term
Nick Anderson	01.11.2020	31.10.2023
Crystal E Ashby	01.09.2021	31.08.2024
Dame Elizabeth Corley	01.02.2016	31.01.2024
Jane Griffiths	01.04.2020	31.03.2026
Chris Grigg	01.07.2013	31.12.2023
Cressida Hogg[1]	01.11.2022	04.05.2023
Ewan Kirk	01.06.2021	31.05.2024
Stephen Pearce	01.06.2019	01.06.2025
Nicole Piasecki	01.06.2019	01.06.2025
Lord Sedwill	01.11.2022	31.10.2025

1. Appointed non-executive director and Chair designate on 1 November 2022; as announced on 28 July 2022 she will succeed Sir Roger Carr as Chair at the conclusion of the Company's AGM due to be held on 4 May 2023 when her term as Chair will commence (see paragraph entitled 'Chair designate' above).

The non-executive directors are normally appointed for an initial three-year term that, subject to review, may be extended subsequently for further such terms. Non-executive directors do not have periods of notice.

In accordance with the UK Corporate Governance Code, all directors are subject to annual election or re-election at the Company's AGM.

Service contracts and letters of appointment continued

Policy on payment for loss of office

Operation
The policy on payment for loss of office provides a clear set of principles that govern the payments that will be made for loss of office, and take account of the need to ensure a smooth transition for leadership roles during times of change. The policy that will apply for a specific executive director's payments for loss of office will be the policy that was in place at the point when the payments for loss of office were agreed for the executive director in question.

Any termination payment made in connection with the departure of an executive director will be subject to approval by the Committee, having regard to the terms of the service contract or other legal obligations and the specific circumstances surrounding the termination, including whether the scenario aligns to an example under the approved leaver criteria, performance, service and health or other circumstances that may be relevant.

In addition to payments described below, the Committee may pay such amounts as are necessary to settle or compromise any claim or by way of damages, where the Committee views it as in the best interests of the Company to do so. In the event of the termination of an executive director's contract, it is the Committee's policy to seek to limit any payment to not more than one year's base salary. Where appropriate the Company may also meet a director's reasonable legal expenses in connection with their termination of their appointment.

Notice and pay in lieu of notice
For executive directors, employment contracts will generally be on terms that allow them to be terminated on up to 12 months' notice from either party or by way of payment of base salary in lieu of notice, at the Company's discretion. Neither notice nor a payment in lieu of notice will be given in the event of gross misconduct.

For US-based executive directors, employment contracts are typically for one-year periods and renew automatically unless one party gives at least 60 days' notice of non-renewal. If the employment is (a) terminated by the Company (other than for cause as defined in the contract) or (b) the executive director resigns for a 'Good Reason' (as defined in the contract), the executive director is entitled to a termination payment equal to (i) one year's base salary and (ii) a bonus payable at target level pro-rated for service for the relevant financial year. They will also be entitled to a continuation of medical benefits for 18 months (or a cash payment in lieu).

In all cases, the Committee seeks to include provisions in directors' employment contracts to allow the Company to pay any notice or severance payments on a phased basis and apply mitigation if the executive director secures alternative employment, to the extent that this is reasonably practicable taking into account local labour law, tax and other relevant considerations.

Other than notice payments, the Company has no obligation to make any termination payments when the Chairman's appointment terminates. Non-executive directors do not have periods of notice and the Company has no obligation to make any termination payments when their appointment terminates, other than to pay fees in accordance with the appointment letters.

Retirement benefits
As governed by the rules of the relevant pension plan. No enhancement for leavers will be made.

Annual Incentive Plan
Where an executive director's employment is terminated after the end of a performance year but before the payment is made, the executive director will remain eligible for an annual incentive award for that performance year subject to an assessment based on performance achieved over the period. No award will be made in the event of gross misconduct.

The Committee may, as set out below, exercise its discretion to allow an annual incentive payment for the year of cessation as part of the termination package for executive directors. Where it does so, the exercise of the discretion and reason why the Committee considered such action appropriate will be disclosed.

Where an executive director leaves during the relevant performance year by reason of death, ill-health, disability, retirement, a transfer of business, redundancy, or in such circumstances as the Committee determines, the Committee may use its discretion to determine that an executive director will remain entitled to receive a bonus (subject to an assessment based on performance over the performance year and pro-rated for time) in respect of the financial year in which the individual ceased employment.

In all cases, one-third of the bonus will be subject to compulsory deferral as set out previously, unless the Committee decides otherwise.

The Committee's policy is not to award an annual incentive for any portion of the notice period not served.

The treatment set out above does not apply to the President and Chief Executive Officer, BAE Systems, Inc. and the applicable treatment is provided in the section on notice and pay in lieu of notice.

Long-Term Incentive Plans
The treatment of outstanding share awards in the event that an executive director leaves is governed by the relevant share plan rules.

Under the Long-Term Incentive Plan, where an executive director leaves the Group by reason of ill-health, injury, disability, retirement with the agreement of the Company (other than in the case of Restricted Shares held by US executive directors), sale of a business or employing company, redundancy or leaving in such circumstances as the Committee determines (each an 'approved leaver'), unvested awards and options generally continue and vest on the normal vesting date (or, in the case of Performance Shares held by US executive directors, the first normal vesting date or, if later, cessation), unless the Committee determines that the awards should vest on cessation. Any performance conditions will be applied at the time of vesting.

On vesting, the number of shares under award will, unless the Committee decides otherwise, be reduced pro-rata to reflect the period in which the executive director was in employment as a proportion of the relevant vesting period (or, in the case of Performance Shares held by US executive directors, as a proportion of the initial three-year vesting period).

In the event of death, awards generally vest at the time of death subject to the satisfaction of any performance conditions at that time. Awards are then pro-rated as set out above.

Where an executive director's employment is terminated for any other reason, his unvested awards and options will lapse. Options normally remain exercisable for six months after cessation (or vesting, if later) and 12 months after death.

If the Committee exercises its discretion to treat a director as an approved leaver as permissible under the leaver provisions of the share plan rules, the exercise of the discretion and reason why the Committee considered such action appropriate will be disclosed.

Where an executive director's employment is terminated or an executive director is under notice of termination for any reason at the date of award of any Long-Term Incentive awards, no Long-Term Incentive awards will be made.

Consideration of employment conditions elsewhere in the Company

The Committee has responsibility for reviewing remuneration and related policies applicable to the wider workforce. To support this, the Committee is provided with periodic in-depth sessions on a range of wider workforce remuneration topics that are designed to provide the Committee with visibility of remuneration practices in the different sectors and geographies in which we operate and for the different populations within the wider workforce across the Company globally. This enables the Committee to take the wider workforce into account when setting the policy for executive remuneration. The Committee also receives insights from the broader employee population using an engagement survey. When considering salary increases for the executive directors, the Committee considers the general level of salary increase across the Group and in the external market.

Whilst the Committee does not consult directly with employees as part of the process for reviewing executive pay, the annual report is the principal means through which we communicate and engage with employees on how executive remuneration aligns with that of the wider workforce. The Company's employees who are shareholders in the Company receive communications with a direct link to the annual report on the Company's website and an invitation to vote on the resolutions being put to the AGM, including those resolutions on executive remuneration. The results of employee shareholder voting on the AGM resolutions, including those relating to executive remuneration, are subsequently reported to the Board for discussion.

Stakeholder considerations

In line with our commitment to full transparency and engagement with our shareholders on the topic of executive remuneration, the Remuneration Committee Chair conducts an annual programme of consultation with our major shareholders and institutional investors. This typically involves setting out the changes planned for the following year, including seeking shareholder input and views on various executive remuneration matters including the development of, or potential changes to, remuneration policy or arrangements. The Remuneration Committee Chair values direct engagement with our shareholders and makes themself available for such meetings throughout the year to hear shareholders' perspective on remuneration matters.

Statutory and other information

Company registration

BAE Systems plc is a public company limited by shares registered in England and Wales with the registered number 1470151.

Directors

The current directors who served during the 2022 financial year are listed on pages 131 to 133. On 1 November 2022 Lord Mark Sedwill was appointed to the Board as a non-executive director and Cressida Hogg was appointed to the Board as a non-executive director and Chair designate. Dame Carolyn Fairbairn and Ian Tyler also served on the Board until 5 May 2022.

On 28 July 2022, the Company announced that Sir Roger Carr would retire from the Board and as Chairman at the conclusion of the Company's Annual General Meeting on 4 May 2023, and that Cressida Hogg would succeed him as Chair at the conclusion of that meeting.

Dividend

An interim dividend of 10.4p per share was paid on 30 November 2022. The directors propose a final dividend of 16.6p per ordinary share. Subject to shareholder approval, the final dividend will be paid on 1 June 2023 to shareholders on the share register on 21 April 2023.

Annual General Meeting (AGM)

The Company's AGM will be held on 4 May 2023.

Certain information in the Strategic report

The following items are set out in the Strategic report on pages 1 to 127:

- disclosures in relation to the use of financial instruments;
- particulars of important events affecting the Group which have occurred since 31 December 2021;
- an indication of likely future developments in the business of the Group;
- an indication of the activities of the Group in the field of research and development;
- actions taken to introduce, maintain or develop arrangements aimed at employees;
- greenhouse gas emissions;
- employee engagement (including regard to employee interests and encouraging employees to be shareholders);
- fostering business relationships with suppliers, customers and others; and
- policy in relation to employment of disabled persons.

Office of Fair Trading undertakings

As a consequence of the merger between British Aerospace and the former Marconi Electronic Systems businesses in 1999, the Company gave certain undertakings to the Secretary of State for Trade and Industry (now the Secretary of State for Business, Energy and Industrial Strategy). In February 2007, the Company was released from the majority of these undertakings and the remainder have been superseded and varied by a new set of undertakings. Compliance with the undertakings is monitored by a compliance officer. Further information regarding the undertakings and the contact details of the compliance officer may be obtained through the Company Secretary at the Company's registered office or through the Company's website.

Profit forecast

In its Annual Report issued on 30 March 2022, the Group made the following statement in respect of the year ending 2021, which is regarded as a profit forecast for the purposes of the Financial Conduct Authority's Listing Rule 9.2.18:

"While the Group is subject to geopolitical and other uncertainties, the following guidance is provided on current expected operational performance. Guidance is provided on the basis of an exchange rate of \$1.38:£1, which is in line with the actual 2021 exchange rate, therefore guidance is the same for both reported and constant exchange rates.

For the year ending 31 December 2022, underlying EBIT is expected to increase in the range of 4% to 6%. Underlying earnings per share is expected to increase in the range of 4% to 6%."

Underlying EBIT was £2,479m in 2022. Underlying earnings per share was 55.5p in 2022.

Political donations

No political donations were made in 2022.

Issued share capital

As at 31 December 2022, BAE Systems' issued share capital of £82,445,460 comprised 3,297,818,342 ordinary shares of 2.5p each and one Special Share of £1. This figure includes 901,301 ordinary shares purchased under the share buyback programme immediately prior to the year end, but not yet settled at that point, which the Company deems to have been cancelled on purchase.

Share buyback

During the year:

- 24,253,065 ordinary shares of 2.5p each were repurchased under the buyback programme of up to £500m announced on 29 July 2021 and such repurchased shares have been cancelled. The total consideration for the purchase of these shares, including commission and stamp duty, was £131,814,268; and
- 82,997,065 ordinary shares of 2.5p each were repurchased under the buyback programme of up to £1.5bn announced on 28 July 2022 and such repurchased shares have been cancelled. The total consideration for the purchase of these shares, including commission and stamp duty, was £663,842,889.

The percentage of called up share capital (excluding treasury shares) as at 31 December 2022, which the shares repurchased in 2022 represents, is 3.65%.

Treasury shares

As at 1 January 2022, the number of shares held in treasury totalled 236,807,031 (having a total nominal value of £5,920,176 and representing 7.0% of the Company's called up share capital at 31 December 2021). During 2022, the Company used 16,720,072 treasury shares (having a total nominal value of £418,002 and representing 0.5% of the Company's called up share capital at 31 December 2022) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (4,944,130 shares in aggregate), awards under the Free and Matching elements of the International Share Incentive Plan (560,098 shares in aggregate), awards vested under the Performance Shares element of the Long-Term Incentive Plan (4,277,781 shares), awards vested under the Restricted Shares element of the Long-Term Incentive Plan (1,560,388 shares) and options exercised under the Share Options element of the Long-Term Incentive Plan and Executive Share Option Plan (5,377,675 shares). The treasury shares utilised in respect of the Share Incentive Plan, the International Share Incentive Plan, and the Performance and Restricted Shares elements of the Long-Term Incentive Plan were disposed of by the Company for nil consideration. The 5,377,675 shares disposed of by the Company in respect of the Share Options element of the Long-Term Incentive Plan and the Executive Share Option Plan were disposed of by the Company for an aggregate consideration of £27,207,673. As at 31 December 2022, the number of shares held in treasury totalled 220,086,959 (having a total nominal value of £5,502,174 and representing 6.7% of the Company's called up share capital at 31 December 2022).

The rights to treasury shares are restricted in accordance with the Companies Act and, in particular, the voting and dividend rights attaching to these shares are automatically suspended.

Rights and obligations of ordinary shares

On a show of hands at a general meeting every holder of ordinary shares present in person and entitled to vote shall have one vote, and every proxy entitled to vote shall have one vote (unless the proxy is appointed by more than one member in which case the proxy has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution; or if the proxy has been instructed by one or more shareholders to vote either for or against a resolution and by one or more of those shareholders to use his discretion how to vote). On a poll, every member present in person or by proxy and entitled to vote shall have one vote for every ordinary share held. Subject to the relevant statutory provisions and the Company's Articles of Association, holders of ordinary shares are entitled to a dividend where declared or paid out of profits available for such purposes. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, holders of ordinary shares are entitled, after repayment of the £1 Special Share, to participate in such a return. There are no redemption rights in relation to the ordinary shares.

Rights and obligations of the Special Share

The Special Share is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the 'Special Shareholder'). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

The holder of the Special Share is entitled to attend a general meeting, but the Special Share carries no right to vote or any other rights at any such meeting, other than to speak in relation to any business in respect of the Special Share. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, the holder of the Special Share shall be entitled to repayment of the £1 capital paid up on the Special Share in priority to any repayment of capital to any other members.

The holder of the Special Share has the right to require the Company to redeem the Special Share at par or convert the Special Share into one ordinary share at any time.

Restrictions on transfer of securities

The restrictions on the transfer of shares in the Company are as follows:

- the Special Share may only be issued to, held by and transferred to the Special Shareholder or his successor or nominee;
- the directors shall not register any allotment or transfer of any shares to a foreign person, or foreign persons acting in concert, who at the time have more than a 15% voting interest in the Company, or who would, following such allotment or transfer, have such an interest;
- the directors shall not register any person as a holder of any shares unless they have received: (i) a declaration stating that upon registration, the share(s) will not be held by foreign persons or that upon registration the share(s) will be held by a foreign person or persons; (ii) such evidence (if any) as the directors may require of the authority of the signatory of the declaration; and (iii) such evidence or information (if any) as to the matters referred to in the declaration as the directors consider appropriate;
- the directors may also refuse to register any instrument of transfer of shares unless the instrument of transfer is in respect of only one class of share and it is lodged at the place where the register of members is kept, accompanied by a relevant certificate or such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer;
- the directors may refuse to register an allotment or transfer of shares in favour of more than four persons jointly;
- where a shareholder has failed to provide the Company with certain information relating to their interest in shares, the directors can, in certain circumstances, refuse to register a transfer of such shares;
- certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws);
- restrictions may be imposed pursuant to the Listing Rules of the Financial Conduct Authority whereby certain of the Group's employees require the Company's approval to deal in shares; and
- awards of shares made under the Company's Long-Term Incentive Plan 2014, Deferred Bonus Plan, Share Incentive Plan, International Share Incentive Plan, Group All-Employee Free Shares Plan and International Profit Sharing Scheme are subject to restrictions on the transfer of shares prior to vesting and/or release.

The Company is not aware of any arrangements between its shareholders that may result in restrictions on the transfer of shares and/or voting rights.

Significant direct and indirect holders of securities

As at 31 December 2022, the Company had been advised of the following significant direct and indirect interests in the issued ordinary share capital of the Company:

Name of shareholder	Percentage notified
Barclays PLC	3.98%
BlackRock, Inc.	9.90%
The Capital Group Companies, Inc.[1]	14.18%
Invesco Limited	4.97%
Silchester International Investors LLP	3.01%

1. As at the date of this report, The Capital Group Companies, Inc.'s percentage notified to the Company stood at 12.88%.

Exercise of rights of shares in employee share schemes

The trustees of the employee trusts do not seek to exercise voting rights on shares held in the employee trusts other than on the direction of the underlying beneficiaries. No voting rights are exercised in relation to shares unallocated to individual beneficiaries.

Restrictions on voting deadlines

The notice of any general meeting shall specify the deadline for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be proposed at the general meeting. The number of proxy votes for, against or withheld in respect of each resolution are publicised on the Company's website after the meeting.

Appointment and replacement of directors

Subject to certain nationality requirements mentioned below, the Company may by ordinary resolution appoint any person to be a director.

The directors also have the power to make appointments to the Board at any time. Any individual so appointed will hold office until the next AGM and shall then be eligible for re-election.

The majority of directors holding office must be British. Otherwise, the directors who are not British shall vacate office in such order that those who have been in office for the shortest period since their appointment shall vacate their office first, unless all of the directors otherwise agree among themselves. Any director who holds the office of either Chairman (in an executive capacity) or Chief Executive shall also be British.

The Company must have not less than six directors holding office at all times. If the number is reduced to below six, then such number of persons shall be appointed as directors as soon as is reasonably practicable to reinstate the number of directors to six. The Company may by ordinary resolution from time to time vary the minimum number of directors.

All directors will stand for election or re-election in 2023 as required by the Company's Articles of Association and in compliance with the UK Corporate Governance Code.

Amendment of the Company's Articles of Association

The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders. Where class rights are varied, such amendments must be approved by the members of each class of shares separately.

In addition, certain provisions of the Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

Powers of the directors

The directors are responsible for the management of the business of the Company and may exercise all powers of the Company subject to applicable legislation and regulation, and the Articles of Association.

At the 2022 AGM, the directors were given the power to buy back a maximum number of 314,658,597 ordinary shares at a minimum price of 2.5p each. The maximum price was the higher of (i) an amount equal to 105% of the average of the middle market quotations of the Company's ordinary shares as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which such ordinary shares are contracted to be purchased, and (ii) the higher of the price of the last independent trade and the highest current independent bid on the London Stock Exchange.

This power will expire at the earlier of the conclusion of the 2023 AGM or 30 June 2023. A special resolution will be proposed at the 2023 AGM to renew the Company's authority to acquire its own shares.

At the 2022 AGM, the directors were given the power to issue new shares up to a nominal amount of £26,218,927. This power will expire on the earlier of the conclusion of the 2023 AGM or 30 June 2023. Accordingly, a resolution will be proposed at the 2023 AGM to renew the Company's authority to issue further new shares.

Conflicts of interest

As permitted under the Companies Act 2006, the Company's Articles of Association contain provisions which enable the Board to authorise conflicts or potential conflicts that individual directors may have.

To avoid potential conflicts of interest the Board requires the Nominations Committee to check that any individuals it nominates for appointment to the Board are free of potential conflicts. In addition, the Board's procedures and the induction programme for new directors emphasise a director's personal responsibility for complying with the duties relating to conflicts of interest. The procedure adopted by the Board for the authorisation of conflicts reminds directors of the need to consider their duties as directors and not grant an authorisation unless they believe, in good faith, that this would be likely to promote the success of the Company. As required by law, the potentially conflicted director cannot vote on an authorisation resolution or be counted in the quorum. Any authorisation granted may be terminated at any time and the director is informed of the obligation to inform the Company without delay should there be any material change in the nature of the conflict or potential conflict so authorised.

Directors' indemnities

The Company has entered into deeds of indemnity with all its current directors and those persons who were directors for any part of 2021 which are qualifying indemnity provisions for the purpose of the Companies Act 2006.

The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited, BAE Systems Executive Pension Scheme Trustees Limited and Alvis Pension Scheme Trustees Limited benefit from indemnities in the governing documentation of the BAE Systems Pension Scheme, the BAE Systems 2000 Pension Plan, the BAE Systems Executive Pension Scheme and the Alvis Pension Scheme, respectively, which are qualifying indemnity provisions for the purpose of the Companies Act 2006.

All such indemnity provisions are in force as at the date of this Directors' report.

Change of control – significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination, alteration or other similar rights in the event of a change of control of the Company:

– The Group entered into a £2bn Revolving Credit Facility dated 12 December 2013 which was amended and restated on 27 October 2021. The facility provides that, in the event of a change of control of the Company, the lenders are entitled to renegotiate terms, or if no agreement is reached on negotiated terms within a certain period, to call for the repayment or cancellation of the facility. The Revolving Credit Facility was undrawn as at 31 December 2022.
– 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 renewed Special Security Agreement, effective date of 5 January 2023, with the US Department of Defense regarding the management of BAE Systems, Inc. in order to comply with the US government's national security requirements. In the event of a change of control of the Company, the Agreement may be terminated or altered by the US Department of Defense.

- In June 2017, BAE Systems Surface Ships Limited entered into a contract with the UK Ministry of Defence (MoD) for the manufacture of the first batch of three Type 26 frigates. This contract was amended and restated in November 2022 to include the manufacture of the second batch of five Type 26 frigates. Where the MoD considers that a proposed change of control of BAE Systems Surface Ships Limited would be contrary to the defence, national security or national interest of the UK or where the change of control would result in increased costs to the MoD under the contract, then the change of control shall not proceed until agreement with the MoD is established. If there is a change of control without notice or notwithstanding the objection of the MoD on such grounds, then the MoD may terminate the contract with immediate effect.
- The FMSP Ships Engineering Management and Delivery agreement between BAE Systems Surface Ships Limited and the MoD was entered into on 31 March 2021 for the provision of surface ship engineering management and delivery services relating to HM Naval Base Portsmouth. Where the MoD considers that a proposed change of control of BAE Systems Surface Ships Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement with the MoD is established. If there is a change of control without notice or notwithstanding the objection of the MoD, the MoD shall be entitled to terminate the agreement.
- In November 2020, BAE Systems Global Combat Systems Munitions Limited and the MoD entered into a 15-year agreement for the provision of ammunition to UK forces (the Next Generation Munitions Solution (NGMS) agreement) from 2023 to 2037. Where the MoD has any concerns regarding a proposed change of control of BAE Systems Global Combat Systems Munitions Limited and such concerns are not resolved, then if the change of control proceeds, the MoD may terminate the contract.
- In November 2012, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 4 of the Astute Class programme. In November 2015, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 5 of the Astute Class programme. In March 2016, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 6 of the Astute Class Programme. In March 2018, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 7 of the Astute Class Programme. Where the MoD considers that a proposed change of control of BAE Systems Marine Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement is established with the MoD. In the event that there is a change of control of BAE Systems Marine Limited, notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the agreements immediately.
- In December 2011, BAE Systems Marine Limited entered into a contract with the MoD for the design of the Dreadnought submarines. Where the MoD considers that a change of control of BAE Systems Marine Limited would be contrary to the defence, national interest or national security of the UK, then the change of control shall not take place until agreement is reached with the MoD on how to proceed. In the event that there is a change of control notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the contract with immediate effect.
- In September 2016, BAE Systems Marine Limited entered into a contract with the MoD for the initial phase of manufacturing activities for the Dreadnought Class programme. This contract was extended and amended in March 2022 to include continuation of manufacturing and associated activities on all four boats in the class. Where the MoD considers that a proposed change of control of BAE Systems Marine Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement is established with the MoD. In the event that there is a change of control of BAE Systems Marine Limited, notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the agreements immediately.
- In December 2018, BAE Systems' subsidiary, ASC Shipbuilding Pty Limited, entered into a contract providing the framework for the design and manufacture of Hunter Class Frigates for the Royal Australian Navy (Head Contract). As part of the acquisition of ASC Shipbuilding Pty Limited from the Australian Commonwealth, BAE Systems Australia Limited entered into a Sovereign Capability and Option Deed (SCOD). Under the Head Contract and the SCOD, if there is a change of control of ASC Shipbuilding Pty Limited or BAE Systems Australia Limited, consent is required from the Australian Commonwealth Government prior to any change of control occurring. If there is a change of control without notice or notwithstanding an objection, the Commonwealth may terminate the Head Contract, take any action to mitigate an actual or potential threat to Australia's national security interests, or exercise its call option under the SCOD and regain ownership of ASC Shipbuilding Pty Limited.
- In March 2022, the Hawk Integrated Support contract was entered into between BAE Systems (Operations) Limited and the MoD for the provision of support services to the Royal Air Force's fleet of Hawk fast jet trainer aircraft and the Royal Air Force Aerobatic Team Aircraft. Where the MoD has any concerns about the actual or proposed change of control of BAE Systems (Operations) Limited (which may include, but not limited to, potential threats of national security), then the UK shall advise the Contractor in writing of any concerns it may have. The MoD may terminate the Contract within six months of the Authority being notified by the Contractor.
- In June 2021, BAE Systems Australia Limited entered into a contract providing the framework for the provision of in-service support for the Hawk aircraft until June 2031. If there is a change of control of BAE Systems Australia Limited or BAE Systems plc without consent from the Australian Commonwealth Government, the Australian Commonwealth may terminate the contract.

In addition, the Company's share plans contain provisions as a result of which options and awards may vest and become exercisable on a change of control of the Company in accordance with the rules of the plans.

Auditor

Deloitte LLP has indicated its willingness to be re-appointed as the Company's auditor and a resolution proposing its re-appointment will be put to the 2023 AGM.

Statement of directors' responsibilities in respect of the Annual Report and the financial statements

The directors are responsible for preparing the Annual Report, and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law, they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the UK (IFRS) and applicable law, and have elected to prepare the parent company financial statements in accordance with UK accounting standards, including Financial Reporting Standard (FRS) 101, Reduced Disclosure Framework.

Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company, and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the UK;
- for the parent company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements;
- assess the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a strategic report, directors' report, directors' remuneration report and corporate governance statement that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of disclosure of information to auditor

The directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that he/she ought to have taken to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Responsibility statement of the directors in respect of the Annual Report and financial statements

Each of the directors listed below confirms that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the undertakings included in the consolidation taken as a whole; and
- the Strategic report and Directors' report, taken together, include a fair review of the development and performance of the business, and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, each of the directors considers that the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Sir Roger Carr	Chairman
Charles Woodburn	Chief Executive
Tom Arseneault	President and Chief Executive Officer of BAE Systems, Inc.
Brad Greve	Group Finance Director
Nick Anderson	Non-executive director
Crystal Ashby	Non-executive director
Dame Elizabeth Corley	Non-executive director
Jane Griffiths	Non-executive director
Chris Grigg	Non-executive director
Cressida Hogg	Non-executive director
Ewan Kirk	Non-executive director
Stephen Pearce	Non-executive director
Nicole Piasecki	Non-executive director
Lord Sedwill	Non-executive director

On behalf of the Board

Sir Roger Carr
Chairman

22 February 2023

Directors' report

The Directors' report was approved by the Board of directors on 22 February 2023.

David Parkes
Company Secretary

Independent Auditor's report

to the members of BAE Systems plc only

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of BAE Systems plc (the Parent Company) and its subsidiaries (the Group) give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2022 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the consolidated income statement;
- the consolidated and Parent Company statements of comprehensive income;
- the consolidated and Parent Company statements of changes in equity;
- the consolidated and Parent Company balance sheets;
- the consolidated cash flow statement;
- the related notes 1 to 37 in the consolidated Group financial statements, including the associated accounting policies; and
- the related notes 1 to 13 in the Parent Company financial statements, including the associated accounting policies.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and United Kingdom adopted international accounting standards. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the FRC's) Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and Parent Company for the year are disclosed in note 2 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the Group or the Parent Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- revenue and margin recognition on long-term contracts;
- carrying value of goodwill; and
- valuation of post-employment benefit obligations.

Within this report, key audit matters are identified as follows:

^ Increased level of risk

≈ Similar level of risk

v Decreased level of risk

Materiality

The materiality that we used for the Group financial statements was £87.5m which was determined on the basis of profit before tax adjusted for adjusting items as well as fair value and foreign exchange adjustments on financial instruments as described further in section 6 below.

Scoping

Twenty-seven components were subject to audit procedures (2021: thirty-one components). Of these, six components (2021: the same six components) were subject to a full-scope audit. Of the remaining twenty-one components, nineteen (2021: twenty-one, with four different components now within this scope) were subject to an audit of specified account balances and two (2021: four with two now removed from scope) were subject to specified audit procedures.

The components, which were either subject to a full-scope audit or audit of specified account balances, contribute 89% of revenue (2021: 87%), 86% of profit before tax (2021: 84%) and 91% of total assets (2021: 92%). The remaining components were subject to other procedures, including conducting analytical reviews, making enquiries, and evaluating and testing management's Group-wide controls.

Significant changes in our approach

There have been no significant changes in our approach from the prior year.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the Group's and Parent Company's ability to continue to adopt the going concern basis of accounting included:

- obtaining an understanding of relevant controls over the going concern models prepared by management, including the review of the inputs and assumptions used in those models;
- testing the accuracy of management's models, including agreement to the most recent Board approved budgets and forecasts;
- challenging the key assumptions of these forecasts by:
  - reading analyst reports, industry data and other external information and comparing these with management's estimates;
  - comparing forecast revenue with the Group's order book and historical performance;
  - evaluating the historical accuracy of forecasts prepared by management;
  - considering potential macro-economic impacts on the forecasts as a consequence of the current geo-political environment;
  - assessing the sensitivity of the headroom and management's forecasts; and
  - assessing the sufficiency of the Group's disclosure concerning the going concern basis.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's and Parent Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In relation to the reporting on how the Group has applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1. Revenue and margin recognition on long-term contracts ≈

Refer to page 145 (Audit Committee report) and Note 1 (accounting policy and financial disclosures)

Revenue:
£21,258m (2021: £19,521m)

Key audit matter description

The estimation of both overall lifetime contract margin and the appropriate level of revenue and profit to recognise in any single accounting period requires the exercise of judgement. Within BAE Systems' contract portfolio there are a number of programmes where the estimates required in reaching these judgements are complex and could lead to a material error within the financial statements if reached incorrectly. Consequently, we consider that revenue and margin recognition represent a significant risk to our audit and a key audit matter.

We focus a greater proportion of audit effort on a number of contracts where we consider there to be the highest degree of judgement required and design contract specific procedures to mitigate the associated risks.

In order to identify the key contracts where there is a significant risk of material misstatement, we undertook a contract risk assessment process at each component utilising data analytics, the latest contract information, our understanding of the business, the results of prior audits and review of external information about market and geo-political conditions which might impact certain contracts. We held meetings with key finance and contract managers, attended quarterly business review meetings and other key management meetings, read and understood underlying contract documentation, and obtained management support for key contract judgements. In addition, we looked for contracts that might have higher levels of judgement associated with the risk of schedule delivery or technical complexity, fixed price contracts which increase the risk of contract losses and other indicators such as any potential climate-related risks, that could increase the risk of a material impact on the financial statements.

As a result of our risk assessment, we identified two contracts where we consider there to be the highest degree of judgement required in estimating the outturn margin position. These are:

- Type 26 frigates; and
- Armored Multi-Purpose Vehicles (AMPV), specifically Low-Rate Initial Production 2 (LRIP2).

We consider the level of risk associated with this key audit matter has remained consistent with the prior year due to a similar level of judgement existing and no significant changes to the forecast revenues on the contracts.

How the scope of our audit responded to the key audit matter

Our contract testing approach included:

Testing the relevant controls

- We obtained an understanding of and tested relevant manual and IT controls within management's Lifecycle Management (LCM) Framework and project accounting processes which management have established to ensure that contracts are appropriately forecast, managed, challenged and accounted for.
- As part of this, we observed the controls in operation by attending a sample of project contract status review meetings, quarterly business review meetings and Group-level meetings to validate the various levels of challenge applied to the forecasts.

Challenging assumptions and estimates

To gain assurance over the contract judgements and estimates made, our work included:

- making inquiries of contract project teams and other personnel to obtain an understanding of the performance of the project throughout the year and at year-end;
- analysing historical contract performance and understanding the reason for in-year movements or changes;
- conducting production site visits to inform our challenge of the cost to complete estimate and understanding of contract status;
- testing the underlying calculations used in the contract assessments for accuracy and completeness, including the estimated costs to complete the contract alongside associated contingencies. As part of this we considered historical forecasting accuracy of costs, including on similar programmes, and challenged future cost expectations with reference to those data points;
- examining external correspondence to assess the timeframe for delivery of the product or service and any judgements made in respect of these;
- examining external evidence to assess contract status and estimation of variable consideration (including associated recoverability of contract balances), such as customer correspondence and, for certain contracts, meeting with the customer directly;
- enquiring with in-house and external legal counsel regarding contract-related litigation and claims;
- considering the potential impact of the Ukraine conflict and supply chain issues, such as inflation, on the cost to complete estimate for significant contracts; and
- considering whether there were any indicators of management override of controls or bias in arriving at their reported position, including a stand back assessment of the contract position.

Key observations

The results of our testing were satisfactory.

