



BAE SYSTEMS



Annual Report 2021 BAE Systems plc

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Our purpose

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


We have an important role in society because we:

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

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


How our purpose connects to our strategy

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

 Page 14
Our strategic framework

How our purpose connects to our culture

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

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Our stakeholders

Chairman's letter continued

Our commitment to sustainability

We recognise that if we wish to win the support of our stakeholders we know we must show leadership, not simply in the products we deliver, but the values we demonstrate.

We supported COP26 and have set ourselves a 2030 net zero greenhouse gas emissions target. Within BAE Systems, Charles Woodburn, as Chief Executive Officer, is the thought leader and prime driver of this important target and the Group has responded to his direction with energy and enthusiasm.

For us all, ESG is not an optional extra in the way we do business. Protecting the environment is mission-critical and engaging with our communities an essential part of our business model, with diversity and inclusion firmly baked into the DNA of the Group.

As I reflect on the last 12 months, there is no doubt that COVID-19 has reinforced our commitment to the societies in which we operate and the importance of relationships with colleagues and communities on which we depend.

Internally we have revised our communication methods using technology to connect with greater informality and increased regularity across the organisation. This has supplemented the traditional interaction the Board has with our colleagues through town halls, site visits and trades union gatherings which were limited through the pandemic, but are now returning as restrictions are lifted.

Whatever challenges COVID-19 may have brought to our business, adversity has undoubtedly brought us all much closer together – a lasting benefit from a difficult period which we are determined will not fade as better times return.

Our commitment to good governance

All of this work is overseen by a first-class Board which I am privileged to chair. We are currently 14 in number with a healthy mix of age, gender, experience, ethnicity and nationality.

In compliance with the UK government's Special Share requirements a majority of the Board and our Chief Executive are British nationals. We also meet the targets set by the Hampton-Alexander and Parker reports with regard to gender and ethnic diversity.

The skillset is a broad mix of finance, operations, HR, strategy and AI. All have earned their place on merit. Four have been recruited in the last 12 months as part of normal succession planning with one further appointment to be made in 2022.

In recognition of our unique position in the US, where we are a top ten prime contractor to the US Department of Defense, our governance structure is augmented by the BAE Systems, Inc. board, which is populated by leading figures formerly from the US government and military and intelligence communities who ensure all that we do in the US is aligned with the needs and requirements of the nation.

It is against this background of multi-layer oversight, high quality board membership, and importantly, total commitment to best practice, that I am confident our business is genuinely performance driven and values led.

Summary

As a company our collective mindset is of immense pride in what we do, rigour in how we do it, people above profit, ethics above outcomes, and safety above everything. We care deeply about how we make money and not simply how much money we make.

It is with these firm beliefs and considerable endeavours that we have delivered sales of £21.3bn, underlying earnings of 47.8p per share, underpinned by an order backlog of £44.0bn and free cash flow of £1,864m.

This has enabled the Board to recommend a final dividend of 15.2p for a total of 25.1p for the full year. Subject to shareholder approval at the May 2022 Annual General Meeting, the dividend will be paid on 1 June 2022 to holders of ordinary shares registered on 22 April 2022.



Sir Roger Carr
Chairman



Work inside our Factory of the Future, in Warton, UK, which is being designed to enable a radically different approach to the design and manufacture of complex combat air systems.

Demand outlook

We have a large order backlog and exceptional programme positions, providing visibility of growth which was further supported by order flow in 2021 that exceeded targets.

Our defence and security capabilities remain highly relevant in an uncertain global environment with complex threats, the requirement in many cases to recapitalise or upgrade ageing equipment, and with the additional need for governments to drive a domestic economic prosperity agenda in a post-pandemic world. This backdrop has resulted in good prospects in existing and new international markets for our products and services in air, maritime, land, space and cyber security.

The US continues to represent the world's largest defence budget and accounts for around 46% of our revenues.

Through a range of innovative technologies and proven capabilities, our US business continues to sustain its robust backlog and diverse portfolio of long-term defence programmes for the US Armed Forces and international allies. The business portfolio remains closely aligned with enduring customer priorities and key focus areas outlined in the US National Defense Strategy, to modernise and maintain military readiness, which we expect to continue with the upcoming 2022 National Defense Strategy. The business has been operating under extended Continuing Resolutions in fiscal year 2022. While the Congressional budget and appropriations impasse is not without risk, the threat environment remains and is expected to result in continued support for US defence spending in the coming years.

In the UK, the Defence Command Paper renewed commitments to our major long-term programmes in complex warship, submarine and combat aircraft design and build, allowing for long-term investment in these key sovereign capabilities, as well as strong support for cyber. The opportunity pipeline is positive with domestic, export and collaboration opportunities identified. We also have the capabilities to support our UK customer with its space ambitions.

Our portfolio is well positioned to benefit from increased defence spending in Asia-Pacific through our Australia business, which is already set to grow significantly due to our contracted positions, and through export opportunities from our UK, US and Australian business to the region. The AUKUS announcement in September 2021 is strategically significant.

As the largest defence provider in the UK and Australia and a top ten prime contractor to the US Department of Defense we are well positioned to support our government customers in these nations as discussions progress. This is a clear example of how nations are looking to coordinate capabilities in multi-domain operations to address the threat environment.

In Europe, a number of nations including Germany and France continue to increase their defence budgets to address the threat environment and in order to meet their NATO commitments. We remain well placed through our positions on the Eurofighter Typhoon, our shareholding in MBDA and our BAE Systems Hägglunds land business based in Sweden, and we are pursuing a number of significant opportunities in the region.

In the Middle East, our long-standing relationships at government and company levels, continued regional instability and the nature of our long-term contracts, mean we expect defence and security to remain a priority. The renewal of certain existing long-term support contracts is tracking in line with expectations and we continue to progress a number of opportunities with existing customers.

The civil aerospace market accounts for around 3% of Group sales. COVID-19 has significantly impacted this market, and a recovery to 2019 levels is likely to be a number of years away. We are seeing some signs of recovery and this remains an important franchise for us in which we have leading capabilities in flight and engine controls across new, developing and more mature programmes with capabilities transferable from defence air platforms.

Balance sheet and capital allocation

The Group recognises the importance to investors of a clear and consistent capital allocation policy. The Group's balance sheet is managed conservatively in line with its policy to retain its investment grade credit rating and to ensure operating flexibility. The Group expects to continue to meet its pension obligations, invest in research and technology and other organic investment opportunities, and plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings.

Consistent with this approach, the Group initiated a share repurchase programme of up to £500m on 30 July which was completed in February 2022. Investment in value-enhancing acquisitions will continue to be considered where market conditions are right, where they deliver on the Group's strategy and where they offer greater long-term value than repurchasing the Group's own shares.

Post-employment benefits schemes

The Group's share of the pre-tax accounting net post-employment benefits deficit improved to a year-end position of £2.1bn from £4.5bn, as discount rates increased and asset performance was strong.

