

# **BAE Systems Global Combat Systems Munitions Limited**

## **Annual Report and Financial Statements**

**31 December 2019**

Registered number: 01842252



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**BAE Systems Global Combat Systems Munitions Limited**  
**Annual Report and Financial Statements**  
**31 December 2019**

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## **Strategic Report**

for the year ended 31 December 2019

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### **Review of business and principal activities**

The principal activities of BAE Systems Global Combat Systems Munitions Limited (the "Company") are the design, development, manufacture and supply of a wide range of defence systems, sub systems and components.

The Company is a wholly owned subsidiary of BAE Systems (Holdings) Limited. The main activity of the Company is the supply of small, medium and large calibre munitions to the UK Ministry of Defence ("MoD"). The Company has a strong order book which includes a 15 year contract with UK MoD for the delivery of munitions capability and the supply of a range of munitions. This contract was awarded in 2008 with the final 5 year price being agreed in 2016. The Company is working with the UK Ministry of Defence to agree a replacement to the existing Munitions Acquisition Supply Solution partnering agreement. The Company also continues to have contracts with other 3rd parties. During the year the Company adopted IFRS 16 and as such now recognises a right-of-use asset of £101m and an associated lease liability of £103m. It also acquired an investment from another BAE subsidiary for £15M, CTAI International SAS.

The Company's profit for the financial year is £18,792k (2018 £14,410k profit).

During the year, a prior period restatement was identified in relation to RO Maschinen und Anlagenbau, ROMA creditor. It was identified that ROMA was liquidated in 2014 and therefore the 2018 balance sheet has been restated.

The future potential impact of the COVID-19 pandemic on the Company is not yet known but may be significant. While the Company cannot currently quantify what the effects might be, it continues to monitor the pandemic and its impact, to ensure appropriate actions can be taken to mitigate risks to the Company.

### **Key performance indicators**

Key financial performance indicators are shown below:

	<b>2019</b>	<b>2018</b>
	<b>£000</b>	<b>£000</b>
Order intake	<b>222,000</b>	206,000
Revenue	<b>209,579</b>	192,876
Profit before tax	<b>23,070</b>	12,213
Return on sales	<b>11%</b>	6%

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

**Revenue** represents the amounts derived from the provision of goods and services.

**Profit before tax** is used for internal performance analysis as a measure of operating profitability that is comparable over time.

**Return on sales** this shows the percentage of profit before tax as a function of sales.

**Strategic Report (continued)**  
for the year ended 31 December 2019

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**Principal risks and uncertainties**

The Company's principal risks are identified below.

*UK defence sector spending*

The 2015 UK Strategic Defence and Security Review provided additional clarity regarding future Army programmes and we believe that our advanced planning work with the UK Ministry of Defence will generate revenues that remain in line with the overall business plan.

The UK government has stated its commitment to meeting the NATO target of spending at least 2% of Gross Domestic Product on defence and to increasing the defence budget by at least 0.5% above inflation, in every year of the current parliament. The government is expected to recommence an Integrated Foreign Policy, Defence and Security Review later this year after it was paused owing to COVID19.

*Terms of trade*

The Company has long-standing relationships and security arrangements with the government of the UK and its agencies. It is important that these relationships and arrangements are maintained.

In the defence and security industries, governments can typically modify contracts or terminate them at short notice. 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 terms of the UK's relationship with the EU after the end of the Transition Period are currently uncertain, rendering it difficult for the Company to prepare in detail for the changes in the regulatory environment that are likely to apply beyond the Transition Phase.

*Delivery risk*

Undertaking work within our core competencies and skills built on many years' experience in this market reduces the overall execution risks. However, although most risks are negligible, the high technical requirements within our development contracts need careful management to minimise the inherent risks in that aspect of our work.

**The outbreak of contagious diseases may have an adverse effect on the Company's business, financial condition and results of operations**

Contagious diseases can have an adverse effect on the Company's business, financial condition and results of operations. There is currently a COVID-19 coronavirus pandemic across the world. Governments are taking a number of steps to mitigate the impact of this pandemic, including implementing quarantines. Many people have contracted the disease across the world and many deaths have occurred. It is not clear for how long this pandemic will last or how much more extensive it will become, or the further measures that will be taken by governments and others to seek to control this pandemic and its impact.

Since the outbreak of the COVID-19 coronavirus pandemic, the Company has taken a number of responsive measures including reducing site operational levels and introducing new cleaning regimes, safe working distance measures and protective equipment for its employees. A significant proportion of the Company's employees are working from home. While the Company is liaising closely with its customers and suppliers to understand any changes in requirements and priorities during this time, the uncertainties surrounding the development of this pandemic make it difficult to predict the extent to which the Company may be affected.

**Strategic Report (continued)**  
for the year ended 31 December 2019

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The COVID-19 coronavirus pandemic could also result in changes to the outlook in the Company's markets. Areas of the Company's business that could be impacted include a decrease in defence spending by the Company's major customers (primarily the UK Ministry of Defence), the failure to obtain awards for defence contracts, the failure of suppliers to deliver parts to the Company, the requirement for the Company or its suppliers to close plants, the inability of the Company 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 Company 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 Company's business, financial condition and results of operations.

**Section 172(1) Statement**

This Statement contains an overview of how the directors have performed their duty to promote the success of the Company as set out in section 172(1) of the UK's Companies Act 2006. That section requires a director of a company to act in the way he or she considers, in good faith, would most likely promote the success of the company for the benefit of its shareholders. In doing this, the director must have regard, amongst other matters, to:

- 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.

**Decision Making**

The Operational Framework sets out the principles of good governance to which BAE Systems group subsidiaries are required to adhere, together with BAE Systems group's values, policies and processes as described on (pages 84-85) of BAE Systems plc's Annual Report 2019. Decisions affecting a subsidiary are required to be taken in line with the Operational Framework, including in accordance with applicable delegations of authority.

Pursuant to the Operational Framework, BAE Systems' businesses each produce a strategic plan, a financial forecast for the current year and financial projections for the next five years. The Directors of the Company contribute towards this process for the business of the Company and are also responsible for identifying and managing principal and emerging risks in the business. In so doing the Directors have regard to a variety of matters including the interests of various stakeholders, the consequences of their decisions in the long term and the long-term reputation of the Company and its businesses.

**Employees**

Employee engagement is a primary focus for the Directors of the Company, connecting employees to the Company's and the BAE Systems Group's strategy and purpose, empowering them to contribute to improving business performance, creating an environment in which everyone can fulfil their potential. The Directors of the Company keep the Company's employees informed about what is happening across the BAE Systems Group through the group's intranet and email, podcasts, newsletters, and leadership blogs and briefings.

These engagement activities form part of the Company's implementation of the BAE Systems group-wide employee engagement processes and policies which are described on (pages 35-36, 83, 95-98 and 116) of BAE Systems plc's Annual report 2019 (available at: [www.baesystems.com/investors](http://www.baesystems.com/investors)).

**Strategic Report (continued)**  
for the year ended 31 December 2019

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Pursuant to the Group's People Policy, Directors and employees are required to contribute to creating an engaged and inclusive work environment, where individuals are respected and where the value of a diverse workforce is recognised. Also, pursuant to the Policy, employees are to be provided with the means to give their views and feedback. Through the implementation by the Company of these processes and policies, the Directors have regard to the interests of the Company's employees.

**Fostering Business Relationships with Suppliers, Customers and Others**

The Directors recognise that fostering business relationships with key stakeholders, such as customers and suppliers, is essential to the Company's success. The Company has close relationships with its customers, suppliers and industry partners which help us to create best-in-class, cost-effective equipment, goods, services and solutions.

Our largest customers are governments and we also sell to large prime contractors and commercial businesses. Strong and collaborative relationships with our principal government and prime contractors help us to identify our customers' requirements and to help position the Company as a trusted provider. The Directors are in regular contact with the principal government customers of the Company and in particular the UK Ministry of Defence.

The Company, together with its procurement and supply chain function, works with its suppliers and their supply chains to provide equipment, goods and services that meet its customers' requirements. The Company's supplier relationships are often long-term and the Directors meet with key suppliers and work with the BAE Systems group's procurement function to develop deeper relationships with business in the supply chain and develop strategic relationships with key suppliers.

**The Community and the Environment**

The Directors recognise the importance of leading a company that not only generates value for shareholders but also contributes to wider society. Through the Operational Framework the Company implements the requirements of the BAE Systems group's Community Investment Policy, which looks to ensure that we build and nurture mutually beneficial relationships between our business, our people and local stakeholders. Giving back to the communities in which we operate, and to charities that have meaning to our business, is vitally important to our Company and our employees, allowing us to make a positive difference and have an impact where it counts. In particular, the Company is a major employer in Glascoed and the Directors recognise the significance of the Company in the local community.

As a manufacturer, we recognise that our operations have an impact on the environment – from the energy and resources we use, to the products we manufacture and the waste that we generate. As an organisation, the BAE Systems group is committed to reducing the environmental impact of its operations and products, minimising its environmental footprint and, in turn, decreasing operational costs. Through the Operational Framework the Company implements the requirements of the BAE Systems group's Environmental Policy, which details our commitment to high standards of environmental management.