Through our testing of the contracts in relation to this key audit matter we consider the judgements made by the Group in recognising revenue and profit to be reasonable.

5.2. Carrying value of goodwill ≈

Refer to page 145 (Audit Committee report) and Note 8 (accounting policy and financial disclosures)

Goodwill:
£11,819m (2021: £10,910m)

Key audit matter description

The Group holds material goodwill balances, the majority of which are in the US. Management performs an impairment review of the carrying value of each Cash Generating Unit (CGU) on an annual basis in line with the requirements of IAS 36.

The impairment assessment involves judgement in considering whether the carrying value of the CGU is recoverable. Determining the recoverable amount involves significant estimation including:

- forecasting future cash flows;
- determining the discount rate; and
- determining long-term growth rates.

As outlined in Note 8, in the current year, the Group has changed the basis on which goodwill is monitored and assessed for impairment, alongside the reorganisation of the Group's segments and changes made to its internal processes.

As a result, in the current year the key audit matter has focused on the change in basis for assessing goodwill for impairment in addition to the annual impairment assessment performed.

Change in basis for assessing goodwill for impairment

Determining the level in the Group's reporting structure at which goodwill is assessed for impairment requires judgement and changes should only be made when there has been a change in the way in which the Group is organised or managed and/or when there has been a change in the processes and responsibility for monitoring goodwill for impairment at a particular level in the Group.

We therefore determined there to be an increased risk surrounding two aspects of this change:

1) that the basis for the change is not appropriate based on the relevant facts and circumstances; and
2) in making the change, there is a risk that an impairment that would otherwise have been identified on the previous basis could be overlooked. We pinpointed this specific aspect of the risk to the Land Munitions CGU. This was as a result of the lower headroom in comparison to the other CGUs during 2021.

An impairment assessment was performed by management prior to the transition to the new basis, to assess whether an impairment would have arisen for the Land Munitions CGU. The Land Munitions CGU held £427m of goodwill at 31 December 2021 and 30 June 2022, the latter date being the point at which management changed the basis of assessing goodwill for impairment.

Annual goodwill impairment assessment

Through our risk assessment, we determined there to be a heightened level of impairment risk in relation to the carrying value of goodwill, amounting to £3,753m associated with the Platforms & Services (P&S) CGU. The basis on which management is assessing this goodwill for impairment has not changed.

Through our risk assessment, we determined that the key drivers of future cash flows in the P&S CGU were future demand, long-term contract margin and operating cash flow assumptions, predominantly within the Combat Mission Systems business. In addition, given the macro-economic environment, we identified that both the Land Munitions and P&S CGUs were sensitive to movements in the discount rate and long-term growth rate.

The size of the balance, level of judgement applied, both in revising the basis on which goodwill is assessed for impairment and also in carrying out the annual impairment review, combined with the audit effort involved in challenging these risk areas means we consider this to be a key audit matter.

How the scope of our audit responded to the key audit matter

We have performed a series of specific audit procedures to address the key audit matter identified above.

Change in basis for assessing goodwill for impairment

In respect of the change in the level at which goodwill is assessed for impairment, we performed the following to address the two risks noted above:

- we obtained a detailed understanding of the changes made by management to the Group's operating segments, and also to relevant financial processes and responsibilities for monitoring goodwill and assessing it for impairment. This included challenging the underlying rationale behind the changes and the impact of these changes on the way the sectors and lines of business are managed, and goodwill is monitored;
- we challenged management on the timing of changes and the appropriate date at which amendments to the level at which goodwill is assessed should become effective, in particular given this impacted the point at which the Land Munitions CGU was considered for impairment on the previous basis and thus which discount rate to apply;
- we challenged management's impairment assessment of the Land Munitions CGU on the previous basis in the same way as outlined for the annual goodwill impairment assessment below;
- we considered available contradictory evidence and whether an impairment should first be recorded under the previous basis before transition to the current basis of assessment; and
- we assessed the extent of disclosures provided in the financial statements with respect to the rationale behind the change and its overall impact on goodwill impairment assessment.

Annual goodwill impairment assessment

A number of procedures were performed in relation to the annual impairment assessment of the P&S CGU and in considering whether there was any impairment at the date of change in basis for assessing goodwill of the Land Munitions CGU. These included the following:

- we obtained a detailed understanding of management's process and tested key controls for performing the CGU impairment assessment. Specific focus was given to understanding management's process and controls over forecasting future cash flows, forecasting for the impact of climate-change and determination of the key assumptions as detailed above;
- we challenged forecast performance with reference to the recent and historical performance of the CGU, historical forecasting accuracy and external industry benchmarks. This included performing sensitivity analysis to evaluate the impact of changing a range of assumptions including suppressed growth, lower margin assumptions, changes in the discount rate and impacts of the higher inflationary environment;
- we assessed the risks and opportunities identified by management in their forecasts and modelled different scenarios to understand the impact of both adverse and positive changes to the future forecasts and the level of associated headroom;
- we challenged the long-term growth rate assumption with reference to market, industry and economic data combined with an evaluation of the underlying key contracts that underpin the future growth assumptions;
- in the case of P&S, where management's forecasts have assumed significant contract renewals or an extension to existing contracts (i.e. moving from initial to full rate of production), we challenged those judgements with operational management and, where relevant, correspondence with the customer over contract renewal;
- operating cash flow and working capital assumptions were challenged, including the impact of climate change-related risks, with reference to our revenue contract audit work for key programmes, as well as historical trends for each line of business;
- we tested the integrity of management's impairment model used to derive the recoverable amount; and
- we involved our valuation specialists to support our challenge of the applicable discount rate.

Key observations

We have undertaken audit procedures on the forecasts for the P&S and Land Munitions businesses and are satisfied that the assumptions are reasonable and justifiable based on available evidence, both internal and external.

We completed our assessment of the change in basis of monitoring and assessing goodwill for impairment and concluded that the approach taken is appropriate and reflects underlying changes to the business, including specifically the level at which goodwill is monitored for performance purposes internally. We are also satisfied that a material impairment would not have arisen for the Land Munitions CGU on the previous basis of assessment, prior to the change.

The Group concluded that no reasonably possible change in a key assumption would lead to impairment, and we concur with that conclusion.

5.3. Valuation of post-employment benefit obligations ≈

Refer to page 145 (Audit Committee report) and Note 25 (accounting policy and financial disclosures)

Group's share of the net IAS 19 surplus after allocation to equity accounted investments (EAI):
£646m (2021: £2,124m net deficit)

Valuation of post-employment benefit obligation assets before allocation to equity accounted investments:
£25,343m (2021: £31,580m)

Valuation of post-employment benefit obligation liabilities before allocation to equity accounted investments:
£23,868m (2021: £33,866m)

Key audit matter description

The principal post-employment benefit schemes are held in the UK and US and are funded defined benefit schemes, with assets held in separate trustee-administered funds.

We identified the following areas which were the focus of our procedures in auditing the Group's net post-employment benefit surplus as a key audit matter:

Net surplus position

A number of the Group's post-employment benefit schemes have moved from a net deficit position to a net surplus position during 2022. As outlined in note 25, the ability to recognise the net surplus on the balance sheet is dependent on the legal rights of the scheme employer and the practical ability of the Group to recover the surplus, which then determines the necessary tax treatment. The surplus is a function of the value of the scheme assets, less the value of the defined benefit obligation liability.

Assets

Given the size and nature of the scheme assets there is significant audit effort required in ensuring the valuation of assets is appropriate.

Certain asset classes are inherently more judgemental to value and have a higher level of associated valuation risk, namely:

- private equity investments;
- pooled investment vehicles without published market prices;
- private placements;
- longevity swap derivatives; and
- property assets.

Liabilities

The key judgements relating to the post-employment benefit obligation liabilities include:

- inflation assumptions for the UK schemes, including the basis for determining the inflation risk premium;
- discount rates; and
- mortality assumptions.

Given the significant size of the post-employment benefit obligations at year-end, small changes to these input assumptions can lead to material changes in the net IAS 19 surplus. Assumptions are also made in the determination of the Group's share of assets and liabilities of multi-employer schemes in which it participates and the corresponding amounts attributed to other participating employers, including BAE Systems plc on a company-only basis and MBDA, as an EAI.

Whilst new risks have emerged in the current year as regards the need to consider the recognition of a surplus and the related tax treatment, we consider the overall level of risk associated with this key audit matter is consistent with the prior year.

How the scope of our audit responded to the key audit matter

Net surplus position

In relation to the recognition of the net surplus position, and the related tax treatment, we have performed the following procedures:

- in conjunction with our legal and actuarial experts we inspected the legal agreements for the relevant pension schemes and the legal advice received by the Company as to its right to recover the surplus;
- we challenged management's assessment of the basis on which the net surplus could be recovered by the Group in the future including with input from our legal and actuarial experts; and
- in conjunction with our tax specialists, we evaluated the tax treatment of the pension surplus taking into account the above assessment and the rationale for which the withholding tax charge has been netted off against the surplus position rather than being recognised gross.

Assets

In relation to asset valuations, we have performed the following procedures with increased focus on those assets with a higher valuation risk as noted above:

- we obtained a detailed understanding and performed walkthroughs of management's process and reviewed relevant internal controls reports from service providers, with specific focus on understanding key controls relating to the valuation of certain asset classes. We then tested the pension asset valuation controls for a number of the asset classes operated both by management and relevant service providers;
- we sought and obtained third party confirmation from asset managers and/or custodians or other supporting evidence as appropriate;
- in conjunction with our actuarial specialists, we challenged the fair value assumptions used to value the longevity swaps including the future projected mortality rates and discount rate;
- we assessed publicly-available information on the assets (including fact sheets and prospectuses), comparing to internal and external benchmarks (i.e. market prices, relevant indices or comparably priced instruments) and reconciling inputs used by management to determine the asset values; and
- in the case of specialist asset classes, such as properties, we involved relevant specialists to challenge the third-party valuations performed with reference to recent market transactions, rental yields, and movements in the MSCI Real Estate index.

Liabilities

In relation to post-employment benefit obligations, we have performed the following procedures:

- we obtained a detailed understanding and performed walkthroughs of management's process, with specific focus on understanding key controls relating to the valuation of the post-employment benefit obligation including maintenance of membership data;
- in conjunction with our actuarial specialists, we challenged the assumptions used in the IAS 19 valuation, including assessing and challenging the reasonableness of the assumptions against available market data and benchmarking against peers;
- we gave specific focus to challenging the basis on which the Group determined the inflation rate actuarial assumptions for the UK and US Schemes, with reference to our own determined ranges, and other market data sources;
- we considered the adjustment made by management to the CMI (Continuous Mortality Investigation) 2021 mortality tables to apply a weighting factor to reflect its assessment of the potential COVID-19 mortality impact, with reference to advice the Group has received from its actuaries;
- we assessed the relevant control environment of the third-party administrators who maintain membership data on behalf of the Group through review of their ISAE 3402 controls reporting, including considering and responding to any findings therein;
- we agreed a sample of cash contributions made into the pension funds; and
- we assessed the competence, capabilities and objectivity of the actuaries engaged by management to perform the valuations of the schemes.

Key observations

We concluded our testing of the assets and are satisfied that they are appropriately valued.

When taken together, we consider the discount rate, inflation and other key pension assumptions used in calculating the post-employment benefit obligation to be within our independently developed reasonable range.

We are satisfied that the judgement taken on the relevant tax rate to apply to the pension surplus and the net presentation of the surplus position is appropriate.

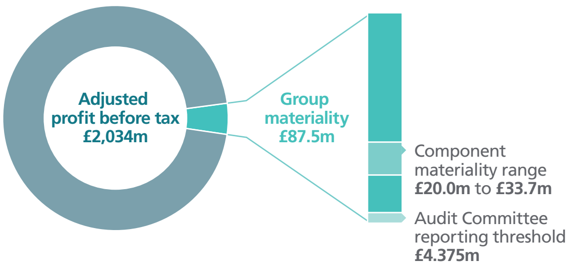
6. Our application of materiality

6.1. Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Materiality	£87.5m (2021: £82.5m)	£34.2m (2021: £39.5m)
Basis for determining materiality	4.3% of adjusted profit before tax of £2,034m (2021: 4.7% of adjusted profit before tax of £1,769m). This reflects adjusting items of £91m and fair value adjustments and foreign exchange movements on financial instruments of £136m, detailed in notes 1 and 5 of the financial statements.	0.7% of net assets of £4,712m (2021: 0.9% of net assets of £4,341m).
Rationale for the benchmark applied	Adjusted profit before tax was considered to be the most relevant benchmark as it is considered the most stable and comparable profit metric. The adjustments relate to items we consider one-off in nature and not reflective of the underlying performance of the business. We consider the measure suitable having also considered the other relevant benchmarks of profit before taxation, where our materiality equates to 4.4%, or net assets, where our materiality equates to 0.8%.	We consider net assets the key benchmark used by members of the Parent Company in assessing financial performance.
Component materiality	The work performed on components identified in our Group audit scope (excluding the Parent Company) was completed to a component materiality level between £20.0m and £33.7m (2021: £20.4m and £31.7m).	



6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Parent Company financial statements
Performance materiality	70% (2021: 70%) of Group materiality	70% (2021: 70%) of Parent Company materiality
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: – the quantum and nature of the uncorrected misstatements identified in the prior year audit; – our assessment of the potential for uncorrected misstatements in the current year; – our risk assessment, including our assessment of the overall control environment; – no substantial changes to the business have been noted from the prior year; and – the size and nature of the contract-based significant risks of material misstatement identified.	

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £4.375m (2021: £4.125m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1. Identification and scoping of components

We performed our scoping of the Group audit by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the audit risks. This exercise has considered the relative size of each reporting unit's contribution to revenue, profit before tax and adjusted profit before tax, alongside further financial or contractual risks, which we consider to be present.

We have considered units that contribute more than 10% of the Group's revenue or adjusted profit before tax to be 'financially significant' and requiring a full scope audit. In addition, as part of our risk assessment procedures and using our knowledge of the business, we assess where else we consider it appropriate to perform a full scope audit. This resulted in full scope audits for six components located in the UK, the Kingdom of Saudi Arabia and the US, and included the Group's largest joint venture, Matra BAE Dynamics Alenia (MBDA).

Additionally, our audit planning identified twenty-one non-financially significant components, located in the UK, the Kingdom of Saudi Arabia, Australia, and the US, where we consider there to be a reasonable possibility of material misstatement in specific balances within the financial statements. As a result of our risk assessment procedures and the detailed scoping exercise performed at the planning stage of our audit, we determined that it was appropriate to rotate certain non-financially significant components in and out of our Group audit scope in the current year. We have directed component auditors to perform an audit of specified account balances or specified audit procedures on the respective income statements and balance sheets for these components.

For all components designated financially significant or subject to an audit of specified account balances, revenue was determined to be in scope for the audit.

For all other reporting units not included in full-scope, specified account balance scope or specified audit procedure scope, we performed centrally directed analytical review procedures to confirm our conclusion that there was no significant risk of material misstatement in the residual population.

We also audited the consolidation process and performed audit procedures on centrally managed balances including treasury, post-employment benefit obligations, litigation and claims, goodwill, tax, and head office costs.

As each of the business units maintains separate financial records, we have engaged component auditors from the Deloitte member firms in the US, UK, Kingdom of Saudi Arabia and Australia to perform procedures at all the wholly-owned components under our direction and supervision. This approach also allows us to engage local auditors who have appropriate knowledge of local regulations to perform the audit work, under a common Deloitte audit approach.

In respect of MBDA, we have engaged with the entity's non-Deloitte auditors to perform a full-scope audit under our direction, supervision and review.

The Parent Company is located in the United Kingdom and audited directly by the Group audit team.

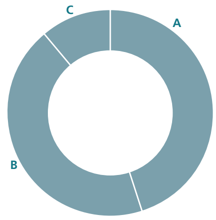
The twenty-five components within either full or specified account balance scope contribute the following proportions to total Group results.

7.2. Our consideration of the control environment

The Group operates a range of IT systems which underpin the financial reporting process. These vary by business and/or by geography. For all components that were subject to either a full scope or audit of specified balances, we identified relevant IT systems for the purpose of our audit work. These were typically the principal Enterprise Resource Planning (ERP) systems for each business that underpin the general ledger and contract accounting balances, and in some cases also included ancillary/feeder systems into the main ERP.

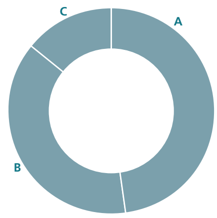
In the current year our controls approach was principally designed to inform our risk assessment and also to allow us to test the operating effectiveness of certain relevant revenue controls. We also assessed relevant general IT controls. The Group continues to invest in its IT systems and there is an ongoing programme of remediating any control findings where they are identified through its own assurance framework, including Internal Audit, or through the external audit. As part of our controls work in the prior and current year, we identified certain control deficiencies that management is in the process of remediating as disclosed in the Audit Committee report on page 145. In the current year this included identifying a new change management segregation of duties deficiency within the ERP system of one of the Group's overseas businesses. Where deficiencies have been identified and the remediation activity remained ongoing during the current year, or the remediated controls were not in place for a sufficient enough period prior to the year-end, we did not seek to place reliance on those relevant IT systems for the purpose of our audit.

Revenue



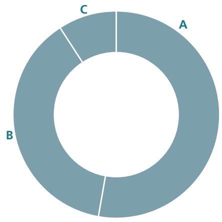
A	Full audit scope	45%
B	Specified account balances	44%
C	Specified audit procedures and review at Group level	11%

Profit before tax



A	Full audit scope	48%
B	Specified account balances	38%
C	Specified audit procedures and review at Group level	14%

Total assets



A	Full audit scope	53%
B	Specified account balances	38%
C	Specified audit procedures and review at Group level	9%

The majority of the focus of our controls assessment is in relation to the Group's contract accounting processes, the Lifecycle Management Framework (LCM). For each component where revenue is in scope, we obtain an understanding of key contract controls, such as with respect to the estimation of contract costs and the amount of contract revenue to recognise in the period. In the current year we have also sought to test certain relevant revenue controls. At each business unit we also consider key controls relevant to other income statement and balance sheet items where they are considered relevant to our audit for risk assessment purposes.

We have also considered head office controls relating to central balances and processes such as pension accounting, consolidation and financial reporting, treasury, tax, and the Group's planning and budgeting process.

During the course of our audit, we placed reliance on a number of relevant contract accounting controls and certain valuation controls in relation to pension assets.

7.3. Our consideration of climate-related risks

We have engaged with both the central finance and sustainability functions to gain an understanding of BAE's assessment of, and the process undertaken to both identify and quantify, the Group's climate-related risks. We have engaged our climate specialists in our assessment to consider broader industry and market-wide practice.

We completed an independent climate-based risk assessment in order to consider the potential impact of climate change on the Group's financial statements incorporating both business specific knowledge and wider industry awareness. We used this to assess the completeness of the Group's identified risks. In addition, component teams have considered the local regulatory and legal environment, and therefore the likelihood of unidentified environmental claims arising. As set out by management in pages 222 and 223 to the financial statements, the areas of financial reporting principally impacted are those reliant on future forecasts or future performance, notably recoverability of goodwill and revenue recognition on long-term contracts.

In relation to the Group's future forecasts, we considered the appropriateness of amounts included by management in relation to climate change in the context of the underlying businesses' specific needs and existing asset base, including engaging with segment management to understand the process undertaken to identify required activities to achieve the Group's Net Zero ambition. In considering the disclosures presented as part of the Strategic Report, we engaged our climate specialists to assess compliance with the Task Force on Climate-Related Financial Disclosures (TCFD) and the recommendations made by both the Task Force and FRC as set out in their thematic reviews. We have also assessed whether these disclosures reflect our understanding of the Group's approach to climate. With respect to the financial statements, we considered whether the current assessed impact of climate change required further or enhanced disclosure as part of critical accounting estimates. However, we concluded the current presentation as a factor within the estimate of revenue and goodwill, rather than a material driver of these estimates, is proportionate to the relative risk of the Group and current assessed potential financial impact.

For further information regarding our assessment of revenue recognition on long-term contracts and the carrying value of goodwill, please refer to sections 5.1 and 5.2 above.

7.4. Working with other auditors

Our oversight of component auditors included directing the planning of their audit work and understanding their risk assessment process to identify key areas of estimates and judgement, as well as supervising the execution of their audit work. We issued detailed referral instructions to the component auditors, reviewed and supervised their work through a number of visits to each of the component auditors during the planning and performance stages of our audit, alongside frequent remote communication. Further, we challenged the related component inter-office reporting and findings from their work, reviewed underlying audit files, attended component audit closing meetings in person, or virtually where in person attendance was not possible, and held regular remote communication to interact on any related audit and accounting matters which arose.

Additionally, all teams were involved in our annual planning workshop, which was led by the Group audit team. Visits to meet with component teams in the UK, US, Australia and Kingdom of Saudi Arabia were also conducted by either the lead audit partner or senior members of the engagement team (including at a partner or director level).

The BAE Systems, Inc. business units in the US are subject to a Department of Defence Special Security Arrangement (SSA), which is a government requirement setting out specific protocol that foreign controlled companies must comply with in order to be able to undertake government defence contracts. As part of this there is restriction on the flow of information outside of the US. Therefore, for the US components there are restrictions around access to the audit file and specific workpapers for non-US nationals. As such, and consistent with previous years, we have designed alternative procedures, including involvement of an additional independent US national partner, to ensure appropriate oversight of the US component team.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements, or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

9. Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- the Group's own assessment of the risks that irregularities may occur either as a result of fraud or error;
- results of our enquiries of management, internal legal counsel, internal audit, directors and the Audit Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Group's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations, including obtaining an understanding of the Group's bribery and corruption and whistleblowing policies;
- the matters discussed among the audit engagement team including significant component audit teams and involving relevant internal specialists, including tax, valuations, pensions and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the level of judgement involved in estimating costs to complete on long-term contracts and the subsequent impact on revenue and margin recognition. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pension legislation, and taxation legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group's ability to operate or to avoid a material penalty, including in respect of export controls, defence contracting and anti-bribery and corruption legislation.

11.2. Audit response to risks identified

As a result of performing the above, we identified revenue and margin recognition on long-term contracts as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee, in-house legal counsel and where appropriate, circularising external legal counsel, concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports, and reviewing correspondence with relevant regulatory authorities; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and significant component audit teams and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

13. Corporate Governance Statement

The Listing Rules require us to review the directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the Group's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- the directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 127;
- the directors' explanation as to its assessment of the Group's prospects, the period this assessment covers and why the period is appropriate set out on page 126;
- the directors' statement on fair, balanced and understandable set out on page 148;
- the board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 126;
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 138; and
- the section describing the work of the Audit Committee set out on page 145.

14. Matters on which we are required to report by exception

14.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

14.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

15. Other matters which we are required to address

15.1. Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by the members on 10 May 2018 to audit the financial statements for the year ending 31 December 2018 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is five years covering 31 December 2018 to 31 December 2022.

16. Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

As required by the Financial Conduct Authority (FCA) Disclosure Guidance and Transparency Rule (DTR) 4.1.14R, these financial statements will form part of the European Single Electronic Format (ESEF) prepared Annual Financial Report filed on the National Storage Mechanism of the UK FCA in accordance with the ESEF Regulatory Technical Standard (ESEF RTS). This auditor's report provides no assurance over whether the annual financial report has been prepared using the single electronic format specified in the ESEF RTS. We have been engaged to provide assurance on whether the annual financial report has been prepared using the single electronic format specified in the ESEF RTS and will publicly report separately to the members on this.

John Adam
Senior Statutory Auditor

For and on behalf of
Deloitte LLP Statutory Auditor

London, United Kingdom
22 February 2023

Financial statements

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Financial glossary

Shareholder information

Group accounting policies

Accounting policies are included within the relevant note to the Group accounts.

Preparation of the consolidated financial statements

Basis of preparation

The consolidated financial statements of BAE Systems plc have been prepared on a going concern basis, as discussed in the Directors' report on page 127, and in accordance with UK-adopted international accounting standards and the Companies Act 2006 applicable to companies reporting under IFRS.

The consolidated financial statements are presented in pounds sterling and, unless stated otherwise, rounded to the nearest million. They have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments).

Transactions in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date, with the resulting exchange differences recognised in the income statement.

Significant accounting policies

The significant accounting policies applied in the preparation of these consolidated financial statements are set out in the relevant notes. These policies have been applied consistently to all the years presented, unless otherwise stated. The directors believe that the consolidated financial statements reflect appropriate judgements and estimates, and provide a true and fair view of the Group's financial performance and position.

Key sources of estimation uncertainty

The application of the Group's accounting policies requires the use of estimates. In response to the potential impact of risks and uncertainties, the Group undertakes risk assessments and scenario planning in order to be able to respond to potential rapid changes in circumstances. The Group therefore considers a range of estimates and assumptions in the application of its accounting policies and management's assessment of the carrying value of assets and liabilities. In the event that these estimates or assumptions prove to be incorrect, there may be an adjustment to the carrying values of assets and liabilities within the next year. Potential areas of the Group's financial statements which could be materially impacted may include, but are not limited to:

Accounting policy	Description	Notes
Revenue and profit recognition	The Group accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Group's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired. The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks which are reliant on the knowledge and experience of the Group's project managers, engineers and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances. The long-term nature of many of the Group's contracts means that judgements are made in estimating future costs on a contract, as well as when risks will be mitigated or retired. The impact of global supply chain issues, volatility in global gas and energy prices, and the ongoing response to climate change, have increased uncertainty in relation to these judgements and estimates. The Group continues to work closely and collaboratively with its key customers to continue to deliver effectively on its contracts and commitments. However, the volume, scale, complexity and long-term nature of its programmes mean that a range of calculated potential sensitivities would be wide-ranging and not practicable to calculate. Owing to the ongoing uncertainty regarding the potential future impact of the current uncertainties, the Group's estimates and assumptions related to revenue recognition could be impacted by issues such as reduced productivity as a result of operation disruption, production delays and increased costs as a result of disruption to the supply chain, changing working practices to move towards net zero, or where there is uncertainty as to the recovery from customers of programme costs incurred. As shown in note 1, the Group has recognised £0.3bn of revenue in respect of performance obligations satisfied or partially satisfied in previous years (2021 £0.3bn). This continues to provide an approximation of the potential revenue sensitivity arising as a result of management's estimates and assumptions for variable consideration, future costs, and technical and other risks, however it may not reflect the full potential impact on the contract receivables and contract liabilities balances.	1

Post-employment benefit obligations	A number of actuarial assumptions are made in assessing the value of post-employment benefit obligations, including discount rate, inflation rate and mortality assumptions. For each of the actuarial assumptions used there is a wide range of possible values and management estimates a point within that range that most appropriately reflects the Group's circumstances. If estimates relating to these actuarial assumptions are no longer valid or change due to changing economic and social conditions, then the potential obligations due under these schemes could change significantly. Discount and inflation rates could change significantly as a result of a prolonged economic downturn, monetary policy decisions and interventions or other macroeconomic issues. The impact of estimates made with regard to mortality projections may also change. Similarly, the values of many assets are subject to estimates and assumptions, in particular those which are held in unquoted pooled investment vehicles. The associated fair value of these unquoted pooled investments is estimated with consideration of the most recently available valuations provided by the investment or fund managers. These valuations inherently incorporate a number of assumptions including the impact of climate change on the underlying investments. The overall level of estimation uncertainty in valuing these assets could therefore give rise to a material change in valuation within the next 12 months. Furthermore, estimates are required around the Group's ability to access its defined benefit surpluses, and on what basis, which then determines the associated rate of tax to apply. Depending on the outcome, judgement is then required to determine the presentation of any tax payable in recovering a surplus. Note 25 provides information on the key assumptions and analysis of their sensitivities.	25

In preparing the consolidated financial statements management has considered the potential impact of climate change, in the context of the disclosures included in the Strategic report this year and the impact of the Group's net zero ambitions. Estimates and judgement are required in establishing how the Group will pursue its net zero targets, as well as further mitigating actions identified as part of the detailed review of climate risks and opportunities. These have been factored in to the future business plans of the Group, through the IBP process, and are not considered to have a material impact on the financial reporting estimates and judgements. The following additional areas of estimation were considered in reaching this conclusion:

- estimates of future cash flows to support impairment assessments of the carrying value of non-current assets and the assessment of going concern and the longer-term viability of the Group;
- an assessment of the useful economic lives of assets; and
- potential climate-related impacts on the Group's environmental provisions, in particular with regard to legislative changes.

Critical judgements made in applying accounting policies

In the course of preparing the financial statements and when applying its accounting policies, the Group has been required to make judgements with regard to the actions required to enable the business to continue to meet customers' requirements, in an operating environment still dominated by uncertainties arising from global economic uncertainties. No critical judgements have been made in the process of applying the Group's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Changes in accounting policies

The following standards, interpretations and amendments to existing standards became effective on 1 January 2022 and have not had a material impact on the Group:

- Amendments to IFRS 3 Business Combinations, effective from 1 January 2022;
- Amendments to IAS 16 Property, Plant and Equipment – Proceeds before Intended Use effective from 1 January 2022;
- Amendments to IAS 37 Onerous Contracts – Cost of Fulfilling a Contract effective from 1 January 2022; and
- Annual Improvements to IFRS Accounting Standards 2018–2020 Cycle effective from 1 January 2022.

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2022. These either have been, or are expected to be endorsed by the UK Endorsement Board and are not expected to have a material impact on the Group:

- IFRS 17 Insurance Contracts, effective from 1 January 2023;
- Amendments to IAS 1: Presentation of Financial Statements, effective from 1 January 2023;
- Amendments to IAS 1 and IFRS Practice Statement 2: Disclosure of Accounting Policies, effective from 1 January 2023;
- Amendments to IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors, effective from 1 January 2023;
- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture; and
- Amendments to IAS 12: Income Taxes, effective from 1 January 2023.

Consolidation

The financial statements of the Group consolidate the results of the Company and its subsidiary entities, and include its share of its equity accounted investments' results accounted for under the equity method.

A subsidiary is an entity controlled by the Group. The Group controls a subsidiary when it is exposed, or has the rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. The results of subsidiaries are included in the income statement from the date of acquisition.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Joint ventures are accounted for under the equity method where the Consolidated income statement includes the Group's share of their profits and losses, and the Consolidated balance sheet includes its share of their net assets within equity accounted investments.

The assets and liabilities of overseas subsidiaries and equity accounted investments are translated at the exchange rates ruling at the balance sheet date. The income statements of such entities are translated at average rates of exchange during the year. All resulting exchange differences are recognised directly in a separate component of equity. Translation differences that arose before the transition date to IFRS (1 January 2004) are presented in equity, but not as a separate component. When a foreign operation is sold, the cumulative exchange differences recognised in equity since 1 January 2004 are recognised in the income statement as part of the profit or loss on sale.