Under the funding deficit recovery plan agreed in February 2020 all scheduled lump sum Company contributions were made in 2020.

Executive Committee changes

At the end of 2021 Cliff Robson was appointed as Group Managing Director of the Air sector, replacing Chris Boardman who retired.

Following the formation of the Group's new Digital Intelligence business with effect from 2022, the following changes were made to the Executive Committee. David Armstrong was appointed Group Managing Director, Digital Intelligence. Karin Hoeing was appointed Group ESG, Culture & Business Transformation Director, and was succeeded as Group Human Resources Director by Tania Gandamihardja. Gabby Costigan was appointed Group Managing Director, Business Development. She was succeeded as Chief Executive, BAE Systems Australia by Ben Hudson. In turn, Julian Cracknell was appointed Chief Technology & Information Officer. Simon Barnes, Managing Director, BAE Systems Saudi Arabia, also joined the Executive Committee.

Summary

The fundamentals of our business remain strong, and the strategy of the Group is unchanged. Our business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. Relationships with, and support from, our customers remain strong, with defence and security continuing to be a priority for governments in our key markets, with continued demand for our capabilities. This backdrop, together with our focus on programme execution, positions us to grow our sales profitably and increase cash conversion in the coming years. We are evolving the business to have an appropriate sustainability agenda embedded at its core, with a constant focus on operational performance and value creation. As demonstrated this year, higher cash generation gives us increased strategic flexibility focused on technology and aligned to our customers' priorities, and enables us to deliver increased cash returns to shareholders.



Charles Woodburn
Chief Executive

The work of the Board continued

AGM vote and succession planning

As reported to shareholders last year, following an unsolicited offer made to the Chief Executive, Charles Woodburn, the Board agreed to take steps to secure his continued leadership of the Company. It did so having agreed the significant contribution that he had made since his appointment and the importance of his role in leading the Company at a critical time in its development. Based on feedback received from customers and other stakeholders, the directors believed that continuity in leadership was crucial to maintaining customer relationships and in sustaining the progress made in the execution of major defence programmes, which are vital to the long-term success of the Company.

With the support of the Board, the Remuneration Committee agreed certain changes to the Chief Executive's salary and incentives and achieved the objective of securing his continued service. Those changes were an important part of the Directors' Remuneration Report as put to shareholders at the Company's AGM in 2021. The resolution was passed with over three-quarters of votes cast in favour and the directors were very appreciative of the support the resolution received. The Board acknowledges the importance of shareholder views and feedback. We continue to engage with investors to maintain open dialogue and to ensure we understand their views. We recognise that from time to time, the views and priorities of shareholders may differ and we have to consider how best to balance these views when decision making. Prior to the meeting, largely facilitated by the Chairman, the Board engaged with shareholders accounting for nearly 70% of the Company's share capital. The depth of engagement was positively received as was the exceptional level of transparency in both the dialogue and also in the reporting provided by the directors in the 2020 Annual Report. This engagement provided the Board with a clear understanding of the ongoing support for the current senior executive team, but also feedback that the Board should ensure robust succession plans.

Executive director succession planning, therefore, was a key focus for the Board in 2021. It completed an in-depth review of succession plans for all Executive Committee level roles including the Chief Executive. This included a rigorous analysis of key executives identified as possible 'ready now' successors for each of these roles. More details of the review have been provided in the Nominations Committee Report (see page 126).

Similarly, non-executive succession remained an important topic for the Board as seasoned and valued members drew towards the end of their terms of office as independent directors, in accordance with the provisions of the UK Corporate Governance Code.

Capital allocation – share buyback decision

Having completed the Integrated Business Planning (IBP) process in November 2020, the Board recognised the long-term strength of the Company based on its programmes, technologies and customer relationships. The strong foundations of the business were evident in its performance, particularly with regard to cash. The long-term nature of many of the Company's key programmes and franchises provides a firm basis from which to forecast performance, and subject to risks and uncertainties, invest for the future. Against this background of improving performance and the outlook for the business, the Board undertook a review of capital allocation, and accelerated returns to shareholders.

The starting point for the Board in these discussions was its funding obligations to Company pension schemes – the basis of an important stakeholder relationship with employees past and present. With regard to its principal funding obligations to the main UK scheme, it was recognised that the Company had agreed a funding plan in 2020 that reduced the level of deficit significantly through deficit contributions totalling £1.4bn.

The Board also considered the long-term needs of the business and the investment required to help ensure it is well placed to continue to provide the capabilities required by our customers in the long term. Notably, during the previous year, the Board had agreed a £1.7bn investment in two new US businesses to help us access complementary technologies and accelerate profitable growth. In addition, the Company continues to benefit from considerable capital investment across all of its principal operations, much of which is funded by our customers as part of long-term commercial agreements and programmes. The Board has also agreed major capital expenditure investments to be funded by the Company, most notably in our US Electronic Systems business and the FCAS programme in the UK.

Against a background of continued investment in the Company and meeting its wider stakeholder obligations, the Board considered a proposal to initiate a share buyback programme that would have the effect of enhancing returns to shareholders.

In order to ensure the necessary operational flexibility in managing the Company's operations, the Board agreed the need to continue to manage the balance sheet conservatively and maintain its objective of paying dividends, in line with its policy of long-term sustainable cover of around two times underlying earnings.

A share buyback programme of up to £500m was agreed in July, noting that the return from this would be in excess of the Company's weighted average cost of capital. It also agreed in principle with the trustees of the main UK pension scheme as to the deficit recovery implications of a buyback, pursuant to which it was subsequently agreed that additional deficit funding would be provided to the value of 10% of the value of the buyback programme.

Climate change

At the end of 2020, the Company set a target of achieving net zero greenhouse gas emissions across our operations by 2030. The directors previously reviewed the proposed strategy for achieving this and considered the infrastructure and activity required to achieve the goal. Further work was undertaken by the Board during 2021 to continue to develop directors' knowledge and understanding of the Company's climate transition strategy and the associated risks and opportunities. In particular, it looked at how customer requirements were likely to change, in order to address the climate policies being adopted by government customers. Consideration was also given to the possible impact that climate change will have on the Company's supply chain and the Company's ability to react and innovate in delivering a sustainable future that addresses the challenges posed by climate change.

The Board has developed an initial understanding of the Company's climate transition priorities and risk profile, and this will continue to mature over time with the availability of more refined data.

As part of its Strategy Review the Board was provided with feedback on the results of customer engagement and the need to adopt more environmentally friendly solutions to reduce greenhouse gas emissions. The Board also considered the initial results of the work undertaken to identify key technologies required to address our customers' sustainability requirements. These have focused on step-changes in fuel efficiency and options to use non-fossil fuels to power land and maritime platforms. Based on our power management expertise derived from our US-based digital aero-engine controls business, the Company has been at the

forefront in providing sustainable transit bus solutions for some time. As part of the 2021 Strategy Review, the Board agreed the importance of continuing to identify and invest in sustainable solutions for defence and commercial customers.