These activities form part of the Company's implementation of the BAE Systems group-wide community and environment processes and policies and the BAE Systems group's impacts thereon which are described in the Environment and climate change and Fostering strong community partnerships sections (pages 40-42) of BAE Systems plc's Annual report 2019 (available at: [www.baesystems.com/investors](http://www.baesystems.com/investors)).

**Maintaining a reputation for high standards of business conduct**

The BAE Systems Group aims to be a recognised leader in business conduct which helps us to earn and maintain stakeholder trust and sustain business success. The Directors consider it fundamental to maintain a culture focused on embedding responsible business behaviours. All employees of the Company are expected to act in accordance with the requirements of BAE Systems Group policies, including the Code of Conduct, at all times. As well as being the right thing to do, this reduces the risk of compliance failure and supports us in attracting and retaining high-calibre employees.

Detailed information on the BAE Systems Group-wide business conduct processes and policies are described in

**Strategic Report (continued)**  
for the year ended 31 December 2019

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BAE Systems plc's annual report 2019 (available at: [www.baesystems.com/investors](http://www.baesystems.com/investors)) and in particular the Ethics and business conduct section on pages (38-39).

**Approved by the Board and signed on its behalf by**



**A R Collins**  
Director

Date 22nd June 2020

## **Directors' Report**

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### **Company registration**

BAE Systems Global Combat Systems Munitions Limited (the "Company") is a private company, limited by shares and registered in England and Wales with the registered number 01842252.

### **Results and dividends**

The Company's profit for the financial year is £18,792k (2018 £14,410k profit). The directors propose a dividend of £20,000k (2018 £nil).

### **Looking forward**

The Company is working with the UK Ministry of Defence to agree a replacement to the existing Munitions Acquisition Supply Solution partnering agreement.

The future potential impact of the COVID-19 pandemic on the Company is not yet known but may be significant. While the Company cannot currently quantify what the effects might be, it continues to monitor the pandemic and its impact, to ensure appropriate actions can be taken to mitigate risks to the Company.

### **Going concern**

After making due enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue operational existence for at least 12 months from the date of approval of the financial statements. For this reason they continue to adopt the going concern basis in preparing the financial statements. While there remains significant uncertainty as to the future impact of the COVID-19 pandemic, the Company and its ultimate parent entity BAE Systems plc continue to conduct ongoing risk assessments of the potential impact of the pandemic on its business operations and liquidity. The impact on the Company to date is set out in note 26. Having undertaken these assessments, the directors consider that the Company will be able to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

### **Employees**

The Company is committed to giving full and fair consideration to applications for employment from disabled people who meet the requirements for roles, and making available training opportunities and appropriate accommodation to disabled people employed by the Company. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Company continues and that appropriate training is arranged.

Employee engagement enables our employees to contribute to improving business performance and helps us to gauge our performance in creating an environment in which everyone can fulfil their potential.

More information on employee engagement is given on page 3 of the Strategic Report.

The Company welcomes employees becoming shareholders in BAE Systems plc and BAE Systems plc offers employee share plans to support this.

### **Engagement with suppliers, customers and others**

Engagement with suppliers, customers and others has been considered within the Strategic Report on page 4.

### **Research and development**

The Company is focused on technology innovation and engineering excellence and invests in next-generation research and technology programmes to improve the manufacturing and service of products, generating substantial intellectual property. Total research and development expenditure in the year was £2,900k (2018 £1,900k), of which £900k (2018 £700k) was funded by the Company.



**Directors' Report (continued)**

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**Financial instruments**

The international nature of the Company's business means it is exposed to volatility in currency exchange rates. In order to protect itself against currency fluctuations, the Company's policy is to hedge all material firm transactional exposures.

**Qualifying Indemnity Provisions**

The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan 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 and the Alvis Pension Scheme, respectively, given by the Company, which are qualifying indemnity provisions for the purpose of the Companies Act 2006. All such indemnity provisions are in force at the date of this Directors' Report. There were no other qualifying indemnity provisions to disclose.

**Directors and their interests**

The directors who served throughout the year and up to the date of this report, unless otherwise stated, were as follows:

A R Collins  
J B Osbaldestin (resigned 06 April 2020)  
G E P Plant (appointed 06 April 2020)

The Board is not aware of any contract of significance in relation to the Company in which any director has, or has had, a material interest.

**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 they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

**Auditor**

The auditor, Deloitte LLP, has indicated its willingness to continue in office and, in accordance with Section 487(2) of the Companies Act 2006, has been re-appointed.

**Approved by the Board and signed on its behalf by**



**A R Collins**  
Director

Date 22nd June 2020

Registered office:  
BAE Systems Global Combat Systems Munitions Limited  
Warwick House  
PO Box 87  
Farnborough Aerospace Centre  
Hampshire  
GU14 6YU  
United Kingdom

## **Directors' Responsibilities Statement**

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The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 101 (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 Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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## **Independent Auditor's Report to the Members of BAE Systems Global Combat Systems Munitions Limited**

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### **Report on the audit of the financial statements**

#### **Opinion**

In our opinion the financial statements of BAE Systems Global Combat Systems Munitions Limited (the "Company"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Income Statement;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity;
- the related notes 1 to 28.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

#### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the 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, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### **Conclusions relating to going concern**

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

#### **Other information**

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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## **Independent Auditor's Report to the Members of BAE Systems Global Combat Systems Munitions Limited (continued)**

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In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

### **Responsibilities of directors**

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the 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 Company or to cease operations, or have no realistic alternative but to do so.

### **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

### **Report on other legal and regulatory requirements**

#### **Opinions on other matters prescribed by 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 Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report and the directors' report.

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**Independent Auditor's Report to the Members of BAE Systems Global Combat Systems Munitions Limited (continued)**

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**Matters on which we are required to report by exception**

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.
- the directors were not entitled to take advantage of the small companies' exemption in preparing the directors' report and from the requirement to prepare a strategic report.

We have nothing to report in respect of these matters.

**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.



Douglas King ACA (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

2 Hardman Street  
Manchester  
M3 3HF

Date: 22nd June 2020

**BAE Systems Global Combat Systems Munitions Limited**  
**Annual Report and Financial Statements**  
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**Income Statement**  
for the year ended 31 December 2019

	Note	2019 £000	2018 £000
<b>Revenue</b>	3	<b>209,579</b>	192,876
Operating costs	4	<b>(193,304)</b>	(183,086)
Other income	5	<b>4,525</b>	2,153
<b>Operating profit</b>		<b>20,800</b>	11,943
Income from investments	6	<b>2,335</b>	186
Financial income	7	<b>3,949</b>	1,600
Financial expense	8	<b>(4,014)</b>	(1,516)
<b>Profit before tax</b>		<b>23,070</b>	12,213
Tax	11	<b>(4,278)</b>	2,197
<b>Profit for the financial year</b>		<b>18,792</b>	14,410

**BAE Systems Global Combat Systems Munitions Limited**  
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**Statement of Comprehensive Income**  
for the year ended 31 December 2019

	Note	2019 £000	2018 £000
Profit for the financial year		18,792	14,410
<b>Items that will not be reclassified to the income statement:</b>			
Remeasurements on retirement benefit schemes	20	(1,800)	(21,400)
Tax on items that will not be reclassified to the income statement	11	336	3,638
<b>Items that may be reclassified to income statement:</b>			
Amounts (charged)/credited to hedging reserve	22	(744)	779
Tax on items that may be reclassified to the income statement	22	126	(132)
<b>Total comprehensive income for the year</b>		<b>16,710</b>	<b>(2,705)</b>

The notes on pages 17 to 59 form part of these financial statements.

The results for 2019 and 2018 arise from continuing activities.

**BAE Systems Global Combat Systems Munitions Limited**  
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**Balance Sheet**  
as at 31 December 2019

	Note	2019 £000	Restated 2018* £000
<b>Non-current assets</b>			
Property, plant and equipment	12	87,814	93,412
Right-of-use assets	19	101,258	-
Investments	13	15,149	-
Other financial assets	18	762	-
Retirement benefit surpluses	20	107,400	92,800
		<u>312,383</u>	<u>186,212</u>
<b>Current assets</b>			
Inventories	15	25,990	19,006
Trade, other and contract receivables	16	218,235	211,283
Other financial assets	18	1,317	429
Cash and cash equivalents		-	3
		<u>245,542</u>	<u>230,721</u>
<b>Total assets</b>		<u>557,925</u>	<u>416,933</u>



**BAE Systems Global Combat Systems Munitions Limited**  
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**Balance Sheet (continued)**  
as at 31 December 2019

	Note	2019 £000	Restated 2018* £000
<b>Non-current liabilities</b>			
Lease liabilities	19	(98,556)	-
Other financial liabilities	18	(898)	(188)
Retirement benefit obligations	20	(55,900)	(43,400)
Provisions	21	(2,277)	(1,051)
Deferred tax liabilities	14	(13,576)	(13,827)
		<u>(171,207)</u>	<u>(58,466)</u>
<b>Current liabilities</b>			
Trade and other payables	17	(288,011)	(286,277)
Lease liabilities	19	(3,945)	-
Other financial liabilities	18	(2,272)	(588)
Provisions	21	(3,832)	(4,475)
Current tax		(3,751)	-
		<u>(301,811)</u>	<u>(291,340)</u>
<b>Total liabilities</b>		<u>(473,018)</u>	<u>(349,806)</u>
<b>Net assets</b>		<u><u>84,907</u></u>	<u><u>67,127</u></u>
<b>Capital and reserves</b>			
Issued share capital	22	50,000	50,000
Other reserves	22	(1,229)	(611)
Retained earnings		36,136	17,738
<b>Total equity</b>		<u><u>84,907</u></u>	<u><u>67,127</u></u>

Approved by the Board on 22nd June 2020 and signed on its behalf by



A R Collins  
Director

Registered number: 01842252

\*The effects of the prior period restatement are summarised in note 27.