Consolidated income statement for the year ended 31 December

	Notes	2022 £m	2022 Total £m	2021 £m	2021 Total £m
Continuing operations					
Revenue	1		**21,258**		19,521
Operating costs	2		**(19,269)**		(17,743)
Other income	4		**215**		472
Share of results of equity accounted investments	1		**180**		139
Operating profit	1		**2,384**		2,389
Financial income		**47**		32	
Financial expense		**(442)**		(311)	
Net finance costs	5		**(395)**		(279)
Profit before taxation			**1,989**		2,110
Taxation expense	6		**(315)**		(198)
Profit for the year			**1,674**		1,912
Attributable to:					
Equity shareholders			**1,591**		1,758
Non-controlling interests			**83**		154
			1,674		1,912
Earnings per share	7				
Basic earnings per share			**51.1p**		55.2p
Diluted earnings per share			**50.5p**		54.7p

Consolidated statement of comprehensive income for the year ended 31 December

	Notes	2022 Other reserves[1] £m	2022 Retained earnings £m	2022 Total £m	2021 Other reserves[1] £m	2021 Retained earnings £m	2021 Total £m
Profit for the year		–	1,674	1,674	–	1,912	1,912
Other comprehensive income							
Items that will not be reclassified to the income statement:							
Consolidated:							
Remeasurements on post-employment benefit schemes and other investments		–	2,851	2,851	–	2,451	2,451
Tax on items that will not be reclassified to the income statement	6	–	(357)	(357)	–	(394)	(394)
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method (net of tax)		–	116	116	–	64	64
Items that may be reclassified to the income statement:							
Consolidated:							
Currency translation on foreign currency net investments		1,172	–	1,172	32	–	32
Reclassification of cumulative currency translation reserve on disposal of subsidiaries	20	(17)	–	(17)	(9)	–	(9)
Fair value (loss)/gain arising on hedging instruments during the year	15	(102)	–	(102)	11	–	11
Cumulative fair value loss/(gain) on hedging instruments reclassified to the income statement		5	–	5	(32)	–	(32)
Tax on items that may be reclassified to the income statement	6	24	–	24	4	–	4
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method (net of tax)		(8)	–	(8)	(4)	–	(4)
Total other comprehensive income for the year (net of tax)		1,074	2,610	3,684	2	2,121	2,123
Total comprehensive income for the year		1,074	4,284	5,358	2	4,033	4,035
Attributable to:							
Equity shareholders		1,053	4,186	5,239	(3)	3,882	3,879
Non-controlling interests		21	98	119	5	151	156
		1,074	4,284	5,358	2	4,033	4,035

1. An analysis of other reserves is provided in note 27.

Consolidated statement of changes in equity for the year ended 31 December

	Notes	Attributable to equity holders of BAE Systems plc Issued share capital £m	Share premium £m	Other reserves[1] £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
Balance at 1 January 2021		87	1,249	5,923	(2,616)	4,643	278	4,921
Profit for the year		–	–	–	1,758	1,758	154	1,912
Total other comprehensive income for the year		–	–	(3)	2,124	2,121	2	2,123
Total comprehensive income for the year		–	–	(3)	3,882	3,879	156	4,035
Share-based payments (inclusive of tax)	32	–	–	–	94	94	–	94
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)		–	–	(35)	–	(35)	–	(35)
Ordinary share dividends	27	–	–	–	(777)	(777)	(202)	(979)
Purchase of own shares	27	(2)	–	2	(371)	(371)	–	(371)
Unclaimed assets programme proceeds		–	3	–	–	3	–	3
At 31 December 2021		85	1,252	5,887	212	7,436	232	7,668
Profit for the year		–	–	–	1,591	1,591	83	1,674
Total other comprehensive income for the year		–	–	1,053	2,595	3,648	36	3,684
Total comprehensive income for the year		–	–	1,053	4,186	5,239	119	5,358
Share-based payments (inclusive of tax)	32	–	–	–	127	127	–	127
Cumulative fair value loss on hedging instruments transferred to the balance sheet (net of tax)		–	–	8	–	8	–	8
Ordinary share dividends	27	–	–	–	(802)	(802)	(166)	(968)
Purchase of own shares	27	(3)	–	3	(793)	(793)	–	(793)
At 31 December 2022		**82**	**1,252**	**6,951**	**2,930**	**11,215**	**185**	**11,400**

1. An analysis of other reserves is provided in note 27.

Consolidated balance sheet as at 31 December

	Notes	2022 £m	2021 £m
Non-current assets			
Intangible assets	8	**12,644**	11,716
Property, plant and equipment	9	**3,235**	2,852
Right-of-use assets	10	**1,425**	1,091
Investment property	11	**63**	67
Equity accounted investments	12	**787**	554
Other investments	13	**99**	76
Other receivables	14	**618**	551
Post-employment benefit surpluses	25	**1,297**	483
Other financial assets	15	**322**	305
Deferred tax assets	16	**338**	622
	21	**20,828**	18,317
Current assets			
Inventories	17	**976**	811
Trade, other and contract receivables	14	**6,166**	4,825
Current tax	18	**133**	71
Other financial assets	15	**252**	194
Cash and cash equivalents	19	**3,107**	2,917
		10,634	8,818
Total assets		**31,462**	27,135
Non-current liabilities			
Loans	22	**(5,189)**	(4,604)
Lease liabilities	10	**(1,375)**	(1,083)
Contract liabilities	23	**(945)**	(519)
Other payables	24	**(1,441)**	(1,248)
Post-employment benefit obligations	25	**(651)**	(2,607)
Other financial liabilities	15	**(272)**	(302)
Deferred tax liabilities	16	**(5)**	(77)
Provisions	26	**(338)**	(331)
		(10,216)	(10,771)
Current liabilities			
Loans and overdrafts	22	**(53)**	(457)
Lease liabilities	10	**(241)**	(212)
Contract liabilities	23	**(3,882)**	(2,874)
Trade and other payables	24	**(4,990)**	(4,636)
Other financial liabilities	15	**(328)**	(214)
Current tax	18	**(103)**	(27)
Provisions	26	**(249)**	(276)
		(9,846)	(8,696)
Total liabilities		**(20,062)**	(19,467)
Net assets		**11,400**	7,668
Capital and reserves			
Issued share capital	27	**82**	85
Share premium		**1,252**	1,252
Other reserves	27	**6,951**	5,887
Retained earnings		**2,930**	212
Total equity attributable to equity holders of BAE Systems plc		**11,215**	7,436
Non-controlling interests		**185**	232
Total equity		**11,400**	7,668

Approved by the Board of BAE Systems plc on 22 February 2023 and signed on its behalf by:

C N Woodburn
Chief Executive

B M Greve
Group Finance Director

Consolidated cash flow statement for the year ended 31 December

	Notes	2022 £m	2021 £m
Profit for the year		**1,674**	1,912
Taxation expense	6	**315**	198
Adjustment in respect of research and development expenditure credits	4	**(35)**	(16)
Share of results of equity accounted investments	1	**(180)**	(139)
Net finance costs	5	**395**	279
Depreciation, amortisation and impairment	2	**767**	720
Gain on disposal of property, plant and equipment, and investment property	2,4	**(3)**	(192)
Gain in respect of held for sale assets and business disposals	2,4	**(93)**	(158)
Gain on disposal of non-current investments	4	**(7)**	–
Cost of equity-settled employee share schemes	3	**101**	92
Movements in provisions		**(54)**	(66)
Difference between pension funding contributions paid and the pension charge		**1**	(18)
(Increase)/decrease in working capital:			
Inventories		**(93)**	54
Trade, other and contract receivables		**(1,069)**	610
Trade and other payables, and contract liabilities		**1,485**	(615)
Research and development expenditure credits – cash received		**–**	20
Taxation paid		**(365)**	(234)
Net cash flow from operating activities		**2,839**	2,447
Dividends received from equity accounted investments	12	**94**	57
Interest received		**32**	23
Principal element of finance lease receipts		**9**	10
Purchase of property, plant and equipment, and investment property[1]		**(599)**	(516)
Purchase of intangible assets		**(94)**	(96)
Purchase of non-current other investments		**(8)**	(15)
Proceeds from funding related to assets[1]		**157**	150
Proceeds from sale of property, plant and equipment, and investment property		**18**	271
Proceeds from sale of non-current other investments		**7**	–
Equity accounted investment funding	12	**–**	(3)
Purchase of subsidiary undertakings, net of cash and cash equivalents acquired	35	**(162)**	(30)
Cash flow in respect of business disposals, net of cash and cash equivalents disposed	20	**124**	215
Net cash flow from investing activities		**(422)**	66
Interest paid		**(269)**	(247)
Equity dividends paid	27	**(802)**	(777)
Purchase of own shares	27	**(788)**	(368)
Dividends paid to non-controlling interests		**(166)**	(202)
Partial disposal of shareholding in subsidiary undertaking		**–**	28
Principal element of lease payments		**(236)**	(217)
Cash inflow from derivative financial instruments (excluding cash flow hedges)		**533**	61
Cash outflow from derivative financial instruments (excluding cash flow hedges)		**(205)**	(149)
Cash flow from movement in cash collateral		**–**	(18)
Cash outflow from repayment of loans		**(400)**	(367)
Net cash flow from financing activities	29	**(2,333)**	(2,256)
Net increase in cash and cash equivalents		**84**	257
Cash and cash equivalents at 1 January		**2,917**	2,667
Effect of foreign exchange rate changes on cash and cash equivalents		**106**	(7)
Cash and cash equivalents at 31 December		**3,107**	2,917

1. To align with further detail provided in the current year cash flow statement, funding received from the UK government for the construction of assets for the year ended 31 December 2021 has been presented in equivalent detail with the cash inflow now shown separately as 'Proceeds from funding related to assets' to cash outflows on the 'Purchase of property, plant and equipment, and investment property'.

Notes to the Group accounts

1. Segmental analysis and revenue recognition

Revenue and profit recognition

Revenue represents income derived from contracts for the provision of goods and services, over time or at a point in time, by the Group to customers in exchange for consideration in the ordinary course of the Group's activities.

The Group accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Group's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired.

The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks which are reliant on the knowledge and experience of the Group's project managers, engineers, and finance and commercial professionals. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events and circumstances.

The Group typically enters into the following types of contracts with customers:

- to design, build or create assets uniquely available to the customer such as ships and aircraft;
- to service or maintain assets over a period of time;
- to give access to software and licences; and
- to offer bespoke services to customers, for example through training or the offering of cyber, intelligence and security capabilities.

Revenue is recognised against each of these types of contracts in line with the following accounting policies.

Performance obligations

Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract.

In some cases, the Group provides warranties to its customers to give them assurance that its products and services will function in line with agreed-upon specifications. Warranties are not provided separately and, therefore, do not represent separate performance obligations. A provision for warranties is recognised when the underlying products and services are sold (see note 26 for further detail).

Transaction price

At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Group expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as variable price mechanisms, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Group's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Group's pricing principles.

Whilst payment terms vary from contract to contract, on many of the Group's contracts, an element of the transaction price is received in advance of delivery. When cash is received in advance of goods or services being delivered, a contract liability is recognised. The Group therefore has significant contract liabilities (note 23). The Group's contracts are not considered to include significant financing components on the basis that there is no difference between the consideration and the cash selling price. UK Ministry of Defence contracting rules prohibit the inclusion of financing in the sales price. Negotiations on competitive international export contracts do not make allowance for the cash payment profile.

Revenue and profit recognition

Revenue is recognised as performance obligations are satisfied as control of the goods and services is transferred to the customer.

For each performance obligation within a contract, the Group determines whether it is satisfied over time or at a point in time. Performance obligations are satisfied over time if one of the following criteria is satisfied:

- the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs;
- the Group's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date.

The Group has determined that most of its contracts satisfy the over-time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Group's performance as it is performed (typically services or support contracts, for example in the case of ongoing maintenance and support of aircraft and flying capability), or the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date (typically development or production contracts, such as in the production of ships or aircraft to customers' unique specifications).

For each performance obligation to be recognised over time, the Group recognises revenue using an input method, based on costs incurred in the period. Revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks including the impact of global economic uncertainties and climate change. Revenue and associated margin are therefore recognised progressively as costs are incurred, and as risks have been mitigated or retired. The Group has determined that this method appropriately depicts the Group's performance in transferring control of the goods and services to the customer.

1. Segmental analysis and revenue recognition continued

If the over-time criteria for revenue recognition are not met, revenue is recognised at the point in time that control is transferred to the customer, which is usually when legal title passes to the customer and the business has the right to payment, for example, on delivery.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

Software licences

The Group sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right to access the Group's intellectual property as it exists throughout the licence period or a right to use the Group's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right to access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship and revenue in respect of right to use licences is recognised on delivery of the software to the customer or, if the customer chooses not to access and take delivery of the software, on expiry of the licence arrangement. A software licence is considered to be a right to access the Group's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

- the contract requires, or the customer reasonably expects, that the Group will undertake activities that significantly affect the intellectual property; and
- the licence directly exposes the customer to the effects of those activities; and
- those activities do not result in the transfer of a good or service to the customer.

Contract modifications

The Group's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Group's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

1. prospectively, as an additional, separate contract;
2. prospectively, as a termination of the existing contract and creation of a new contract; or
3. as part of the original contract using a cumulative catch-up.

The majority of the Group's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

Costs to obtain a contract

The Group expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Group does not typically incur costs to obtain contracts that it would not have incurred had the contracts not been awarded, such as sales commission.

Costs to fulfil a contract

Contract fulfilment costs in respect of over-time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

Reporting segments

The Group has five sectors which, together with HQ, make its six reporting segments as defined by IFRS 8 Operating Segments:

- **Electronic Systems** comprises the US- and UK-based electronics activities, including electronic warfare systems, navigation systems, electro-optical sensors, military and commercial digital engine and flight controls, precision guidance and seeker solutions, next-generation military communications systems and data links, persistent surveillance capabilities, space electronics and electric drive propulsion systems;
- **Platforms & Services** has operations in the US, UK and Sweden. It manufactures and upgrades combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair, and the management and operation of government-owned munitions facilities;
- **Air** comprises the Group's UK-based air activities for European and International Markets, US Programmes and development of future combat air systems alongside its businesses in the Kingdom of Saudi Arabia, together with its 37.5% interest in the European MBDA joint venture;
- **Maritime** comprises the Group's UK-based maritime and land activities, as well as its Australia business;
- **Cyber & Intelligence** comprises the US-based Intelligence & Security business and UK-headquartered Digital Intelligence business, which have been aggregated together due to the similarities of the services offered. Together, they cover the Group's cyber security and secure government activities; and
- **HQ** comprises the Group's head office and UK-based shared services activities, together with a 49% interest in Air Astana.

The Board (the chief operating decision maker as defined by IFRS 8 Operating Segments) monitors the results of these reporting segments to assess performance and make decisions about the allocation of resources. Segmental performance is evaluated based on Key Performance Indicators – sales[1] (see page 232) and underlying EBIT[1] (see page 233). Finance costs and taxation expense are managed on a Group basis.

1. Sales and underlying EBIT are alternative performance measures defined in the Financial glossary on page 302.

1. Segmental analysis and revenue recognition continued

Sales[1] and revenue by reporting segment

	Sales[1]		Deduct Share of revenue of equity accounted investments		Add Subsidiaries' revenue from equity accounted investments		Revenue	
	2022 £m	2021[2] £m	**2022 £m**	2021[2] £m	**2022 £m**	2021[2] £m	**2022 £m**	2021[2] £m
Electronic Systems	**5,057**	4,491	**(73)**	(54)	**73**	54	**5,057**	4,491
Platforms & Services	**3,688**	3,395	**(90)**	(79)	**–**	2	**3,598**	3,318
Air	**7,698**	7,449	**(2,651)**	(2,505)	**1,239**	1,097	**6,286**	6,041
Maritime	**4,598**	4,169	**(119)**	(79)	**5**	3	**4,484**	4,093
Cyber & Intelligence	**2,205**	1,923	**–**	–	**–**	–	**2,205**	1,923
HQ	**420**	281	**(410)**	(271)	**–**	–	**10**	10
	23,666	21,708	**(3,343)**	(2,988)	**1,317**	1,156	**21,640**	19,876
Intra-group sales/revenue	**(410)**	(398)	**1**	9	**27**	34	**(382)**	(355)
	23,256	21,310	**(3,342)**	(2,979)	**1,344**	1,190	**21,258**	19,521

	Intra-group revenue		Revenue from external customers	
	2022 £m	2021[2] £m	**2022 £m**	2021[2] £m
Electronic Systems	**115**	101	**4,942**	4,390
Platforms & Services	**43**	34	**3,555**	3,284
Air	**29**	19	**6,257**	6,022
Maritime	**71**	80	**4,413**	4,013
Cyber & Intelligence	**114**	111	**2,091**	1,812
HQ	**10**	10	**–**	–
	382	355	**21,258**	19,521

1. Sales is an alternative performance measure defined in the Financial glossary on page 302. It is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. With effect from 2022, the Group established a new Digital Intelligence business, bringing together our non-US digital and data capabilities to further strengthen how we deliver these services and capabilities for our customers. The new Digital Intelligence business is reported within the Cyber & Intelligence segment. In addition, our BAE Systems Australia business transitioned from the Air segment to the Maritime segment. Comparative segmental financial information for 2021 has been re-presented in this report to reflect the new business structure.

Sales[1] and revenue by customer location

	Sales[1]		Revenue	
	2022 £m	2021 £m	**2022 £m**	2021 £m
UK	**4,608**	4,201	**4,324**	3,935
Rest of Europe	**3,021**	2,435	**1,824**	1,502
US	**10,166**	9,109	**10,157**	9,108
Canada	**125**	141	**125**	141
Kingdom of Saudi Arabia	**2,539**	2,497	**2,540**	2,476
Qatar	**1,156**	1,267	**885**	1,014
Rest of Middle East	**263**	326	**225**	275
Australia	**854**	763	**853**	762
Rest of Asia and Pacific	**420**	449	**283**	285
Africa, and Central and South America	**104**	122	**42**	23
	23,256	21,310	**21,258**	19,521

1. Sales is an alternative performance measure defined in the Financial glossary on page 302. It is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

1. Segmental analysis and revenue recognition continued

Revenue from external customers by domain

	2022					2021[1]				
	Air £m	**Maritime £m**	**Land £m**	**Cyber £m**	**Total £m**	Air £m	Maritime £m	Land £m	Cyber £m	Total £m
Electronic Systems	**4,404**	**145**	**393**	**–**	**4,942**	3,846	87	457	–	4,390
Platforms & Services	**41**	**1,043**	**2,471**	**–**	**3,555**	37	1,061	2,186	–	3,284
Air	**6,223**	**34**	**–**	**–**	**6,257**	5,987	33	2	–	6,022
Maritime	**268**	**3,778**	**367**	**–**	**4,413**	255	3,417	341	–	4,013
Cyber & Intelligence	**250**	**274**	**127**	**1,440**	**2,091**	264	411	136	1,001	1,812
HQ	**–**	**–**	**–**	**–**	**–**	–	–	–	–	–
	11,186	**5,274**	**3,358**	**1,440**	**21,258**	10,389	5,009	3,122	1,001	19,521

1. With effect from 2022, the Group established a new Digital Intelligence business, bringing together our non-US digital and data capabilities to further strengthen how we deliver these services and capabilities for our customers. The new Digital Intelligence business is reported within the Cyber & Intelligence segment. In addition, our BAE Systems Australia business transitioned from the Air segment to the Maritime segment. Comparative segmental financial information for 2021 has been re-presented in this report to reflect the new business structure.

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2022 £m	2021 £m
US Department of Defense	**7,439**	7,008
UK Ministry of Defence	**4,721**	4,185
Kingdom of Saudi Arabia Ministry of Defence and Aviation	**2,425**	2,380

Revenue from the UK Ministry of Defence and the US Department of Defense was generated by the five reporting segments, excluding HQ. Revenue from the Kingdom of Saudi Arabia Ministry of Defence and Aviation was generated by the Air and Maritime segments.

Operating profit/(loss) by reporting segment

	Underlying EBIT[1]		Adjusting items[3]		Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	2022 £m	2021[2] £m	**2022 £m**	2021[2] £m	**2022 £m**	2021[2] £m	**2022 £m**	2021[2] £m	**2022 £m**	2021[2] £m
Electronic Systems	**838**	766	**–**	33	**(91)**	(84)	**–**	–	**747**	715
Platforms & Services	**326**	259	**–**	–	**–**	(1)	**(4)**	(6)	**322**	252
Air	**849**	772	**(1)**	132	**(1)**	(10)	**(38)**	(45)	**809**	849
Maritime	**356**	351	**–**	–	**–**	(1)	**(4)**	(3)	**352**	347
Cyber & Intelligence	**232**	179	**78**	3	**(19)**	(5)	**–**	–	**291**	177
HQ	**(122)**	(122)	**14**	182	**–**	–	**(29)**	(11)	**(137)**	49
	2,479	2,205	**91**	350	**(111)**	(101)	**(75)**	(65)	**2,384**	2,389
Net finance costs									**(395)**	(279)
Profit before taxation									**1,989**	2,110
Taxation expense									**(315)**	(198)
Profit for the year									**1,674**	1,912

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 302. It is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. With effect from 2022, the Group established a new Digital Intelligence business, bringing together our non-US digital and data capabilities to further strengthen how we deliver these services and capabilities for our customers. The new Digital Intelligence business is reported within the Cyber & Intelligence segment. In addition, our BAE Systems Australia business transitioned from the Air segment to the Maritime segment. Comparative segmental financial information for 2021 has been re-presented in this report to reflect the new business structure.
3. Adjusting items were referred to as non-recurring items in the prior year. No change has been made to the definition of these items, but the name has been changed to reflect that some items could be considered recurring in nature.

1. Segmental analysis and revenue recognition continued

Share of results of equity accounted investments within reporting segments

	Underlying EBIT[1]		Adjusting items[2]		Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles		Financial and taxation expense		Share of results of equity accounted investments	
	2022 £m	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m
Electronic Systems	**4**	4	**–**	–	**–**	–	**–**	–	**4**	4
Platforms & Services	**11**	9	**–**	–	**–**	–	**(4)**	(6)	**7**	3
Air	**164**	151	**–**	–	**–**	–	**(38)**	(45)	**126**	106
Maritime	**11**	11	**–**	–	**–**	–	**(4)**	(3)	**7**	8
HQ	**65**	29	**–**	–	**–**	–	**(29)**	(11)	**36**	18
	255	204	**–**	–	**–**	–	**(75)**	(65)	**180**	139

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 302. It is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. Adjusting items were referred to as non-recurring items in the prior year. No change has been made to the definition of these items, but the name has been changed to reflect that some categories of items could be considered recurring in nature.

Adjusting items

2022

Adjusting items in 2022 comprises a £94m gain on the disposal of the Financial Services business in Digital Intelligence, £16m costs related to current and historical business transactions, and a £13m gain related to past service on the pension schemes.

2021

Adjusting items in 2021 reflect a gain of £350m, comprising a gain in HQ on the sale of the Filton and Broughton sites (£182m), gains on disposal of Advanced Electronics Company in the Air segment (£132m, of which £63m is attributable to non-controlling interests – see note 20), and on disposal of a business in our Electronic Systems segment (£26m), and a net £10m gain relating to historical and current year acquisitions.

Performance obligations

The Group's order book[1], reconciled to order backlog as defined by the Group, is shown below.

	2022 £bn	2021 £bn
Order backlog[2] as defined by the Group	**58.9**	44.0
Deduct Unfunded order backlog	**(2.3)**	(2.3)
Deduct Share of order backlog[2] of equity accounted investments	**(12.0)**	(10.1)
Add Order backlog[2] in respect of orders from equity accounted investments	**4.3**	3.9
Order book[1]	**48.9**	35.5

1. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.
2. Order backlog is an alternative performance measure defined in the Financial glossary on page 302. It is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

The Group expects that approximately 33% (2021 41%) of the order book will be recognised as revenue during the next year, with the remainder largely recognised over the following four (2021 four) years.

For each performance obligation to be recognised over time, the Group recognises revenue using an input method, based on costs incurred in the period. Revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks. Revenue and associated margin are therefore recognised progressively as costs are incurred, and as risks have been mitigated or retired. The Group has determined that this method appropriately depicts the Group's performance in transferring control of the goods and services to the customer. Accordingly, revenue of £0.3bn (2021 £0.3bn) was recognised during the year in respect of performance obligations satisfied or partially satisfied in previous years.

1. Segmental analysis and revenue recognition continued

Prior year re-presentation

With effect from 2022, the Group established a new Digital Intelligence business, bringing together our non-US digital and data capabilities to further strengthen how we deliver these services and capabilities for our customers. The new Digital Intelligence business is reported within the Cyber & Intelligence segment. In addition, our BAE Systems Australia business transitioned from the Air segment to the Maritime segment. Comparative segmental financial information for 2021 has been re-presented in this report to reflect the new business structures. The below table outlines the impact on the key reported line items:

	2021					
	Sales[1]			Revenue		
	As reported £m	Adjustment £m	**Re-presented £m**	As reported £m	Adjustment £m	**Re-presented £m**
Electronic Systems	4,491	–	**4,491**	4,491	–	**4,491**
Platforms & Services	3,395	–	**3,395**	3,318	–	**3,318**
Air	8,321	(872)	**7,449**	6,913	(872)	**6,041**
Maritime	3,416	753	**4,169**	3,340	753	**4,093**
Cyber & Intelligence	1,752	171	**1,923**	1,752	171	**1,923**
HQ	307	(26)	**281**	36	(26)	**10**
	21,682	26	**21,708**	19,850	26	**19,876**
Intra-group sales/revenue	(372)	(26)	**(398)**	(329)	(26)	**(355)**
	21,310	–	**21,310**	19,521	–	**19,521**

	Underlying EBIT[1]			Operating profit		
	As reported £m	Adjustment £m	**Re-presented £m**	As reported £m	Adjustment £m	**Re-presented £m**
Electronic Systems	766	–	**766**	715	–	**715**
Platforms & Services	259	–	**259**	252	–	**252**
Air	856	(84)	**772**	930	(81)	**849**
Maritime	288	63	**351**	289	58	**347**
Cyber & Intelligence	156	23	**179**	152	25	**177**
HQ	(120)	(2)	**(122)**	51	(2)	**49**
	2,205	–	**2,205**	2,389	–	**2,389**

1. Sales and underlying EBIT are alternative performance measures defined in the Financial glossary on page 302. They are presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

2. Operating costs

Research and development

The Group undertakes research and development activities either on its own behalf or on behalf of customers.

Group-funded expenditure on research, and on development activities not meeting the conditions for capitalisation, is written off as incurred and charged to the income statement.

Customer-funded expenditure on research and development activities is recognised in the income statement in accordance with the Group's revenue recognition policy (note 1).

	2022 £m	2021 £m
Raw materials, subcontracts and other bought-in items used	**7,088**	6,934
Change in inventories of finished goods and work-in-progress	**6**	27
Staff costs (note 3)	**7,495**	6,667
Depreciation	**549**	513
Amortisation	**215**	188
Impairment – property, plant and equipment (note 9), and right-of-use assets (note 10)	**2**	4
Impairment – intangible assets (note 8)	**1**	15
Current and historical business transaction costs	**16**	3
Loss on disposal of property, plant and equipment, and investment property	**2**	2
Other operating charges	**3,895**	3,390
Operating costs	**19,269**	17,743

Operating costs includes research and development expenditure of £276m (2021 £251m) funded by the Group. Development investment of £11m (2021 £4m) was capitalised during the year (see note 8).

Fees payable to the Company's auditor and its associates included in operating costs

	2022			2021		
	UK £'000	**Overseas £'000**	**Total £'000**	UK £'000	Overseas £'000	Total £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**2,963**	**–**	**2,963**	2,349	–	2,349
Fees payable to the Company's auditor and its associates for other services to the Group:						
The audit of the Company's subsidiaries	**5,184**	**7,413**	**12,597**	4,154	5,561	9,715
Total audit fees	**8,147**	**7,413**	**15,560**	6,503	5,561	12,064
Audit-related assurance services[1]	**805**	**3**	**808**	632	3	635
Other non-audit services	**1**	**–**	**1**	–	–	–
Total non-audit fees[2]	**806**	**3**	**809**	632	3	635
Total fees payable to the Company's auditor and its associates	**8,953**	**7,416**	**16,369**	7,135	5,564	12,699

1. Audit-related assurance services principally comprises fees in respect of the review of the Group's Half-yearly Report and, in 2022, ESG assurance work.
2. In addition to the amounts shown above, the auditor received fees of £446k (2021 £nil) for the audit of the BAE Systems UK pension schemes and £534k (2021 £453k) for the audit of BAE Systems pension schemes in the US.

3. Employees

The average and year-end numbers of employees, excluding those in equity accounted investments, were as follows:

	Average		At year end	
	2022 Number '000	2021[1] Number '000	**2022 Number '000**	2021[1] Number '000
Electronic Systems	**16**	16	**16**	16
Platforms & Services	**12**	12	**12**	12
Air	**19**	20	**19**	19
Maritime	**23**	22	**24**	22
Cyber & Intelligence	**11**	10	**11**	11
HQ	**2**	2	**2**	2
	83	82	**84**	82

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were as follows:

	2022 £m	2021 £m
Wages and salaries	**6,350**	5,643
Social security costs	**485**	428
Share-based payments (note 32)	**101**	92
Pension costs – defined contribution plans (note 25)	**299**	246
Pension costs – defined benefit plans (note 25)	**230**	233
Other post-employment benefit costs (note 25)	**30**	25
	7,495	6,667

1. With effect from 2022, the Group established a new Digital Intelligence business, bringing together our non-US digital and data capabilities to further strengthen how we deliver these services and capabilities for our customers. The new Digital Intelligence business is reported within the Cyber & Intelligence segment. In addition, our BAE Systems Australia business transitioned from the Air segment to the Maritime segment. Comparative segmental financial information for 2021 has been re-presented in this report to reflect the new business structure.

4. Other income

Leases

Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

	2022 £m	2021 £m
Research and development expenditure credits	**35**	16
Operating lease income from investment property (note 10)	**3**	9
Operating lease income from subleasing right-of-use assets (note 10)	**1**	1
Profit on disposal of businesses	**94**	158
Profit on disposal of non-current investment	**7**	–
Gain on sale of property, plant and equipment	**1**	–
Profit on disposal of investment property	**4**	194
Management recharges to equity accounted investments (note 33)	**8**	19
Royalties	**30**	17
Gain on historical acquisition	**–**	13
Other	**32**	45
Other income	**215**	472

5. Net finance costs

Interest income and borrowing costs

Interest income and borrowing costs are recognised in the income statement in the period in which they are incurred.

	2022 £m	2021 £m
Interest income on cash and other financial instruments	**34**	29
Interest income on finance lease receivables (note 10)	**1**	1
Net present value adjustments	**12**	2
Financial income	**47**	32
Interest expense on bonds and other financial instruments	**(221)**	(206)
Facility fees	**(4)**	(3)
Interest expense on lease liabilities (note 10)	**(48)**	(43)
Net present value adjustments on provisions and other payables	**(4)**	–
Net interest expense on post-employment benefit obligations (note 25)	**(37)**	(65)
Gain/(loss) on remeasurement of financial instruments at fair value through profit or loss[1,2]	**396**	(29)
Foreign exchange (losses)/gains[2,3]	**(524)**	35
Financial expense	**(442)**	(311)
Net finance costs	**(395)**	(279)

1. Comprises gains and losses on derivative financial instruments, principally derivative instruments to manage the Group's exposure to interest rate fluctuations on external borrowings and exchange rate fluctuations on balances with the Group's subsidiaries and equity accounted investments.
2. The net gain or loss on remeasurement of financial instruments at fair value through profit or loss and the net gain or loss on foreign exchange are presented within finance costs as the gains and losses relate to the same underlying transactions.
3. The foreign exchange losses/gains primarily reflects exchange rate movements on US dollar-denominated borrowings.

Additional analysis

	2022 £m	2021 £m
Net finance costs:		
Group	**(395)**	(279)
Share of equity accounted investments	**(25)**	(27)
Total of Group and equity accounted investments' finance costs	**(420)**	(306)
Analysed as:		
Underlying net interest expense[1]:		
Group	**(230)**	(220)
Share of equity accounted investments	**(16)**	(21)
	(246)	(241)
Other:		
Group:		
Net interest expense on post-employment benefit obligations	**(37)**	(65)
Fair value and foreign exchange adjustments on financial instruments and investments	**(128)**	6
Share of equity accounted investments:		
Net interest expense on post-employment benefit obligations	**(1)**	(2)
Fair value and foreign exchange adjustments on financial instruments and investments	**(8)**	(4)
Total of Group and equity accounted investments' finance costs	**(420)**	(306)

1. Underlying net interest expense is an alternative performance measure defined in the Financial glossary on page 302. It is presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

6. Taxation expense

Income tax expense comprises current and deferred tax. Current and deferred tax is recognised in profit or loss, except to the extent that it relates to a business combination or items recognised directly in equity or other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences:

- on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- related to investments in subsidiaries and equity accounted investments to the extent that it is probable that they will not reverse in the foreseeable future; and
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Taxation expense

	2022 £m	2021 £m
Current taxation		
UK:		
Current year	**(115)**	(114)
Adjustments in respect of prior years	**(1)**	96
	(116)	(18)
Overseas:		
Current year	**(354)**	(204)
Adjustments in respect of prior years	**(15)**	5
	(369)	(199)
Total current taxation	**(485)**	(217)
Deferred taxation		
UK:		
Origination and reversal of temporary differences	**11**	24
Adjustments in respect of prior years	**(3)**	–
Tax rate adjustment	**4**	10
	12	34
Overseas:		
Origination and reversal of temporary differences	**132**	(23)
Adjustments in respect of prior years	**27**	8
Tax rate adjustment	**(1)**	–
	158	(15)
Total deferred taxation	**170**	19
Taxation expense	**(315)**	(198)
UK	**(104)**	16
Overseas	**(211)**	(214)
Taxation expense	**(315)**	(198)

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.

	2022 £m	2021 £m
Profit before taxation	**1,989**	2,110
UK corporation tax rate	**19%**	19%
Expected income tax expense	**(378)**	(401)
Effect of tax rates in foreign jurisdictions, including US state taxes	**(54)**	(56)
Expenses not tax effected	**(19)**	(5)
Income not subject to tax	**68**	70
Research and development tax credits	**15**	23
Adjusting items	**17**	48
Chargeable gains	**–**	(3)
Utilisation of previously unrecognised tax losses	**–**	2
Adjustments in respect of prior years	**8**	109
Adjustments in respect of equity accounted investments	**34**	26
Tax rate adjustment	**3**	10
Other	**(9)**	(21)
Taxation expense	**(315)**	(198)

Calculation of the underlying effective tax rate

	2022 £m	2021 £m
Profit before taxation	**1,989**	2,110
Add back: Taxation expense of equity accounted investments	**50**	38
Add back/(deduct): Taxable adjusting items	**1**	(347)
Deduct: Non-taxable adjusting items	**(92)**	(3)
Adjusted profit before taxation	**1,948**	1,798
Taxation expense	**(315)**	(198)
Taxation expense of equity accounted investments	**(50)**	(38)
Exclude: One-off tax benefit[2]	**–**	(94)
Exclude: Taxation adjustments in respect of taxable adjusting items	**–**	19
Exclude: Tax rate adjustment	**(3)**	(10)
Adjusted taxation expense (including equity accounted investments)	**(368)**	(321)
Underlying effective tax rate[1]	**19%**	18%

1. Underlying effective tax rate is an alternative performance measure defined in the Financial glossary on page 302.
2. The one-off tax benefit of £94m in 2021 was in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime.