Ethical business conduct

The success of the Group is underpinned by our ability to uphold high standards of governance and ethical business conduct.

The Board sets the ethical standards and values that guide all that we do as a Company. It also regularly reviews the activities that ensure we have a robust and effective ethics programme. At the end of 2020 the directors approved a refreshed Code of Conduct (the Code), after it had been reviewed, updated and externally benchmarked as part of a triennial review process.

The Code is an important part of how we embed our ethical standards and values into the organisational culture of the Company, which is facilitated by:

- leadership and role modelling;
- workforce communication and engagement;
- training and reinforcement; and
- encouraging the right behaviours, and the need to speak up.

During 2021, the Board reviewed ethical business conduct across the Company. It was informed that the roll-out of the refreshed Code of Conduct was ongoing and supported by our annual all-employee training programme based on discussions within teams. The Board was also provided with details of the contacts made to the Company's Ethics Helpline, analysing (on an anonymised basis) the reports made, including the nature of the matters reported.

The Board spent time considering how we maintain a robust, positive ethical culture that continues to reflect the changing needs of society, and is responsive to changes in the workplace – particularly one changed by the COVID-19 pandemic. The directors recognised our comprehensive approach to business conduct matters, welcoming the increasing use of data to provide greater insight into the workplace. They also appreciated the focus on employee engagement and communication aimed at bolstering a corporate culture that aligns with our values and behaviours.

Supply chain and customers

The Board was very aware of the supply chain challenges that many companies encountered during 2021, and received regular updates on the performance of our suppliers. Also, the Group's head of procurement briefed the Board on the actions that were being taken to manage any potential issues. It was informed that a proactive approach was being taken to manage supplier relationships with the Group working closely with suppliers to anticipate any issues and take action where possible to ensure continuity of supply. The value of long-term supplier partnerships was clearly shown during 2021, with our long-term global supply agreements – put in place prior to the pandemic – being of particular assistance in maintaining supply of certain critical commodities. In the UK alone, the Group supports over 5,000 suppliers and we are signatories to the UK government's Prompt Payments Code, through which we commit to assist those suppliers by paying promptly within the agreed payment terms. The Board is informed of any significant issues concerning our commitments under the Code.

Throughout 2021 the Board was briefed regularly on the status of our relationships with key customers. The Chief Executive and the President & CEO of our US business maintained a similar level of close contact with customers during 2021 as had been the case in 2020, despite the ongoing challenges of dealing with the pandemic. The decisions taken to support our employees during these difficulties fed through to our relationships with customers. For example, in the UK and Saudi Arabia, at the height of the pandemic, our employees continued to support Typhoon aircraft availability in very difficult circumstances, and our Maritime Services business successfully supported the Royal Navy in its first major Carrier Strike Group deployment. In the US, the decisions taken in past years to invest in new production capability and processes were critical to our ability to deliver an increased volume of combat vehicles to US military customers.

This year, provided there is a continued easing of pandemic restrictions, the Board will be looking to engage more directly with customers.

Community investment

In 2019 the Board sought shareholder approval to amend the Company's Articles of Association, in order to facilitate a programme that would unlock the value represented by unclaimed assets on our share register. Having received that approval, the Board agreed to a programme whereby unclaimed share assets were sold and the proceeds used to fund good causes benefiting the local communities in which we operate (with a proportion of funds retained to be used, should it be possible to locate the former owners of the assets at a future date). Importantly, it was also agreed that this would be in addition to our regular funding for community initiatives.

During 2021 a total of £1.8m raised through the programme has been committed to six community projects, further details of which can be found on pages 62 and 63. Further commitments will be made to community projects this year.

ESG engagement

ESG matters were discussed on a regular basis by directors throughout 2021 – be that through the Environmental, Social and Governance Committee or in the Board itself. Our core purpose connects us to our stakeholders and during the year the Board continued to engage in communicating our ambitions for ESG matters.

The directors have continued to stress the importance of maintaining our focus on ethical business conduct, the safety of our workforce and promoting a diverse and inclusive workplace. It is also taking action to ensure that we play our part in tackling climate change, and engage more deeply in explaining the important societal role played by our industry in helping government customers fulfil their defence and security obligations.

In October last year, the Company held an ESG event and the directors engaged with more than 130 investors and other stakeholders. The topics discussed at the event centred largely on our environmental responsibilities and the robust governance processes we apply to our products and services – all of which is in addition to the legal and regulatory controls applied by governments. The event was well received, and we have committed to holding further such events in future, aimed at increasing the level of transparency and accountability we provide to stakeholders.

Climate change and the environment

Climate change is one of society's greatest challenges. There is growing recognition of the impact of climate change on the future success of businesses. This includes, for our business, the physical impacts of climate change and the impacts of transitioning to a low carbon economy.

Solving the challenge of climate change requires all of us to act together, with urgency. One of the focus areas of our sustainability agenda is to play our part in addressing the significant and lasting impact of climate change. As a defence and security company, technology is at the core of our business and we must leverage this while progressing our ambition of net zero greenhouse gas emissions. Our goal is to develop and implement a long-term strategy that reduces the impact of our activities, supply chain and products on the environment.