**BAE Systems Global Combat Systems Munitions Limited**  
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**Statement of Changes in Equity**  
for the year ended 31 December 2019

	<b>Issued share capital £000</b>	<b>Other reserves £000</b>	<b>Retained earnings £000</b>	<b>Total equity £000</b>
At 1 January 2018	50,000	(1,258)	40,080	88,822
Prior year adjustment (note 27)	-	-	5,000	5,000
<b>At 1 January 2018 (as restated)</b>	<b>50,000</b>	<b>(1,258)</b>	<b>45,080</b>	<b>93,822</b>
Profit for the year	-	-	14,410	14,410
Other comprehensive income	-	779	(21,400)	(20,621)
Taxation in respect of items of other comprehensive income	-	(132)	3,638	3,506
Dividends	-	-	(25,000)	(25,000)
Share-based payments	-	-	1,010	1,010
<b>At 31 December 2018 (as restated)</b>	<b>50,000</b>	<b>(611)</b>	<b>17,738</b>	<b>67,127</b>
Profit for the year	-	-	18,792	18,792
Other comprehensive expense	-	(744)	(1,800)	(2,544)
Taxation in respect of items of other comprehensive income	-	126	336	462
Share-based payments	-	-	1,070	1,070
<b>At 31 December 2019</b>	<b>50,000</b>	<b>(1,229)</b>	<b>36,136</b>	<b>84,907</b>

## **Notes to the Financial Statements**

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### **1. General information**

BAE Systems Global Combat Systems Munitions Limited (the "Company") is a private company, limited by shares, and registered in England and Wales and incorporated in the United Kingdom. Its ultimate controlling party is BAE Systems plc. The address of the Company's registered office is shown on page 7.

The principal activity of the Company is set out in the Strategic Report on page 1. These financial statements, which have been prepared in accordance with the Companies Act 2006, are presented in pounds sterling and, unless otherwise stated, rounded to the nearest thousand.

### **2. Accounting policies**

#### **2.1 Basis of preparation**

These financial statements have been prepared in accordance with Financial Reporting Standard 101 (FRS 101) "Reduced Disclosure Framework". The Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (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 IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91-99 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 requirements of paragraph 52, the second sentence of paragraph 89, and paragraphs 90, 91 and 93 of IFRS 16 Leases. The requirements of paragraph 58 of IFRS 16, provided that the disclosure of details in indebtedness relating to amounts payable after 5 years required by company law is presented separately for lease liabilities and other liabilities, and in total;
- 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 paragraph 17 and 18A of IAS 24 Related Party Disclosures;

## Notes to the Financial Statements

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### 2. Accounting policies (continued)

#### 2.1 Basis of preparation (continued)

- 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)-134(f) and 135(c)-135(e) of IAS 36 Impairment of Assets.

The Company intends to continue to prepare its financial statements in accordance with FRS 101.

The Company is exempt under section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its ultimate parent, BAE Systems plc, a Company registered in England and Wales. Accordingly, these financial statements present information about the Company as an individual undertaking and not as a group.

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).

#### **Critical accounting judgements**

Certain of the Company's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the financial statements. The critical accounting policies are listed below:

Critical accounting judgement	Description
Valuation of retirement benefit obligations	Defined benefit pension scheme accounting valuations are prepared by independent actuaries. The liabilities of the pension schemes are valued based on a number of actuarial assumptions. For each of the actuarial assumptions used there is a range of possible values and management estimates the point within that range that most appropriately reflects the Company's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.
Right-of-use assets valuation	The carrying value of the Company's Right-of-use assets are reviewed at each Balance Sheet date to determine whether there is any indication of impairment as required by IAS 36 Impairment of Assets.

#### **Judgements made in applying accounting policies**

In the course of preparing the financial statements, no judgements have been made in the process of applying the Company's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

## **Notes to the Financial Statements**

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### **2. Accounting policies (continued)**

#### **2.1 Basis of preparation (continued)**

##### **Key sources of estimation uncertainty**

The application of the Company's accounting policies requires the use of estimates. In the event that these estimates prove to be incorrect, there may be an adjustment to the carrying amounts of assets and liabilities within the next financial year.

##### **Changes in accounting policies**

IFRS 16 Leases became effective on 1 January 2019. The impact of adoption is set out in note 19.

Several other standards, interpretations and amendments to existing standards became effective on 1 January 2019, none of which had a material impact on the Company.

##### **Significant accounting policies**

The significant accounting policies applied in the preparation of these financial statements are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated. The directors believe that the financial statements reflect appropriate judgements and estimates, and provide a true and fair view of the Company's financial performance and position.

The significant estimates in relation to the Company's critical accounting policies are set out above.

The following paragraphs summarise the main accounting policies of the Company and have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

#### **2.2 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 Company to customers in exchange for consideration in the ordinary course of the Company's activities.

##### *Performance obligations*

Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract. The Company 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.

## Notes to the Financial Statements

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### 2. Accounting policies (continued)

#### 2.2 Revenue and profit recognition (continued)

##### *Transaction price*

At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Company'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 Company's pricing principles. Whilst payment terms vary from contract to contract, on many of the Company's contracts, an element of the transaction price is received in advance of delivery. The Company therefore has significant contract liabilities. The Company'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 either as a result of UK Ministry of Defence contracting rules which prohibit the inclusion of financing in the sales price or negotiations on competitive international export contracts which 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 Company 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 Company's performance as it performs;
- Company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Company's performance does not create an asset with an alternative use to the Company and it has an enforceable right to payment for performance completed to date.

The Company 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 Company's performance as it performs (typically services or support contracts) or the Company's performance does not create an asset with an alternative use to the Company and it has an enforceable right to payment for performance completed to date (typically development or production contracts).

For each performance obligation to be recognised over time, the Company 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 Company has determined that this method faithfully depicts the Company's performance in transferring control of the goods and services to the customer.

If the over-time criteria for revenue recognition are not met, revenue is recognised at the point in time that

## Notes to the Financial Statements

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### 2. Accounting policies (continued)

#### 2.2 Revenue and profit recognition (continued)

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.

##### *Outstanding commitments*

The Company regularly reviews outstanding commitment for purchases in its supply chain in order to inform revenue recognition under IFRS15 trading principles. Where the Company has received notification that the supplier has completed the manufacture of goods, but has not yet delivered and invoiced for them and the ultimate customer controls the asset, i.e. neither the subcontractor or the Company have an alternative use for the asset, the Company will accrue for these costs and recognise revenue in line with overtime trading principles under IFRS15.

##### *Contract modifications*

The Company'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 Company'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; or
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 Company'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 Company expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Company 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.

## **Notes to the Financial Statements**

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### **2. Accounting policies (continued)**

#### **2.3 Leases**

##### *The Company as lessee*

All leases in which the Company 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 Company. 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 Company's incremental borrowing rate is used, which is the interest rate the Company 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 and any initial direct costs.

The carrying amounts of the Company's right-of-use assets are reviewed at each balance sheet date to determine whether there is any indication of impairment.

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.

Comparative amounts for the year ended 31 December 2018 have not been restated on adoption of IFRS 16 Leases and are presented in accordance with IAS 17 Leases, whereby lease payments made under operating leases are recognised in the Income Statement on a straight-line basis over the lease term. See note 19 for further details.

#### **2.4 Research and development**

The Company undertakes research and development activities either on its own behalf or on behalf of customers.

Company-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.

Where the research and development activity is performed on behalf of customers, the revenue arising is recognised in the Income Statement in accordance with the Company's revenue recognition policy.

Total research and development expenditure in the year was £2,900k (2018 £1,900k), of which £900k (2018 £700k) was funded by the Company.

#### **2.5 Interest income and borrowing costs**

Interest income and borrowing costs are recognised in the Income Statement in the period in which they are incurred.



## Notes to the Financial Statements

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### 2. Accounting policies (continued)

#### 2.6 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.

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 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:	
Computer 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 Company's property, plant and equipment are reviewed at each Balance Sheet date to determine whether there is any indication of impairment.