The Group's underlying effective tax rate is sensitive to the geographic mix of profits and may be impacted when multiple territories implement the Organisation for Economic Co-operation and Development's Global Anti-Base Erosion Model Rules (Pillar Two). Management is closely monitoring the progress of the tax legislation process in each jurisdiction in which the Group operates. As at the balance sheet date, none of the jurisdictions in which the Group operates had enacted or substantively enacted tax legislation related to Pillar Two. The Group does not have sufficient information at this stage to determine the potential quantitative impact.

6. Taxation expense continued

Tax recognised in other comprehensive income

	2022			2021		
	Before tax £m	**Tax (expense)/ benefit £m**	**Net of tax £m**	Before tax £m	Tax (expense)/ benefit £m	Net of tax £m
Items that will not be reclassified to the income statement:						
Consolidated:						
Remeasurements on post-employment benefit schemes and other investments	**2,851**	**(285)**	**2,566**	2,451	(482)	1,969
Tax rate adjustment	**–**	**(72)**	**(72)**	–	88	88
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method	**140**	**(24)**	**116**	85	(21)	64
Items that may be reclassified to the income statement:						
Consolidated:						
Currency translation on foreign currency net investments	**1,172**	**–**	**1,172**	32	–	32
Reclassification of cumulative currency translation reserve on disposal of subsidiary	**(17)**	**–**	**(17)**	(9)	–	(9)
Fair value (loss)/gain arising on hedging instruments during the year	**(102)**	**25**	**(77)**	11	(2)	9
Cumulative fair value loss/(gain) on hedging instruments reclassified to the income statement	**5**	**(1)**	**4**	(32)	6	(26)
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method	**(9)**	**1**	**(8)**	(1)	(3)	(4)
	4,040	**(356)**	**3,684**	2,537	(414)	2,123

	2022			2021		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Current tax						
Consolidated:						
Remeasurements on post-employment benefit schemes and other investments	**–**	**57**	**57**	–	61	61
	–	**57**	**57**	–	61	61
Deferred tax						
Consolidated:						
Remeasurements on post-employment benefit schemes and other investments	**–**	**(342)**	**(342)**	–	(543)	(543)
Tax rate adjustment	**–**	**(72)**	**(72)**	–	88	88
Fair value tax loss/(gain) arising on hedging instruments during the year	**25**	**–**	**25**	(2)	–	(2)
Cumulative fair value tax (loss)/gain on hedging instruments reclassified to the income statement	**(1)**	**–**	**(1)**	6	–	6
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method	**1**	**(24)**	**(23)**	(3)	(21)	(24)
	25	**(438)**	**(413)**	1	(476)	(475)
Tax on other comprehensive income	**25**	**(381)**	**(356)**	1	(415)	(414)

7. Earnings per share

The weighted average number of ordinary shares used for the purpose of calculating earnings per share is calculated by taking the number of ordinary shares outstanding at the start of the year *less* the weighted average number of shares repurchased, *plus* the weighted average number of shares issued within the year (including those issued from treasury), and those shares held in trust that are no longer contingently returnable (i.e. all performance conditions attached to them are met, excluding the passage of time). The number of ordinary shares outstanding at the start of the year is calculated by taking the total number of ordinary shares in issue, less treasury shares and shares held in trust which are contingently returnable (i.e. where the performance conditions attached to those shares have not been met, excluding the passage of time). The weighted average number of ordinary shares purchased, issued or released is calculated by reference to the day on which each transaction occurred.

The weighted average number of ordinary shares used in calculating diluted earnings per share is calculated by taking the weighted average number of ordinary shares outstanding, *plus* the number of ordinary shares which are considered potentially dilutive ordinary shares in respect of share incentive schemes, should the vesting conditions have been met as at the period end.

	2022			2021		
	£m	**Basic pence per share**	**Diluted pence per share**	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	**1,591**	**51.1**	**50.5**	1,758	55.2	54.7
Add back/(deduct):						
Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles, post tax[1]	**90**			84		
Net interest expense on post-employment benefit obligations, post tax[1]	**31**			55		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**110**			(1)		
Adjusting items attributable to shareholders, post tax[2]	**(94)**			(279)		
Underlying earnings[3], post tax	**1,728**	**55.5**	**54.8**	1,617	50.7	50.4
One-off tax benefit[4]	**–**			(94)		
Underlying earnings[3], excluding one-off tax benefit	**1,728**	**55.5**	**54.8**	1,523	47.8	47.4

	Millions	**Millions**	Millions	Millions
Ordinary shares in issue as at 1 January		**3,404**		3,467
Less:				
Treasury shares as at 1 January		**(237)**		(249)
Shares held in trust which were contingently returnable as at 1 January		**(23)**		(23)
Number of ordinary shares outstanding as at 1 January		**3,144**		3,195
Net weighted average number of ordinary shares repurchased in year		**(32)**		(8)
Weighted average number of ordinary shares used in calculating basic earnings per share	**3,112**	**3,112**	3,187	3,187
Incremental ordinary shares in respect of employee share schemes		**41**		24
Weighted average number of ordinary shares used in calculating diluted earnings per share		**3,153**		3,211

1. The tax impact is calculated using the underlying effective tax rate of 19% (2021 18%). The calculation of the underlying effective tax rate is shown in note 6.
2. In 2021, £63m of the gain on disposal of AEC was attributable to non-controlling interest. Therefore, only the gain attributable to shareholders has been removed in calculating the underlying earnings attributable to shareholders. See note 20 for more details. The tax on adjusting items has been determined using the actual tax due on those items, see note 6 for details.
3. Underlying earnings per share is an alternative performance measure defined in the Financial glossary on page 302. It is presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
4. The one-off tax benefit of £94m in 2021 was in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime.

8. Intangible assets

Intangible assets are carried at cost or valuation, less accumulated amortisation and impairment losses.

Cost or valuation

Goodwill

Under the acquisition method for business combinations, goodwill is the acquisition-date fair value of the consideration transferred, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Software

Software includes:

- **Computer software licences acquired** for use within the Group are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software; and
- **Software development costs** that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Group-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred.

Development costs

Development costs funded by the Group on activities applied to a plan or design for the production of new or substantially improved products are capitalised as an internally generated intangible asset if certain conditions are met. The costs capitalised include materials, direct labour and related overheads.

Programme and customer-related

Intangible assets recognised by the Group include those relating to ongoing programmes within businesses acquired, mainly in respect of customer relationships and order backlog. These assets are initially recognised at their fair value at the acquisition date.

Other

Other intangible assets includes patents, trademarks and licences.

Amortisation

Goodwill is not amortised, but is tested annually for impairment, and carried at cost less accumulated impairment losses. Amortisation on intangible assets, excluding goodwill, is charged to the income statement on a straight-line basis over their estimated useful lives.

For programme-related intangibles, amortisation is set on a programme-by-programme basis over the life of the individual programme. Amortisation for customer-related intangibles is also set on an individual basis.

The estimated useful lives are as follows:

Software	up to 5 years
Development costs	up to 10 years
Programme and customer-related	up to 15 years
Other	up to 20 years

The Group has no indefinite-life intangible assets other than goodwill.

Impairment of intangible assets, property, plant and equipment, right-of-use assets, investment property and equity accounted investments

The carrying amounts of the Group's intangible assets (excluding goodwill), property, plant and equipment, right-of-use assets, investment property and equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment, as required by IAS 36 Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

Goodwill is tested annually for impairment. For the purposes of impairment testing, goodwill is allocated to Cash-Generating Units (CGUs), or a group of CGUs on a consistent basis. The impairment calculations require the use of estimates of the future profitability and cash-generating ability of the CGU to determine its value in use based on the Group's five-year Integrated Business Plan and the pre-tax discount rate used in discounting these projected cash flows.

An impairment loss is recognised whenever the carrying amount of an asset or its CGU exceeds its recoverable amount, which is the higher of its value in use, and its fair value less cost of disposal.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs.

Impairment losses are recognised in the income statement.

An impairment loss in respect of goodwill is not reversed. An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and equity accounted investments is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

8. Intangible assets continued

	Goodwill £m	Software £m	Development costs £m	Programme and customer-related £m	Other £m	Total £m
Cost or valuation						
At 1 January 2021	15,555	837	111	542	99	17,144
Additions:						
Acquired separately	–	90	–	–	–	90
Internally developed	–	3	4	–	–	7
Business acquisitions (note 35)	20	2	–	6	9	37
Disposals[1]	–	(38)	–	–	–	(38)
Transfer from property, plant and equipment	–	1	–	–	–	1
Foreign exchange adjustments	49	(2)	1	3	2	53
At 31 December 2021	15,624	893	116	551	110	17,294
Additions:						
Acquired separately	–	76	–	–	–	76
Internally developed	–	6	11	–	–	17
Business acquisitions (note 35)	91	–	–	66	5	162
Disposals[1]	–	(34)	–	–	–	(34)
Business disposals	(191)	–	–	–	–	(191)
Transfer from property, plant and equipment	–	5	–	–	–	5
Foreign exchange adjustments	1,069	27	14	71	15	1,196
At 31 December 2022	**16,593**	**973**	**141**	**688**	**130**	**18,525**
Amortisation and impairment						
At 1 January 2021	4,709	487	75	94	34	5,399
Amortisation[2]	–	104	3	75	11	193
Impairment charge	–	15	–	–	–	15
Disposals[1]	–	(38)	–	–	–	(38)
Foreign exchange adjustments	5	1	1	1	1	9
At 31 December 2021	4,714	569	79	170	46	5,578
Amortisation[2]	–	106	2	95	15	218
Impairment charge	–	1	–	–	–	1
Disposals[1]	–	(34)	–	–	–	(34)
Business disposals	(168)	–	–	–	–	(168)
Foreign exchange adjustments	228	21	10	21	6	286
At 31 December 2022	**4,774**	**663**	**91**	**286**	**67**	**5,881**
Net book value						
At 31 December 2022	**11,819**	**310**	**50**	**402**	**63**	**12,644**
At 31 December 2021	10,910	324	37	381	64	11,716
At 1 January 2021	10,846	350	36	448	65	11,745

1. Includes intangible assets with £nil net book value no longer used by the Group.
2. Amortisation of £218m (2021 £193m) includes £215m (2021 £188m) charged to the income statement as an amortisation expense and £3m (2021 £5m) recoverable on customer contracts.

8. Intangible assets continued

Impairment testing

The recoverable amount of the Group's goodwill is based on value in use estimated using risk-adjusted future cash flow projections from the five-year Integrated Business Plan (IBP) and a terminal value based on the projections for the final year of that plan, with growth rate assumptions of 2% applied for each significant group of Cash-Generating Units (CGUs). The IBP process includes the use of historical experience, available government spending data and the Group's order backlog, as well as the impact of evolving issues such as global economic uncertainty and climate change. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital and adjusted for factors specific to the market in which the CGU operates, have been used in discounting these projected risk-adjusted cash flows.

Significant CGUs

Within the year, the Group restructured its operations (see note 1 for details) and changed elements of how it operates. As a result, the level at which goodwill is monitored has changed, resulting in goodwill being allocated to the group of CGUs within the Maritime segment (the 'Maritime CGU'), which is now identified as a significant CGU. Prior to the reallocation of goodwill, an impairment assessment was performed based on the previous allocation, and no impairment was identified.

A summary of the significant groups of CGUs is presented below.

		Allocated goodwill		Pre-tax discount rate	
Cash-Generating Unit	Key assumptions	**2022 £bn**	2021 £bn	**2022 %**	2021 %
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	**5.2**	4.9	**9**	9
Platforms & Services	Continued demand in the Group's principal markets for existing and successor military tracked vehicles, naval guns, missile launchers, artillery systems, munitions, upgrade programmes and support, and in the US for complex infrastructure, maritime and aviation services	**3.8**	3.3	**9**	9
Maritime	Continued demand, primarily from the UK and Australian governments, for existing and successor programmes for submarines, complex warships and munitions. This includes upgrade and sustainment programmes in these areas as well as in the field of air, electronic systems and wide-area surveillance	**1.5**	1.5	**10**	8

The headroom, calculated as the difference between net assets including allocated goodwill as at 31 December 2022 and the value in use calculations, for the CGUs listed above, is shown below. The table also shows the headroom assuming a 1% reduction in the terminal value growth rate assumption, a 2% increase in the discount rate and a 1% reduction in the operating margin used in the value in use calculations, considered to be reasonable worst-case scenarios in the current economic climate.

	Headroom as at 31 December		Headroom assuming a 1% reduction in the terminal value growth rate assumption		Headroom assuming a 2% increase in the discount rate		Headroom assuming a 1% reduction in operating margin	
Cash-Generating Unit	**2022 £bn**	2021 £bn	**2022 £bn**	2021 £bn	**2022 £bn**	2021 £bn	**2022 £bn**	2021 £bn
Electronic Systems	**5.4**	4.3	**3.8**	2.8	**2.0**	1.3	**4.5**	3.6
Platforms & Services	**2.1**	1.5	**1.3**	0.7	**0.3**	(0.1)	**1.5**	0.9
Maritime	**4.2**	5.1	**3.5**	4.1	**1.7**	3.1	**3.5**	4.3

Other CGUs

The remaining goodwill balance of £1.3bn (2021 £1.2bn) is allocated across multiple CGUs. No individual CGU exceeds 10% of the Group's total goodwill balance. The majority of the projected cash flows within these CGUs are primarily underpinned by expected levels of government spending on defence, aerospace and security, and the Group's ability to capture a broadly consistent market share.

Capital commitments

At 31 December 2022, capital expenditure of £41m (2021 £25m) in respect of intangible assets was contracted for but not provided for in the accounts.

9. Property, plant and equipment

Cost

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. The cost of demonstration assets is written off as incurred. The reimbursement of the cost of an item of property, plant and equipment by way of a government grant is presented as deferred income and recognised in the income statement on a basis consistent with the depreciation of the asset over its estimated useful life.

Assets held for leasing out under operating leases are included in property, plant and equipment at cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is provided, normally on a straight-line basis, to write off the cost of items of property, plant and equipment over their estimated useful lives to any estimated residual value, using the following rates:

Buildings	up to 50 years, or the lease term if shorter
Plant and machinery:	
Computing equipment and motor vehicles	4 to 5 years
Other equipment	10 to 20 years, or the project life if shorter

No depreciation is provided on freehold land and assets in the course of construction.

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment

The carrying amounts of the Group's property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

9. Property, plant and equipment continued

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 1 January 2021	2,531	3,610	6,141
Additions[1]	239	262	501
Business acquisitions (note 35)	–	1	1
Transfer to intangible assets	–	(1)	(1)
Reclassification between categories	7	(7)	–
Disposals	(23)	(115)	(138)
Foreign exchange adjustments	–	6	6
At 31 December 2021	2,754	3,756	6,510
Additions[1]	302	289	591
Business acquisitions (note 35)	–	1	1
Transfer to intangible assets	–	(5)	(5)
Reclassification between categories	16	(16)	–
Disposals	(45)	(131)	(176)
Foreign exchange adjustments	143	227	370
At 31 December 2022	**3,170**	**4,121**	**7,291**
Depreciation and impairment			
At 1 January 2021	1,113	2,373	3,486
Depreciation charge for the year	94	202	296
Impairment charge	–	4	4
Reclassification between categories	4	(4)	–
Disposals	(22)	(112)	(134)
Foreign exchange adjustments	2	4	6
At 31 December 2021	1,191	2,467	3,658
Depreciation charge for the year	109	218	327
Impairment charge	–	2	2
Disposals	(40)	(125)	(165)
Business disposals	–	–	–
Foreign exchange adjustments	79	155	234
At 31 December 2022	**1,339**	**2,717**	**4,056**
Net book value			
At 31 December 2022	**1,831**	**1,404**	**3,235**
At 31 December 2021	1,563	1,289	2,852
At 1 January 2021	1,418	1,237	2,655

1. Includes £160m (2021 £149m) of land and buildings at Barrow-in-Furness, UK, funded by the UK government.

Assets in the course of construction

	Land and buildings £m	Plant and machinery £m	Total[1] £m
At 31 December 2022	**547**	**292**	**839**
At 31 December 2021	398	274	672

1. Includes £464m (2021 £262m) at Barrow-in-Furness, UK, funded by the UK government.

Capital commitments

At 31 December 2022, capital expenditure of £403m (2021 £210m) in respect of property, plant and equipment was contracted for but not provided for in the accounts.

10. Leases

The Group as lessee

All leases in which the Group is lessee (except as noted below) are recognised as a right-of-use asset and a corresponding lease liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between repayment of the lease liability and finance cost. The finance cost is charged to the income statement over the lease term to produce a constant periodic rate of interest on the lease liability. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The lease liability is initially measured as the present value of future lease payments, discounted using the interest rate implicit in the lease. Where this rate is not determinable, the Group's incremental borrowing rate is used, which is the interest rate the Group would have to pay to borrow the amount necessary to obtain an asset of similar value, in a similar economic environment with similar terms and conditions.

The right-of-use asset is initially measured at cost, comprising the initial value of the lease liability, any lease payments made (net of any incentives received from the lessor) before the commencement of the lease, any initial direct costs and any restoration costs.

The carrying amounts of the Group's right-of-use assets are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

Payments in respect of short-term leases, low-value leases and leases of intangible assets are charged to the income statement on a straight-line basis over the lease term.

The Group as lessor

Leases in which the Group is lessor are classified as finance leases or operating leases. If the lease transfers substantially all of the risks and rewards of ownership to the lessee, the lease is classified as a finance lease. All other leases are classified as operating leases.

A sublease where the Group is an intermediate lessor is classified as a finance lease when it transfers substantially all of the risks and rewards of the right-of-use asset arising from the head lease.

Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

Amounts due from lessees under finance leases are recognised as a receivable discounted at the interest rate implicit in the lease. Finance lease income is recognised in the income statement over the lease term to produce a constant periodic rate of interest on the receivable.

The Group leases land, buildings, vehicles and equipment under non-cancellable lease arrangements. The leases have varying terms, including escalation clauses, renewal rights and purchase options. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

Right-of-use assets

	2022			2021		
	Land and buildings £m	**Plant and machinery £m**	**Total £m**	Land and buildings £m	Plant and machinery £m	Total £m
Net book value at 1 January	**1,075**	**16**	**1,091**	1,037	16	1,053
Additions during the year	**397**	**20**	**417**	117	9	126
Business acquisitions (note 35)	**1**	**–**	**1**	–	–	–
Lease modifications during the year	**50**	**1**	**51**	125	(1)	124
Depreciation charge for the year	**(205)**	**(12)**	**(217)**	(206)	(8)	(214)
Business disposals (note 20)	**(3)**	**–**	**(3)**	–	–	–
Foreign exchange adjustments	**85**	**–**	**85**	2	–	2
Net book value at 31 December	**1,400**	**25**	**1,425**	1,075	16	1,091

10. Leases continued

Lease liabilities

A maturity analysis of the future undiscounted lease payments in respect of the Group's lease liabilities is presented in the table below:

	2022 £m	2021 £m
Payments due:		
Within one year	**290**	240
Between one and five years	**632**	586
Later than five years	**1,227**	683
Total undiscounted gross payments	**2,149**	1,509
Deduct: Impact of discounting	**(533)**	(214)
Lease liabilities	**1,616**	1,295

The Group is also committed to future undiscounted lease payments of £5m in respect of leases which had not yet commenced at 31 December 2022 (2021 £214m).

The total cash outflow for leases in the year ended 31 December 2022, including short-term leases and low-value leases, amounted to £314m (2021 £281m).

Amounts recognised in the income statement

	2022 £m	2021 £m
Included in operating costs:		
Depreciation on right-of-use assets	**(217)**	(214)
Short-term lease expense	**(25)**	(19)
Low-value lease expense	**(5)**	(4)
	(247)	(237)
Included in other income:		
Operating lease income from investment property	**3**	9
Operating lease income from subleasing right-of-use assets	**1**	1
	4	10
Included in net finance costs:		
Interest income on finance lease receivables	**1**	1
Interest expense on lease liabilities	**(48)**	(43)
	(47)	(42)

10. Leases continued

Operating leases

The Group is party to operating leases in which it is the lessor, primarily relating to investment property. Under the terms of the lease agreements, no contingent rents are receivable. The leases have varying terms including escalation clauses and renewal rights. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

A maturity analysis of the future undiscounted lease receipts from operating leases, in which the Group is lessor, is presented in the table below:

	2022 £m	2021 £m
Receipts due:		
Within one year	**3**	2
Between one and two years	**3**	1
Between two and three years	**2**	1
Between three and four years	**2**	1
Between four and five years	**2**	1
Later than five years	**6**	2
	18	8

Finance lease receivables

A sublease is classified as a finance lease when it transfers substantially all of the risks and rewards of the right-of-use asset arising from the head lease.

A maturity analysis of the future undiscounted lease receipts from finance leases, in which the Group is lessor, is presented in the table below:

	2022 £m	2021 £m
Receipts due:		
Within one year	**11**	11
Between one and two years	**10**	11
Between two and three years	**5**	10
Between three and four years	**4**	5
Between four and five years	**4**	4
Later than five years	**2**	7
Total undiscounted gross receipts	**36**	48
Deduct: Impact of discounting	**(2)**	(4)
Finance lease receivables (note 14)	**34**	44

11. Investment property

Cost
Land and buildings that are leased to non-Group entities are classified as investment property. The Group measures investment property at its cost less accumulated depreciation and impairment losses.

Depreciation
Depreciation is provided, on a straight-line basis, to write off the cost of investment property over its estimated useful life of up to 50 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment
The carrying amounts of the Group's investment property are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

	£m
Cost	
At 1 January 2021	200
Additions	17
Disposals	(141)
At 31 December 2021	76
Additions	5
Disposals	(4)
At 31 December 2022	**77**
Depreciation and impairment	
At 1 January 2021	72
Depreciation charge for the year	3
Disposals	(66)
At 31 December 2021	9
Depreciation charge for the year	5
Disposals	–
At 31 December 2022	**14**
Net book value	
At 31 December 2022	**63**
At 31 December 2021	67
At 1 January 2021	128

Fair value	
At 31 December 2022	**76**
At 31 December 2021	82

The fair values above are based on and reflect current market values as prepared by in-house professionals who have the appropriate professional qualifications and recent experience of valuing properties in the location and of the type being valued.

Capital commitments
At 31 December 2022, capital expenditure of £14m (2021 £20m) in respect of investment property was contracted for but not provided for in the accounts.

12. Equity accounted investments

Equity accounted investments comprises joint ventures and associates. A joint venture is a joint arrangement whereby the parties that have joint control have rights to the net assets of the arrangement. An associate is an entity over which the Group has significant influence but not control or joint control.

The Group recognises its share of the profit or loss and other comprehensive income of equity accounted investments as a separate line in the Consolidated income statement and Consolidated statement of comprehensive income, respectively.

The carrying value of an equity accounted investment comprises the Group's share of net assets and purchased goodwill, and is assessed for impairment as a single asset. The carrying amounts of the Group's equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

Principal equity accounted investments

Joint venture	Principal activities	Shareholding	Principally operates in
Eurofighter Jagdflugzeug	Management and control of the European Typhoon programme	33%	Germany
MBDA	Development and manufacture of guided weapons	37.5%	Europe

The following tables summarise the financial information of the Group's principal equity accounted investments included in their own financial statements, as adjusted for fair value adjustments at acquisition and differences in accounting policies, and reconcile this to the Group's interest in those equity accounted investments.

	2022		2021	
	Eurofighter Jagdflugzeug £m	**MBDA £m**	Eurofighter Jagdflugzeug £m	MBDA £m
Revenue (100%)	**3,693**	**3,590**	3,165	3,513
Underlying EBIT[1] excluding depreciation and amortisation	**19**	**574**	6	512
Depreciation and amortisation	**(4)**	**(152)**	–	(117)
Financial income	**2**	**25**	2	7
Financial expense	**(2)**	**(13)**	(2)	(12)
Taxation expense	**(6)**	**(105)**	(3)	(107)
Profit for the year (100%)	**9**	**329**	3	283
Remeasurements on post-employment benefit schemes, net of tax	**–**	**310**	–	172
Amounts (debited)/credited to hedging reserve, net of tax	**–**	**(4)**	–	17
Foreign exchange adjustments	**(5)**	**(24)**	–	13
Total comprehensive income for the year (100%)	**4**	**611**	3	485
Group's share of total comprehensive income for the year	**1**	**230**	1	182
Non-current assets	**30**	**2,464**	32	2,280
Cash and cash equivalents	**42**	**2,650**	24	2,367
Current assets excluding cash and cash equivalents	**8,591**	**4,697**	7,630	4,210
Current assets	**8,633**	**7,347**	7,654	6,577
Non-current financial liabilities excluding trade and other payables, and provisions	**–**	**(10)**	–	(5)
Other non-current liabilities	**(47)**	**(20)**	(62)	(527)
Non-current liabilities	**(47)**	**(30)**	(62)	(532)
Current financial liabilities excluding trade and other payables, and provisions	**(10)**	**–**	(7)	–
Other current liabilities	**(8,581)**	**(8,416)**	(7,590)	(7,424)
Current liabilities	**(8,591)**	**(8,416)**	(7,597)	(7,424)
Net assets (100%)	**25**	**1,365**	27	901

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 302.

12. Equity accounted investments continued

	2022			2021		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Group's share of net assets	**8**	**512**	**520**	9	338	347
Goodwill adjustment	**–**	**8**	**8**	–	7	7
Carrying value	**8**	**520**	**528**	9	345	354

	2022			2021		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Dividends received	**3**	**80**	**83**	2	41	43

Group summary

The Group also has a number of individually immaterial joint ventures and associates, the carrying values of the most significant at 31 December 2022 are as follows: Rheinmetall BAE Systems Land (RBSL) (£82m), FADEC International (£48m), Air Astana (£63m), FNSS (£22m) and Panavia Aircraft (£18m). The following table shows a reconciliation of opening to closing carrying value for both the Group's principal and immaterial joint ventures and associates in aggregate.

	Principal equity accounted investments £m	Other joint ventures £m	Other associates £m	Total £m
At 1 January 2021	231	96	82	409
Group's share of profit for the year	107	28	4	139
Group's share of remeasurements on post-employment benefit schemes	85	–	–	85
Tax on items that will not be reclassified to the income statement	(21)	–	–	(21)
Foreign exchange adjustments	6	–	(1)	5
Amounts credited to hedging reserve	8	4	–	12
Tax on items that may be reclassified to the income statement	(2)	(1)	–	(3)
Group's share of total comprehensive income for the year	183	31	3	217
Equity accounted investment funding	–	3	–	3
Dividends received from equity accounted investments	(43)	(14)	–	(57)
Foreign exchange adjustments	(17)	(1)	–	(18)
At 31 December 2021	354	115	85	554
Group's share of profit for the year	126	46	8	180
Group's share of remeasurements on post-employment benefit schemes	140	–	–	140
Tax on items that will not be reclassified to the income statement	(24)	–	–	(24)
Foreign exchange adjustments	(10)	–	(1)	(11)
Amounts (debited)/credited to hedging reserve	(2)	4	–	2
Tax on items that may be reclassified to the income statement	1	–	–	1
Group's share of total comprehensive income for the year	231	50	7	288
Dividends received from equity accounted investments	(83)	(11)	–	(94)
Foreign exchange adjustments	26	13	–	39
At 31 December 2022	**528**	**167**	**92**	**787**

Contingent liabilities

The Group is not aware of any material contingent liabilities in respect of its equity accounted investments.

13. Other investments

Other investments are carried at fair value through other comprehensive income.

	2022 £m	2021 £m
Fair value through other comprehensive income	**99**	76

14. Trade, other and contract receivables

Trade and contract receivables are measured at amortised cost under IFRS 9 Financial Instruments as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding.

Contract receivables represent amounts for which the Group has an unconditional right to consideration in respect of unbilled revenue recognised at the balance sheet date and comprise costs incurred plus attributable margin.

Trade receivables, contract receivables, amounts owed by equity accounted investments and finance lease receivables include a provision for expected credit losses. The Group measures the provision at an amount equal to lifetime expected credit losses, estimated by reference to past experience and relevant forward-looking factors.

The Group writes off a receivable when there is objective evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation.

US deferred compensation plan assets are measured at fair value in accordance with IAS 19 Employee Benefits.

	2022 £m	2021 £m
Non-current		
Contract receivables	**20**	21
Prepayments	**201**	70
Accrued income	**1**	1
US deferred compensation plan assets	**328**	376
Finance lease receivables (note 10)	**24**	33
Other receivables	**44**	50
	618	551
Current		
Contract receivables	**3,473**	2,671
Trade receivables	**1,506**	1,043
Amounts owed by equity accounted investments (note 33)	**75**	34
Prepayments	**509**	444
Accrued income	**62**	53
Finance lease receivables (note 10)	**10**	11
Other receivables[1]	**531**	569
	6,166	4,825

1. Includes £329m (2021 £419m) in relation to VAT receivable in the Kingdom of Saudi Arabia.

Trade receivables are stated net of a provision for expected credit losses. Disclosures relating to the ageing of trade receivables and movements in the provision for expected credit losses are provided in note 15.

15. Other financial assets and liabilities and financial risk management

Derivative financial instruments and hedging activities

The international nature of the Group's business means it is exposed to volatility in currency exchange rates. In order to protect itself against currency fluctuations, the Group's policy is to hedge all material firm transactional exposures.

The Group uses interest rate derivative instruments to manage the Group's exposure to interest rate fluctuations on its borrowings and deposits by varying the proportion of fixed rate debt relative to floating rate debt over the forward time horizon.

The Group uses foreign exchange derivative instruments to manage the Group's exposure to currency fluctuations on its borrowings and deposits with the Group's subsidiaries and equity accounted investments.

In accordance with its treasury policy, the Group does not hold derivative financial instruments for trading purposes.

The Group aims to achieve hedge accounting treatment for all derivatives that hedge material foreign currency exposures.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, such instruments are stated at fair value at the balance sheet date. The fair values are estimated by discounting expected future cash flows and then adjusting for credit risk and market risk.

Fair value through profit or loss

Gains and losses on derivative financial instruments that are not designated as cash flow hedges are recognised within finance costs in the income statement for the year.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the exposure to variability in cash flows relating to a highly probable forecast transaction (income or expense) or recognised asset or liability, the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. Amounts recognised in equity are removed from the hedging reserve and included in the cost of the underlying transaction or reclassified to the income statement when the underlying transaction affects profit or loss. These amounts are presented within the same line item in the income statement as the underlying transaction, typically revenue or operating costs. The ineffective portion of any change in the fair value of the instrument is recognised in the income statement within finance costs immediately. The Group treats the foreign currency basis element of the designated foreign exchange derivative hedging instruments as a cost of hedging and as such it is excluded from the hedge designation. Any hedges entered into on behalf of equity accounted investments (note 33) are classified as cash flow hedges.

	2022		2021	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**175**	**(237)**	191	(172)
Debt-related derivative financial instruments	**147**	**(35)**	114	(130)
	322	**(272)**	305	(302)
Current				
Cash flow hedges – foreign exchange contracts	**229**	**(249)**	186	(181)
Other foreign exchange/interest rate contracts	**23**	**(79)**	8	(33)
	252	**(328)**	194	(214)

Debt-related derivative financial instruments

The debt-related derivative financial instruments represent the fair value of cross-currency, interest rate and foreign exchange derivatives relating to the US$800m 3.8% bond, repayable 2024, the US$500m 7.5% bond, repayable 2027, the US$1,300m 3.4% bond, repayable 2030, and the US$400m 5.8% bond, repayable 2041 (see note 22). These derivatives have been entered into specifically to manage the Group's exposure to foreign exchange or interest rate risk.

15. Other financial assets and liabilities and financial risk management continued

Interest rate risk

The Group's objective is to manage its exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, including interest rate and cross-currency swaps.

The Group's interest rate management policy is that a minimum of 50% (2021 50%) and a maximum of 90% (2021 90%) of gross debt is maintained at fixed interest rates. At 31 December 2022, the Group had 85% (2021 87%) of fixed rate debt and 15% (2021 13%) of floating rate debt based on a gross debt of £5.0bn (2021 £5.1bn), including debt-related derivative financial assets.

Based on contracted maturities and/or repricing dates, the following amounts are exposed to interest rate risk over the future as shown below:

	2022			2021		
	Within one year £m	**Between one and two years £m**	**Later than two years £m**	Within one year £m	Between one and two years £m	Later than two years £m
Cash and cash equivalents	**3,107**	**–**	**–**	2,917	–	–
Loans and overdrafts	**745**	**745**	**745**	661	661	661

The floating rate debt has been predominantly achieved by entering into interest rate swaps which swap the fixed rate US dollar interest payable on debt into either floating rate sterling or US dollars. At the end of 2022, the Group had a total of $0.9bn (2021 $0.9bn) of this type of swap outstanding with a weighted average duration of 1.8 years (2021 2.8 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 12.9 years (2021 12.2 years). Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 4.2% (2021 2.6%) on US dollars. The cost of the fixed rate debt was 3.7% (2021 3.8%).

IBOR reform

The Group has interest rate swaps that reference USD LIBOR, with a combined notional value of $0.9bn, that mature in October 2024. During the year, the Group adhered to the International Swaps and Derivatives Association (ISDA) 2020 IBOR Fallbacks Protocol, which will be used to calculate the USD floating rates applicable for these interest rate swaps between the period post cessation of USD LIBOR and maturity of the swaps. The Group has no other derivatives that reference IBOR benchmarks.