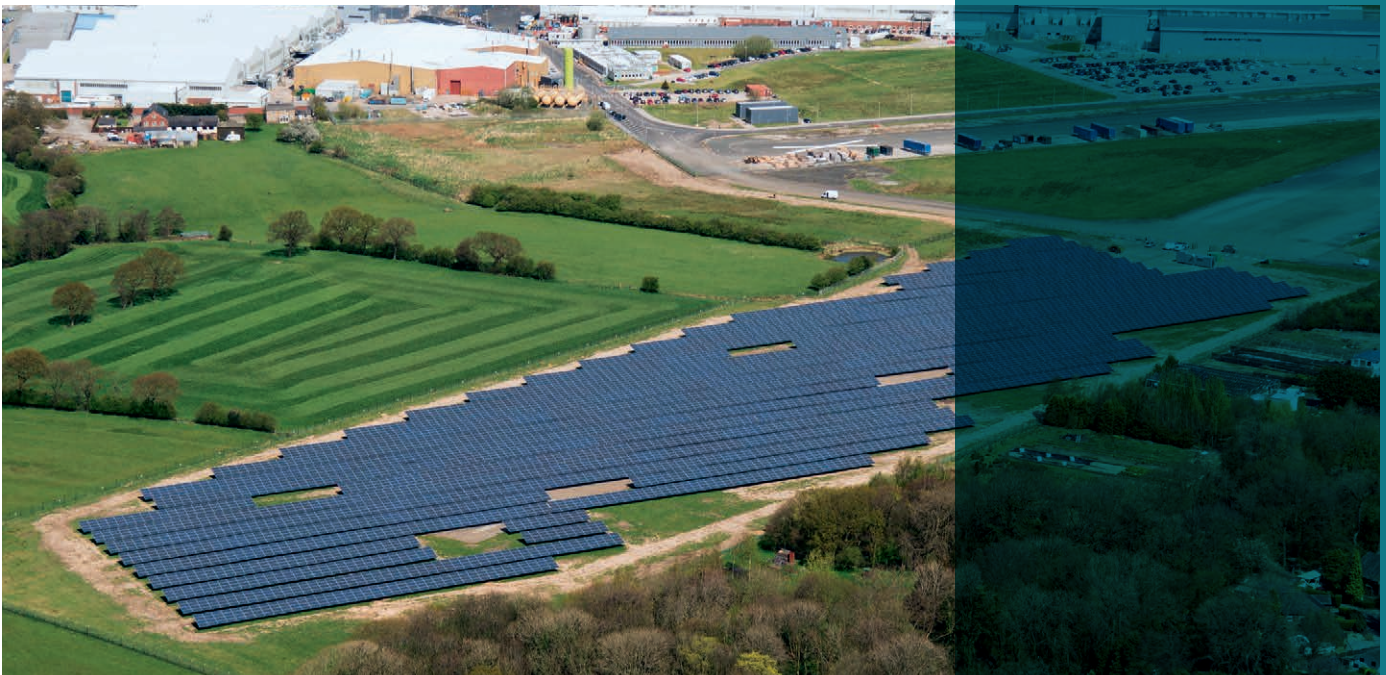
We are progressing our net zero ambition and are developing milestones in line with the UN Race to Zero via the Business Ambition for 1.5°C pathway. Part of our strategy is to reduce our energy consumption, purchase renewable energy and develop on-site renewable electricity supplies where practicable. As well as innovating for a net zero future for ourselves, we are also working with governments and commercial customers to design sustainable solutions to help reduce greenhouse gas emissions and assist them with their transition towards net zero. We also intend to work with our supply chain to reduce emissions.

We know that innovation is key to delivering a sustainable future and managing the challenges posed by climate change. We have a responsibility to use our expertise to pioneer new ways to tackle the very real threats of climate change, learn from others, collaborate and share best practice to achieve this common goal. We are already using technology to transform our operations. It is important for us as a defence company, to understand the challenges that climate change will bring so that we continue to design systems fit for operation in these future environments.

We are also managing our other environmental impacts too, supporting responsible consumption and managing environmental impacts across our operations. We recognise that all of our operations have an impact on the environment, from the energy and resources we use, to the products we manufacture and the waste we generate. We continue to look for ways to reduce energy use, water consumption and waste, emissions and other discharges, as well as to reduce the impacts of our products and supply chain.

Climate change and the environment

Climate risk and opportunity scenario planning



We welcome the development of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and recognise climate change as one of the biggest threats the world faces, and one which poses particular challenges to our business. Supporting a low carbon transition will enhance our business resilience by providing new opportunities.

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

To better understand how the potential long-term impacts of climate change could impact our business, in line with the TCFD recommendations, this year we have begun the process of climate change scenario analysis. We have conducted **qualitative climate change risk and opportunity hotspot mapping** with representatives from across our business to obtain a better understanding of the climate issues that could impact the business in the future.

We identified the climate-related risks and opportunities with the potential to impact BAE Systems' business model and strategy by developing high level impact pathways to demonstrate the causal links between the risk and opportunity drivers and the expected impacts based on likelihood of occurrence and the potential to impact the Group in terms of costs, revenue and asset value.

We are exposed to a number of **risks associated with a shift to a low carbon economy**, the most material of these risks over the medium to long term being the cost of substituting existing products and services with lower emissions options and disposal of legacy assets. Associated with this are potential risks around our ability to attract and retain future talent.

While we recognise these risks, **the opportunity around the transition** is also significant for BAE Systems over the medium to long term. There is an opportunity for us to play a key role in enabling the low carbon transition through our development of innovative new technologies. There is growing demand, and therefore revenue streams, for low emissions products and services from new and existing customers, including in adjacent sectors.

Beyond transition aspects, we also recognise the risks arising from **physical changes in climate**, in particular the potential impacts of extreme weather events impacting our operational sites and equipment where we operate around the world, as well as risks to our suppliers. We are already taking action around extreme weather events using analytical tools to apply natural catastrophe classifications to our main operational sites worldwide. In 2020, we conducted a refresh of this data and during 2021 we modelled climate scenarios for 2030, 2050 and 2085, which gives us a portfolio-level understanding of the Group's exposure to natural hazards, both current and future.

We have prioritised sites requiring hazard-specific surveys, which will lead to the identification and implementation of risk improvement recommendations, which may include investment to improve facilities, for locations not previously assessed. We are also modelling climate scenarios for Tier 1 critical suppliers.

We have conducted a qualitative review into the scenario attributes of orderly (below 2°C), disorderly (approximately 2°C) transition scenarios and a business as usual (greater than 4°C) scenario considering peer-reviewed, publicly available third party scenarios, including the International Energy Agency (IEA), Network for Greening the Financial System (NGFS) and the IPCC's Representative Concentration Pathways.

We have reviewed these qualitative scenarios along with the material risks and opportunities identified. We have significant experience in managing our exposure to physical risks and our strategy to manage those risks already takes into account different climate change scenarios. From the data we already have available we have a good view as to which of our assets are at most risk thereby enabling us to address those risks.

In relation to the transition risks we have incorporated the future sustainability of our operations and the further development of our net zero roadmap into our strategy. Our work to date in relation to net zero has focused on a 1.5°C pathway and based on current information we believe our strategy is sufficiently resilient to respond to transition risks associated with that scenario. We have started to progress quantitative climate change scenario analysis which will enable us to enhance the maturity of our views in this regard.

Climate change and the environment continued

We have included in this report climate-related disclosures consistent with the TCFD Recommendations and Recommended Disclosures pursuant to Listing Rule 9.8.6(R)(8). The following table summarises our disclosures and refers to where further detail on climate-related financial disclosures is located:


Governance

Our Board oversees, through the Environmental, Social and Governance Committee, our approach to sustainability, including climate change. The Committee ensures that appropriate climate change and environmental programmes are in place and incentives are set as required to reduce the Group's environmental impact.

Our Executive Committee receives regular updates and briefings on our net zero agenda and during 2021 were set bonus-related objectives (see page 152 of the Annual remuneration report) to support our progress in net zero, including supporting development of sector net zero roadmaps.

Day-to-day responsibility for environmental issues including climate-related issues sits with our Group ESG, Culture and Business Transformation Director.

Our Operational Framework provides a robust governance structure, policies and processes that manage climate-related issues wherever we operate.