## **Notes to the Financial Statements**

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### **2. Accounting policies (continued)**

#### **2.7 Impairment**

The carrying amounts of the Company's intangible assets are reviewed at each Balance Sheet date to determine whether there is any indication of impairment as required by IAS 36, Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Impairment losses are recognised in the Income Statement.

An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and right-of-use assets 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.

#### **2.8 Investments**

Fixed asset investments in shares in subsidiary undertakings and in shares in participating interests are stated at cost less provision for impairment.

#### **2.9 Inventories**

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value. Inventory is provided for when it is either surplus to requirements or if it is awaiting disposal or scrappage.

#### **2.10 Trade, other and contract receivables**

The Company writes off a trade receivable when there is objective evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation.

Contract receivables represent amounts for which the Company has an unconditional right to consideration in respect of unbilled revenue recognised at the Balance Sheet date and comprise costs incurred plus attributable margin.

#### **2.11 Trade and other payables**

Trade and other payables are stated at amortised cost.

## **Notes to the Financial Statements**

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### **2. Accounting policies (continued)**

#### **2.12 Provisions**

A provision is recognised in the Balance Sheet when the Company 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 Company 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 restructuring programmes are supported by detailed plans and based on previous experience as well as other known factors. Future operating costs are not provided for.

#### **2.13 Financial instruments**

##### *Derivative financial instruments and hedging activities*

The international nature of the Company's business means it is exposed to volatility in currency exchange rates. In order to protect itself against currency fluctuations, the Company's policy is to hedge all material firm transactional exposures.

In accordance with its treasury policy, the Company does not hold derivative financial instruments for trading purposes.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, such instruments are stated at fair value at the balance sheet date. The fair values are estimated by discounting expected future cash flows.

The Company has applied the IFRS 9 general hedge accounting requirements from the date of initial application on 1 January 2018.

##### *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 Company 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.

## **Notes to the Financial Statements**

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### **2. Accounting policies (continued)**

#### **2.14 Dividends**

Dividends received and receivable are credited to the Company's Income Statement. Equity dividends paid on ordinary share capital are recognised as a liability in the period in which they are declared.

#### **2.15 Retirement benefit obligations**

##### *Defined contribution pension schemes*

A defined contribution pension scheme is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts.

Obligations for contributions are recognised as an expense in the Income Statement as incurred.

##### *Defined benefit pension schemes*

The cost of providing benefits is determined periodically by independent actuaries and charged to the Income Statement in the period in which those benefits are earned by the employees. Remeasurements, including actuarial gains and losses, are recognised in the Statement of Comprehensive Income in the period in which they occur. Past service costs resulting from a plan amendment or curtailment are recognised immediately in the Income Statement.

The retirement benefit surpluses and obligations recognised in the Company's Balance Sheet represents 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 48. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

IAS 19 Employee Benefits, limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Company has applied IFRIC 14 and has determined that there is no limit on the recognition of the surpluses in its defined benefit pension schemes as at 31 December 2019.

The Company participates in a number of group and multi-employer schemes administered by its ultimate parent company, BAE Systems plc. A share of the IAS 19 Employee Benefits, pension deficit has been allocated to all participating employers. This allocation is based on the relative payroll contributions of active members which is consistent with prior years.

Whilst this methodology is intended to reflect a reasonable estimate of the share of the deficit, it may not accurately reflect the obligations of the participating employers. Gains and losses resulting from changes to the relative payroll contributions of active members year on year are included within the actual return on assets and actuarial gains and losses for the disclosures in respect of changes in the fair value of scheme assets and changes in the present value of defined benefit obligations, respectively.

In the event that an employer who participates in BAE Systems plc'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 Company considers the likelihood of this event arising as remote.

## Notes to the Financial Statements

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### 2. Accounting policies (continued)

#### 2.16 Tax

Tax expense comprises current and deferred tax. Current and deferred tax is recognised in the profit or loss except to the extent that it relates to a business combination or items recognised directly in equity or in 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.

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.

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 corporate income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

#### 2.17 Related party transactions

The Company has related party relationships with BAE Systems plc and its subsidiaries/joint-ventures. Transactions occur with related parties in the normal course of business, are priced on an arm's-length basis and settled on normal trade terms.

## Notes to the Financial Statements

### 2. Accounting policies (continued)

#### 2.18 Share based payments

BAE Systems plc, the Company's ultimate parent company, issues equity-settled share options to employees of the Company. In accordance with the requirements of IFRS 2 Share-based Payment, the Company has recognised a charge for the equity-settled share options issued to its employees.

Equity-settled share options and long-term incentive plan arrangements are measured at fair value at the date of grant using an option pricing model.

The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of shares that will actually vest.

### 3. Revenue

Revenue by reporting segment

	2019 £000	2018 £000
External sales	189,025	182,145
Intercompany sales	20,554	10,731
	<u>209,579</u>	<u>192,876</u>
	<u>209,579</u>	<u>192,876</u>
	2019 £000	2018 £000
United Kingdom	178,594	171,540
Rest of Europe	15,435	15,358
Rest of the world	15,550	5,978
	<u>209,579</u>	<u>192,876</u>
	<u>209,579</u>	<u>192,876</u>

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**Notes to the Financial Statements**

**4. Operating costs**

	<b>2019</b>	2018
	<b>£000</b>	£000
Raw materials, subcontracts and other bought-in items used	<b>72,396</b>	65,961
Staff costs (note 9)	<b>52,031</b>	52,330
Depreciation, amortisation and impairment	<b>19,721</b>	13,065
Lease and sublease expense	<b>2,669</b>	8,534
Other operating charges	<b>46,487</b>	43,196
	<b>193,304</b>	183,086

The remuneration of the auditor for the year ended 31 December 2019 for auditing of the financial statements was £125k (2018 £200k) and £nil (2018 £nil) in respect of non-audit work.

Total research and development expenditure was £2,900k (2018 £1,900k), of which £900k (2018 £700k) was funded by the Company.

**5. Other income**

	<b>2019</b>	2018
	<b>£000</b>	£000
Royalty receivable	<b>1,983</b>	1,169
Other operating income	<b>2,542</b>	984
	<b>4,525</b>	2,153

**6. Income from investments**

	<b>2019</b>	2018
	<b>£000</b>	£000
Dividends from investments	<b>2,335</b>	186
	<b>2,335</b>	186

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**7. Financial income**

	2019 £000	2018 £000
Net interest income on retirement benefit obligations (note 20)	1,500	1,600
Foreign exchange gains	2,449	-
	<u>3,949</u>	<u>1,600</u>

**8. Financial expense**

	2019 £000	2018 £000
Interest expense	1,031	1,035
Foreign exchange losses	-	481
Interest expense on lease liabilities (note 19)	2,983	-
	<u>4,014</u>	<u>1,516</u>

**9. Employees**

The monthly average number of Company employees was 980 (2018 932). The aggregate staff costs of Company employees were as follows:

	2019 £000	2018 £000
Wages and salaries	40,929	37,026
Social security costs	3,987	3,858
Cost of defined benefit pension scheme (note 20)	5,100	9,700
Cost of defined contribution pension scheme (note 20)	945	736
Share-based payments	1,070	1,010
	<u>52,031</u>	<u>52,330</u>



**Notes to the Financial Statements**

**10. Directors' remuneration**

The disclosures below represent an allocation of the emoluments received by the directors to reflect their qualifying services to the Company.

	<b>2019</b>	2018
	<b>£000</b>	£000
Directors' remuneration	<b>375</b>	200
Company contributions to defined benefit pension schemes	<b>43</b>	36
	<b>418</b>	236

Retirement benefits are accruing to the following number of directors under:

	<b>2019</b>	2018
	<b>Number of</b>	Number of
	<b>directors</b>	directors
Defined benefit schemes	<b>2</b>	2

	<b>2019</b>	2018
	<b>Number of</b>	Number of
	<b>directors</b>	directors
Number of directors in respect of whose qualifying services BAE Systems plc shares were received or receivable under long-term incentive schemes	<b>1</b>	1

Amounts paid in respect of the highest paid director were as follows:

	<b>2019</b>	2018
	<b>£000</b>	£000
Remuneration and amounts receivable under long-term incentive schemes	<b>215</b>	131
Company contributions to defined benefit pension schemes	<b>19</b>	22
	<b>234</b>	153

The highest paid director's defined benefit accrued pension and accrued lump sum at 31 December 2019 were £11,000 (2018 £13,000) and £nil (2018 £nil), respectively.

During the year, the highest paid director exercised share options and received shares under a long-term incentive scheme.

## Notes to the Financial Statements

### 11. Tax

The Company has not provided for current tax for the year as any taxable profits will be covered by the surrender of losses from fellow group companies, in respect of which no payment will be made.