The Group's undrawn committed Revolving Credit Facility of £2bn, contracted until April 2025, was amended on 27 October 2021 to migrate the benchmark interest rate applicable away from LIBOR to risk-free rates, SOFR and SONIA.

Sensitivity analysis

A change of 100 basis points in short-term rates applied to the average fixed/floating mix and level of borrowings would vary the interest cost to the Group by approximately £7.3m (2021 £7m).

In respect of cash deposits, given the fluctuation in the Group's working capital requirements, cash is generally invested for short-term periods based at floating interest rates. A change of 100 basis points in the average interest rates during the year applied to the average cash deposits would vary the interest receivable by approximately £19m (2021 £21m). Should interest rates fluctuate by a different rate to those disclosed, the impact can be linearly interpolated.

15. Other financial assets and liabilities and financial risk management continued

Liquidity risk

Contractual cash outflows on financial liabilities

The contracted cash outflows on loans and overdrafts, derivative financial instruments and other financial instruments at the reporting date are shown below, classified by maturity. The cash outflows are shown on a gross basis, are not discounted, are translated at the spot rate and include estimated interest payments where applicable. Contracted cash outflows reflect the gross cash outflow on derivative financial instruments and exclude the broadly offsetting cash inflows for the receive leg of derivatives that are settled separately to the pay leg.

	2022					2021				
		Contracted cash outflow					Contracted cash outflow			
	Carrying amount £m	**Within one year £m**	**Between one and five years £m**	**Later than five years £m**	**Total £m**	Carrying amount £m	Within one year £m	Between one and five years £m	Later than five years £m	Total £m
Cash outflows without directly offsetting inflows										
Accruals[1]	**(2,025)**	**(1,997)**	**(28)**	**–**	**(2,025)**	(1,855)	(1,832)	(23)	–	(1,855)
Trade and other payables[2]	**(2,154)**	**(2,126)**	**(28)**	**–**	**(2,154)**	(1,867)	(1,846)	(21)	–	(1,867)
Lease liabilities	**(1,616)**	**(290)**	**(632)**	**(1,227)**	**(2,149)**	(1,295)	(240)	(586)	(683)	(1,509)
Loans and overdrafts	**(5,242)**	**(199)**	**(2,377)**	**(4,893)**	**(7,469)**	(5,061)	(593)	(1,785)	(4,848)	(7,226)
	(11,037)					(10,078)				
Cash outflows with largely offsetting inflows[3]										
Cash flow hedges – financial assets	**404**	**(7,434)**	**(4,444)**	**(443)**	**(12,321)**	377	(6,509)	(4,081)	(173)	(10,763)
Cash flow hedges – financial liabilities	**(486)**	**(8,258)**	**(5,758)**	**(741)**	**(14,757)**	(353)	(6,204)	(4,963)	(214)	(11,381)
Other foreign exchange/interest rate contracts – financial assets	**23**	**(2,364)**	**–**	**–**	**(2,364)**	8	(417)	–	–	(417)
Other foreign exchange/interest rate contracts – financial liabilities	**(79)**	**(1,693)**	**–**	**–**	**(1,693)**	(33)	(2,247)	(3)	–	(2,250)
Debt-related derivatives – financial assets[4]	**147**	**(58)**	**(534)**	**(1,124)**	**(1,716)**	114	(489)	(127)	(360)	(976)
Debt-related derivatives – financial liabilities[4]	**(35)**	**(47)**	**(47)**	**–**	**(94)**	(130)	(486)	(141)	(1,123)	(1,750)
	(26)					(17)				
	(11,063)					(10,095)				

1. Accruals presented in the table excludes £719m (2021 £646m) of accruals which are non-financial liabilities.
2. Trade and other payables excludes other taxes and social security costs, deferred income and US deferred compensation plan liabilities (see note 24) on the basis that these are non-financial liabilities. The prior year included other taxes and social security costs, which have been removed in the current year. The prior year has been re-presented in the current year to reflect this change.
3. Cash outflows in relation to derivatives presented in this table do not include the cash inflows which would be received when closing out the trades. These cash inflows are expected to largely offset all outflows presented within this table.
4. Cash outflows in relation to debt-related derivatives were presented net of the associated cash inflows in the prior year. These have been presented without the associated inflow in the current year, and the prior year comparatives have been re-presented to reflect this change.

Borrowing facilities

The Group's objective is to maintain adequate undrawn committed borrowing facilities.

At 31 December 2022, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2021 £2bn). The RCF was undrawn throughout the year. The RCF also acts as a backstop to Commercial Paper issued by the Group. At 31 December 2022, the Group had no Commercial Paper in issue (2021 £nil).

15. Other financial assets and liabilities and financial risk management continued

Currency risk

The Group's objective is to reduce its exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates, mainly the US dollar, euro, Saudi riyal and Australian dollar.

The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency-denominated transactions. All material firm transactional exposures are hedged using foreign exchange forward contracts and the Group aims, where possible, to apply cash flow hedge accounting to these transactions.

The currency and notional amount of the designated hedging instruments match the currency and principal amounts of the forecast transactions being hedged, therefore the hedging instruments and hedged items have values which will generally move in opposite directions because of the same hedged risk. As the critical terms of the hedging instruments match those of the hedged items, an economic relationship can be demonstrated on an ongoing basis.

The hedge ratio is 1:1 on the basis that the notional amount of the designated hedging instruments matches the principal amount of the forecast foreign currency sales/purchases designated as the hedged items. The Group does not designate groups of items with offsetting risk positions as hedged items.

The Group considers the potential sources of hedge ineffectiveness to be:

– valuation adjustments for credit risk made to derivative hedging instruments at each hedge effectiveness measurement date;
– changes to the timing and amount of forecast transactions; and
– non-occurrence of the designated hedged items.

Ineffectiveness due to foreign currency basis was highly immaterial.

The Group enters into derivative contracts with varying maturities up to 2032. The following table presents the sterling nominal amounts of the foreign currency contracts used to hedge foreign currency risk, split by maturity profile, along with the exchange rate:

		2022				2021			
		Currency purchased		**Currency sold**		Currency purchased		Currency sold	
(Purchase)/sale contracts	**Maturity date**	**Weighted average hedged rate**	**Notional value of currency purchased £m**	**Weighted average hedged rate**	**Notional value of currency sold £m**	Weighted average hedged rate	Notional value of currency purchased £m	Weighted average hedged rate	Notional value of currency sold £m
Sterling/US dollar	Within one year	**1.23**	**(2,790)**	**1.24**	**3,060**	1.36	(1,937)	1.35	2,347
	Between one and five years	**1.28**	**(1,423)**	**1.30**	**2,171**	1.36	(1,047)	1.36	2,210
	Later than five years	**1.40**	**(31)**	**1.29**	**19**	1.41	(64)	1.41	13
Sterling/euro	Within one year	**1.12**	**(3,689)**	**1.12**	**3,299**	1.14	(3,471)	1.13	3,117
	Between one and five years	**1.09**	**(2,576)**	**1.09**	**2,583**	1.09	(2,823)	1.09	2,727
	Later than five years	**1.08**	**(383)**	**1.07**	**388**	1.05	(161)	1.04	159
Other	Within one year	**n/a**	**(2,873)**	**n/a**	**2,869**	n/a	(2,073)	n/a	2,060
	Between one and five years	**n/a**	**(1,437)**	**n/a**	**1,455**	n/a	(617)	n/a	620
	Later than five years	**n/a**	**(379)**	**n/a**	**378**	n/a	(13)	n/a	13
Cash flow hedges			**(15,581)**		**16,222**		(12,206)		13,266

The effect of cash flow hedges on the Group's financial position and performance for the year is as follows:

	2022				2021			
(Purchase)/sale contracts	**Change in the value of hedging instruments since 1 January £m**	**Change in the value of hedged items since 1 January £m**	**Notional amount £m**	**Carrying amount £m**	Change in the value of hedging instruments since 1 January £m	Change in the value of hedged items since 1 January £m	Notional amount £m	Carrying amount £m
Sterling/US dollar	**(106)**	**106**	**1,006**	**(102)**	11	(11)	1,522	24
Sterling/euro	**9**	**(9)**	**(378)**	**17**	5	(5)	(452)	10
Other	**(5)**	**5**	**13**	**3**	(5)	5	(10)	(10)
Cash flow hedges	**(102)**	**102**	**641**	**(82)**	11	(11)	1,060	24

15. Other financial assets and liabilities and financial risk management continued

Currency risk continued

Sensitivity analysis

The Group is exposed to movements in foreign currency exchange rates in respect of the translation of net assets and income statements of foreign subsidiaries and equity accounted investments. The Group does not hedge the translation effect of exchange rate movements on the income statements or balance sheets of foreign subsidiaries and equity accounted investments it regards as long-term investments.

The estimated impact on foreign exchange gains and losses in net finance costs of a ten cent movement in the closing sterling to US dollar exchange rate on the retranslation of US dollar-denominated bonds held by BAE Systems plc is approximately £258m (2021 £203m).

The Group enters into cash flow hedges in order to manage all material firm transactional exposures. The estimated impact on fair value gains and losses in other reserves of a ten cent movement in the closing sterling to US dollar exchange rates on the transactional cash flow hedges is approximately £94m (2021 £111m). The estimated impact of a ten cent movement in the closing sterling to euro exchange rate on the transactional cash flow hedges is approximately £35m (2021 £39m).

Credit risk

For trade receivables, contract receivables, amounts due from equity accounted investments and finance lease receivables, the Group measures a provision for expected credit losses at an amount equal to lifetime expected credit losses, estimated by reference to past experience and relevant forward-looking factors.

The Group's assessment is that credit risk in relation to defence-related sales to government customers or subcontractors to governments is extremely low as the probability of default is insignificant; therefore the provision for expected credit losses is immaterial in respect of receivables from these customers. For all non-government commercial customers, the Group assesses expected credit losses, including risk arising from global economic uncertainty; however, this is not considered material to the financial statements. The Group considers that default has occurred when a receivable is past 180 days overdue, because historical experience indicates that these receivables are generally not recoverable. The Group recognises a provision of 100% against all receivables over 180 days past due unless there is evidence that individual receivables in this category are recoverable.

The carrying amount of the Group's financial assets represents the maximum exposure to credit risk.

Movements on the provision for expected credit losses are as follows:

	2022 £m	2021 £m
At 1 January	**15**	36
Net remeasurement of loss allowance	**7**	(19)
Amounts written off	**(2)**	(2)
At 31 December	**20**	15

For contract receivables, amounts due from equity accounted investments and finance lease receivables the expected credit loss provision is immaterial as the probability of default is insignificant.

The Group writes off a receivable when there is evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation. None of the trade receivables that were written off during the year are still subject to enforcement activity. The ageing of trade receivables is detailed below:

	2022			2021		
	Gross £m	**Provision £m**	**Net £m**	Gross £m	Provision £m	Net £m
Not past due	**969**	**–**	**969**	783	–	783
Up to 180 days overdue	**499**	**(1)**	**498**	223	(1)	222
Past 180 days overdue	**58**	**(19)**	**39**	52	(14)	38
	1,526	**(20)**	**1,506**	1,058	(15)	1,043

Cash management

Cash flow forecasting is performed by the businesses on a monthly basis. The Group monitors a rolling forecast of its liquidity requirements to ensure that there is sufficient cash to meet operational needs and maintain adequate headroom.

Surplus cash held by the businesses over and above balances required for working capital management is loaned to the Group's centralised treasury department. Surplus cash is invested in instant-access current accounts, short-term deposits and money market funds, choosing instruments with appropriate maturities or sufficient liquidity to provide adequate headroom as determined by cash forecasts.

The Group's objective is to monitor and control counterparty credit risk and credit limit utilisation. The Group adopts a conservative approach to the investment of its surplus cash which is deposited with financial institutions with investment-grade (BBB- and above) credit ratings for short periods. The cash and cash equivalents balance at 31 December 2022 of £3,107m (2021 £2,917m) was invested with 44 (2021 36) financial institutions. A credit limit is allocated to each institution taking account of its market capitalisation, credit rating and credit default swap price. The cash and cash equivalents of the Group are invested in non-speculative financial instruments which are usually highly liquid, such as short-term deposits. The Group therefore believes it has reduced its exposure to counterparty credit risk through this process.

15. Other financial assets and liabilities and financial risk management continued

Credit risk continued

The cash and cash equivalents balance is subject to review for impairment under IFRS 9 as set out below:

Counterparty credit rating at 31 December	2022	2021
AAA to AA-	**67%**	68%
A+ to A-	**32%**	31%
BBB+ to BBB-	**1%**	1%

Offsetting financial assets and liabilities

	2022			2021		
	Balance sheet £m	**Amounts not offset £m**	**Net balances £m**	Balance sheet £m	Amounts not offset £m	Net balances £m
Assets						
Other financial assets	**574**	**(455)**	**119**	499	(383)	116
Liabilities						
Other financial liabilities	**(600)**	**455**	**(145)**	(516)	383	(133)

16. Deferred tax

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

As at 31 December 2021, the most significant recognised deferred tax assets relate to the deficits on the Group's pension/post-employment schemes (see below). This is because post-employment benefit costs are deducted in determining accounting profit as service is provided by employees, but deducted in determining taxable profit either when contributions are paid to the pension/post-employment schemes or when post-employment benefits are paid. As at 31 December 2022, the majority of the UK post-employment benefit schemes were in surplus, therefore the deferred tax asset balance in relation to deficits is much smaller.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different taxable entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2022 £m	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m
Property, plant and equipment	**48**	42	**(126)**	(101)	**(78)**	(59)
Intangible assets	**15**	17	**(2)**	(2)	**13**	15
Capitalised research and development	**149**	–	**–**	–	**149**	–
Provisions and accruals	**233**	203	**–**	–	**233**	203
Goodwill	**–**	–	**(352)**	(302)	**(352)**	(302)
Pension/post-employment schemes:						
Deficits	**97**	430	**–**	–	**97**	430
Additional contributions and other[1]	**162**	228	**–**	–	**162**	228
Share-based payments	**64**	28	**–**	–	**64**	28
Financial instruments	**17**	–	**(1)**	(9)	**16**	(9)
Other items	**27**	24	**(2)**	(19)	**25**	5
Rolled over capital gains	**–**	–	**(14)**	(13)	**(14)**	(13)
Capital losses carried forward	**14**	13	**–**	–	**14**	13
Trading losses carried forward	**4**	6	**–**	–	**4**	6
Deferred tax assets/(liabilities)	**830**	991	**(497)**	(446)	**333**	545
Set off of tax	**(492)**	(369)	**492**	369	**–**	–
Net deferred tax assets/(liabilities)	**338**	622	**(5)**	(77)	**333**	545

1. Includes deferred tax assets on US deferred compensation plans and relief to be claimed in future periods on UK pension contributions.

16. Deferred tax continued

Movement in temporary differences during the year

	At 1 January 2022 £m	Foreign exchange adjustments £m	Acquisitions and disposals £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2022 £m**
Property, plant and equipment	(59)	(12)	–	(7)	–	**(78)**
Intangible assets	15	2	(13)	9	–	**13**
Capitalised research and development	–	4	–	145	–	**149**
Provisions and accruals	203	25	–	5	–	**233**
Goodwill	(302)	(39)	–	(11)	–	**(352)**
Pension/post-employment schemes:						
Deficits	430	3	–	20	(356)	**97**
Additional contributions and other[1]	228	13	–	(21)	(58)	**162**
Share-based payments	28	–	–	12	24	**64**
Financial instruments	(9)	1	–	3	21	**16**
Other items	5	3	–	17	–	**25**
Rolled over capital gains	(13)	–	–	(1)	–	**(14)**
Capital losses carried forward	13	–	–	1	–	**14**
Trading losses carried forward	6	–	–	(2)	–	**4**
	545	–	(13)	170	(369)	**333**

	At 1 January 2021 £m	Foreign exchange adjustments £m	Acquisitions and disposals £m	Recognised in income £m	Recognised in equity £m	At 31 December 2021 £m
Property, plant and equipment	(70)	(1)	–	12	–	(59)
Intangible assets	4	–	(3)	14	–	15
Provisions and accruals	199	1	–	3	–	203
Goodwill	(279)	(2)	–	(21)	–	(302)
Pension/post-employment schemes:						
Deficits	845	(1)	–	11	(425)	430
Additional contributions and other[1]	251	1	–	6	(30)	228
Share-based payments	19	–	–	7	2	28
Financial instruments	(18)	–	–	(3)	12	(9)
Other items	14	–	–	(9)	–	5
Rolled over capital gains	(11)	–	–	(2)	–	(13)
Capital losses carried forward	11	–	–	2	–	13
Trading losses carried forward	7	–	–	(1)	–	6
	972	(2)	(3)	19	(441)	545

1. Includes deferred tax assets on US deferred compensation plans and relief to be claimed in future periods on UK pension contributions.

Unrecognised deferred tax assets and liabilities

Deferred tax assets have not been recognised in respect of the following items:

	2022		2021	
	Gross amount £m	**Unrecognised deferred tax asset £m**	Gross amount £m	Unrecognised deferred tax asset £m
Deductible temporary differences, including tax credits	**9**	**9**	6	5
Capital losses carried forward	**227**	**55**	196	45
Trading and other losses carried forward	**237**	**38**	231	37
	473	**102**	433	87

These assets have not been recognised as the incidence of future profits in the relevant countries and legal entities cannot be accurately predicted at this time.

The Group has not recognised any deferred tax liability on temporary differences totalling £189m (2021 £390m) relating to potentially taxable unremitted earnings of overseas subsidiaries and equity accounted investments because the Group is in a position to control the timing of the reversal of the temporary differences and none are expected to reverse in the foreseeable future.

16. Deferred tax continued

Changes in tax rates

Both recognised and unrecognised UK deferred tax balances as at 31 December 2022 have been calculated at a blended rate of 24.2% (2021 22.8%). As at 31 December 2022, an increase in the UK current tax rate has been enacted, from 19% to 25% with effect from 1 April 2023. An adjustment has been made to reflect the fact that most of the UK deferred tax balances are expected to unwind at 25%. Including the impact of tax changes in other jurisdictions, this adjustment has been recorded as an adjusting item of £3m in the Consolidated income statement and as a loss of £72m in the Consolidated statement of comprehensive income.

17. Inventories

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value. Inventory cost is valued using the most appropriate method based on the business use of inventory. In the majority of cases this is moving average unit cost, with some businesses using standard cost or first in first out (FIFO) as methods more indicative of their use of inventory.

	2022 £m	2021 £m
Raw materials and consumables	**535**	432
Work-in-progress	**372**	312
Finished goods and goods for resale	**69**	67
	976	811

The Group recognised £26m (2021 £13m) as a write down of inventories to net realisable value.

18. Current tax

Current tax for the current and prior years is recognised as a liability to the extent that it has not yet been settled, and as an asset to the extent that the amounts already paid exceed the amount due or the benefit of a tax loss can be carried back to recover current tax of a prior year. Current tax assets and liabilities are measured at the amount expected to be paid to or recovered from taxation authorities, using the rates that have been enacted or substantively enacted by the balance sheet date.

	2022 £m	2021 £m
Tax provisions	**(145)**	(106)
Research and development expenditure credits receivable	**131**	81
Other	**44**	69
	30	44
Represented by:		
Current tax assets	**133**	71
Current tax liabilities	**(103)**	(27)
	30	44

Tax provisions of £145m (2021 £106m) are in respect of known tax issues, of which £87m (2021 £54m) relates to the US, £56m (2021 £50m) relates to the UK and £2m (2021 £2m) relates to overseas territories.

19. Cash and cash equivalents

Cash and cash equivalents includes cash in hand, call and term deposits, investments in money market funds and other short-term liquid investments with original maturities of three months or less and which are subject to an insignificant risk of change in value. For the purpose of the cash flow statement, cash and cash equivalents also includes bank overdrafts that are repayable on demand and which form an integral part of the Group's cash management.

	2022 £m	2021 £m
Cash	**484**	903
Money market funds	**1,149**	1,171
Short-term deposits	**1,474**	843
	3,107	2,917

Cash and cash equivalents includes £55m (2021 £83m) which is subject to regulatory restrictions and is therefore not available for general use by other entities within the Group.

20. Business disposals

Assets and liabilities of disposal groups classified as held for sale comprise assets and liabilities that are expected to be recovered primarily through sale rather than continuing use. Assets and liabilities of disposal groups classified as held for sale are measured at the lower of their carrying value and fair value less costs to sell.

Business disposals during 2022

On 9 July 2022, the Group entered into an agreement for the sale of BAE Systems' financial crime detection business from the Digital Intelligence business in our Cyber & Intelligence segment. The sale to SymphonyAI completed on 28 October 2022. Disposal costs of £25m were incurred in relation to the sale, relating to costs incurred in the sale and operational separation of the business.

The gain recognised on disposal was as follows:

	£m
Cash received or receivable:	
Cash	131
Total disposal consideration	**131**
Carrying amount of net assets sold (see below)	(29)
Disposal costs	(25)
Cumulative currency translation gain	17
Gain on sale before tax	**94**
Net cash inflow arising on disposal:	
Cash consideration received	131
Less: cash and cash equivalents disposed	(17)
Less: disposal costs	(13)
	101

Assets and liabilities presented as at the date of disposal were as follows:

	£m
Intangible assets including goodwill	23
Right-of-use assets	3
Trade, other and contract receivables	26
Cash and cash equivalents	17
Total assets	**69**
Lease liabilities	(3)
Contract liabilities	(9)
Trade and other payables	(27)
Provisions	(1)
Total liabilities	**(40)**
Net assets disposed	**29**

Business disposals during 2021

Advanced Electronics Company

In December 2020, the Group's Overhaul and Maintenance Company (OMC) entered into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company Limited (AEC) to Saudi Arabian Military Industries, and this was reported in the financial statements for the year ending 31 December 2020 as assets held for sale. The sale was completed on 23 February 2021. AEC was included in the Air segment.

20. Business disposals continued

Business disposals during 2021 continued

The gain recognised on disposal was as follows:

	2021 £m
Cash received or receivable:	
Cash	182
Deferred consideration	32
Total disposal consideration	214
Carrying amount of net assets sold (see below)	(91)
Gain on sale before tax and reclassification of foreign currency translation reserve	123
Reclassification of foreign currency translation reserve	9
Gain on sale before tax	132
Attributable to:	
Equity shareholders	69
Non-controlling interests	63
	132
Net cash inflow arising on disposal:	
Cash consideration received	193
Less: cash and cash equivalents disposed	–
	193

Of the total consideration receivable, £32m was deferred to be received over the 18 months following disposal. £11m of this contingent consideration was received in 2021 in relation to the sale of AEC, in addition to the cash received on disposal. The gain on disposal has been included in the profit for the year from continuing operations as a component of Other income, and recognised as an adjusting item.

The Group's share of the net assets of AEC as at the date of disposal was as follows:

	£m
Intangible assets including goodwill	16
Property, plant and equipment	8
Equity accounted investments	67
Net assets disposed	91

BAE Systems Rokar International

On 1 April 2021, BAE Systems agreed the sale of BAE Systems Rokar International Limited (Rokar) for \$31m (£22m), net of cash held by Rokar. This resulted in consideration received of \$47m (£34m), a disposal of net assets of \$12m (£8m), including \$16m (£12m) of cash, and a gain before tax on disposal of \$35m (£26m) which has been included in the profit for the year from continuing operations as a component of Other income, and recognised as an adjusting item. Rokar was within the Electronic Systems segment.

21. Geographical analysis of assets

Analysis of non-current assets by geographical location

Asset location	Notes	2022 £m	2021 £m
UK		**4,563**	4,222
Rest of Europe		**1,965**	1,475
US		**10,719**	9,713
Kingdom of Saudi Arabia		**586**	449
Australia		**518**	487
Rest of Asia and Pacific		**5**	5
		18,356	16,351
Other investments	13	**99**	76
Other receivables	14	**416**	480
Post-employment benefit surpluses	25	**1,297**	483
Other financial assets	15	**322**	305
Deferred tax assets	16	**338**	622
Non-current assets		**20,828**	18,317

22. Loans and overdrafts

Loans and overdrafts are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, loans and overdrafts are stated at amortised cost. Any difference between the amount initially recognised and the redemption value is recognised in the income statement over the period of the borrowings.

	2022 £m	2021 £m
Non-current		
US$800m 3.8% bond, repayable 2024	**664**	589
US$750m 3.85% bond, repayable 2025	**621**	550
US$500m 7.5% bond, repayable 2027	**415**	368
US$1,300m 3.4% bond, repayable 2030	**1,073**	952
US$1,000m 1.9% bond, repayable 2031	**824**	732
US$400m 5.8% bond, repayable 2041	**330**	293
US$550m 4.75% bond, repayable 2044	**447**	396
US$1,000m 3% bond, repayable 2050	**815**	724
	5,189	4,604
Current		
£400m 4.125% bond, repayable 2022	**–**	400
Accrued interest	**53**	57
	53	457

US$500m of the US$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps that mature in October 2024 and give an effective rate during 2022 of 3.4%.

The US$500m 7.5% bond, repayable 2027, was converted at issue to a sterling fixed rate bond by utilising cross-currency swaps and has an effective rate during 2022 of 7.7%.

The US$400m 5.8% bond, repayable 2041, has been converted to a floating rate bond by utilising interest rate swaps that mature in October 2024 and give an effective rate during 2022 of 5.3%.

US$1,237m of the US$1,300m 3.4% bond, repayable 2030, was converted at issue to a sterling fixed rate bond by utilising cross-currency swaps and has an effective rate during 2022 of 3.5%.

23. Contract liabilities

Contract liabilities represent the obligation to transfer goods or services to a customer for which consideration has been received, or consideration is due, from the customer.

	2022 £m	2021 £m
Non-current		
Contract liabilities	**945**	519
Current		
Contract liabilities	**3,882**	2,874
	4,827	3,393

Revenue recognised in the year includes £2,393m (2021 £2,701m) that was included in the opening contract liabilities balance.

Non-current and current contract liabilities as at 1 January 2021 were £524m and £3,238m, respectively.

The increase in contract liabilities since 2021 is primarily due to customer advances received during the year.

24. Trade and other payables

Trade and other payables are stated at amortised cost.

US deferred compensation plan liabilities represent the present value of expected future payments required to settle the obligation to employees in accordance with IAS 19 Employee Benefits.

	2022 £m	2021 £m
Non-current		
Accruals	**50**	43
Amounts owed to equity accounted investments (note 33)	**8**	7
Other taxes and social security costs	**–**	1
Deferred income[1]	**1,006**	808
US deferred compensation plan liabilities	**357**	375
Other payables	**20**	14
	1,441	1,248
Current		
Trade payables	**839**	697
Amounts owed to equity accounted investments (note 33)	**1,061**	923
Other taxes and social security costs	**76**	197
Accruals	**2,679**	2,458
Deferred income	**109**	135
Other payables	**226**	226
	4,990	4,636

1. Includes £1,004m (2021 £806m) of funding received from the UK government for property, plant and equipment at Barrow-in-Furness, UK.

25. Post-employment benefits

Pension schemes

Defined contribution

Obligations for contributions are recognised as an expense in the income statement as incurred.

Defined benefit

The cost of providing benefits is determined periodically by independent actuaries and charged to the income statement in the period in which those benefits are earned by the employees. Remeasurements, including actuarial gains and losses, are recognised in the Consolidated statement of comprehensive income in the year in which they occur. Past service costs resulting from a plan amendment or curtailment are recognised immediately in the income statement.

The post-employment benefit surpluses and obligations recognised in the Group's balance sheet represent the fair value of scheme assets, less the present value of the defined benefit obligations calculated using a number of actuarial assumptions as set out on page 271. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

IAS 19 Employee Benefits limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Group has applied IFRIC 14 and has determined that there is no limit on the recognition of the surpluses in its defined benefit pension schemes as at 31 December 2022. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Group, which is assumed to be via a refund. These have been recognised after deducting a 35% withholding tax which would be levied prior to the future refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the Group.

MBDA participates in the Group's defined benefit schemes and, as these are multi-employer schemes, the Group has allocated a share of the IAS 19 pension surpluses and deficits to MBDA based on the relative payroll contributions of active members or actual obligations where known. Whilst this methodology is intended to reflect a reasonable estimate of the share of the surplus or deficit, it may not accurately reflect the obligations of the participating employers.

In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

The Group's share of the IAS 19 pension surplus or deficit allocated to equity accounted investments is included in the balance sheet within equity accounted investments.

Background

Pension schemes

BAE Systems plc operates pension schemes for the Group's qualifying employees in the UK, US and other countries. The principal schemes in the UK and US are funded defined benefit schemes, and the assets are held in separate trustee-administered funds. The largest funded defined benefit scheme is the Main Scheme which represents 93% (2021 93%) of the UK IAS 19 defined benefit obligation at 31 December 2022. The schemes in other countries are primarily defined contribution schemes.

At 31 December 2022, the weighted average durations of the UK and US defined benefit pension obligations were 13 years (2021 17 years) and 12 years (2021 12 years), respectively.

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the Main Scheme and US schemes in aggregate is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme[1]	28	21	51
US schemes[2]	28	17	55

1. Source: 31 March 2021 actuarial valuation reports.
2. Source: Annual updates of the US schemes as at 1 January 2022.

25. Post-employment benefits continued

Regulatory framework

The funded UK schemes are registered and subject to the statutory scheme specific-funding requirements outlined in UK legislation, including the payment of levies to the Pension Protection Fund as set out in the Pension Act 2004. These schemes were established under trust and the responsibility for their governance lies jointly with the Trustees and the Group.

The funded US schemes are tax-qualified pension schemes regulated by the Pension Protection Act 2006 and insured by the Pension Benefit Guaranty Corporation (PBGC) up to certain limits. These schemes were established under, and are governed by, the US Employee Retirement Income Security Act 1974 and the BAE Systems Administrative Committee is a named fiduciary with the authority to manage their operation.

Benefits

The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The Normal Retirement Age for the majority of active members of the Main Scheme is 65. Specific benefits applicable to members differ between schemes. Further details on the benefits provided by each scheme are provided on the BAE Systems Pensions website: baesystemspensions.com

A UK High Court judgment was delivered on 26 October 2018 concerning gender equalisation for the effect of Guaranteed Minimum Pensions (GMPs) for occupational pension schemes. A further UK High Court judgment was delivered on 20 November 2020 which rules that past cash-equivalent transfer values needed to account for gender equalisation for the effect of GMPs. In 2018 and 2020, a non-recurring past service cost was included in the income statement to reflect the expectation that the impact of GMP equalisation would increase the pension deficit in the balance sheet. In 2022, an allowance of £96m (2021 £140m) was included within the pension surplus (2021 deficit) (before allocation to equity accounted investments) to reflect these rulings.

The US defined benefit schemes ceased to be final salary schemes in January 2013. The benefits accrued based on the final salaries of members at that point will become payable on retirement. The Normal Retirement Age for the largest scheme in the US is 65.

Other post-employment benefits

The Group operates a number of non-pension retirement benefit schemes, under which certain employees are eligible to receive benefits after retirement, the majority of which relate to the provision of medical benefits to retired employees of the Group's subsidiaries in the US.

Funding

Introduction

Disclosures in respect of pension funding are provided below. Disclosures in respect of pension accounting under IAS 19 are provided on pages 271 to 277.

The majority of the UK and US defined benefit pension schemes are funded by the Group's subsidiaries and equity accounted investments. The individual pension schemes' funding requirements are based on actuarial measurement frameworks set out in their funding policies.

For funding valuation purposes, pension scheme assets are included at market value at the valuation date, whilst the liabilities are measured on an actuarial funding basis using the projected unit credit method and discounted to their present value based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The funding valuations are performed by professionally qualified independent actuaries and include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 271. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

25. Post-employment benefits continued

Funding continued

UK valuations

Funding valuations of the Group's UK defined benefit pension schemes are performed at least every three years. Following the accelerated payment in 2021 of the remaining sponsor deficit reduction contributions under the previously agreed deficit recovery plan, the Group and Trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 March 2021. This valuation was concluded and signed off on 30 June 2022.

The results of the most recent triennial valuations are shown below. These valuations were agreed with the Trustees and certified by the scheme actuaries after consultation with The Pensions Regulator in the UK.

	Main Scheme as at 31 March 2021 £bn	Other schemes as at 31 March 2020 £bn
Market value of assets	22.9	2.1
Present value of liabilities	(22.9)	(2.0)
Funding surplus	–	0.1
Percentage of accrued benefits covered by the assets at the valuation date	100%	105%

The valuations in 2020 and 2021 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 90
Life expectancy of a male at age 65, currently aged 45 (years)	88 – 91
Life expectancy of a female at age 65, currently aged 45 (years)	90 – 93

As part of the process of the Main Scheme's 2021 valuation, the Trustees and the Group agreed to update the methodology to use a cash flow matching strategy, such that assets are invested with the aim of the expected income directly matching the expected benefit payments of the Scheme. The cash flow matching strategy aims to manage risk through a defined amount of risk buffer assets, which equate to the agreed prudence margin in the valuation. The risk buffer assets are measured over time to assure the Scheme is sufficiently funded. The asset portfolio is currently invested in a selection of bonds designed to match the pension payments for current pensioners, as well as a mix of growth-seeking assets aimed to generate returns for the pension payments for future pensioners. Over time, assets from the return-seeking portfolio will be realised to purchase additional, lower-risk assets to match the increasing current pensioner portfolio.