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Strategy


During 2021, the Group revised its strategic framework to include 'advance and integrate our sustainability agenda', which includes our response to climate change and our net zero programme to reflect our commitment to sustainability.

In response to climate change we are developing and implementing a long-term strategy to progress our ambition of net zero greenhouse gas emissions across our operations and value chain. This strategy, which is aligned to the Paris Agreement, is intended to ensure that our business is resilient to climate-related risks and opportunities.

During 2021, we further developed our understanding of the climate-related risks and opportunities with the potential to impact BAE Systems' business model and strategy. We are now progressing quantification of material risk and opportunities against identified scenarios. Further work is planned for 2022 to enable us to develop our views in relation to the resilience of our strategy.

Our strategy starts with emissions reductions, for example improving energy efficiency and introducing cleaner technologies, and also includes purchasing renewable energy and collaborating across our value chain.

We also intend to continue to take into account opportunities associated with climate change, including the ways in which we can use our advanced engineering capabilities and world-class technologies to develop new products and services that support low carbon or reduced emissions requirements.

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Our net zero programme

Risk management

Our approach to identifying, assessing and managing environmental risks, including climate-related risk, is embedded within our approach to risk management. Environmental risks may present as financial or non-financial risks depending on the extent to which their impacts can be quantified, and how they have been classified.

Climate change and environment is a principal risk for the Group.

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Metrics and targets

Many of the climate-related risks and opportunities we face are related to the transition to a low carbon economy. The adoption of our net zero action plan is a key part of addressing these risks. Accordingly the key metric we are currently using to assess these risks is our greenhouse gas emissions data.


We report greenhouse gas Scope 1, 2 and 3 (employee business travel only) emissions in line with the Streamlined Energy and Carbon Reporting (SECR) regulations. We also report data on electricity, waste and water.

Businesses set objectives to improve the performance of their operations such as reducing energy used and the generation of waste, emissions and other discharges, such as effluents. Some of our businesses also set targets to reduce water consumption.

We aim to reduce our emissions as a minimum in line with the 1.5°C pathway by achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030 and by implementing the actions set out in our net zero roadmaps for the relevant businesses, and working towards a net zero value chain by 2050.

We have joined the UN Race to Zero via the Business Ambition for 1.5°C campaign.

Our UK business intends to submit net zero milestones for the Science Based Targets initiative during 2022. We will look to extend this to other parts of the Group as we mature the development of our net zero roadmap and our related internal processes.

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Climate change and the environment continued

Greenhouse gas emissions data¹

Absolute energy consumption²

	2021		2020	
	Global kWh	UK kWh	Global kWh	UK kWh
Energy consumption Scope 1 and 2 ²	1,624,601,505	725,396,538	1,700,834,942	669,133,482

Greenhouse gas emissions data

Scope definition	2021		2020	
	Global tonnes CO ₂ e	UK tonnes CO ₂ e	Global tonnes CO ₂ e	UK tonnes CO ₂ e
1 Emissions from activities which BAE Systems owns or controls (Scope 1) ²	142,241	76,133	151,190	69,948
2 Emissions from the electricity and steam purchased for BAE Systems' use (Scope 2 – location-based) ²	268,735	71,602	336,207	73,221
Total gross Scope 1 and 2 emissions²	410,976	147,735	487,397	143,169
3 Emissions from employee business travel (Scope 3) ³	24,094	4,145	54,769	11,941

Greenhouse gas emissions per employee⁴

	2021		2020	
	Global tonnes CO ₂ e	UK tonnes CO ₂ e	Global tonnes CO ₂ e	UK tonnes CO ₂ e
Per each full-time equivalent employee (Scope 1 and 2)	5	4	5	4

- Ramboll US Consulting, Inc. has provided independent third-party verification of BAE Systems' 2021 greenhouse gas (GHG) emissions, in order to provide limited assurance that based on the verification process and procedures conducted there is no evidence that the Company's reporting is not complete, not accurate, not consistent, not transparent and free of material discrepancies. BAE Systems' management is responsible for preparing the GHG inventory and for the collection and presentation of information within it. Ramboll's responsibility is to express conclusions on the agreed verification work and to determine based on the verification process and procedures conducted that there is no evidence that the work has not been prepared in accordance with the outlined methodology statement below. The reliability of the reported information and data is subject to inherent uncertainties given the available methods for determining, calculating or estimating the GHG emissions. It is important to understand our conclusions in this context.
- Relevant reporting period 1 November 2020 to 31 October 2021.
- Relevant reporting period 1 January 2021 to 31 December 2021.
- Including subsidiaries.

Methodology

The greenhouse gas emissions data is reported in line with the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard 'Operational Control' method. Our reporting boundary for Streamlined Energy and Carbon Reporting (SECR) is the same as our reporting boundary for the purposes of our financial statements. Emission factors for fuels and UK electricity are published at www.gov.uk/government/collections/government-conversion-factors-for-company-reporting. Emission factors for US electricity are published at www.epa.gov/energy/emissions-generation-resource-integrated-database-egrid. Electricity emission factors for Sweden, Saudi Arabia, Australia and Rest of World are published at www.iea.org/data-and-statistics/data-product/emissions-factors-2021.

For the 2021 reporting cycle, the 2021 UK government emissions factors published by the Department for Business, Energy and Industrial Strategy have been used. The most up-to-date Emissions and Generation Resource Integrated Database factors published by the US Environmental Protection Agency (EPA) are used for US electricity. For the 2021 reporting cycle, the most recent US factors are from the year 2019. The US EPA is due to release the updated 2020 figures in the first quarter of 2022, however they have not been released in time to be used for the current calculations.

The principal record of the Group's worldwide facilities is its legal department's Global Property Database.

Greenhouse gas emissions are primarily calculated from energy consumption records reported via the Group's global environmental database. Where actual usage data is not available for facilities and residences within the Global Property Database, an estimated consumption is used based on the type of building or previous consumption data.

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

Emissions from pension scheme properties not occupied by the Group are not included. Where a business or facility is acquired during a reporting year, it will be included in our reporting in the next full reporting year after the change. If a business or facility has closed during the reporting year, the site will be excluded from the boundary in the next full reporting year after the change. Emissions from subsidiaries are included in the data set.

The Scope 2 Greenhouse Gas Emissions associated with the Greenhouse Gas Protocol 'Market-Based' Method have been calculated as 232,856 tCO₂e. In line with the Greenhouse Gas Protocol Guidance, this figure has been calculated using residual-mix emission factors where available for our UK, US and Swedish operations. In our other significant operating regions, residual-mix emission factors are either unavailable or the resulting absolute emissions at Group level are within the margin of error and therefore country-specific emissions factors have been used in line with the Greenhouse Gas Protocol Guidance. If sites consume grid electricity backed by REGOs, this has been taken into consideration within the calculations.