	2019 £000	2018 £000
<b>Current tax</b>		
UK:		
Current tax	(4,350)	-
	<u>(4,350)</u>	<u>-</u>
<b>Deferred tax</b>		
Origination and reversal of temporary differences	(95)	2,181
Adjustments in respect of prior years	167	16
	<u>(4,278)</u>	<u>2,197</u>
<b>Tax</b>	<u>(4,278)</u>	<u>2,197</u>

## Notes to the Financial Statements

### 11. Tax (continued)

#### Reconciliation of tax expense

The following reconciles the expected tax (expense), using the UK corporation tax rate, to the reported tax (expense)/income:

	2019 £000	2018 £000
<b>Profit before tax</b>	<b>23,070</b>	12,213
UK corporation tax rate	<b>19.00%</b>	19.00%
Expected tax expense on profit	<b>(4,383)</b>	(2,320)
Expenses not tax effected	<b>(171)</b>	(8)
Income not subject to tax	<b>519</b>	32
Property, plant and equipment	<b>(462)</b>	(408)
Provisions and accruals	<b>7</b>	(7)
Pensions	<b>48</b>	(18)
Share based payments	<b>(31)</b>	(34)
Imputed expense	<b>28</b>	23
Losses received from fellow group companies	<b>-</b>	4,921
Adjustments in respect of prior years	<b>167</b>	16
<b>Tax result</b>	<b>(4,278)</b>	2,197

The UK corporation tax rate will remain 19% from 1 April 2020 rather than being reduced to 17%.

**Notes to the Financial Statements**

**11. Tax (continued)**

**Tax recognised in other comprehensive income**

	<b>2019</b>			<b>2018</b>		
	<b>Before tax</b>	<b>Tax benefit/ (expense)</b>	<b>Net of tax</b>	<b>Before tax</b>	<b>Tax benefit/ (expense)</b>	<b>Net of tax</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Items that will not be reclassified to the Income Statement:</b>						
Remeasurements on retirement benefit schemes	(1,800)	336	(1,464)	(21,400)	3,638	(17,762)
<b>Items that may be reclassified to the Income Statement:</b>						
Amounts (charged)/credited to hedging reserve	(744)	126	(618)	779	(132)	647
	<u>(2,544)</u>	<u>462</u>	<u>(2,082)</u>	<u>(20,621)</u>	<u>3,506</u>	<u>(17,115)</u>

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**11. Tax (continued)**

	<b>2019</b>			<b>2018</b>		
	<b>Other reserves £000</b>	<b>Retained earnings £000</b>	<b>Total £000</b>	<b>Other reserves £000</b>	<b>Retained earnings £000</b>	<b>Total £000</b>
<b>Current tax</b>						
Retirement benefit schemes	-	283	283	-	-	-
	-	283	283	-	-	-
<b>Deferred tax</b>						
Financial instruments	126	-	126	(132)	-	(132)
Retirement benefit schemes	-	53	53	-	3,638	3,638
	126	53	179	(132)	3,638	3,506
<b>Tax on other comprehensive income</b>	<b>126</b>	<b>336</b>	<b>462</b>	<b>(132)</b>	<b>3,638</b>	<b>3,506</b>

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**Notes to the Financial Statements**

**12. Property, plant and equipment**

	Land and buildings £000	Plant and machinery £000	Total £000
<b>Cost or valuation</b>			
At 1 January 2019	37,510	159,509	197,019
Additions	582	7,253	7,835
Disposals	(322)	(287)	(609)
Transfers between classes	(303)	303	-
<b>At 31 December 2019</b>	<b>37,467</b>	<b>166,778</b>	<b>204,245</b>
<b>Depreciation</b>			
At 1 January 2019	11,284	92,323	103,607
Depreciation charge for the year	1,324	12,092	13,416
Disposals	(322)	(270)	(592)
<b>At 31 December 2019</b>	<b>12,286</b>	<b>104,145</b>	<b>116,431</b>
<b>Net book value</b>			
<b>At 31 December 2019</b>	<b>25,181</b>	<b>62,633</b>	<b>87,814</b>
At 31 December 2018	26,226	67,186	93,412
<b>Non-depreciated assets:</b>			
<b>Assets in the course of construction</b>			
<b>At 31 December 2019</b>	<b>580</b>	<b>11,715</b>	<b>12,295</b>
At 31 December 2018	433	13,222	13,655

**Capital commitments**

Capital expenditure contracted for but not provided for in full in the financial statements is £2,786k (2018 £2,753k).

## Notes to the Financial Statements

### 13. Investments

	Investments £000
<b>Cost</b>	
At 1 January 2019	-
Additions	15,149
<b>At 31 December 2019</b>	<b>15,149</b>
<b>Net book value</b>	
<b>At 31 December 2019</b>	<b>15,149</b>
At 31 December 2018	-

#### Impairment testing

During the year, management conducted an impairment review of the investments held by the Company. As a result of this review, there were no impairments or impairment reversals required.

The recoverable amount (both during the year and at acquisition) of the investments held by the Company was calculated with reference to their value in use. The value in use calculations use risk-adjusted future cash flow projections based on the five-year Integrated Business Plan (IBP) and include a terminal value based on the projections for the final year of that plan, with growth rate assumptions in the range 0% to 2% applied. The IBP process includes the use of historic experience, available government spending data and the BAE Systems plc group's order backlog. Pre-tax discount rates, derived from the group's post-tax weighted average cost of capital of 6.62% (2018 6.36%) (adjusted for risks specific to the market in which the cash-generating unit operates), have been used in discounting these projected risk-adjusted cash flows.

## Notes to the Financial Statements

### 13. Investments (continued)

#### Subsidiary undertakings and participating interests at 31 December 2019

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiary undertakings and significant holdings as at 31 December 2019 is disclosed below. Unless otherwise stated, all subsidiary undertakings and significant holdings are owned directly by the Company and, unless otherwise stated, have a financial year end of 31 December.

Company name	Class of shares held	Proportion of class (%)
Royal Ordnance (Crown Service) Pension Scheme Trustees Limited <i>Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom</i>	Ordinary shares of £1	100%
Royal Ordnance Senior Staff Pension Scheme Trustees Limited <i>Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom</i>	Ordinary shares of £1	100%
International Military Sales Limited <i>Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom</i>	Ordinary shares of £1	100%
CTA International SAS <i>13 Route De La Miniere, 78000 Versailles, France</i>	Ordinary shares of €15	50%

### 14. Deferred taxation

#### Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2019 £000	2018 £000	2019 £000	2018 £000	2019 £000	2018 £000
Property, plant and equipment	-	-	(5,037)	(5,643)	(5,037)	(5,643)
Provisions and accruals	95	219	-	-	95	219
Retirement benefit schemes:						
Deficits	-	-	(8,819)	(8,462)	(8,819)	(8,462)
Financial instruments	185	59	-	-	185	59
Deferred tax assets/(liabilities)	280	278	(13,856)	(14,105)	(13,576)	(13,827)
Set off of tax	-	-	-	-	-	-
Net deferred tax assets/(liabilities)	280	278	(13,856)	(14,105)	(13,576)	(13,827)



**Notes to the Financial Statements**

**14. Deferred taxation (continued)**

**Movement in temporary differences during the year**

	At 1 January 2019 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2019 £000
Property, plant and equipment	(5,643)	606	-	(5,037)
Provisions and accruals	219	(124)	-	95
Retirement benefit schemes:				
Deficits	(8,462)	(410)	53	(8,819)
Financial instruments	59	-	126	185
	<u>(13,827)</u>	<u>72</u>	<u>179</u>	<u>(13,576)</u>

	At 1 January 2018 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2018 £000
Property, plant and equipment	(5,934)	291	-	(5,643)
Provisions and accruals	176	43	-	219
Retirement benefit schemes:				
Deficits	(12,253)	153	3,638	(8,462)
Financial instruments	191	-	(132)	59
Other items	(1,710)	1,710	-	-
	<u>(19,530)</u>	<u>2,197</u>	<u>3,506</u>	<u>(13,827)</u>

The deferred tax liability has been prepared applying a closing tax rate of 17% on the basis that any deferred assets or liabilities released or settled are likely to reverse after April 2020. However, in the Spring Budget 2020, the Government announced that from 1 April 2020 the corporation tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020. As the proposal to keep the rate at 19% had not been substantively enacted at the Balance Sheet date, its effects are not included in these financial statements and the rate of 17% is used. If the proposal had been substantively enacted at the Balance Sheet date the deferred tax liabilities would have increased to £15,172k due to the change in the tax rate.

**Notes to the Financial Statements**

**15. Inventories**

	<b>2019</b>	2018
	<b>£000</b>	£000
Work in progress (goods to be sold)	<b>25,990</b>	19,006
	<u><b>25,990</b></u>	<u>19,006</u>

**16. Trade, other and contract receivables**

	<b>2019</b>	2018
	<b>£000</b>	£000
Trade receivables	<b>11,242</b>	14,378
Amounts owed by BAE Systems plc and its subsidiaries	<b>180,650</b>	183,860
Other debtors	<b>5,779</b>	2,077
Prepayments and accrued income	<b>3,311</b>	6,758
Contract receivables	<b>17,253</b>	4,210
	<u><b>218,235</b></u>	<u>211,283</u>

Amounts owed by BAE Systems plc and its subsidiaries are payable on demand. No interest is applied to amounts owed.