The 2020 valuations for the other schemes use a different method in that discount rates were directly based on prudent levels of expected returns for the assets held by the schemes, reflecting the planned investment strategies and maturity profiles of each scheme. The discount rates are curves which provide a different rate for each year into the future.

The inflation assumptions for each of the valuations were derived using data from the Bank of England, which is based on the difference between the yields on index-linked and fixed-interest long-term government bonds. The inflation assumption is a curve which provides a different rate for each year into the future.

Under IAS 19, the discount rate for accounting purposes is based on third-party AA corporate bond yields whereas, for funding valuation purposes, the discount rate is based on a prudent level of expected returns from the broader and mixed types of investments reflected in the schemes' investment strategies.

There have been no changes to the contributions or benefits, as set out in the rules of the schemes, for pension scheme members as a result of the new funding valuations.

The results of future triennial valuations and associated funding requirements will be impacted by a number of factors, including the future performance of investment markets and anticipated members' longevity.

US valuations

The Group's US pension schemes are valued annually, with the latest valuations performed as at 1 January 2022.

25. Post-employment benefits continued

Funding continued

Contributions

Under the terms of the trust deeds of the UK schemes, the Group is required to have a funding plan determined at the conclusion of the triennial funding valuations.

Equity accounted investments make regular contributions to the schemes in which they participate in line with the schedule of contributions and are allocated a share of funding contributions.

In 2022, total employer contributions to the Group's pension schemes were £267m (2021 £324m), including amounts funded by equity accounted investments of £23m (2021 £39m), and included approximately £45m (2021 £90m) of deficit recovery payments in respect of the UK schemes.

Contributions in 2023, for both UK and US schemes, are expected to be at a similar level to 2022.

Risk management

The defined benefit pension schemes expose the Group to actuarial risks, including market (investment) risk, interest rate risk, inflation risk and longevity risk.

Risk	Mitigation
Market (investment) risk Asset returns may not move in line with the liabilities and may be subject to volatility.	Following the 23 September 2022 UK 'mini budget', gilt yields increased at an unprecedented rate causing significant market turmoil. Throughout the period following the mini budget, the Group and Trustees monitored the schemes closely with the help of independent advisers. The schemes remained in a strong position throughout and continued to have sufficient liquidity to meet all payments as they fell due. The investment portfolios are highly diversified, investing in a wide range of assets, in order to reduce the exposure of the total portfolio to a materially adverse impact from a single security or type of security. To reduce volatility, certain assets are held in a matching portfolio, which largely consists of index-linked bonds, gilts and swaps, designed to mirror movements in corresponding liabilities. Some 42% (2021 45%) of the Group's pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term. Some of the Group's pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. The Main Scheme has an equity option strategy protecting £0.9bn of assets against a significant fall in equity markets, in line with the prior year. The strategy also caps the upside if equity markets increase more than an agreed percentage.
Interest rate risk Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	As part of the funding valuation finalised during 2022, the main UK Scheme has adopted a cash flow matching strategy, whereby contractual income from assets is designed to directly match benefits paid to members each year. A portfolio of assets with contractual income has been structured to match benefits already in payment, representing around half of the liabilities. This inherently hedges the associated interest rate risk. As members retire and become pensioners, additional matching assets will be purchased to keep pace. Interest rate risk associated with the remaining purchase of matching assets is mitigated via a hedging strategy involving mainly physical assets rather than derivatives and only modest levels of leverage. The overall level of interest rate hedging on the funding basis has increased compared to 2021.
Inflation risk Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	The main UK Scheme's cash flow matching strategy includes aligning asset income to the inflation-linked members' benefit payments. Inflation risk associated with benefits already in payment is inherently hedged by the portfolio of contractual income assets structured to match them, as well as an overlay of inflation swaps held with several banks to reduce counterparty risk. The overall level of inflation hedging on the funding basis is broadly similar to 2021. The Group's US scheme benefits are not indexed with inflation. In 2014, the Main Scheme implemented a pension increase exchange to allow retired members to elect for a higher current pension in exchange for foregoing certain rights to future pension increases.
Longevity risk Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.	Longevity adjustment factors are used in the majority of the UK pension schemes in order to adjust the pension benefits payable so as to share the cost of people living longer with employees. In 2013, with the agreement of the Company, the Trustees of the 2000 Plan, Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme entered into arrangements with Legal & General to insure against longevity risk for the current pensioner population, covering a total of £4.4bn of pension scheme liabilities. These arrangements reduce the funding volatility relating to increasing life expectancy. This longevity risk cover with Legal & General remains in place following the merger of the 2000 Plan and SIPS into the Main Scheme.

25. Post-employment benefits continued

IAS 19 accounting

The disclosures below relate to post-retirement benefit schemes in the UK, US and other countries which are accounted for as defined benefit schemes in accordance with IAS 19.

Principal actuarial assumptions

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the long-term nature of the obligation covered, may not necessarily occur in practice.

	UK			US		
	2022	2021	2020	**2022**	2021	2020
Financial assumptions						
Discount rate – past service (%)	**4.8**	1.9	1.4	**5.0**	2.8	2.4
Discount rate – future service (%)	**4.8**	1.9	1.6	**5.0**	2.8	2.4
Retail Prices Index (RPI) inflation (%)	**3.0**	3.1	2.7	**n/a**	n/a	n/a
Rate of increase in salaries (%)	**3.0**	3.1	2.7	**n/a**	n/a	n/a
Rate of increase in deferred pensions (%)	**2.3/3.0**	2.4/3.1	2.0/2.7	**n/a**	n/a	n/a
Rate of increase in pensions in payment (%)	**1.7 – 3.6**	1.7 – 3.7	1.6 – 3.6	**n/a**	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	**86 – 89**	86 – 89	86 – 88	**87**	87	87
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	88 – 90	**89**	89	89
Life expectancy of a male currently aged 45 (years)	**87 – 90**	86 – 90	87 – 89	**87**	87	87
Life expectancy of a female currently aged 45 (years)	**89 – 91**	89 – 91	89 – 91	**89**	89	88

Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments using a third-party AA corporate bond yield curve to produce a single equivalent discount rate for the UK and US territories. This inherently captures the maturity profile of the expected benefit payments. For the UK territory, the discount rate used for future service differs from that used for past service as it only uses the cash flows relating to active members, which have a different duration. Further information on the duration of the schemes is detailed on page 267.

Retail Prices Index (RPI) and Consumer Prices Index (CPI) inflation

In the UK, the inflation assumptions are derived by reference to the difference between the yields on index-linked and fixed-interest long-term government bonds, or advice from the local actuary depending on the available information. Index-linked government bonds contain a premium that investors are willing to pay to mitigate the risk that RPI inflation is higher than expected. To account for this, the RPI assumption includes an inflation risk premium deduction.

As a consequence of RPI reform announcements, the Company has reviewed its approach to setting inflation assumptions. The inflation risk premium deduction has been set at 0.55% per annum (2021 0.55%) and the CPI assumption has been set at 0.7% per annum (2021 0.7%) lower than RPI. The resulting RPI assumption is 3.0% per annum and the CPI assumption is 2.3% per annum. The 0.7% per annum RPI-CPI differential is a weighted average of a 1% per annum differential pre-2030 and 0.1% per annum differential post-2030; this reflects the anticipated change to the RPI index from 2030. In the US, inflation assumptions are not relevant as the Group's US pension schemes are not indexed with inflation.

Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 3.0% (2021 RPI inflation of 3.1%), plus a promotional scale. From 1 January 2013, employees in the US schemes no longer accrue salary-related benefits.

Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.3% (2021 CPI inflation of 2.4%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 3.0% (2021 RPI inflation of 3.1%). For all UK schemes, the rate of increase in deferred pensions is subject to inflation caps.

Rate of increase in pensions in payment

The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes' benefits increase at rates based on either RPI or CPI inflation, and some are subject to an inflation cap. With the exception of two smaller schemes, the rate of increase in pensions in payment is based on RPI inflation.

Life expectancy

For its UK pension schemes, the Group has used the Self-Administered Pension Schemes S3 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members, in conjunction with the results of an investigation into the actual mortality experience of scheme members and information on the demographic profile of the scheme's membership.

In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2021 tables (published by the Institute of Actuaries) have been used (in 2021, the Continuous Mortality Investigation 2020 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% per annum (2021 1.0%), an initial rate adjustment parameter ('A') of 0.25% (2021 0.25%) in conjunction with a smoothing parameter ('S_K') of 7 for all members (2021 7). The Group has chosen to apply a weighting to the 2021 data in recognition of the abnormal excess deaths as a result of COVID-19. No further adjustments have been made to improvements expected in future years. The impacts of COVID-19 will continue to be monitored and assessed at future reporting dates.

For the majority of the US schemes, the mortality tables used at 31 December 2022 are a blend of the fully generational PRI-2012 White Collar table and the PRI-2012 Blue Collar table, both projected using Scale MP-2021.

25. Post-employment benefits continued

IAS 19 accounting continued

US healthcare schemes

The latest valuations of the principal schemes, covering retiree medical and life insurance schemes in certain US subsidiaries, were performed by independent actuaries as at 1 January 2022. These valuations were rolled forward to reflect the information at 31 December 2022. The method of accounting for these is similar to that used for defined benefit pension schemes.

Long-term healthcare cost is assumed to increase at 4.7% per annum (2021 4.8%). This is based on an assumed increase in 2022 of 6.3% for pre-retirement and 5.3% for post-retirement, with both rates then reducing to 4.5% by 2029 and remaining at 4.5% per annum each year thereafter.

Summary of movements in post-employment benefit obligations

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2022	(1,973)	(313)	(2,286)
Actual return on assets excluding amounts included in net interest expense	(5,094)	(1,199)	(6,293)
Decrease in liabilities due to changes in financial assumptions	10,745	1,067	11,812
Increase in liabilities due to changes in demographic assumptions	(39)	–	(39)
Experience losses	(1,672)	(6)	(1,678)
Contributions in excess of service cost	8	(9)	(1)
Past service cost – plan amendments	14	2	16
Net interest expense	(31)	(6)	(37)
Foreign exchange adjustments	–	(24)	(24)
Movement in other schemes	–	5	5
Total net IAS 19 surplus/(deficit) at 31 December 2022	**1,958**	**(483)**	**1,475**
Withholding tax on surpluses	(722)	–	(722)
Total net IAS 19 surplus/(deficit) at 31 December 2022 (net of withholding tax)	**1,236**	**(483)**	**753**
Allocated to equity accounted investments	(107)	–	(107)
Group's share of net IAS 19 surplus/(deficit) excluding Group's share of amounts allocated to equity accounted investments at 31 December 2022	**1,129**	**(483)**	**646**

Surplus recognition

A number of schemes are in an accounting surplus position. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Group, which is assumed to be via a refund. These have been recognised after deducting a 35% withholding tax, which would be levied prior to the future refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the Group.

Amounts recognised on the balance sheet

The table below shows a reconciliation between the gross assets and liabilities of the Group's UK, US and other post-employment benefit schemes and the amounts recognised on the Group's balance sheet after allocation to equity accounted investments.

	2022				
	UK defined benefit pension schemes £m	**US and other pension schemes £m**	**US healthcare schemes £m**	**Kingdom of Saudi Arabia end of service benefit £m**	**Total £m**
Present value of unfunded obligations	**(104)**	**(105)**	**–**	**(142)**	**(351)**
Present value of funded obligations	**(19,462)**	**(3,927)**	**(128)**	**–**	**(23,517)**
Fair value of scheme assets	**21,524**	**3,629**	**190**	**–**	**25,343**
Total net IAS 19 surplus/(deficit)	**1,958**	**(403)**	**62**	**(142)**	**1,475**
Withholding tax on surpluses	**(722)**	**–**	**–**	**–**	**(722)**
Allocated to equity accounted investments	**(107)**	**–**	**–**	**–**	**(107)**
Group's share of net IAS 19 surplus/(deficit)	**1,129**	**(403)**	**62**	**(142)**	**646**
Represented by:					
Post-employment benefit surpluses	**1,224**	**11**	**62**	**–**	**1,297**
Post-employment benefit obligations	**(95)**	**(414)**	**–**	**(142)**	**(651)**
	1,129	**(403)**	**62**	**(142)**	**646**
Group's share of net IAS 19 surplus of equity accounted investments	**38**	**–**	**–**	**–**	**38**

The US unfunded pension obligations have associated assets held in deferred compensation schemes with a fair value of £56m (2021 £61m), which are shown in Other Investments. The funds held in these trusts can be used solely for the satisfaction of the unfunded obligations.

25. Post-employment benefits continued

IAS 19 accounting continued

	2021				
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Kingdom of Saudi Arabia end of service benefit £m	Total £m
Present value of unfunded obligations	(152)	(131)	–	(153)	(436)
Present value of funded obligations	(28,768)	(4,512)	(150)	–	(33,430)
Fair value of scheme assets	26,947	4,415	218	–	31,580
Total net IAS 19 (deficit)/surplus	(1,973)	(228)	68	(153)	(2,286)
Allocated to equity accounted investments	162	–	–	–	162
Group's share of net IAS 19 (deficit)/surplus	(1,811)	(228)	68	(153)	(2,124)
Represented by:					
Post-employment benefit surpluses	383	32	68	–	483
Post-employment benefit obligations	(2,194)	(260)	–	(153)	(2,607)
	(1,811)	(228)	68	(153)	(2,124)
Group's share of net IAS 19 deficit of equity accounted investments	(69)	–	–	–	(69)

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £1.1bn (2021 £4.1bn).

Changes in the fair value of scheme assets before allocation to equity accounted investments

	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Kingdom of Saudi Arabia end of service benefit £m	Total £m
Value of scheme assets at 1 January 2021	25,029	4,482	218	–	29,729
Interest income	345	103	5	–	453
Actual return on assets excluding amounts included in interest income	2,274	49	2	–	2,325
Actual return on assets	2,619	152	7	–	2,778
Contributions by employer	313	11	1	14	339
Contributions by employer in respect of employee salary sacrifice arrangements	71	–	–	–	71
Total contributions by employer	384	11	1	14	410
Members' contributions	6	–	–	–	6
Administrative expenses	(12)	(7)	(1)	–	(20)
Transfer to other investments	–	(56)	–	–	(56)
Foreign exchange translation	–	39	2	–	41
Benefits paid	(1,079)	(206)	(9)	(14)	(1,308)
Value of scheme assets at 31 December 2021	26,947	4,415	218	–	31,580
Interest income	490	132	6	–	628
Actual return on assets excluding amounts included in interest income	(5,094)	(1,199)	(48)	–	(6,341)
Actual return on assets	(4,604)	(1,067)	(42)	–	(5,713)
Contributions by employer	257	10	–	14	281
Contributions by employer in respect of employee salary sacrifice arrangements	72	–	–	–	72
Total contributions by employer	329	10	–	14	353
Members' contributions	5	–	–	–	5
Administrative expenses	(18)	(7)	(1)	–	(26)
Foreign exchange translation	–	521	26	–	547
Benefits paid	(1,135)	(243)	(11)	(14)	(1,403)
Value of scheme assets at 31 December 2022	**21,524**	**3,629**	**190**	**–**	**25,343**

25. Post-employment benefits continued

IAS 19 accounting continued

Assets of defined benefit pension schemes

	2022								
	UK			US and other			Total		
	Quoted £m	**Unquoted £m**	**Total £m**	**Quoted £m**	**Unquoted £m**	**Total £m**	**Quoted £m**	**Unquoted £m**	**Total £m**
Equities:									
UK[1]	**209**	**–**	**209**	**–**	**–**	**–**	**209**	**–**	**209**
Overseas	**624**	**–**	**624**	**–**	**–**	**–**	**624**	**–**	**624**
Pooled investment vehicles[2]	**3**	**8,892**	**8,895**	**793**	**–**	**793**	**796**	**8,892**	**9,688**
Fixed-interest securities:									
UK gilts	**2,397**	**–**	**2,397**	**–**	**–**	**–**	**2,397**	**–**	**2,397**
UK corporates	**1,832**	**2,416**	**4,248**	**–**	**–**	**–**	**1,832**	**2,416**	**4,248**
Overseas government	**29**	**–**	**29**	**599**	**–**	**599**	**628**	**–**	**628**
Overseas corporates	**1,248**	**56**	**1,304**	**2,105**	**–**	**2,105**	**3,353**	**56**	**3,409**
Index-linked securities:									
UK gilts	**2,050**	**–**	**2,050**	**–**	**–**	**–**	**2,050**	**–**	**2,050**
UK corporates	**–**	**952**	**952**	**–**	**–**	**–**	**–**	**952**	**952**
Overseas corporates	**9**	**–**	**9**	**–**	**–**	**–**	**9**	**–**	**9**
Property[3]	**–**	**1,731**	**1,731**	**–**	**37**	**37**	**–**	**1,768**	**1,768**
Derivatives[4]	**–**	**(1,595)**	**(1,595)**	**–**	**–**	**–**	**–**	**(1,595)**	**(1,595)**
Cash:									
Sterling	**566**	**84**	**650**	**–**	**–**	**–**	**566**	**84**	**650**
Foreign currency	**12**	**(1)**	**11**	**95**	**–**	**95**	**107**	**(1)**	**106**
Other	**–**	**10**	**10**	**–**	**–**	**–**	**–**	**10**	**10**
Total	**8,979**	**12,545**	**21,524**	**3,592**	**37**	**3,629**	**12,571**	**12,582**	**25,153**

	2021								
	UK			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[1]	1,188	–	1,188	–	–	–	1,188	–	1,188
Overseas	3,468	–	3,468	–	–	–	3,468	–	3,468
Pooled investment vehicles[2]	257	8,058	8,315	990	–	990	1,247	8,058	9,305
Fixed-interest securities:									
UK gilts	1,253	–	1,253	–	–	–	1,253	–	1,253
UK corporates	1,850	3,171	5,021	–	–	–	1,850	3,171	5,021
Overseas government	67	–	67	305	–	305	372	–	372
Overseas corporates	1,152	50	1,202	2,990	–	2,990	4,142	50	4,192
Index-linked securities:									
UK gilts	3,397	–	3,397	–	–	–	3,397	–	3,397
UK corporates	–	1,270	1,270	–	–	–	–	1,270	1,270
Property[3]	–	1,967	1,967	–	42	42	–	2,009	2,009
Derivatives[4]	–	(1,317)	(1,317)	–	(3)	(3)	–	(1,320)	(1,320)
Cash:									
Sterling	931	91	1,022	–	–	–	931	91	1,022
Foreign currency	14	4	18	91	–	91	105	4	109
Other	39	37	76	–	–	–	39	37	76
Total	13,616	13,331	26,947	4,376	39	4,415	17,992	13,370	31,362

1. Includes £3m (2021 £5m) of the Company's own ordinary shares.
2. Primarily invested in private markets and exchange traded funds. The amounts classified as unquoted primarily comprise investments in private markets, with the majority held in infrastructure, alternatives and direct funds, valued in accordance with International Private Equity and Venture Capital Valuation Guidelines.
3. Valued on the basis of open market value at the end of the year determined in accordance with the Royal Institution of Chartered Surveyors' Appraisal and Valuation Standards and the Practice Note contained therein. Includes £223m (2021 £263m) of property occupied by Group companies.
4. Includes equity protection options, forward foreign exchange contracts, futures, and interest rate, inflation and longevity swaps. In addition, the total derivative figures shown are net of £520m (2021 £464m) of repurchase agreements. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

25. Post-employment benefits continued

IAS 19 accounting continued

Longevity swap

The Group holds longevity insurance contracts for some of its UK defined benefit pension schemes. These provide long-term protection and income to the underlying pension scheme in the event that insured members live longer than expected.

The value of the longevity insurance contracts held by the Group are calculated by an actuary. At a high level, they are measured by discounting the difference between the projected fixed and floating cash flows payable under the contracts, excluding the value of future projected fees. The significant assumptions used for this valuation are the discount rate and mortality assumptions; fair values for these assumptions are advised by an actuary based on external data and characteristics of the insured member population.

As at 31 December 2022, the longevity swap valuation leads to a negative adjustment to the assets which reflects that experience to date on the contracts has been higher than expected deaths.

Changes in the present value of the defined benefit obligations before allocation to equity accounted investments

	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Kingdom of Saudi Arabia end of service benefit £m	Total £m
Defined benefit obligations at 1 January 2021	(29,391)	(4,894)	(157)	(132)	(34,574)
Current service cost	(237)	(13)	(1)	(23)	(274)
Contributions by employer in respect of employee salary sacrifice arrangements	(71)	–	–	–	(71)
Total current service cost	(308)	(13)	(1)	(23)	(345)
Members' contributions	(6)	–	–	–	(6)
Past service cost – plan amendments	(3)	–	(1)	–	(4)
Actuarial gain/(loss) due to changes in financial assumptions	1,145	220	6	(2)	1,369
Actuarial gain/(loss) due to changes in demographic assumptions	74	(8)	1	–	67
Experience losses	(1,109)	(8)	(2)	(6)	(1,125)
Interest expense	(401)	(113)	(4)	(4)	(522)
Foreign exchange translation	–	(33)	(1)	–	(34)
Benefits paid	1,079	206	9	14	1,308
Defined benefit obligations at 31 December 2021	(28,920)	(4,643)	(150)	(153)	(33,866)
Current service cost	(231)	(12)	(1)	(27)	(271)
Contributions by employer in respect of employee salary sacrifice arrangements	(72)	–	–	–	(72)
Total current service cost	(303)	(12)	(1)	(27)	(343)
Members' contributions	(5)	–	–	–	(5)
Past service cost – plan amendments	14	2	(1)	–	15
Actuarial gain due to changes in financial assumptions	10,745	1,067	32	47	11,891
Actuarial loss due to changes in demographic assumptions	(39)	–	–	–	(39)
Experience (losses)/gains	(1,672)	(6)	3	(4)	(1,679)
Interest expense	(521)	(138)	(4)	(5)	(668)
Foreign exchange translation	–	(545)	(18)	(14)	(577)
Benefits paid	1,135	243	11	14	1,403
Defined benefit obligations at 31 December 2022	**(19,566)**	**(4,032)**	**(128)**	**(142)**	**(23,868)**

25. Post-employment benefits continued

IAS 19 accounting continued

Amounts recognised in the income statement after allocation to equity accounted investments

	2022			
	UK defined benefit pension schemes £m	**US and other pension schemes £m**	**Other schemes £m**	**Total £m**
Included in operating costs:				
Current service cost	**(210)**	**(12)**	**(28)**	**(250)**
Past service cost – plan amendments	**13**	**2**	**(1)**	**14**
Administrative expenses	**(16)**	**(7)**	**(1)**	**(24)**
	(213)	**(17)**	**(30)**	**(260)**
Included in net finance costs:				
Net interest expense on post-employment benefit obligations	**(28)**	**(6)**	**(3)**	**(37)**
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs	**(10)**	**–**	**–**	**(10)**
Group's share of equity accounted investments' finance costs	**(1)**	**–**	**–**	**(1)**

	2021			
	UK defined benefit pension schemes £m	US and other pension schemes £m	Other schemes £m	Total £m
Included in operating costs:				
Current service cost	(217)	(13)	(24)	(254)
Past service cost – plan amendments	(3)	–	(1)	(4)
Administrative expenses	(11)	(7)	(1)	(19)
	(231)	(20)	(26)	(277)
Included in net finance costs:				
Net interest expense on post-employment benefit obligations	(52)	(10)	(3)	(65)
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs	(10)	–	–	(10)
Group's share of equity accounted investments' finance costs	(2)	–	–	(2)

The Group incurred a charge of £299m (2021 £246m) in relation to defined contribution schemes for employees.

25. Post-employment benefits continued

IAS 19 accounting continued

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2022 and keeping all other assumptions as set out on page 271.

The pension schemes hold a number of unquoted pooled investment vehicles, which are investments in private markets. These are valued based on latest available valuation reports, and as noted on page 223, these valuations are subject to estimation uncertainty as their valuation techniques incorporate a number of assumptions, including those associated with the COVID-19 pandemic and the impact of climate change. Should these funds' actual valuations at 31 December 2022 be on average 2% different to those assumed, this would result in a £0.2bn (2021 £0.2bn) change in the valuation of the assets.

Financial assumptions

The estimated impact of changes in the discount rate and inflation assumptions on the defined benefit pension obligation, together with the estimated impact on scheme assets, is shown in the table below. The estimated impact on scheme assets takes into account the Group's risk management activities in respect of interest rate and inflation risk. The sensitivity analysis on the defined benefit obligation is measured on an IAS 19 accounting basis and, therefore, does not reflect the natural hedging in the discount rate used for funding valuation purposes.

	Decrease/(increase) in pension obligation[1] £bn	(Decrease)/increase in scheme assets[1] £bn
Discount rate:		
0.5 percentage point increase/decrease	1.4/(1.5)	(1.2)/1.4
1.0 percentage point increase/decrease	2.6/(3.2)	(2.3)/2.9
2.0 percentage point increase/decrease	4.7/(7.2)	(4.3)/6.6
3.0 percentage point increase/decrease	6.5/(12.4)	(5.9)/11.4

1. Before allocation to equity accounted investments and deduction of withholding tax.

	(Increase)/decrease in pension obligation[1] £bn	Increase/(decrease) in scheme assets[1] £bn
Inflation:		
0.1 percentage point increase/decrease	(0.2)/0.2	0.1/(0.1)
0.5 percentage point increase/decrease	(0.8)/0.8	0.7/(0.6)
1.0 percentage point increase/decrease	(1.5)/1.5	1.4/(1.1)

1. Before allocation to equity accounted investments and deduction of withholding tax.

Demographic assumptions

Changes in the life expectancy assumption, including the benefit of longevity swap arrangements (see longevity risk on page 270), would have the following effect on the total net IAS 19 surplus:

	(Decrease)/increase in net surplus[1] £bn
Life expectancy:	
One-year increase/decrease	(0.8)/0.7

1. Before allocation to equity accounted investments and deduction of withholding tax.

26. Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and the amount has been reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax discount rate.

Warranties and after-sales service

Warranties and after-sales service are provided in the normal course of business with provisions for associated costs being made based on an assessment of future claims with reference to past experience. A provision for warranties is recognised when the underlying products and services are sold. The provision is based on historical warranty data and a weighting of possible outcomes against their associated probabilities.

Reorganisations

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced to those affected. The costs associated with the reorganisation programmes are supported by detailed plans and based on previous experience as well as other known factors. Future operating costs are not provided for.

Legal, contractual and environmental

The Group holds provisions for expected legal, contractual and environmental costs that it expects to incur over an extended period. Management exercises judgement to determine the amount of these provisions. Provision is made for known issues based on past experience of similar items and other known factors. Each provision is considered separately and the amount provided reflects the best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes.

	Warranties and after-sales service £m	Reorganisations £m	Legal, contractual and environmental £m	Other £m	Total £m
Non-current	57	–	249	25	331
Current	52	38	136	50	276
At 1 January 2022	109	38	385	75	607
Created	39	20	81	19	159
Utilised	(31)	(24)	(45)	(20)	(120)
Transfer from other balance sheet categories	2	–	1	–	3
Released	(16)	(1)	(64)	(11)	(92)
Net present value adjustments	–	–	(6)	(3)	(9)
Business acquisitions	–	–	–	6	6
Business disposals	–	–	–	(1)	(1)
Foreign exchange adjustments	6	1	21	6	34
At 31 December 2022	**109**	**34**	**373**	**71**	**587**
Represented by:					
Non-current	57	9	244	28	338
Current	52	25	129	43	249
	109	**34**	**373**	**71**	**587**

26. Provisions continued

Warranties and after-sales service

Warranty and after-sales service provisions are generally utilised within three years post-delivery. Whilst actual events could result in potentially significant differences to the quantum, but not the timing, of the outflows in relation to the provisions, management has reflected current knowledge in assessing the provision levels.

Reorganisations

Reorganisation provisions are generally utilised within one to three years. There is limited volatility around the timing and amount of the ultimate outflows related to these provisions.

Other debtors includes £nil (2021 £9m) which is reimbursable in respect of reorganisation costs.

Legal, contractual and environmental

Reflecting the inherent uncertainty within many legal proceedings, the amount of the outflows could differ significantly from the amount provided. While the timing of the outflows is also uncertain, the Group expects these provisions to be utilised over a period of approximately 25 years.

Other

There are no individually significant provisions included within other provisions.

27. 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 2021	3,467	87	1	1	87
Shares cancelled	(63)	(2)	–	–	(2)
At 1 January 2022	3,404	85	1	1	85
Shares cancelled	(107)	(3)	–	–	(3)
At 31 December 2022	**3,297**	**82**	**1**	**1**	**82**

Special Share

One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the Special Shareholder). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British. The effect of these requirements can also be amended by regulations made by the directors and approved by the Special Shareholder.

The Special Shareholder may require the Company at any time to redeem the Special Share at par or to convert the Special Share into one ordinary voting share. The Special Shareholder is entitled to receive notice of and to attend general meetings and class meetings of the Company's shareholders, but has no voting right, nor other rights, other than to speak in relation to any business in respect of the Special Share.

Treasury shares

As at 31 December 2022, 220,086,959 (2021 236,807,031) ordinary shares of 2.5p each with an aggregate nominal value of £5,502,174 (2021 £5,920,176) were held in treasury. During 2022, 16,720,072 (2021 12,188,518) treasury shares were used to satisfy awards and options under the Share Incentive Plan, International Share Incentive Plan, Performance Share Plan, the Performance Shares and Restricted Shares elements of the Long-Term Incentive Plan, and the Executive Share Option Plan.

BAE Systems Employee Share Option Plan (ESOP) Trust

The Group has an ESOP discretionary trust to administer the share plans and to acquire Company shares, using funds loaned by the Group, to meet commitments to Group employees. Dividend waivers were in operation for shares within the ESOP Trust, other than those owned beneficially by the participants, for the dividends paid in the year.

At 31 December 2022, the ESOP Trust held 7,268,002 (2021 7,022,472) ordinary shares of 2.5p each, with a market value of £62m (2021 £39m). The shares held by the ESOP Trust are recorded at cost and deducted from retained earnings until such time as the shares vest unconditionally to employees.

A dividend waiver was also in operation for the dividends paid in the year over shares within the Company's share incentive plan trusts other than those shares owned beneficially by the participants.

Own shares held

Own shares held, including treasury shares and shares held by BAE Systems ESOP Trust, are recognised as a deduction from retained earnings.

27. Share capital and other reserves continued

Equity dividends

Equity dividends on ordinary share capital are recognised as a liability on the date that the shareholder's right to receive payment is established. This is generally the date that the dividend is declared.

	2022 £m	2021 £m
Final 15.2p dividend per ordinary share paid in the year (2021 14.3p)	**480**	461
Interim 10.4p dividend per ordinary share paid in the year (2021 9.9p)	**322**	316
	802	777

After the balance sheet date, the directors proposed a final dividend of 16.6p per ordinary share. The dividend proposed amounts to approximately £511m, although the final payment is likely to be lower as a result of the impact of share buybacks. The dividend, which is subject to shareholder approval, will be paid on 1 June 2023 to shareholders registered on 21 April 2023. The ex-dividend date is 20 April 2023.

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 5 May 2023.

Other reserves

	Merger reserve £m	Statutory reserve £m	Revaluation reserve £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2021	4,589	202	10	3	94	1,025	5,923
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	27	27
Reclassification of cumulative currency translation reserve on disposal of subsidiary	–	–	–	–	–	(9)	(9)
Net amounts debited to hedging reserve	–	–	–	–	(52)	–	(52)
Equity accounted investments (net of tax)	–	–	–	–	9	(13)	(4)
Purchase of own shares	–	–	–	2	–	–	2
At 31 December 2021	4,589	202	10	5	51	1,030	5,887
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	1,151	1,151
Reclassification of cumulative currency translation reserve on disposal of subsidiary	–	–	–	–	–	(17)	(17)
Net amounts debited to hedging reserve	–	–	–	–	(65)	–	(65)
Equity accounted investments (net of tax)	–	–	–	–	3	(11)	(8)
Purchase of own shares	–	–	–	3	–	–	3
At 31 December 2022	**4,589**	**202**	**10**	**8**	**(11)**	**2,153**	**6,951**

27. Share capital and other reserves continued

Other reserves continued

Merger reserve

The merger reserve arose on the acquisition of the Marconi Electronic Systems (MES) business by British Aerospace in 1999 to form BAE Systems, and represents the amount by which the fair value of the shares issued by British Aerospace as consideration exceeded their nominal value.

Statutory reserve

Under Section 4 of the British Aerospace Act 1980, this reserve may only be applied in paying up unissued shares of the Company to be allotted to members of the Company as fully paid bonus shares.

Revaluation reserve

The revaluation reserve relates to the revaluation at fair value of the net assets of the BVT joint venture previously held as an equity accounted investment on the acquisition of the remaining 45% interest in 2009.

Capital redemption reserve

The capital redemption reserve represents the cumulative nominal value of the Company's ordinary shares repurchased and subsequently cancelled.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

Capital

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

At 31 December 2022, the Group's capital was £11,411m (2021 £7,617m), which comprises total equity of £11,400m (2021 £7,668m), excluding amounts accumulated in equity relating to cash flow hedges of £(11)m (2021 £51m). Net debt (excluding lease liabilities) was £2,023m (2021 £2,160m).