The GHG emissions data generated in line with this methodology is used for preparing the SECR report.

Scope 1 emissions from refrigerant gases have been excluded from the SECR disclosure. These emissions have historically been excluded from the GHG inventory on the basis of technical feasibility. An annual strategic and risk review of refrigerant gas used in 2021 did not indicate that any change in this exclusion was required.

Diversity and inclusion

These ambitions will rely on a diversity of talent, and illustrate why diversity and inclusion remains a key business priority. In 2021 we established clear ambitions and metrics, embedding these within our process, practices, policies, systems and training.

The Group is committed to giving open, full and fair consideration to applications for employment from disabled people and people with health conditions or impairments who meet the requirements for roles. We also ensure training opportunities and appropriate accommodation are available to all. We firmly believe that the inclusion of all of our people, enabling them to contribute to the best of their ability, is vital to our business. Our commitment to disability inclusion and accessibility in the workplace can also be recognised through our pledge to support The Valuable 500 campaign.

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

These ambitions will be supported by a range of targets:

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

We also need more women in senior grades, including science, technology, engineering and maths (STEM) roles. In the past three years our gender diversity for senior managers has increased from 17.4% to 22.4%, with gains seen in our Engineering, Manufacturing and Operations, and Project Management functions. In 2021 we launched the Emerging Female Leaders programme to enable the progression of women at the mid-point in their careers.

However we are also looking at the broader pipeline of talent, and we have focused our efforts on those starting their career. In 2021, 23% of our 2,000 UK apprentices were female and our overall female population and those working in STEM roles also continued to grow.

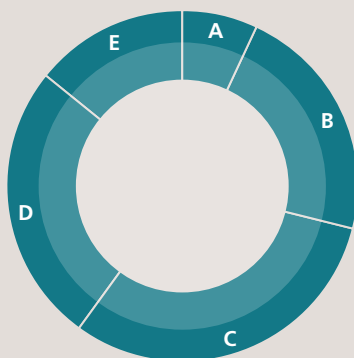
Recognising gender diversity is just one area of our focus. In 2021 we launched a major focus on self-identification, to support our aim to achieve broader diversity and inclusion in our workplace. To accelerate this we launched a UK campaign for employees to complete their characteristics and we established a plan of activity to improve our representation within the business. Examples include:

- early career and education outreach work to increase representation of females and ethnic minorities;
- inclusive hiring guidelines to adapt our language, recruitment process and experience;
- initiated and tested new talent management programmes for emerging female leaders and ethnic minorities;
- launched inclusive buddying and leadership development programmes to support those joining or advancing through the business; and
- initiated targeted support such as menopause awareness, support and training.

Gender diversity

	Male	Female
	9	5
Board	64%	36%
	256	74
Senior managers ^{1,2}	78%	22%
	64,000	18,000
Total employees ^{3,4}	78%	22%

Age diversity^{3,4}



A	24 years and younger	7%
B	25–34 years	22%
C	35–49 years	31%
D	50–59 years	26%
E	60 years and older	14%

Gender pay gap

We have published our fifth annual gender pay gap report in line with UK regulations. For 2021, the average gender pay gap for our UK workforce was 8.7% (2020 9.1%) which is 7.4% lower than the current UK national average of 16.1%. We rely on employing large numbers of employees with STEM qualifications and we, like other companies, face challenges recruiting females with these qualifications because there are significantly fewer women who study and work in these fields. As a result, a greater proportion of our workforce and our senior leadership population is male and this is a major factor in our gender pay gap. We continue to work hard to improve our gender balance and remain steadfast in our commitment to delivering the plans we have in place to increase the number of women in BAE Systems and support the progression of women into senior executive positions.

1. Senior managers are defined as employees (excluding executive directors) who have responsibility for planning, directing or controlling the activities of the Group or a strategically significant part of the Group and/or who are directors of subsidiary companies.
2. Executive Committee (excluding executive directors) and their direct reports.
3. Excluding share of equity accounted investments.
4. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes and controls are in place to collate and validate this data.

Board of directors



Sir Roger Carr
Chairman

Appointed to the Board: 2013 **Nationality:** UK
Skills, competence and experience

Sir Roger was appointed Chairman in 2014, having joined the Board in 2013 as Chair Designate. He is an experienced company chairman with a wealth of knowledge gained across a number of business sectors. With over two decades of boardroom experience, Sir Roger has a deep understanding of good stewardship, corporate governance and the enablers of board effectiveness.

Sir Roger is a Senior Advisor to KKR and provides board advisory services for certain of its companies, Chairman of the English National Ballet and Vice President of the Royal Navy and Royal Marines Charity.

He has previously held a number of senior appointments including Chairman of Centrica plc, Vice Chairman of the BBC Trust, Deputy Chairman and Senior Independent Director of the Court of the Bank of England, President of the Confederation of British Industry, Chairman of Cadbury plc, Chairman of Chubb plc, Chairman of Mitchells & Butlers plc, Chairman of Thames Water plc and Chief Executive of Williams plc.

Throughout his career he has served on a number of external committees including the Prime Minister's Business Advisory Group, the Manufacturing Council of the CBI, The Higgs Committee on Corporate Governance and Business for New Europe. He is a Fellow of the Royal Society for the encouragement of Arts, Manufactures and Commerce, a Companion of the Institute of Management, and an Honorary Fellow of the Chartered Governance Institute. He is also a Visiting Fellow of Said Business School, University of Oxford and holds an Honorary Doctorate in Business from Nottingham Trent University.

He was knighted for Services to Business in the Queen's New Year's Honours list 2011.

Other non-executive appointments
None.

Committee membership
Chair of Nominations Committee.



Dr Charles Woodburn
Chief Executive

Appointed to the Board: 2016 **Nationality:** UK
Skills, competence and experience

Charles joined BAE Systems in May 2016 as Chief Operating Officer and became Chief Executive on 1 July 2017.

He is an experienced business leader with over 25 years' experience in the defence and aerospace, and oil and gas industries. Prior to joining the Company in 2016, he was Chief Executive Officer of Expro Group, before which he spent 15 years with Schlumberger Limited holding a number of senior management positions in Asia, Australia, Europe and the US. He is a Fellow of the Royal Academy of Engineering.

Non-executive appointments
None.



Tom Arseneault
President and Chief Executive
Officer of BAE Systems, Inc.

Appointed to the Board: 2020 **Nationality:** US
Skills, competence and experience

Tom was appointed to the Board on 1 April 2020, serving as President and Chief Executive Officer of BAE Systems, Inc. Throughout his career, Tom has led complex organisations responsible for fulfilling critical and technologically challenging missions. Most recently he served as President and Chief Operating Officer of BAE Systems, Inc., having had a 23-year career in various senior roles within BAE Systems, Inc.

Prior to his senior leadership appointments, Tom managed various organisations and programmes for Sanders, a Lockheed Martin company, until it was acquired by BAE Systems in 2000. Earlier in his career, he held a variety of engineering and programme management positions with General Electric and TASC.