**17. Trade and other payables**

	<b>2019</b>	2018
	<b>£000</b>	£000
<b>Current</b>		
Contract liabilities	<b>127,451</b>	109,855
Trade payables	<b>5,640</b>	11,329
Amounts owed to BAE Systems plc and its subsidiaries	<b>100,788</b>	115,307
Other taxes and social security costs	<b>25,149</b>	24,280
Accruals and deferred income	<b>28,983</b>	25,506
	<u><b>288,011</b></u>	<u>286,277</u>

Amounts owed by BAE Systems plc and its subsidiaries are payable on demand. No interest is applied to amounts owed.

The effects of the prior year misstatement are summarised in note 27.

**Notes to the Financial Statements**

**18. Other financial assets and liabilities**

	2019 £000	2018 £000
<b>Financial assets</b>		
<b>Non-current</b>		
Cash flow hedges – foreign exchange contracts	762	-
<b>Current</b>		
Cash flow hedges – foreign exchange contracts	1,317	429
<b>Financial liabilities</b>		
<b>Non-current</b>		
Cash flow hedges – foreign exchange contracts	(898)	(188)
<b>Current</b>		
Cash flow hedges – foreign exchange contracts	(2,272)	(588)

## Notes to the Financial Statements

### 19. Leases

IFRS 16 Leases became effective on 1 January 2019. The impact of adoption is set out in note 24.

The Company 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.

	<b>31 December 2019</b>		
	Land and buildings £000	Plant and machinery £000	Total £000
Additions during the year	121	49	170
Depreciation expense for the year	6,102	203	6,305
Net book value	100,954	304	101,258

#### Lease liabilities

A maturity analysis of the future undiscounted lease payments in respect of the Company's lease liabilities is presented in the table below.

	<b>2019</b> <b>£000</b>
Payments due:	
Within one year	6,839
Between one and five years	28,429
Later than five years	94,969
	<b>130,237</b>

The Balance Sheet recognises a value of £102,503k for lease liabilities, due to the impact of discounting which is £27,734k.

The total cash outflow for leases in the year ended 31 December 2019, including short-term leases and low-value leases, amounted to £6,716k. Short term leases are in relation to the Glascoed and Radway Green sites.

**Notes to the Financial Statements**

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**19. Leases (continued)**

**Amounts recognised in the Income Statement**

	<b>2019</b>
	<b>£000</b>
<b>Included in operating costs:</b>	
Depreciation on right-of-use assets	6,305
	<u>6,305</u>
<b>Included in net finance costs:</b>	
Interest expense on lease liabilities	2,983
	<u>2,983</u>

## Notes to the Financial Statements

### 20. Retirement benefit obligations

#### Background

BAE Systems plc operates pension schemes for qualifying employees in the UK, US and other countries. The principal schemes in the UK are funded defined benefit schemes and the assets are held in separate trustee-administered funds. During 2019, several legacy BAE Systems pension arrangements were merged into the BAE Systems Pension Scheme (Main Scheme). Contributions and members' benefits are unchanged. The allocation of each Company's share of the pension deficit is based on the relative payroll contributions of active members, as outlined on page 26. This is now being calculated on the basis of contributions into the newly merged Main Scheme rather than for each legacy scheme separately. As each of the legacy schemes had different funding levels compared to the merged Main Scheme, there are resulting gains and losses. These gains and losses are recorded within other comprehensive income in the statement of comprehensive income and are included within actual return on assets and actuarial gains and losses for the disclosures in respect of changes in the fair value of scheme assets and changes in the present value of defined benefit obligations, respectively.

At 31 December 2019, the weighted average durations of the UK defined benefit pension obligations were 17 years (2018 17 years).

The Company participates in the following BAE Systems plc schemes: BAE Systems Pension Scheme (Main Scheme) and Royal Ordnance Pension Scheme.

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the most significant schemes (based on the size of the closing net deficit/surplus) is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme (merged) <sup>1</sup>	31	21	48
Royal Ordnance Pension Scheme <sup>2</sup>	18	20	62

1. Source: 31 October 2019 actuarial valuation reports for the legacy schemes within the recently-merged Main Scheme.

2. Source: Royal Ordnance Pension Scheme actuarial valuation 31 March 2017.

#### 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 BAE Systems plc.

#### Benefits

The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The Normal Retirement Age for active members of the Main Scheme 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: [www.baesystemspensions.com](http://www.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. In 2018, a non-recurring past service cost was included in the income statement to reflect the expectation that the impact of GMP equalisation would increase the pension deficit in the balance sheet. In 2019, an allowance was included within the pension deficit which is a consistent proportion of the UK liabilities as applied in 2018 and reflects the updated UK IAS 19 valuations as at 31 December 2019.

## Notes to the Financial Statements

### 20. Retirement benefit obligations (continued)

#### Funding

##### Introduction

Disclosures in respect of pension funding provided below reflect the pension schemes as a whole. Disclosures in respect of pension accounting under IAS 19 are provided on pages 48 - 53.

The majority of the UK defined benefit pension schemes are funded by BAE Systems plc'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 professional qualified independent actuaries and include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 48. 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.

##### Valuations

Funding valuations of the UK defined benefit schemes are performed every three years. Following the merger of several of the UK pension schemes in October 2019, BAE Systems plc and the trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 October 2019. The next funding valuations for the other UK schemes will have an effective date of no later than 31 March 2020.

The results of the most recent triennial valuations are shown below: These valuations and, where necessary, deficit recovery plans were agreed with the trustees and certified by the scheme actuaries after consultations with The Pensions Regulator in the UK.

	Main Scheme as at 31 October 2019 £bn	Other schemes as at 31 March 2017 £bn
Market value of assets	20.6	2.2
Present value of liabilities	(22.5)	(2.0)
Funding (deficit)/surplus	(1.9)	0.2
Percentage of accrued benefits covered by the assets at the valuation date	92%	110%

The valuations in 2017 and 2019 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 90
Life expectancy of a male currently aged 45 (years)	88 – 92
Life expectancy of a female currently aged 45 (years)	90 – 93

The discount rate assumptions used in the 2017 and 2019 valuations were directly based on prudent

## **Notes to the Financial Statements**

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### **20. Retirement benefit obligations (continued)**

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 are derived using data from the Bank of England which is based on the difference between the yields on index-linked and fixed interest long-term government bonds. The inflation assumption is a curve which provides a different rate for each year into the future.

The funding valuations resulted in a significantly lower deficit than under IAS 19, largely due to lower liabilities reflecting the higher discount rate assumption. Under IAS 19, the discount rate for accounting purposes is based on third-party AA corporate bond yields whereas, for funding valuation purposes, the discount rate is based on a prudent level of expected returns from the broader and mixed types of investments reflected in the schemes' investment strategies, which are expected overall to yield higher returns than bonds.

The 2019 funding agreement is underpinned by a contingency plan, which includes a commitment by BAE Systems plc to a further £50m of deficit funding in each of 2021 and 2022 into the Main Scheme prior to the next triennial valuation in the event that the scheme funding level were to fall below pre-determined parameters. In addition, BAE Systems plc would be required to pay £187m in respect of the Main Scheme if the funding level were to fall significantly and were to remain at or below those levels for nine months.

There have been no changes to the contributions or benefits, as set out in the rules of the schemes, for pension scheme members as a result of the new funding valuations.

The results of future triennial valuations and associated funding requirements will be impacted by a number of factors, including the future performance of investment markets and anticipated members' longevity.

#### **Contributions**

Under the terms of the trust deeds of the UK schemes, BAE Systems plc is required to have a funding plan determined at the conclusion of the triennial funding valuations.

The total Company contributions made to the defined benefit schemes in the year ended 31 December 2019 were £8,900k (2018 £8,600k).

Deficit contributions will further increase in line with any percentage growth in dividend payments made by BAE Systems plc. As part of the 31 October 2019 valuation agreement, BAE Systems plc agreed to pay £1bn into the Main Scheme in 2020 representing an advancement of £1bn in deficit contributions that were due, under the 2017 valuation deficit recovery plan, between 2022 and 2026. The annual payments are expected to end in 2021 and the deficit is expected to be cleared in 2026.

#### **Risk management**

The defined benefit pension schemes expose the Company to actuarial risks, including market



## Notes to the Financial Statements

### 20. Retirement benefit obligations (continued)

(investment) risk, interest rate risk, inflation risk and longevity risk.