The capital structure of the Group reflects the judgement of the directors of an appropriate balance of funding required. The Group's policy is to maintain an investment grade credit rating and ensure operating flexibility, whilst:

- meeting its pension obligations;
- investing in research and technology and pursuing other organic investment opportunities;
- paying dividends in line with the Group's policy of long-term sustainable cover of around two times underlying earnings (see note 7);
- making accelerated returns of capital to shareholders when the balance sheet allows and when the return from doing so is in excess of the Group's Weighted Average Cost of Capital; and
- investing in value-enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.

Purchase of own shares

2021 buyback

On 29 July 2021, the Company announced the details of a share buyback programme to repurchase up to £500m of its own shares over the following 12 months.

As part of the buyback programme, it was agreed that should a better alternative use for the Company's cash reserves be identified, the share buyback programme would be ceased, and the money instead used for the alternative purpose. Therefore, when the Company issued a mandate to the brokers to purchase shares on their behalf, the mandates were structured such that they could be revoked at any point. As such, no financial liability was recognised for shares not yet purchased under the programme.

During 2021, 63,272,873 shares were repurchased for a total price, including transaction costs, of £371m. These shares were subsequently cancelled, with the nominal value of shares cancelled deducted from share capital against the capital redemption reserve.

The 2021 share buyback programme was completed on 2 February 2022. During 2022, a further 24,253,065 shares were repurchased for a total price, including transaction costs, of £132m. In total 87,525,938 shares were repurchased under the scheme for a total price, including transaction costs, of £503m.

2022 buyback

In July 2022, the directors also approved a new share buyback programme of up to £1.5bn over the next three years under the same terms as the 2021 buyback programme. At 31 December 2022, 82,997,065 shares were repurchased for a total price, including transaction costs, of £664m. These shares have been subsequently cancelled, with the nominal value of shares cancelled deducted from share capital against the capital redemption reserve.

28. Cash flow from operating activities

Reconciliation of net cash flow from operating activities to free cash flow[1]

	2022 £m	2021 £m
Net cash flow from operating activities	**2,839**	2,447
Add back Taxation paid	**365**	234
Purchase of property, plant and equipment, and investment property[2]	**(599)**	(516)
Purchase of intangible assets	**(94)**	(96)
Purchase of non-current other investment	**(8)**	(15)
Proceeds from funding related to assets[2]	**157**	150
Proceeds from sale of property, plant and equipment, and investment property	**18**	271
Proceeds from sale of non-current other investments	**7**	–
Equity accounted investment funding	**–**	(3)
Principal element of lease payments and receipts	**(227)**	(207)
Net capital expenditure, lease principal amounts and financial investment	**(746)**	(416)
Dividends received from equity accounted investments	**94**	57
Operating business cash flow[1]	**2,552**	2,322
Taxation paid[3]	**(365)**	(234)
Interest paid, net of interest received	**(237)**	(224)
Free cash flow[1]	**1,950**	1,864

Reconciliation of operating business cash flow[1] to net cash flow from operating activities by reporting segment

	Operating business cash flow[1]		Deduct Dividends received from equity accounted investments		Add back Net capital expenditure, lease principal amounts and financial investment		Net cash flow from operating activities	
	2022 £m	2021 £m	2022 £m	2021 £m	2022 £m	2021 £m	2022 £m	2021 £m
Electronic Systems	**650**	774	**(6)**	(3)	**216**	180	**860**	951
Platforms & Services	**525**	287	**–**	(6)	**108**	70	**633**	351
Air	**1,140**	628	**(84)**	(44)	**146**	159	**1,202**	743
Maritime & UK Land	**235**	321	**(4)**	(4)	**187**	140	**418**	457
Cyber & Intelligence	**154**	173	**–**	–	**37**	29	**191**	202
HQ	**(152)**	139	**–**	–	**52**	(162)	**(100)**	(23)
	2,552	2,322	**(94)**	(57)	**746**	416	**3,204**	2,681
Taxation paid[3]							**(365)**	(234)
Net cash flow from operating activities							**2,839**	2,447

1. Operating business cash flow and Free cash flow are alternative performance measures defined in the Financial glossary on page 302. They are presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. To align with further detail provided in the current year cash flow statement, funding received from the UK government for the construction of assets for the year ended 31 December 2021 has been presented in equivalent detail with the cash inflow now shown separately as 'Proceeds from funding related to assets' to cash outflows on the 'Purchase of property, plant and equipment, and investment property'.
3. Taxation is managed on a Group-wide basis.

29. Movement in assets and liabilities arising from financing activities

	As at 1 January 2022 £m	Cash flow[3] £m	Non-cash movements: Foreign exchange movements £m	Non-cash movements: Leases £m	Non-cash movements: Fair value adjustments £m	Non-cash movements: Financial expense £m	Non-cash movements: Other movements[1] £m	As at 31 December 2022 £m
Assets								
Other financial assets[2]	**122**	**(550)**	**–**	**–**	**581**	**17**	**–**	**170**
	122	**(550)**	**–**	**–**	**581**	**17**	**–**	**170**
Liabilities								
Loans	**(5,061)**	**615**	**(584)**	**–**	**–**	**(212)**	**–**	**(5,242)**
Lease liabilities	**(1,295)**	**284**	**(95)**	**(464)**	**–**	**(48)**	**2**	**(1,616)**
Other financial liabilities[2]	**(163)**	**205**	**–**	**–**	**(155)**	**(1)**	**–**	**(114)**
	(6,519)	**1,104**	**(679)**	**(464)**	**(155)**	**(261)**	**2**	**(6,972)**
		554						
Other interest paid		**23**						
Purchase of own shares		**788**						
Equity dividends paid		**802**						
Dividends paid to non-controlling interests		**166**						
Net cash flow from financing activities		**2,333**						

	As at 1 January 2021 £m	Cash flow[3] £m	Non-cash movements: Foreign exchange movements £m	Non-cash movements: Leases £m	Non-cash movements: Fair value adjustments £m	Non-cash movements: Financial expense £m	Non-cash movements: Other movements[1] £m	As at 31 December 2021 £m
Assets								
Other financial assets[2]	146	(79)	–	–	37	18	–	122
	146	(79)	–	–	37	18	–	122
Liabilities								
Loans	(5,323)	574	(43)	–	–	(209)	(60)	(5,061)
Lease liabilities	(1,256)	260	(7)	(246)	–	(43)	(3)	(1,295)
Other financial liabilities[2]	(231)	154	–	–	(81)	(5)	–	(163)
Cash collateral[4]	(18)	18	–	–	–	–	–	–
	(6,828)	1,006	(50)	(246)	(81)	(257)	(63)	(6,519)
		927						
Other interest paid		10						
Purchase of own shares		368						
Equity dividends paid		777						
Dividends paid to non-controlling interests		202						
Partial disposal of shareholding in subsidiary undertaking		(28)						
Net cash flow from financing activities		2,256						

1. Other movements includes movements arising on the acquisition or disposal of businesses.
2. Excluding cash flow hedges, for which the cash flow is reported within cash flow from operating activities. See note 15 for an analysis of other financial assets and liabilities.
3. Cash flow movements represent both payments or receipts of principal and payments of interest, which are presented separately in the consolidated cash flow statement. Cash flow movements in the prior year were presented net of interest paid. The movement tables have been re-presented in the current year to disclose greater levels of detail and, as a result, the 2021 comparatives have been re-presented to the same level of detail.
4. Reported in other payables.

30. Net debt (excluding lease liabilities)

Components of net debt (excluding lease liabilities)

	Notes	2022 £m	2021 £m
Cash and cash equivalents	19	**3,107**	2,917
Debt-related derivative financial instrument assets – non-current	15	**147**	114
Loans – non-current	22	**(5,189)**	(4,604)
Loans and overdrafts – current	22	**(53)**	(457)
Debt-related derivative financial instrument liabilities – non-current	15	**(35)**	(130)
Net debt (excluding lease liabilities)[1]		**(2,023)**	(2,160)

1. Net debt (excluding lease liabilities) is an alternative performance measure defined in the Financial glossary on page 302. It is presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

31. Fair value measurement

Fair value of financial instruments

Certain of the Group's financial instruments are held at fair value.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date.

The fair values of financial instruments held at fair value have been determined based on available market information at the balance sheet date, and the valuation methodologies listed below:

– the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;

– the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and

– the fair values of money market funds are calculated by multiplying the net asset value per share by the investment held at the balance sheet date.

Due to the variability of the valuation factors, the fair values presented at 31 December may not be indicative of the amounts the Group will realise in the future.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

– Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;

– Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

– Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

31. Fair value measurement continued

Carrying amounts and fair values of certain financial instruments

	Notes	2022 Carrying amount £m	2022 Fair value £m	2021 Carrying amount £m	2021 Fair value £m
Financial instruments measured at fair value:					
Non-current					
Other investments at fair value through other comprehensive income	13	**99**	**99**	76	76
Other financial assets	15	**322**	**322**	305	305
Other financial liabilities	15	**(272)**	**(272)**	(302)	(302)
Current					
Other financial assets	15	**252**	**252**	194	194
Money market funds	19	**1,149**	**1,149**	1,171	1,171
Other financial liabilities	15	**(328)**	**(328)**	(214)	(214)
Financial instruments not measured at fair value:					
Non-current					
Loans	22	**(5,189)**	**(4,588)**	(4,604)	(5,045)
Current					
Loans and overdrafts	22	**(53)**	**(53)**	(457)	(462)

All of the financial assets and liabilities measured at fair value are classified as level 2 using the fair value hierarchy, except for money market funds, which are classified as level 1, and other investments, which are at a combination of level 1 and level 3. The total value of investments classified as level 3 is immaterial. There were no transfers between levels during the year.

Financial assets and liabilities in the Group's Consolidated balance sheet are either held at fair value or at amortised cost. With the exception of loans, the carrying value of financial instruments measured at amortised cost approximates their fair value. The fair value of loans presented in the table above is derived from market prices, classified as level 1 using the fair value hierarchy.

32. Share-based payments

The Group has granted equity-settled share options and Long-Term Incentive Plan arrangements which are measured at fair value at the date of grant using an option pricing model. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the number of shares that will actually vest.

Details of the terms and conditions of each share-based payment plan are given in the Annual remuneration report on pages 160 to 205.

Expense in year

	2022 £m	2021 £m
Executive Share Option Plan	**10**	8
Performance Share Plan	**35**	32
Restricted Share Plan	**10**	8
	55	48

The Group also incurred a charge of £46m (2021 £44m) in respect of the equity-settled all-employee Free Shares and Matching Partnership Shares elements of the Share Incentive Plan.

Executive Share Option Plan

	2022		2021	
	Number of shares '000	**Weighted average exercise price £**	Number of shares '000	Weighted average exercise price £
Outstanding at 1 January	**47,280**	**5.16**	43,561	5.20
Granted during the year	**8,141**	**7.39**	10,995	5.02
Exercised during the year	**(18,020)**	**5.30**	(2,695)	4.68
Expired during the year	**(2,587)**	**5.50**	(4,581)	5.49
Outstanding at 31 December	**34,814**	**5.58**	47,280	5.16
Exercisable at 31 December	**8,271**	**5.38**	17,279	5.57

	2022	2021
Range of exercise price of outstanding options (£)	**3.89 – 7.83**	3.01 – 6.49
Weighted average remaining contracted life (years)	**7**	7
Weighted average fair value of options granted (£)	**1.87**	1.00

Performance Share Plan and Restricted Share Plan

	Performance Share Plan		Restricted Share Plan	
	2022 Number of shares '000	2021 Number of shares '000	**2022 Number of shares '000**	2021 Number of shares '000
Outstanding at 1 January	**27,915**	25,878	**5,413**	4,974
Granted during the year	**6,799**	9,387	**2,205**	2,304
Exercised during the year	**(3,719)**	(2,108)	**(1,383)**	(1,523)
Expired during the year	**(3,652)**	(5,242)	**(430)**	(342)
Outstanding at 31 December	**27,343**	27,915	**5,805**	5,413
Exercisable at 31 December	**387**	387	**38**	–

	2022	2021	**2022**	2021
Weighted average remaining contracted life (years)	**5**	5	**5**	5
Weighted average fair value of awards granted (£)	**7.32**	4.90	**7.49**	5.01

The exercise price for the Performance Share Plan and Restricted Share Plan is £nil (2021 £nil).

32. Share-based payments continued

Details of options/awards granted in the year

The fair value of equity-settled options/awards granted in the year has been measured using the weighted average inputs below and the following valuation models:

Executive Share Option Plan – Binomial
Performance Share Plan – Monte Carlo
Restricted Share Plan – Dividend valuation

	2022	2021
Range of share price at date of grant (£)	**7.35 – 7.83**	5.00 – 5.68
Expected option/award life (years)	**3 – 10**	3 – 10
Volatility (%)	**29**	28
Risk-free interest rate (%)	**1 – 3**	0.1 – 0.2

Volatility was calculated with reference to the Group's weekly share price volatility, after allowing for dividends, for the greater of 30 weeks or for the period until vest date.

The average share price in the year was £7.53 (2021 £5.33).

33. Related party transactions

The Group has a related party relationship with its directors and key management personnel (see below), equity accounted investments (note 12) and pension schemes (note 25).

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

	Sales to related parties		Purchases from related parties		Amounts owed by related parties		Amounts owed to related parties[1]		Management recharges[1]	
Related party	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m
Advanced Electronics Company Limited	**–**	1	**–**	–	**–**	–	**–**	–	**–**	–
Eurofighter Jagdflugzeug GmbH	**1,219**	1,068	**442**	402	**67**	26	**91**	74	**–**	–
FADEC International LLC	**73**	54	**–**	–	**–**	–	**–**	–	**–**	–
MBDA SAS	**19**	23	**76**	114	**6**	2	**949**	837	**8**	19
Panavia Aircraft GmbH	**22**	32	**49**	46	**1**	1	**2**	–	**–**	–
BAE Systems Pension Schemes	**–**	–	**20**	16	**–**	–	**193**	207	**–**	–
Other	**11**	12	**28**	8	**3**	5	**27**	19	**–**	–
	1,344	1,190	**615**	586	**77**	34	**1,262**	1,137	**8**	19

1. Also relates to disclosures under IAS 24 Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2022, £1,021m (2021 £907m) was owed by BAE Systems plc and £241m (2021 £230m) by other Group subsidiaries.

The Group also manages certain treasury functions on behalf of some of their equity accounted investments. This includes entering into foreign exchange derivatives on their behalf. As at 31 December 2022, we entered into forward contracts to purchase €313m, sell $21m, and purchase £14m worth of other currencies (2021 purchase €250m, sell $20m and purchase £4m worth of other currencies) on their behalf. No service fee is charged for these arrangements.

The Group considers key management personnel, as defined under IAS 24 Related Party Disclosures, to be the members of the Group's Executive Committee and the Company's non-executive directors. Fuller disclosures on directors' remuneration are set out in the Annual remuneration report on pages 160 to 205. Total emoluments for directors and key management personnel charged to the Consolidated income statement were:

	2022 £'000	2021 £'000
Short-term employee benefits	**22,238**	17,755
Post-employment benefits	**677**	1,121
Share-based payments	**12,023**	8,940
	34,938	27,816

34. Contingent liabilities

Contingent liabilities are potential future cash outflows which are either not probable or cannot be measured reliably.

The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business. Various Group undertakings are parties to legal actions and claims which arise in the normal course of business. Provision is made for any amounts that the directors consider may become payable (see note 26).

The Group believes that any significant liability in respect of its guarantees and performance bond arrangements, and legal actions and claims not already provided for, is remote.

35. Acquisitions of businesses

Businesses acquired during 2022

On 11 November 2021, the Group announced its intention to acquire 100% of the share capital of BIS Invest S.a.r.l. and its subsidiaries, together the Bohemia Interactive Simulations Group (BISim Group) for a consideration of $200m (£151m). On 4 March 2022, this deal passed all required pre-closing activities, and the acquisition was completed. Using the latest game-based technology, the experienced BISim team of engineers develops high-fidelity, cost-effective training and simulation software products and components to meet the growing demand for defence applications. BISim forms part of the Cyber & Intelligence segment.

The results and financial position of the acquired business have been consolidated from the date of acquisition. The purchase price allocation exercise was finalised in the year and summarised below.

Acquisition consideration and fair value of net assets acquired

	£m
Intangible assets	71
Property, plant and equipment	1
Right-of-use assets	1
Receivables	10
Deferred tax assets	1
Lease liabilities	(1)
Payables	(8)
Deferred tax liabilities	(14)
Provisions	(6)
Cash and cash equivalents	5
Net identifiable assets acquired	60
Goodwill	91
Net assets acquired	**151**
Satisfied by:	
Cash consideration	151
Total consideration	**151**

The net outflow of cash in respect of the acquisition of BISim is as follows:

	£m
Cash consideration	151
Cash and cash equivalents acquired	(5)
Net cash outflow in respect of the acquisition of the business	**146**

35. Acquisition of businesses continued

Businesses acquired during 2022 continued

The goodwill recognised is primarily attributable to expected synergies. No goodwill is expected to be deductible for tax purposes. Goodwill has been allocated to the Intelligence & Security business. No impairment losses have been recognised in respect of goodwill in the year ended 31 December 2022.

The acquisition contributed £38m to the Group's revenue and £8m to the Group's underlying EBIT[1] between the date of acquisition and 31 December 2022. If it had been completed on 1 January 2022, the Group's revenue from the acquisition would have been £42m, and the Group's underlying EBIT[1] would have been £8m for the year ended 31 December 2022.

Contractual cash flows on trade, other and contract receivables are recognised net of expected credit losses. No contingent liabilities have been recognised or require disclosure in respect of this acquisition.

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 302. It is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

Businesses acquired during 2021

On 4 March 2021, the Group acquired 100% of the share capital of Pulse Power and Measurement Limited for a consideration of £21m. The net assets acquired, including intangible assets identified, were valued at £11m, resulting in goodwill of £10m.

On 14 September 2021, the Group acquired 100% of the share capital of In-Space Missions Limited for a fair value consideration of £15m. The provisional net assets acquired, including intangible assets identified, have been valued at £5m, resulting in provisional goodwill of £10m.

The purchase price allocation for all 2021 acquisitions was finalised within the current year.

36. Events after the reporting period

There were no events after the reporting period which would materially impact the balances reported in this Annual Report.

37. Information about related undertakings

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiaries and equity accounted investments as at 31 December 2022 is disclosed below. Unless otherwise stated, the Group's shareholding represents ordinary shares held indirectly by BAE Systems plc, the year end is 31 December and the address of the registered office is Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom. For companies incorporated outside of the United Kingdom, the country of incorporation is shown in the address. No subsidiary undertakings have been excluded from the consolidation.

Subsidiaries – wholly-owned

4219 Lafayette, LLC[1]
4219 Lafayette Center Drive, Chantilly VA 20151, United States

Aircraft Research Association Limited[2]
Manton Lane, Bedford MK41 7PF, United Kingdom

Alvis Limited

Alvis Pension Scheme Trustees Limited[3]

Alvis Vickers Limited

Armstrong Whitworth Aircraft Limited[3]

ASC Shipbuilding Pty Limited
Bldg 01, Level 2, 640 Mersey Road North, Osborne SA 5017, Australia

Australian Marine Engineering Corporation (Finance) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Avro International Aerospace Limited[3]

BAE Systems (Al Diriyah C4i) Limited[3]

BAE Systems (Canada) Inc.
220 Laurier Avenue West, Suite 1200, Ottawa ON K1P 5Z9, Canada

BAE Systems (Combat and Radar Systems) Limited
Charter Place, 23/27 Seaton Place, St. Helier, Jersey JE1 1JY

BAE Systems (Corporate Air Travel) Limited

BAE Systems (Defence Systems) Limited

BAE Systems (Dynamics) Limited

BAE Systems (Farnborough 3) Limited

BAE Systems (Finance) Limited

BAE Systems (Funding Four) Unlimited Company
Riverside One, Sir John Rogerson's Quay, Dublin D02 X576, Ireland

BAE Systems (Funding Three) Limited

BAE Systems (Funding Two) Limited

BAE Systems (Gripen Overseas) Limited

BAE Systems (Holdings) Limited[3]

BAE Systems (International) Limited

BAE Systems (Kazakhstan) Limited

BAE Systems (Kuwait) Limited

BAE Systems (Land and Sea Systems) Limited[4]

BAE Systems (Malaysia) Sdn Bhd
Level 25 Menara Hong Leong, No. 6 Jalan Damanlela, Bukit Damansara, 50490 Kuala Lumpur, Malaysia

BAE Systems (MEH) Limited

BAE Systems (Military Air) Overseas Limited

BAE Systems (Nominees) Limited[3]

BAE Systems (Oman) Limited

BAE Systems (Operations) Limited[5]

BAE Systems (Operations) Singapore Pte Limited
One Marina Boulevard #28-00, Singapore 018989, Singapore

BAE Systems (Overseas Holdings) Limited

BAE Systems (Poland) Sp. z o.o.
ul. Abp. A. Baraniaka 88, 61-131 Poznan, Poland

BAE Systems (Projects) Limited

BAE Systems (Property Investments) Limited

BAE Systems (Vehicles and Equipment) Limited[6]

BAE Systems 2000 Pension Plan Trustees Limited[3]

BAE Systems AB[7]
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems Air Japan KK
1-1 Katamachi, Shinjuku-ku, Tokyo, Japan

BAE Systems Al Diriyah Programme Limited[3]

BAE Systems Applied Intelligence (Asia Pacific) Pte Limited
United Square, 101 Thomson Road, #25-03/04, 307591, Singapore

BAE Systems Applied Intelligence (Connect) A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence (GCS) Limited
Surrey Research Park, Guildford, Surrey GU2 7RQ, United Kingdom

BAE Systems Applied Intelligence Integrated Computer Solutions (Kuwait) (S.P.C.)
Al Hamra Tower, Office Number 3503, 35th Floor, East Maqwa, Kuwait City, Kuwait

BAE Systems Applied Intelligence (Integration) Limited
Surrey Research Park, Guildford, Surrey GU2 7RQ, United Kingdom

BAE Systems Applied Intelligence (International) Limited
Priestley Road, Surrey Research Park, Guildford, Surrey GU2 7RQ, United Kingdom

BAE Systems Applied Intelligence (Japan) KK
12/F Ark Mori Building, 1-12-32 Akasaka, Minato-ku, Tokyo, 107-6024, Japan

BAE Systems Applied Intelligence (Spain) S.A.
Paseo de la Castellana, 141, Cuzco IV, 28046 Madrid, Spain

BAE Systems Applied Intelligence (UK) Limited

BAE Systems Applied Intelligence A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence GCS Inc.[8]
CSC, 100 Shockoe Slip, 2nd Floor Richmond VA 23219, United States

BAE Systems Applied Intelligence Limited
Surrey Research Park, Guildford, Surrey GU2 7RQ, United Kingdom

BAE Systems Applied Intelligence LLC[1]
8000 Towers Crescent Blvd, 13th Floor, Vienna VA 22182, United States

BAE Systems Applied Intelligence Malaysia Sdn Bhd
Level 25, Menara Hong Leong, No. 6 Jalan Damanlela, Bukit Damansara, 50490 Kuala Lumpur, Malaysia

BAE Systems Applied Intelligence Pty Limited
Level 26, 459 Collins Street, Melbourne VIC 3000, Australia

BAE Systems Australia (Electronic Systems) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia (NSW) Holdings Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia (NSW) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Datagate Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Defence Holdings Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Defence Pty Limited[10]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Holdings Limited[3]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Logistics Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Sea Sentinel Project Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Avionics Singapore Pte Limited
One Marina Boulevard, #28-00, Singapore 018989, Singapore

BAE Systems Bofors AB
SE-691 80 Karlskoga, Sweden

BAE Systems Bofors Holdings Sdn Bhd
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

BAE Systems C-ITS AB
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems Communications Solutions LLC[1]
Knowledge Oasis, Building 4, Second Floor, 0402-Z427, Knowledge Oasis Muscat, PO Box 16, Postal Code 135, Muscat, Oman

BAE Systems Controls Inc.[9]
1098 Clark Street, Endicott NY 13760, United States

BAE Systems Creole Inc.[11]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Datagate Holdings Limited

BAE Systems Datagate Limited[6]

BAE Systems Deployed Systems Limited[12]

BAE Systems do Brasil Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems Electronic Systems (Overseas) Limited

BAE Systems Electronics Limited

BAE Systems Enterprises Limited

BAE Systems Executive Pension Scheme Trustees Limited[3]

BAE Systems Finance B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Finance Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Flight Training (Australia) Pty Limited[13]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Funds Management[3,14]

BAE Systems GCS International Limited

BAE Systems Global Combat Systems Bridging Limited[6]

BAE Systems Global Combat Systems Munitions Limited

BAE Systems Global LLC[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Hägglunds AB
SE-691 80, Karlskoga, Sweden

BAE Systems Hawaii Shipyards Inc.[8]
The Corporation Company, Inc., 1136 Union Mall, Suite 301, Honolulu HI 96813, United States

37. Information about related undertakings continued

Subsidiaries – wholly-owned continued

BAE Systems Holding GmbH
Hauptstrasse 48, 82433 Bad Kohlgrub, Germany

BAE Systems Holdings (South Africa) (Pty) Limited
Central Office Park No. 5, 257 Jean Avenue, Centurion, Gauteng, 0157, South Africa

BAE Systems Holdings B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Holdings Inc.[9]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Holdings International LLC[1]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

BAE Systems Imaging Solutions Inc.[9]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems India (Homeland Security) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Services) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Technology) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Ventures) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems Information and Electronic Systems Integration Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Insurance (Isle of Man) Limited
Tower House, Loch Promenade, Douglas, IM1 2LZ, Isle of Man

BAE Systems Integrated System Technologies (KSA) Limited

BAE Systems Integrated System Technologies (Overseas) Limited

BAE Systems Integrated System Technologies Limited

BAE Systems International Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Jacksonville Ship Repair LLC[1]
8500 Hecksher Drive, Jacksonville FL 32226, United States

BAE Systems Japan GK
Ark Mori Building, 1-12-32 Akasaka, Minato-Ku, Tokyo, Japan

BAE Systems Land & Armaments Holdings LLC[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Land & Armaments Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Land & Armaments L.P.[1]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Land Systems (Finance) Limited

BAE Systems Land Systems (Investments South Africa) Limited[6]

BAE Systems Land Systems (Investments) Limited

BAE Systems Land Systems (Ranges) Limited[6]

BAE Systems Land Systems ATF Limited

BAE Systems Land Systems FMTV International Inc.[11]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Land Systems Pinzgauer (Holdings) Limited

BAE Systems Land Systems Pinzgauer Limited

BAE Systems MAI Turkey Hava Sistemleri A.Ş.
Üniversiteler Mahallesi, Beytepe Lodumlu Köy Yolu Cad. No: 5/348 Çankaya, Ankara, Turkey

BAE Systems Marine (Holdings) Limited

BAE Systems Marine (YSL) Limited

BAE Systems Marine Limited

BAE Systems Norfolk Ship Repair Inc.[8]
CT Corporation System, 4701 Cox Road, Suite 285, Glen Allen VA 23060-6802, United States

BAE Systems Oman LLC[1]
PO Box 74, Postal Code 111, Seeb, Oman

BAE Systems Ordnance Systems Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Overseas Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Pension Funds CIF Trustees Limited[3]

BAE Systems Pension Funds Investment Management Limited[3,16]

BAE Systems Pension Funds Trustees Limited[3]

BAE Systems Project Services Limited

BAE Systems Projects (Canada) Limited

BAE Systems Properties Limited

BAE Systems Quest Limited[3]

BAE Systems Air Japan KK[9]
1-1 Katamachi, Shinjuku-ku, Tokyo, Japan

BAE Systems Regional Aircraft Colombia SAS[17]
c/o Brigard & Urrutia, Calle 70 A No. 4-41, Bogotá, Colombia

BAE Systems Resolution Inc.[8]
CT Corporation System, 1999 Bryan Street, Suite 900, Dallas TX 75201, United States

BAE Systems S&S Operations Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems San Diego Ship Repair Inc.[8]
330 N. Brand Boulevard, Glendale CA 91203-2336, United States

BAE Systems Saudi America Limited
Riyadh Kingdom Centre 28th Floor (REGUS), PO Box 23088, Riyadh 11321, Central Province, Riyadh, Kingdom of Saudi Arabia

BAE Systems Saudi Arabia (Maintenance and Equipment Services) Limited
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

BAE Systems Saudi Arabia (Vehicles and Equipment Holdings) Limited[3]

BAE Systems Saudi Arabia (Vehicles and Equipment Nominees) Limited[3]

BAE Systems Saudi Limited
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

BAE Systems Serviços de Aviônicos Ltda.
Rua Ambrósio Molina, No. 1090. Bloco F, Eugênio de Melo, São José dos Campos, São Paulo 12.247-000, Brazil

BAE Systems Share Plans Trustee Limited[3]

BAE Systems Services Limited

BAE Systems Shared Services Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Ship Repair Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Southeast Shipyards AMHC Inc.[8]
1200 South Pine Island Road, Plantation FL 33324, United States

BAE Systems Surface Ships (Holdings) Limited

BAE Systems Surface Ships (Overseas) Limited

BAE Systems Surface Ships (Projects) Limited

BAE Systems Surface Ships Integrated Support Limited

BAE Systems Surface Ships Intermediate Holdings Limited[18]

BAE Systems Surface Ships International Limited

BAE Systems Surface Ships Limited

BAE Systems Surface Ships Maritime Limited

BAE Systems Surface Ships Portsmouth Limited[18]

BAE Systems Surface Ships Projects (Malaysia) Sdn Bhd
Level 29 Menara Binjai, No 2 Jalan Binjai, Off Jalan Ampang, 50450 Kuala Lumpur, Malaysia

BAE Systems Surface Ships Property Services Limited

BAE Systems Surface Ships Support Limited[5]

BAE Systems SWS Defence AB
SE-691 80 Karlskoga, Sweden

BAE Systems Tactical Vehicle Systems LP[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Technology Solutions & Services Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Training Services Limited

BAE Systems TVS Holdings LLC[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Zephyr Corporation[9]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Fifth Corporation[9]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Fourth Corporation[9]
The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Second Corporation[9]
The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Third Corporation[9]
The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems, Inc.[8]
The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle, Delaware 19801, United States

BIS Invest S.à.r.l.
2, Place de Strasbourg, L-2562, Luxembourg, Grand Duchy of Luxembourg

Bohemia Interactive Australia Pty Limited
Unit 2, Building A, 2 Technology Place, Williamtown NSW 2318, Australia

Bohemia Interactive Simulations GK Limited
Abista Kudan Bldg. 10F, 2-4-12 Kudan-minami, Tokyo, Chiyoda Ku, 102-0074, Japan

Bohemia Interactive Simulations GmbH
Vistra Corporate Services, Westendstraße 28, 60325, Frankfurt am Main, Germany

Bohemia Interactive Simulations, Inc.[8]
CT Corporation System, 1200 South Pine Island Road, Plantation FL 33324, United States

Bohemia Interactive Simulations K.S.
Pernerova 691/42, Karlin, 186 00 Prague 8, Czech Republic

Bohemia Interactive Simulations Korea Limited
Rm 1 5/F 437 Teheran-ro, Gangnam-gu, Seoul, 06158, Republic of Korea

Bohemia Interactive Simulations sp z.o.o.
Ul. Ostrobramska 101, 04-041, Warsaw, Poland

Bohemia Interactive Simulations (UK) Limited
31 Hercules Way, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6UU, United Kingdom

Bohemia Invest One Ltd

Bohemia Invest Two Ltd

37. Information about related undertakings continued

Subsidiaries – wholly-owned continued

Brabazon Limited

British Aerospace (Far East) Limited[19]
Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong

British Aerospace (Malaysia) Sdn Bhd[19]
Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No.8, Jalan Kerinchi, 59200 Kuala Lumpur, Malaysia

British Aircraft Corporation (Pension Fund Trustees) Limited[3]

British Aircraft Corporation Limited[3]

CPS International, Inc.[11]
Benedetti & Benedetti, Comosa Building, 21st Floor, PO Box 850120, Panama 5, Panama

Creole (Nigeria) Limited[5]
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance) Surulere, Lagos, Nigeria

Detica B.V.
Luna ArenA, Herikerbergweg 238, 1101 CM Amsterdam, Netherlands

Detica Group Limited

Detica Mexico S. de R.L. de C.V.
Torre Esmeralda II, Blvd Manuel Avila Camacho No. 36 Piso 18, Lomas de Chapultepec, 11000 D.F., Mexico

Detica Services, Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

Dividend Training Limited

ETI Engineering, Inc.[8]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

EVU Czech, S.R.O.
Pernerova 691/42, Karlin, 186 00 Prague 8, Czech Republic

Gloster Aircraft Limited[3]

H-B Utveckling, H-B Development AB
Nybrogatan 7, SE-114 34 Stockholm, Sweden

Hadrian Holdings, Inc.
521 Fifth Avenue, New York NY 101075, United States

Hadrian Trustees Limited[2]

Hägglunds Vehicle GmbH
Ernst-Grote Strasse 13, 30916 Isernhagen, Germany

Hawker Siddeley Aviation Limited[3]

Hawker Siddeley Dynamics Limited[3]

HSA/HSD Pension Fund Trustees Limited[3]

Hunter Aerospace Corporation Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

In-Space Missions Limited
8 Oriel Court, Omega Park, Alton GU34 2YT, United Kingdom