Non-executive appointments
None.



Brad Greve
Group Finance Director

Appointed to the Board: 2020 **Nationality:** US
Skills, competence and experience

Brad joined BAE Systems in 2019 as Group Finance Director Designate and joined the Board on 1 April 2020.

He is a highly experienced executive with deep financial and operational management experience, gained during a 30-year career in international engineering and technology businesses. Prior to joining the Company he held a number of senior executive roles in Schlumberger, undertaking roles in Europe, Africa, South America and the US.

Non-executive appointments
None.

■ Chairman
■ Executive director

Board of directors continued



Nick Anderson
Non-executive director

Appointed to the Board: 2020 Nationality: UK
Skills, competence and experience

As Group Chief Executive of a FTSE 100 industrial engineering company, Nick has a strong record of leading and growing global businesses. His knowledge and experience, particularly in leading international engineering and manufacturing operations, are a particular asset to the Board.

Since being appointed Group Chief Executive of Spirax-Sarco Engineering plc in January 2014, Nick has overseen the successful global growth of Spirax-Sarco Engineering, which serves customers in 130 countries worldwide. Prior to his roles at Spirax-Sarco Engineering, he was Vice-President of John Crane Asia Pacific and President of John Crane Latin America.

Other non-executive appointments
None.

Committee membership

Environmental, Social and Governance Committee, Innovation and Technology Committee and Nominations Committee.



Dame Elizabeth Corley CBE
Non-executive director

Appointed to the Board: 2016 Nationality: UK
Skills, competence and experience

Dame Elizabeth brings a wealth of investor, governance and boardroom experience to the Board. She is a former non-executive director of Pearson plc, and a non-executive director and Chair designate of Schroders plc. She chairs the board of the Impact Investment Institute, having previously chaired the industry Taskforce on Social Impact Investing for the UK government. She served as Chief Executive Officer of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016.

Elizabeth is active in representing the investment industry and developing standards within it. She is a member of the CFA Future of Finance Advisory Council, the AQR Institute of Asset Management at the London Business School, the Committee of 200 and the 300 Club.

Elizabeth is also an acclaimed writer, a Fellow of the Royal Society for the encouragement of Arts, Manufactures and Commerce and a trustee of the British Museum. Dame Elizabeth was awarded a DBE in the Queen's Birthday Honours List 2019.

Other non-executive appointments

Non-executive director of Morgan Stanley plc and Non-executive director and Chair designate of Schroders plc.

Committee membership

Audit Committee, Nominations Committee and Remuneration Committee.



Dr Jane Griffiths
Non-executive director

Appointed to the Board: 2020 Nationality: UK
Skills, competence and experience

Jane has experience in leading high technology businesses and international corporate leadership. She is Chair of Redx Pharma Plc, an AIM listed company. In a long executive career with Johnson & Johnson, she held various executive positions and led its Corporate Citizen Trust in EMEA and sponsored its Women's Leadership Initiative.

Jane previously had been Company Group Chair of Janssen EMEA, Johnson & Johnson's research-based pharmaceutical arm, where she was sponsor of Janssen's Global Pharmaceuticals Sustainability Council. She is a former Chair of the European Federation of Pharmaceutical Industries and Associations, past Chair of the PhRMA Europe Committee and former member of the Corporate Advisory Board of the UK government-backed 'Your Life' campaign, aimed at encouraging more people to study STEM subjects.

Other non-executive appointments

Chair of Redx Pharma Plc and Non-executive director Johnson Matthey Plc.

Committee membership

Chair of Environmental, Social and Governance Committee and member of Nominations Committee.



Crystal E Ashby
Non-executive director

Appointed to the Board: 2021 Nationality: US
Skills, competence and experience

Crystal has held various senior leadership roles within the energy and healthcare sectors and has considerable expertise in government affairs, legal and regulatory matters. She is currently the Executive Vice President and Chief People Officer of the US health insurance company, Independence Health Group.

In her executive career, Crystal held various senior leadership roles during a long career with BP America Inc., culminating with her appointment as Executive Vice President of Government and Public Affairs and Strategic University Partnerships and membership of its Americas Leadership Team. She is an Independent Director on the Board of Texas Reliability Entity and serves on the Engineering Dean's Leadership Advisory Board at the University of Michigan. She is a National Association of Corporate Directors Fellow and a member of the International Women's Forum and American Bar Association.

Other non-executive appointments

Non-executive director of Texas Reliability Entity.

Committee membership

Environmental, Social and Governance Committee and Nominations Committee.



Dame Carolyn Fairbairn
Non-executive director

Appointed to the Board: 2021 Nationality: UK
Skills, competence and experience

Dame Carolyn is a highly regarded business leader who served as Director-General of the Confederation of British Industry from 2015 to 2020. Carolyn spent her early career as an economist with the World Bank in Washington. She also worked in government as a member of the Number 10 Policy Unit during the 1990s, following which she became a partner at McKinsey specialising in digital and media, and held senior executive roles at the BBC and ITV.

She was previously a non-executive director of Lloyds Banking Group, The Vitec Group plc and Capita plc. She is also a former non-executive director of the UK Competition and Markets Authority, the Financial Services Authority and until 2016, a Trustee of Marie Curie.

Dame Carolyn was awarded a DBE in the Queen's Birthday Honours list 2019.

Other non-executive appointments

Non-executive director of HSBC Holdings plc.

Committee membership

Innovation and Technology Committee, Nominations Committee and Remuneration Committee.



Chris Grigg CBE
Non-executive director and
Senior Independent Director

Appointed to the Board: 2013 Nationality: UK
Skills, competence and experience

Chris is Chair of the UK Infrastructure Bank and Chair designate of Tilney Smith & Williamson. He has held a range of leadership roles including Chief Executive of Barclays Commercial Bank and, most recently, Chief Executive of The British Land Company PLC, a position he held for over 11 years. He brings extensive public company and business leadership experience to the Board.

He has more than 30 years' experience in the banking and real estate industries. Prior to joining British Land, he was Chief Executive of Barclays Commercial Bank. Before that, he was a partner at Goldman Sachs. Chris is a former member of the executive board of the European Public Real Estate Association and the board of the British Property Federation.

Other non-executive appointments

Chair designate of Tilney Smith & Williamson.

Committee membership

Environmental, Social and Governance Committee, Nominations Committee and Remuneration Committee.



Dr Ewan Kirk
Non-executive director

Appointed to the Board: 2021 Nationality: UK
Skills, competence and experience

Ewan has extensive experience in commercialising data science and quantitative analysis. He has led multiple ventures to identify, apply and leverage technology and mathematics research in both business and philanthropy.