Risk	Mitigation
<b>Market (investment) risk</b> Asset returns may not move in line with the liabilities and may be subject to volatility.	<p>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.</p> <p>Some 49% (2018 47%) of the UK pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term.</p> <p>Some of the pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. The Main Scheme has an equity option strategy protecting £2.9bn of assets against a significant fall in equity markets.</p>
<b>Interest rate risk</b> Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	<p>In addition to investing in bonds as part of the matching portfolio, the UK schemes invest in interest rate swaps to reduce the exposure to movements in interest rates. The swaps are held with several banks to reduce counterparty risk.</p> <p>The discount rate assumptions set as part of the UK funding valuations directly reflect the expected returns on assets held by the schemes and provide a natural hedge against interest rate risk. The planned investment strategy, which is reflected in the discount rate and liability calculation, is for the schemes to increase their investments in bonds or other assets which match the liabilities as the schemes mature. Under the UK funding valuations, the Company expects the schemes to be fully hedged against interest rate movements following a five-year transition period to the planned investment strategy.</p>
<b>Inflation risk</b> Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	<p>In addition to investing in index-linked bonds as part of the matching portfolio, the principal UK schemes invest in long-term inflation swaps to reduce the exposure to movements in inflation. The swaps are held with several banks to reduce counterparty risk.</p> <p>The UK funding valuations provide a natural hedge against inflation movements within the discount rate. The Company is already fully hedged against inflation movements and, under the planned investment strategy, aims to maintain a fully hedged position.</p> <p>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.</p>
<b>Longevity risk</b> Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.	<p>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.</p> <p>In 2013, with the agreement of BAE Systems plc, the trustees of the 2000 Plan, Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme (SIPS) entered into arrangements with Legal &amp; 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 &amp; General remains in place following the merger of the 2000 Plan and SIPS into the Main Scheme.</p>

### IAS 19 Accounting

The disclosures below relate to pension schemes in the UK which are accounted for as defined benefit

## Notes to the Financial Statements

### 20. Retirement benefit obligations (continued)

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.

	2019	2018	2017
<b>Financial assumptions</b>			
Discount rate – past service (%)	2.1	2.9	2.6
Discount rate – future service (%)	2.2	3.0	2.7
Retail Prices Index (RPI) inflation (%)	2.8	3.1	3.1
Rate of increase in salaries (%)	2.8	3.1	3.1
Rate of increase in deferred pensions (%)	2.0/2.8	2.1/3.1	2.1/3.1
Rate of increase in pensions in payment (%)	1.5 – 3.6	1.6 – 3.7	1.6 – 3.7
<b>Demographic assumptions</b>			
Life expectancy of a male currently aged 65 (years)	87 – 88	86 – 88	86 – 88
Life expectancy of a female currently aged 65 (years)	88 – 90	88 – 90	88 – 90
Life expectancy of a male currently aged 45 (years)	88 – 89	88 – 90	88 – 90
Life expectancy of a female currently aged 45 (years)	89 – 91	90 – 91	90 – 92

#### Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments of the principal schemes using a third-party AA corporate bond yield curve to produce a single equivalent discount rate. This inherently captures the maturity profile of the expected benefit payments. 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 44.

#### Retail Prices Index (RPI) inflation

The inflation assumptions are derived by reference to the difference between the yields on index-linked and fixed-interest long-term government bonds, or advice from the local actuary depending on the available information. As a consequence of RPI reform announcements during 2019, the Company has reviewed its approach to setting inflation assumptions and has decided to set the Consumer Prices Index (CPI) assumption at 0.8% lower than RPI. The resulting CPI assumption is 2.0%.

#### Rate of increase in salaries

The rate of increase in salaries is assumed to be RPI inflation of 2.8% (2018 3.1%), plus a promotional scale.

#### Rate of increase in deferred pensions

The rate of increase in deferred pensions is based on Consumer Prices Index (CPI) inflation of 2.0% (2018 2.1%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 2.8% (2018 3.1%). 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 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

The Company has used the Self-Administered Pension Schemes S2 mortality tables based on year of

**Notes to the Financial Statements**

**20. Retirement benefit obligations (continued)**

birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members and information on the demographic profile of the scheme's membership. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2018 tables (published by the Institute of Actuaries) have been used (in 2018, the Continuous Mortality Investigation 2017 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% (2018 1.25%), an initial rate adjustment parameter ('A') of 0.25% in conjunction with a smoothing parameter ('S<sub>x</sub>') of 7 for all members.

The disclosures below are in respect of the Company's share of the IAS 19 deficit using the allocation methodology outlined on page 26.

***Summary of movements in retirement benefit obligations***

	£'000
Company's share of IAS 19 deficit at 1 January 2019	49,600
Actual return on assets excluding amounts included in interest expense	134,100
Actuarial loss due to changes in assumptions and experience	(135,900)
Contributions in excess of service cost	2,400
Past service cost – plan amendments	-
Net interest income	1,500
<b>Company's share of IAS 19 deficit at 31 December 2019</b>	<b>51,700</b>

***Amounts recognised in the Balance Sheet***

	2019 £'000	2018 £'000
Present value of funded obligations	(1,067,400)	(947,000)
Fair value of scheme assets	1,119,100	996,600
<b>Company's share of IAS 19 deficit, net</b>	<b>51,700</b>	<b>49,600</b>
Represented by:		
Retirement benefit surpluses	107,600	93,000
Retirement benefit obligations	(55,900)	(43,400)
	<b>51,700</b>	<b>49,600</b>

Notes to the Financial Statements

20. Retirement benefit obligations (continued)

*Changes in the fair value of scheme assets*

	£'000
Company's share of the value of scheme assets at 31 December 2017	1,179,400
Interest income	27,100
Actual return on assets excluding amounts included in interest income	(169,100)
Actual return on assets	(142,000)
Contributions by employer	7,200
Contributions by employer in respect of employee salary sacrifice arrangements	1,400
Total contributions by employer	8,600
Members' contributions	200
Administrative expenses	(700)
Benefits paid	(48,900)
Company's share of the value of scheme assets at 31 December 2018	996,600
Interest income	30,200
Actual return on assets excluding amounts included in interest income <sup>1</sup>	134,100
Actual return on assets	164,300
Contributions by employer	7,500
Contributions by employer in respect of employee salary sacrifice arrangements	1,400
Total contributions by employer	8,900
Members' contributions	200
Administrative expenses	(800)
Benefits paid	(50,100)
<b>Company's share of the value of scheme assets at 31 December 2019</b>	<b>1,119,100</b>

**Notes to the Financial Statements**

**20. Retirement benefit obligations (continued)**

***Assets of defined benefit pension schemes***

	2019			2018		
	Quoted £'000	Unquoted £'000	Total £'000	Quoted £'000	Unquoted £'000	Total £'000
Equities:						
UK	29,700	-	29,700	37,600	-	37,600
Overseas	25,900	-	25,900	24,400	200	24,600
Pooled investment vehicles <sup>1</sup>	25,900	166,000	191,900	4,100	85,600	89,700
Fixed interest securities:						
UK gilts	354,200	-	354,200	345,400	-	345,400
UK corporates	284,300	31,800	316,100	292,600	18,500	311,100
Overseas government	500	-	500	600	-	600
Overseas corporates	89,500	200	89,700	93,000	200	93,200
Index-linked securities:						
UK gilts	362,700	4,000	366,700	370,900	200	371,100
UK corporates	3,300	13,400	16,700	6,500	2,000	8,500
Property <sup>2</sup>	-	30,300	30,300	-	38,000	38,000
Derivatives <sup>3</sup>	-	(339,600)	(339,600)	-	(358,400)	(358,400)
Cash:						
Sterling	10,300	14,100	24,400	7,600	15,800	23,400
Foreign currency	400	2,900	3,300	100	2,800	2,900
Other	200	9,100	9,300	100	8,800	8,900
<b>Company total</b>	<b>1,186,900</b>	<b>(67,800)</b>	<b>1,119,100</b>	<b>1,182,900</b>	<b>(186,300)</b>	<b>996,600</b>

1. 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.

2. 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.

3. Includes equity protection options, forward foreign exchange contracts, futures, and interest rate, inflation and longevity swaps. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

## Notes to the Financial Statements

### 20. Retirement benefit obligations (continued)

#### Changes in the present value of the defined benefit obligations

	£'000
Company's share of the defined benefit obligations at 1 January 2018	(1,107,500)
<i>Current service cost</i>	(4,600)
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	(1,400)
Total current service cost	(6,000)
Members' contributions	(200)
Past service cost – plan amendments	(4,400)
Actuarial gain due to changes in assumptions and experience	147,700
Interest expense	(25,500)
Benefits paid	48,900
Company's share of the defined benefit obligations at 31 December 2018	(947,000)
<i>Current service cost</i>	(4,300)
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	(1,400)
Total current service cost	(5,700)
Members' contributions	(200)
Past service cost – plan amendments	
Actuarial loss due to changes in assumptions and experience	(135,900)
Interest expense	(28,700)
Benefits paid	50,100
<b>Company's share of the defined benefit obligations at 31 December 2019</b>	<b>(1,067,400)</b>

#### Amounts recognised in the Income Statement

	2019 £'000	2018 £'000
<b>Included in operating costs:</b>		
Current service cost	(4,300)	(4,600)
Past service cost – plan amendments	-	(100)
Guaranteed Minimum Pension equalisation charge	-	(4,300)
Administrative expenses	(800)	(700)
	<b>(5,100)</b>	<b>(9,700)</b>
<b>Included in finance costs:</b>		
Net interest income on retirement benefit obligations	<b>1,500</b>	1,600

The Company incurred a charge of £945k (2018 £736k) in relation to defined contribution schemes for employees.

#### Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2019 and keeping all other assumptions as set out on page 48.

#### 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 after allocation to other participating employers, is shown in the table below. The estimated impact on scheme assets takes into account the 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.

## Notes to the Financial Statements

### 20. Retirement benefit obligations (continued)

	(Increase)/ decrease in pension obligation £'000	Increase/ (decrease) in scheme assets £'000
<b>Discount rate:</b>		
0.1 percentage point increase	16,000	(16,000)
0.1 percentage point decrease	(16,000)	17,000
<b>Inflation:</b>		
0.1 percentage point increase	(14,000)	13,000
0.1 percentage point decrease	9,000	(12,000)

The sensitivity of the valuation of the liabilities to changes in the inflation assumption presented above assumes that a 0.1 percentage point change to expectations of future inflation results in a 0.1 percentage point change to all inflation-related assumptions (rate of increase in salaries, rate of increase in deferred pensions and rate of increase in pensions in payment) used to value the liabilities. However, upper and lower limits exist on the majority of inflation-related benefits such that a change in expectations of future inflation may not have the same impact on the inflation-related benefits, and hence will result in a smaller change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase)/decrease in the defined benefit pension obligation resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease in pension obligation £'000
<b>Inflation:</b>	
0.5 percentage point increase	(62,000)
0.5 percentage point decrease	55,000
1.0 percentage point increase	(126,000)
1.0 percentage point decrease	107,000

#### *Demographic assumptions*

Changes in the life expectancy assumption, including the benefit of longevity swap arrangements, would have the following effect on the net IAS 19 deficit:

	(Increase)/ decrease in net deficit £'000
<b>Life expectancy:</b>	
One-year increase	(33,000)
One-year decrease	31,000

**Notes to the Financial Statements**

**21. Provisions**

	Warranties and after- sales service £000	Reorganisati ons £000	Total £000
Non-current	1,051	-	1,051
Current	4,456	19	4,475
At 1 January 2019	5,507	19	5,526
Released	(323)	(4)	(327)
Created	3,009	-	3,009
Utilised in year	(2,084)	(15)	(2,099)
<b>At 31 December 2019</b>	<b>6,109</b>	<b>-</b>	<b>6,109</b>
<b>Represented by:</b>			
Non-current	2,277	-	2,277
Current	3,832	-	3,832
	<b>6,109</b>	<b>-</b>	<b>6,109</b>

**Warranties and after-sales service**

Warranty and after-sales service costs are generally incurred within three years post-delivery. Whilst actual events could result in potentially significant differences to the quantum, but not the timing, of the outflows in relation to the provisions, management has reflected current knowledge in assessing the provision levels.

**Reorganisations**

Reorganisation costs are generally incurred within one to three years. There is limited volatility around the timing and amount of the ultimate outflows related to these provisions.



## Notes to the Financial Statements

### 22. Share capital and other reserves

#### Share capital

	£1 Ordinary shares	Nominal value £000
<b>Issued and fully paid</b>		
At 1 January 2018, 31 December 2018 and 31 December 2019	<u>200,000,000</u>	<u>50,000</u>

#### Other reserves

	Hedging reserve £000
<b>At 1 January 2018</b>	(1,258)
Amounts credited to hedging reserve	779
Tax on other comprehensive income	(132)
<b>At 31 December 2018</b>	<u>(611)</u>
Amounts charged to hedging reserve	(744)
Tax on other comprehensive income	126
<b>At 31 December 2019</b>	<u>(1,229)</u>

#### *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.

### 23. Dividends

	2019 £000	2018 £000
Dividends paid in respect of prior year	<u>-</u>	<u>25,000</u>

The directors propose a dividend of £20,000k (2018 £nil).

## Notes to the Financial Statements

### 24. Change in accounting policies

IFRS 16 Leases became effective on 1 January 2019 and replaced IAS 17 Leases, and related interpretations. It results in almost all leases being recognised on the Balance Sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, a right-of-use asset and a financial liability for future lease payments have been recognised. The only exceptions are short-term leases, low-value leases and leases of intangible assets.

The Company has applied the modified retrospective transition approach and has not restated comparative amounts for the year ended 31 December 2018. The Company has elected to measure right-of-use assets at the amount of the lease liability on adoption (adjusted for any lease prepayments or accrued lease expenses, onerous lease provisions, and leased assets which have subsequently been subleased).

The Company has elected to adopt the following practical expedients on transition:

- not to capitalise a right-of-use lease asset or related lease liability where the lease expires before 31 December 2019;
- to use hindsight in determining the lease term;
- to exclude initial direct costs from the measurement of the right-of-use asset; and
- to apply the portfolio approach where a group of leases has similar characteristics.

#### Accounting policy

The accounting policy in respect of leases applied from 1 January 2019 is set out in note 2.3. Comparative amounts for the year ended 31 December 2018 have not been restated and are presented in accordance with IAS 17 Leases, whereby lease payments made under operating leases are recognised in the Income statement on a straight-line basis over the lease term.

#### Reconciliation between operating lease commitments and lease liability

The following table explains the difference between the operating lease commitments disclosed applying IAS 17 at 31 December 2018 and the lease liability recognised on adoption of IFRS 16 at 1 January 2019.

	<b>£000</b>
Total minimum lease payments reported at 31 December 2018 under IAS 17	<b>136,342</b>
Impact of discounting lease liability under IFRS 16	<b>(30,276)</b>
Lease liability recognised on transition to IFRS 16 at 1 January 2019	<b>106,066</b>

The weighted average incremental borrowing rate applied to lease liabilities was 2.89%.

## Notes to the Financial Statements

### 25. Related party transactions

	2019 Sales £000	2019 Purchases £000
CTAI	662	974
MBDA	7,777	1,103
Rheinmetall BAE Systems Land Limited	5,006	-
	13,445	2,077

### 26. Events after the reporting period

The outbreak of the COVID-19 coronavirus was confirmed to be a global pandemic by the World Health Organisation on 11 March 2020 and only after that date did major governments, such as the UK, start taking significant mitigating steps. As such the Company considers this to be a non-adjusting post balance sheet event. The full impact of the COVID-19 pandemic on medium- and long-term economic activity is not yet known, although is likely to be significant. The Company continues to monitor the impact on its business, however while the uncertainty continues, the Company is not able to quantify the possible financial effect of the pandemic. Some asset and liability carrying values may be impacted, particularly where they are reliant on management's use of estimates and judgements when applying accounting policies. Potential areas of the Company's financial statements which could be materially impacted may include, but are not limited to:

- Recognition of revenue and associated margin recognised as costs are incurred and as risks are mitigated or retired;
- The valuation of post-retirement benefit obligations and related deferred tax balances, if estimates relating to actuarial assumptions (including discount and inflation rate assumptions) are no longer valid or change significantly, or if scheme asset values are affected by the impact of the pandemic;
- The carrying value of property, plant and equipment, right-of-use assets, investment property and investments in other group companies;
- Potential credit losses on receivables; the valuation of other financial assets and liabilities; and
- Amendments to existing provisions, or new provisions, being required as a consequence of the pandemic.

## Notes to the Financial Statements

### 27. Prior year restatement

The prior year restatement relates to a prior year overstatement in respect previously reported ROMA creditor, as it was identified that ROMA was liquidated in 2014, this has been recognised in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' with the Financial Statements restated as appropriate.

The impact of the adjustment is as follows:

	2018 £000	2017 £000
Intercompany Creditors	5,000	5,000
Retained Earnings	(5,000)	(5,000)

#### Impact on financial statements

As a result of the restatement prior year comparative information has been restated. The following tables show the adjustments recognised for each individual line item. Line items that are not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided.

#### Balance Sheet (extract)

	2018 As previously reported £000	ROMA adjustment £000	2018 Restated £000
<b>Current liabilities</b>			
Trade and other payables	(286,277)	5,000	(281,277)
<b>Total liabilities</b>	<b>(349,806)</b>	<b>5,000</b>	<b>(344,806)</b>
<b>Net assets</b>	<b>62,127</b>	<b>5,000</b>	<b>67,127</b>
<b>Capital and reserves</b>			
Retained earnings	12,738	5,000	17,738
<b>Total equity</b>	<b>62,127</b>	<b>5,000</b>	<b>67,127</b>

#### Retained Earnings

	2018 £000	2017 £000
<b>Retained earnings – as previously reported</b>	12,738	40,080
Restatement	5,000	5,000
<b>Retained earnings – restated</b>	<b>17,738</b>	<b>45,080</b>

**Notes to the Financial Statements**

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**28. Controlling parties**

The immediate parent company is BAE Systems (Holdings) Limited and the ultimate and controlling party is BAE Systems plc, which is both the smallest and largest parent company preparing group financial statements. Both companies are incorporated in the United Kingdom and registered in England and Wales.

The consolidated financial statements of BAE Systems plc are available to the public and may be obtained from its registered address:

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London  
SW1Y 5AD

Website: [www.baesystems.com](http://www.baesystems.com)