International Military Sales Limited

Jetstream Aircraft Limited[3]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Lemacrown Limited[20]

MES Holdco Limited
Charter Place, 23/27 Seaton Place, St. Helier, Jersey JE1 1JY

MES Interco[14]

Meslink Limited

Newcombe Properties Limited

Pitch Technologies AB
Repslagaregatan 25, SE-582 22 Linköping, Sweden

Pitch Technologies Limited
Sweden House, 5 Upper Montagu Street, London W1H 2AG, United Kingdom

Prismatic Limited[5]
2 Omega Park, Alton GU34 2QE, United Kingdom

PT. BAE Systems Services[8]
Wisma 46, Kota BNI, 34th Floor, Suite 34.01.A, Jl. Jenderal Sudirman Kavling 71, Jakarta 10220, Indonesia

Pulse Power and Measurement Inc.
1717 Pennsylvania Avenue, NW Suite, 1025 Washington DC 20006, United States

Pulse Power and Measurement Limited[21]
65 Shrivenham Hundred Business Park, Watchfield, Swindon, Wiltshire SN6 8TY, United Kingdom

Representaciones SSTS, CA[11]
Ave Francisco de Miranda, Centro Lido El Rosal Oficina 71B, Caracas, Venezuela

Riptide Autonomous Solutions Canada Company
1300-1969 Upper Water Street, Purdy's Wharf Tower II, Halifax, NS, BJ3 3R7, Canada

Royal Ordnance (Crown Service) Pension Scheme Trustees Limited

Royal Ordnance Senior Staff Pension Scheme Trustees Limited

Royal Ordnance Speciality Metals Limited[3,18]

RWT Limited[3,18]

Salford Electrical Instruments Limited[18]
10 Fleet Place, London EC4M 7RB, United Kingdom

Scentcivil Limited[18]
c/o Interpath Limited, 10 Fleet Place, London EC4M 7RB, United Kingdom

Scottish Aviation Limited[3]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Sepia, LLC[1]
4219 Lafayette Center Drive, Chantilly VA 20151, United States

Shipbuilding (MSF) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Shipbuilding (VIC) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Stewart & Stevenson Operations (Nigeria) Limited[11]
9th Floor, St. Nicholas House, 26 Catholic Mission Street, Lagos, Nigeria

Stewart & Stevenson TVS UK Limited

Stratsec.net Sdn Bhd
Unit F-3-1, Blok F, Third Floor, CBD Perdana 3, Jalan Perdana, Cyber 12, 63000 Cyberjaya, Selangor Darul Ehsan, Malaysia

Support Solutions General Services and Contracting Company/Limited Liability company[1,17]
House No. 145, Street No. 1, Qtr. 611, Al Andulous Area, Al Mansour, Baghdad, Iraq

TDS International Holdings Pty Limited[22]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

TDS International Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Techmodal Limited

Techmodal Ventures Limited

TerraSim, Inc.[8]
307 Fourth Avenue, Suite 400, Pittsburgh PA 15222, United States

The Blackburn Aeroplane & Motor Co Limited[3]

The Bristol Aviation Company Limited[3]

The British & Colonial Aeroplane Co. Limited[3]

The Supermarine Aviation Works Limited[3,4]

Thomas Sopwith Aviation Company Limited[3]

VSEL Birkenhead Limited

Warship Design Services Limited[18]
c/o Interpath Limited, 10 Fleet Place, London EC4M 7RB, United Kingdom

Westover Controls Incorporated[8]
1098 Clark Street, Endicott NY 13760, United States

37. Information about related undertakings continued

Subsidiaries – not wholly-owned

Advanced National Company for Aircraft Maintenance Limited (51%)
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

BAE Systems Saudi Development and Training Company Limited (50.98%)[23]
PO Box 67775, Riyadh 11517, Kingdom of Saudi Arabia

BAE Systems SDT (UK) Limited (51%)

Flight Control System Management GmbH (66.6%)[24]
PO Box 801109, 81663 Munich, Germany

Granada Enterprises Limited (51%)
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

Hadrian Properties, Inc. (95%)[14]
521 Fifth Avenue, New York NY 101075, United States

International Systems Engineering Company Limited (46.2%)
PO Box 54002, Riyadh 11514, Kingdom of Saudi Arabia

Overhaul and Maintenance Company Holding (51%)
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

Saudi Maintenance & Supply Chain Management Company Limited (51%)
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

Saudi Technology & Logistics Services Limited (65%)[3]
PO Box 1732, Riyadh 11441, Kingdom of Saudi Arabia

SMSCMC (UK) Limited (51%)

Equity accounted investments

Abercromby Property International (20.42%)
521 Fifth Avenue, New York NY 101075, United States

Air Astana (49%)[10]
121 Kabanbay Batyr Avenue, Yessil District, Astana 010000, Kazakhstan

AMSH B.V. (50%)[25]
Coolsingel 61, 7th Floor – right, 3012 AB Rotterdam, Netherlands

BAE Systems Strategic Aerospace Services WLL (49%)
Building 58, Street 850, Area 23, Qatari Bin Al Fajaa, Doha, Qatar

BAeHAL Software Limited (40%)[3,15]
Airport Lane, HAL Estate, Bangalore 560010, India

BHIC Bofors Defense Asia Sdn Bhd (49%)
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

Canadian Naval Support Limited (50%)[26]
3099 Barrington Street, Halifax NS B3K 5M7, Canada

CTA International SAS (50%)
13 Route De La Miniere, 78034 Versailles Cedex, France

Data Link Solutions L.L.C. (50%)[1,19]
350 Collins Road, Northeast Cedar Rapids IA 52498, United States

Eurofighter Jagdflugzeug GmbH (33%)[3]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

European Aerosystems Limited (50%)[2,3,18,22]

FADEC International LLC (50%)[1]
1098 Clark Street, Endicott NY 13760, United States

FAST Holdings Limited (50%)[15,22]

FAST Training Services Limited (50%)[15]

FNSS Savunma Sistemleri A.S (49%)[22]
Oğulbey Mahallesi, Oğulbey Kumeevleri, No. 441/A, 441/B, Gölbaşı, Ankara, Turkey

KBS Maritime Limited (50%)[7]

MBDA B.V. (37.5%)
Coolsingel 61, 7th Floor – right, 3012 AB Rotterdam, Netherlands

MBDA Holdings S.A.S. (25%)
1 avenue Réaumur, 92350 Le Plessis-Robinson, France

MBDA S.A.S. (37.5%)
1 avenue Réaumur, 92350 Le Plessis-Robinson, France

Nobeli Business Support AB (34%)
SE-691 80 Karlskoga, Sweden

Panavia Aircraft GmbH (42.5%)[3]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Promoveo Solutions JV LLC (49%)
260 Peachtree Street NW, #2200, Atlanta GA 30303, United States

Reaction Engines Limited (15.5%)

Rheinmetall BAE Systems Land Limited (45%)
Hadley Castle Works, PO Box 106, Telford TF1 6QW, United Kingdom

Saab Bofors Test Center AB (30%)
Box 418, SE-691 27 Karlskoga, Sweden

Sealand Support Services Limited (33.3%)[27]
MoD Sealand, Welsh Road, Sealand, Deeside, Flintshire CH5 2LS, United Kingdom

Winner Developments Limited (33.3%)

Notes

1. Unincorporated entity for which the address given is the principal place of business.
2. Company limited by guarantee.
3. Directly owned by BAE Systems plc.
4. Ownership held in class of A shares, B shares and preference shares.
5. Ownership held in class of A shares and B shares.
6. In strike off.
7. Ownership held in ordinary shares and preference shares.
8. Ownership held in common shares.
9. Ownership held in common stock.
10. Ownership held in ordinary shares and redeemable preference shares.
11. Ownership held in authorized shares.
12. 40% owned by BAE Systems plc.
13. Ownership held in ordinary shares, ordinary A and ordinary B shares.
14. Unlimited company.
15. Year end 31 March.
16. Year end 5 April.
17. In liquidation.
18. In Members' Voluntary Liquidation.
19. Year end 30 September.
20. Ownership held in ordinary shares and class of A shares.
21. Ownership held in class of A, B, C, D, E, F and G ordinary shares.
22. Ownership held in class of A shares.
23. 1% owned by BAE Systems plc.
24. 33.3% owned by BAE Systems plc.
25. Ownership held in class of B shares.
26. Ownership held in common shares and B Preferred shares.
27. Ownership held in ordinary and A Cumulative Redeemable Preference shares.

Company statement of comprehensive income for the year ended 31 December

	2022 £m	2021 £m
Profit for the year	**1,648**	902
Other comprehensive income		
Items that will not be reclassified to the income statement:		
Remeasurements on post-employment benefit schemes	**207**	205
Items that may be reclassified to the income statement:		
Amounts credited to hedging reserve	**9**	–
Total other comprehensive income for the year (net of tax)	**216**	205
Total comprehensive income for the year	**1,864**	1,107

Company statement of changes in equity for the year ended 31 December

	Notes	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings[1] £m	Total equity £m
At 1 January 2021		87	1,249	204	2,747	4,287
Profit for the year		–	–	–	902	902
Total other comprehensive income for the year		–	–	–	205	205
Total comprehensive income for the year		–	–	–	1,107	1,107
Share-based payments	10	–	–	–	92	92
Purchase of own shares	9	(2)	–	2	(371)	(371)
Unclaimed assets programme proceeds		–	3	–	–	3
Ordinary share dividends[2]		–	–	–	(777)	(777)
At 31 December 2021		85	1,252	206	2,798	4,341
Profit for the year		–	–	–	1,648	1,648
Total other comprehensive income for the year		–	–	9	207	216
Total comprehensive income for the year		–	–	9	1,855	1,864
Share-based payments	10	–	–	–	102	102
Purchase of own shares	9	(3)	–	3	(793)	(793)
Ordinary share dividends[2]		–	–	–	(802)	(802)
At 31 December 2022		**82**	**1,252**	**218**	**3,160**	**4,712**

1. The non-distributable portion of retained earnings is £955m (2021 £875m).
2. Details of ordinary share dividends are provided in note 27 to the Group accounts.

Company balance sheet as at 31 December

	Notes	2022 £m	2021 £m
Non-current assets			
Intangible assets		**44**	52
Property, plant and equipment		**2**	5
Right-of-use assets		**18**	21
Investments in subsidiary undertakings and participating interests	2	**9,191**	9,117
Amounts owed by subsidiary undertakings	3	**4,501**	4,500
Other receivables	3	**5**	7
Post-employment benefit surpluses	8	**167**	151
Other financial assets	4	**522**	401
		14,450	14,254
Current assets			
Trade and other receivables	3	**80**	63
Current tax		**13**	13
Other financial assets	4	**448**	307
Cash and cash equivalents		**2,533**	2,131
		3,074	2,514
Total assets		**17,524**	16,768
Non-current liabilities			
Loans	5	**(3,042)**	(2,701)
Lease liabilities		**(19)**	(27)
Other payables	6	**(3)**	–
Post-employment benefit obligations	8	**(75)**	(288)
Other financial liabilities	4	**(403)**	(409)
Provisions	7	**(126)**	(126)
		(3,668)	(3,551)
Current liabilities			
Loans	5	**(25)**	(432)
Lease liabilities		**(2)**	(3)
Trade and other payables	6	**(8,596)**	(8,087)
Other financial liabilities	4	**(504)**	(340)
Provisions	7	**(17)**	(14)
		(9,144)	(8,876)
Total liabilities		**(12,812)**	(12,427)
Net assets		**4,712**	4,341
Capital and reserves			
Issued share capital		**82**	85
Share premium		**1,252**	1,252
Other reserves	9	**218**	206
Retained earnings[1]		**3,160**	2,798
Total equity		**4,712**	4,341

1. The Company's profit for the year is £1,648m (2021 £902m).

Approved by the Board of BAE Systems plc on 22 February 2023 and signed on its behalf by:

C N Woodburn
Chief Executive

B M Greve
Group Finance Director

Registered number: 1470151

Notes to the Company accounts

1. Preparation

Basis of preparation

The directors have a reasonable expectation that the Company has adequate resources to continue its operational existence for at least 12 months from the signing of the accounts, notwithstanding the net current liabilities of £6,070m. Therefore, the financial statements of BAE Systems plc have been prepared on a going concern basis, as discussed in the Strategic report on page 127, and in accordance with Financial Reporting Standard (FRS) 101, Reduced Disclosure Framework.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the UK (UK-adopted IFRS), but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken:

- the requirements of paragraphs 45(b) and 46 to 52 of IFRS 2 Share-based Payment;
- the requirements of paragraphs 62, B64(d), B64(e), B64(g), B64(h), B64(j) to B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q)(ii), B66 and B67 of IFRS 3 Business Combinations;
- the requirements of paragraph 33(c) of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;
- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91 to 99 of IFRS 13 Fair Value Measurement;
- the requirements of the second sentence of paragraph 110 and paragraphs 113(a), 114, 115, 118, 119(a) to (c), 120 to 127 and 129 of IFRS 15 Revenue from Contracts with Customers;
- the requirement in paragraph 38 of IAS 1 Presentation of Financial Statements, to present comparative information in respect of: paragraph 79(a)(iv) of IAS 1; paragraph 73(e) of IAS 16 Property, Plant and Equipment; paragraph 118(e) of IAS 38 Intangible Assets; and paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 17 and 18A of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures, to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly-owned by such a member; and
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36 Impairment of Assets.

The Company intends to continue to prepare its financial statements in accordance with FRS 101.

In accordance with Section 408(3) of the Companies Act 2006, the Company is exempt from the requirement to present its own income statement. The amount of profit for the year of the Company is disclosed in the Company statement of comprehensive income and Company balance sheet.

The Company financial statements are presented in pounds sterling and, unless stated otherwise, rounded to the nearest million. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments).

Significant accounting policies

The significant accounting policies applied in the preparation of these individual financial statements are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated.

Investments in subsidiary undertakings and participating interests

Fixed asset investments in shares in subsidiary undertakings and participating interests are stated at cost less provision for impairment.

The Company recognises an increase in its investments in subsidiary undertakings in respect of the cost of share-based payment awards issued by the Company to employees of the Company's operating subsidiaries, with a corresponding entry to equity.

Amounts owed by subsidiary undertakings

Amounts owed by subsidiary undertakings are stated at amortised cost including a provision for expected credit losses. For the purposes of impairment assessment, amounts to subsidiary undertakings are considered low credit risk and, therefore, the Company measures the provision at an amount equal to 12-month expected credit losses.

Other significant accounting policies

Other significant accounting policies are consistent with the Group accounts.

Judgements and sources of estimation uncertainty

In the course of preparing the financial statements, no judgements have been made in the process of applying the Company's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Key sources of estimation uncertainty

Post-employment benefits

A number of actuarial assumptions are made in assessing the value of post-employment benefit obligations, including discount rate, inflation rate and mortality assumptions. For each of the actuarial assumptions used there is a wide range of possible values and management estimates a point within that range that most appropriately reflects the Group's circumstances.

If estimates relating to these actuarial assumptions are no longer valid or change due to changing economic and social conditions, then the potential obligations due under these schemes could change significantly.

Discount and inflation rates could change significantly as a result of a prolonged economic downturn, monetary policy decisions and interventions or other macroeconomic issues. The impact of estimates made with regard to mortality projections may also change.

Similarly, the values of many assets are subject to estimates and assumptions, in particular those which are held in unquoted pooled investment vehicles. The associated fair value of these unquoted pooled investments is estimated with consideration of the most recently available valuations provided by the investment or fund managers. These valuations inherently incorporate a number of assumptions including the impact of climate change on the underlying investments. The overall level of estimation uncertainty in valuing these assets could therefore give rise to a material change in valuation within the next 12 months.

Furthermore, estimates are required around the Group's ability to access its defined benefit surpluses, and on what basis, which then determines the associated rate of tax to apply. Depending on the outcome, judgement is then required to determine the presentation of any tax payable in recovering a surplus.

Note 25 of the Group accounts provides information on the key assumptions and analysis of their sensitivities.

Changes in accounting policies

Several standards, interpretations and amendments to existing standards became effective on 1 January 2022, as detailed on page 223 of the Group accounts, none of which had a material impact on the Company.

2. Investments in subsidiary undertakings and participating interests

	£m
Cost	
At 1 January 2022	9,123
Additions	80
Disposal	(6)
At 31 December 2022	**9,197**
Impairment provisions	
At 1 January 2022 and 31 December 2022	**6**
Net carrying value	
At 31 December 2022	**9,191**
At 31 December 2021	9,117

3. Trade and other receivables

	2022 £m	2021 £m
Non-current		
Amounts owed by subsidiary undertakings[1]	**4,501**	4,500
Other receivables	**5**	7
	4,506	4,507
Current		
Amounts owed by equity accounted investments	**–**	3
Prepayments	**16**	19
Accrued income	**36**	26
Other receivables	**28**	15
	80	63

1. Amounts owed by subsidiary undertakings are repayable on demand. Whilst the majority of these receivables are interest free, certain balances bear interest priced on an arm's-length basis. Provision for expected credit losses is immaterial.

4. Other financial assets and liabilities

	2022		2021	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**7**	**–**	–	–
Other foreign exchange/interest rate contracts	**368**	**(368)**	287	(279)
Debt-related derivative financial instruments	**147**	**(35)**	114	(130)
	522	**(403)**	401	(409)
Current				
Cash flow hedges – foreign exchange contracts	**2**	**(1)**	1	–
Other foreign exchange/interest rate contracts	**446**	**(503)**	306	(340)
	448	**(504)**	307	(340)

Included within other foreign exchange contracts are derivatives entered into on behalf of subsidiaries. These derivatives were passed down to the hedging subsidiary using an internal derivative with equal but opposite terms to the external derivatives, and valued using the same methodology as the external derivatives. The majority of such derivatives were designated in cash flow hedges in the Group accounts. Disclosures in respect of the fair value and maturity profiles of other financial assets and liabilities are provided in notes 15 and 31 to the Group accounts.

5. Loans and overdrafts

	2022 £m	2021 £m
Non-current		
US$1,300m 3.4% bond, repayable 2030	**1,073**	952
US$1,000m 1.9% bond, repayable 2031	**824**	732
US$400m 5.8% bond, repayable 2041	**330**	293
US$1,000m 3% bond, repayable 2050	**815**	724
	3,042	2,701
Current		
£400m 4.125% bond, repayable 2022	**–**	400
Accrued interest	**25**	32
	25	432

6. Trade and other payables

	2022 £m	2021 £m
Non-current		
Other payables	**3**	–
Current		
Amounts owed to subsidiary undertakings[1]	**7,379**	6,947
Amounts owed to equity accounted investments	**1,021**	907
Accruals	**105**	128
Deferred income	**42**	40
Other payables	**49**	65
	8,596	8,087

1. Amounts owed to subsidiary undertakings are repayable on demand. Whilst the majority of these payables are interest free, certain balances bear interest priced on an arm's-length basis.

7. Provisions

	Contractual and other £m
Non-current	126
Current	14
At 1 January 2022	140
Created	4
Utilised	(3)
Net present value adjustments	2
At 31 December 2022	**143**
Represented by:	
Non-current	126
Current	17
	143

The Company holds provisions for contractual costs that it expects to incur over an extended period. These costs are based on past experience of similar items and represent management's best estimate of the likely outcome, but the timing and amount of the outflows could differ significantly from management's estimates. The Company expects these provisions to be utilised over a period of approximately 25 years.

8. Post-employment benefits

The Company participates in all of the Group's UK pension schemes. Regular contributions to the schemes are made in line with the schedule of contributions and a share of deficit funding is allocated to participating employers. The deficit allocation methodology is based on the relative payroll contributions of active members. Full disclosures relating to these schemes are given in note 25 to the Group accounts.

Amounts recognised on the balance sheet

The table below shows the Company's share of the Group's UK pension schemes after allocation to other participating employers.

	2022 £m	2021 £m
Present value of unfunded obligations	**(75)**	(108)
Present value of funded obligations	**(1,676)**	(2,699)
Fair value of scheme assets	**1,933**	2,670
Total net IAS 19 surplus/(deficit)	**182**	(137)
Withholding tax on surpluses	**(90)**	–
Company's share of net IAS 19 surplus/(deficit)	**92**	(137)
Represented by:		
Post-employment benefit surpluses	**167**	151
Post-employment benefit obligations	**(75)**	(288)
	92	(137)

Surplus recognition

A number of schemes are in an accounting surplus position. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Company, which is assumed to be via a refund. These have been recognised after deducting a 35% withholding tax which would be levied prior to the future refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the Company.

9. Share capital and other reserves

Share capital and equity dividends

Disclosures in respect of the Company's share capital and on equity dividends are provided in note 27 to the Group accounts.

Other reserves

	Statutory reserve £m	Capital redemption reserve £m	Hedging reserve £m	Total £m
At 1 January 2021	202	3	(1)	204
Shares cancelled	–	2	–	2
At 31 December 2021	202	5	(1)	206
Amounts credited to hedging reserve	–	–	9	9
Shares cancelled	–	3	–	3
At 31 December 2022	**202**	**8**	**8**	**218**

Statutory reserve

Under Section 4 of the British Aerospace Act 1980, this reserve may only be applied in paying up unissued shares of the Company to be allotted to members of the Company as fully paid bonus shares.

Capital redemption reserve

The capital redemption reserve represents the cumulative nominal value of the Company's ordinary shares repurchased and subsequently cancelled.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

9. Share capital and other reserves continued

Purchase of own shares

2021 buyback

On 29 July 2021, the Company announced the details of a share buyback programme to repurchase up to £500m of its own shares over the following 12 months.

As part of the buyback programme, it was agreed that should a better alternative use for the Company's cash reserves be identified, the share buyback programme would be ceased, and the money instead used for the alternative purpose. Therefore, when the Company issued a mandate to the brokers to purchase shares on their behalf, the mandates were structured such that they could be revoked at any point. As such, no financial liability was recognised for shares not yet purchased under the programme.

During 2021, 63,272,873 shares were repurchased for a total price, including transaction costs, of £371m. These shares have been subsequently cancelled, with the nominal value of shares cancelled deducted from share capital against the capital redemption reserve.

The 2021 share buyback programme was completed on 2 February 2022. During 2022, a further 24,253,065 shares were repurchased for a total price, including transaction costs, of £132m. In total 87,525,938 shares were repurchased under the scheme for a total price, including transaction costs, of £503m.

2022 buyback

In July 2022, the directors also approved a new share buyback programme of up to £1.5bn over the next three years under the same terms as the 2021 buyback programme. At 31 December 2022, 82,997,065 shares were repurchased for a total price, including transaction costs, of £664m. These shares have been subsequently cancelled, with the nominal value of shares cancelled deducted from share capital against the capital redemption reserve.

10. Share-based payments

Options over shares of the Company have been granted to employees of the Company under various plans. Details of the terms and conditions of each share-based payment plan are given in the Annual remuneration report on pages 160 to 205.

	2022		2021	
	Range of exercise price of outstanding options £	**Weighted average remaining contracted life Years**	Range of exercise price of outstanding options £	Weighted average remaining contracted life Years
Executive Share Option Plan (ExSOP)	**4.12 – 7.83**	**8**	3.01 – 6.49	7
Performance Share Plan (PSP)	**–**	**5**	–	5
Restricted Share Plan (RSP)	**–**	**5**	–	6

The average share price in the year was £7.53 (2021 £5.33).

11. Employees

The average and year-end numbers of employees of the Company at 31 December 2022 was 1,938 (2021 1,718) and 2,119 (2021 1,786) respectively. All of the Company's employees work within the Group's HQ segment.

Total staff costs, excluding charges for share-based payments, were as follows:

	2022 £m	2021 £m
Wages and salaries	**133**	126
Social security costs	**18**	15
Pension costs – defined contribution plans	**7**	2
Pension costs – defined benefit plans	**23**	28
	181	171

12. Other information

Company audit fee

Fees payable to the Company's auditor for the audit of the Company's annual accounts totalled £2,963,000 (2021 £2,349,000). Fees payable to Deloitte LLP and its associates for non-audit services to the Company are not required to be disclosed because the Group accounts disclose such fees on a consolidated basis (see note 2 to the Group accounts).

Related party transactions

Disclosures in respect of related party transactions are provided in note 33 to the Group accounts.

Directors' emoluments

Under Schedule 5 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (Schedule 5), total directors' emoluments, excluding Company pension contributions, were £10,064,679 (2021 £9,370,074); these amounts are calculated on a different basis to emoluments in the Annual remuneration report which are calculated under Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (Schedule 8). These emoluments were paid for their services on behalf of the BAE Systems Group. No emoluments related specifically to their work for the Company. Under Schedule 5, the aggregate gains made by the directors from the exercise of share options in 2022 as at the date of exercise was £1,676,502 (2021 £257,493) and the net aggregate value of assets received by directors in 2022 from Long-Term Incentive Plans as calculated at the date of vesting was £5,073,406 (2021 £1,467,959); these amounts are calculated on a different basis from the valuation of share plan benefits under Schedule 8 in the Annual remuneration report. Retirement benefits are accruing to one director in respect of defined benefit schemes and to three directors in respect of defined contribution schemes.

Company guaranteed borrowings

Borrowings by subsidiary undertakings totalling £2,147m (2021 £1,928m), which are included in the Group's borrowings, have been guaranteed by the Company, with the guarantees measured initially at their fair values, and subsequently measured at the higher of the expected credit loss determined under IFRS 9 Financial Instruments and the amount initially recognised less cumulative amortisation.

Information about related undertakings

In accordance with Section 409 of the Companies Act 2006, a full list of the Company's subsidiaries and significant holdings is included in note 37 to the Group accounts.

13. Events after the reporting period

There were no events after the reporting period which would materially impact the balances reported in this Annual Report.

Financial glossary

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

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

Financial performance measures defined by the Group

Measure	Purpose	Definition	Closest IFRS measure and reconciliation
Sales	Enables management to monitor the revenue of both the Group's own subsidiaries as well as its strategically important equity accounted investments, to ensure programme performance is understood and in line with expectations.	Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.	Page 84 Revenue
Underlying EBIT	Provides a measure of operating profitability, excluding one-off events or adjusting items that are not considered to be part of the ongoing operational transactions of the business, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.	Operating profit excluding amortisation of programme, customer-related and other intangible assets (see note 8), impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBIT) and adjusting items[1]. The exclusion of amortisation of acquisition-related intangible assets is to allow consistent comparability internally and externally between our businesses, regardless of whether they have been grown organically or via acquisition.	Page 84 Operating profit
Return on sales	Provides a measure of operating profitability, excluding one-off events, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.	Underlying EBIT as a percentage of sales. Also referred to as margin.	Page 84 Return on revenue
Underlying earnings per share	Provides a measure of the Group's underlying performance, which enables management to compare the profitability of the Group's recurring operations over time.	Profit for the year attributable to shareholders, excluding post-tax impact of amortisation of programme, customer-related and other intangible assets, impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and adjusting items[1] attributable to shareholders, being underlying earnings, divided by number of shares as defined for Basic EPS in accordance with IAS 33 Earnings per Share.	Page 85 Basic earnings per share
Underlying interest expense	Provides a measure of finance costs associated with the operational borrowings of the Group that is comparable over time.	Net finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.	Page 238 Net finance costs
Underlying effective tax rate	Provides a measure of taxation for the Group, excluding one-off items, that is comparable over time.	Taxation expense for the Group and its share of equity accounted investments, excluding any one-off tax benefit/expense, as a percentage of adjusted profit before taxation, being Profit before tax plus taxation expense of equity accounted investments, adjusted for adjusting items[1].	Page 240 Taxation expense

Financial performance measures defined by the Group continued

Measure	Purpose	Definition	Closest IFRS measure and reconciliation
Operating business cash flow	Provides a measure of cash generated by the Group's operations, to service debt and meet tax obligations, and in turn available for use in line with the Group's capital allocation policy.	Net cash flow from operating activities excluding taxation and including net capital expenditure (net of proceeds from funding of assets) and lease principal amounts, financial investment and dividends from equity accounted investments.	Page 86 Net cash flow from operating activities
Free cash flow	Provides a measure of cash generated by the Group's operations after servicing debt and tax obligations, available for use in line with the Group's capital allocation policy.	Operating business cash flow less interest paid (net) and taxation.	Page 86 Net cash flow from operating activities
Net debt (excluding lease liabilities)	Allows management to monitor indebtedness of the Group, to ensure the Group's capital structure is appropriate and capital allocation policy decisions are suitably informed.	Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments). Net debt does not include lease liabilities.	n/a
Order intake	Allows management to monitor the order intake of the Group's own subsidiaries as well as its strategically important equity accounted investments, providing insight into future years' sales performance.	Funded orders received from customers including the Group's share of order intake of equity accounted investments.	n/a
Order backlog	Supports future years' sales performance of subsidiaries and equity accounted investments.	Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.	Page 234 Order book

Financial performance measures derived from IFRS

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

1. Adjusting items are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying business performance. Adjusting items were referred to as non-recurring items in the prior year. No change has been made to the definition of these items, but the name has been changed to reflect that some items could be considered recurring in nature. The Group's definition of adjusting items includes profit or loss on business transactions, the impact of substantively enacted tax rate changes, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-retirement benefit schemes, and other items which management has determined as not being relevant to an understanding of the Group's underlying business performance. Note 1 to the Group accounts includes more information on those items reported as adjusting in the year.

Shareholder information

Registered office

6 Carlton Gardens
London
SW1Y 5AD
United Kingdom

Telephone: +44 (0)1252 373232

Company website: **baesystems.com**

Registered in England and Wales, No. 1470151

Registrars

Equiniti Limited (0140)
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

If you have any queries regarding your shareholding or need to notify any changes to your personal details, please contact Equiniti.

Equiniti's website (**help.shareview.co.uk**) includes a comprehensive set of answers to many frequently asked questions relating to managing a shareholding. If you cannot find the answer to your question, there is an online email form, which will help to ensure your question is directed to the most appropriate team for a response. Alternatively, you can call the BAE Systems Helpline on 0371 384 2044 or, from outside the UK, +44 121 415 7058. Lines are open from 8.30am to 5.30pm Monday to Friday, excluding UK bank holidays.

In addition, the following services are offered to shareholders:

- **Shareview** – online access to your shareholding, including balance movements, indicative share prices and information on recent payments
- **Dividend mandates** – have your dividends paid directly into either your UK bank/building society account or an overseas bank account
- **Dividend reinvestment plan (DRIP)** – have your dividend reinvested in shares purchased on the stock market

More information on all these services can be found on Equiniti's website (**shareview.co.uk**).

American Depositary Receipts

BAE Systems plc American Depositary Receipts (ADRs) are traded on the over-the-counter market under the symbol BAESY. One ADR represents four BAE Systems plc ordinary shares.

JP Morgan Chase Bank N.A. is the depositary. If you should have any queries please contact:

JP Morgan Chase Bank N.A.
PO Box 64504
St Paul
MN 55164-0504, USA

Email: **jpmorgan.adr@eq-us.com**

Telephone (toll free from within US and Canada): +1 800 990 1135

Telephone from outside US and Canada: +1 651 453 2128

ShareGift

ShareGift, the share donation charity (registered charity number 1052686), accepts donations of small parcels of shares which may be uneconomic to sell. Details of the scheme are available from ShareGift at **sharegift.org**, by telephone on 020 7930 3737 or by email: **help@sharegift.org**

Share price information

The middle market price of the Company's ordinary shares on 31 December 2022 was 856p and the range during the year was 547p to 867p.

For more information

Visit the Shareholder information section of our website: **investors.baesystems.com**

Financial calendar

Financial year end	31 December
Annual General Meeting	4 May 2023
2022 final ordinary dividend payable	1 June 2023
2023 half-yearly results announcement	2 August 2023
2023 interim ordinary dividend payable	30 November 2023
2023 full-year results:	
– preliminary announcement	February 2024
– Annual Report	March 2024
2023 final ordinary dividend payable	June 2024

Beware of share fraud

Investment scams are often sophisticated and difficult to spot.

Spot the warning signs

Fraudsters will often:

– contact you out of the blue;
– apply pressure to invest quickly;
– downplay the risks to your money;
– promise tempting returns that sound too good to be true; and
– say that they're only making the offer available to you or even ask you to not tell anyone else about it.

If you're suspicious, report it

You can report the firm or scam to the FCA by contacting their **Consumer Helpline** on **0800 111 6768** or using the reporting form using the link shown below.

If you've lost money in a scam, contact Action Fraud on **0300 123 2040** or **www.actionfraud.police.uk**

How to avoid investment scams

Reject unexpected offers

Scammers usually cold call, but contact can also come by email, post, word of mouth or at a seminar. If you've been offered an investment out of the blue, chances are it's a high-risk investment or a scam.

Check the FCA Warning List

Use the FCA Warning List to check the risks of a potential investment – you can also search to see if the firm is known to be operating without its authorisation.

Get impartial advice

Get impartial advice before investing – don't use an adviser from the firm that contacted you.

Be ScamSmart and visit
www.fca.org.uk/scamsmart

FSC
www.fsc.org
RECYCLED
Paper made from recycled material
FSC® C001785

Carbon neutral
Print product
ClimatePartner.com/13766-2211-1007

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Park works to the EMAS standard and its Environmental Management System is certified to ISO 14001.

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This document is printed on material containing 100% recycled fibre.

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Designed and produced by Radley Yeldar.

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