In 2006, he founded Cantab Capital Partners, a science-driven investment management firm, which was acquired by GAM Investments in 2016 and one of the top-performing quantitative investment companies in the UK. Prior to founding Cantab, Ewan was Partner and Head of Quantitative Strategies Group at Goldman Sachs.

He is Chair of the Isaac Newton Institute for Mathematical Sciences, Chairman of DeepTech Labs, a UK-based venture capital fund that invests in deep technology businesses, and Co-Chair of the Turner Kirk Trust.

Other non-executive appointments
None.

Committee membership
Chair of Innovation and Technology Committee and member of Nominations Committee.



Nicole Piasecki
Non-executive director

Appointed to the Board: 2019 Nationality: US
Skills, competence and experience

Nicole has extensive experience gained from executive positions within the aerospace industry and leadership of multi-functional teams. She previously held a number of engineering, sales, marketing and business strategy roles during her 25-year career with the Boeing Company, including Vice President and General Manager of the Propulsion Systems Division and Vice President of Business Development & Strategic Integration for Boeing's commercial aircraft business, and President of Boeing Japan.

She is Chair of the Board of Trustees of Seattle University and an advisor to Mitsubishi Heavy Industries in Tokyo. Nicole formerly served on the Federal Aviation Authority's Management Advisory Board, the US Department of Transportation's Future of Aviation Advisory Committee and the Federal Reserve Bank of San Francisco's Seattle branch.

Other non-executive appointments
Weyerhaeuser Company and Howmet Aerospace Inc.

Committee membership
Environmental, Social and Governance Committee, Innovation and Technology Committee and Nominations Committee.

- Non-executive director
- Committee chair
- Audit Committee
- Environmental, Social and Governance Committee
- Innovation and Technology Committee
- Nominations Committee
- Remuneration Committee



Stephen Pearce
Non-executive director

Appointed to the Board: 2019 Nationality: AU
Skills, competence and experience

Stephen has 20 years' experience as a director of public companies and more than 30 years of financial and commercial experience in the mining, oil and gas, and utilities industries. He is currently Finance Director of Anglo American plc, a role he has held since April 2017, and a non-executive director of DeBeers.

He previously served as CFO and an executive director of Fortescue Metals Group Limited from 2010 to 2016. He is a Fellow of the Institute of Chartered Accountants, a Fellow of the Governance Institute of Australia and a Member of the Australian Institute of Company Directors.

Other non-executive appointments
None.

Committee membership
Chair of Audit Committee and member of Nominations Committee.



Ian Tyler
Non-executive director

Appointed to the Board: 2013 Nationality: UK
Skills, competence and experience

Ian brings considerable financial and long-term international contracting experience to the Board gained across a number of industrial sectors.

In his executive career, Ian held a number of senior finance and operational positions within industrial companies. He was appointed Finance Director of Balfour Beatty plc and subsequently appointed as Chief Executive in 2005. He is currently Chairman of Vistry Group PLC, Amey plc and Affinity Water Limited.

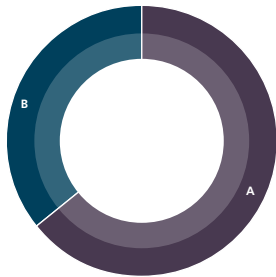
Ian was formerly Chairman of Cairn Energy PLC and non-executive director of Mediclinic International plc, Cable & Wireless Communications Plc and VT Group plc.

Other non-executive appointments
Chairman of Vistry Group PLC, Amey plc (a subsidiary of Ferrovial, S.A.) and Affinity Water Limited. Non-executive director of Anglo American plc.

Committee membership
Chair of Remuneration Committee and member of Audit Committee and Nominations Committee.

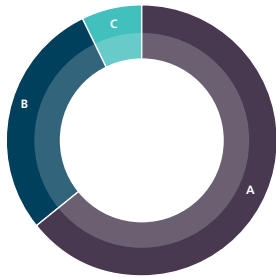
Board information

Gender



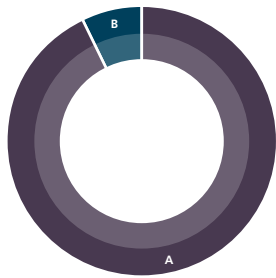
A Male	9
B Female	5

Nationality



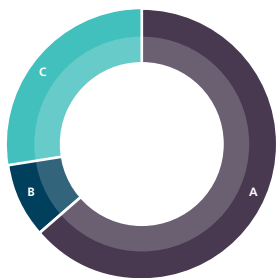
A UK	9
B US	4
C Australia	1

Ethnicity



A White	13
B Black	1

Tenure – independent non-executive directors



A Up to three years	7
B Over three and up to six years	1
C Over six years	3

Chairman
Non-executive director
Executive director

Committee chair
Audit Committee
Environmental, Social and Governance Committee

Innovation and Technology Committee
Nominations Committee
Remuneration Committee

Membership and attendance

	Board meetings	Committee membership	Audit Committee	Environmental, Social and Governance Committee	Innovation and Technology Committee ¹	Nominations Committee	Remuneration Committee
Sir Roger Carr²	9/9	N	–	–	–	5/5	–
Nick Anderson	9/9	E I N	–	3/3	1/1	5/5	–
Crystal E Ashby³	4/4	E N	–	1/1	–	2/2	–
Dame Elizabeth Corley	9/9	A N R	6/6	–	–	5/5	6/6
Dame Carolyn Fairbairn⁴	8/8	I N R	–	–	1/1	4/4	1/1
Jane Griffiths	9/9	E N	–	3/3	–	5/5	–
Chris Grigg	9/9	E N R	–	3/3	–	5/5	6/6
Ewan Kirk⁵	6/6	I N	–	–	1/1	3/3	–
Stephen Pearce	9/9	A N	6/6	–	–	5/5	–
Nicole Piasecki	9/9	E I N	–	3/3	1/1	5/5	–
Ian Tyler	9/9	A N R	6/6	–	–	5/5	6/6
Charles Woodburn Chief Executive	9/9		–	–	–	–	–
Brad Greve Group Finance Director	9/9		–	–	–	–	–
Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.	9/9		–	–	–	–	–

- The Committee's inaugural meeting was held in October 2021.
- Sir Roger Carr joined the Board in October 2013 and was appointed as Chairman in February 2014.
- Appointed on 1 September 2021.
- Appointed on 1 March 2021.
- Appointed on 1 June 2021.

The average length of appointment of non-executive members of the Board (as at 31 December 2021) was four years.

The average length of appointment of executive members of the Board (as at 31 December 2021) was three years.

Skills and experience

Risk management	5	1
Long-term contracting	6	3
Legal and regulatory	3	3
International business/commercial	11	3
Human capital management	1	
Financial/accounting	7	1
Environmental and social	5	
Engineering, science and technology	7	2
Company leadership	7	3
Board experience	10	

Executive
Non-executive

Nominations Committee report



Sir Roger Carr
Chairman of the
Nominations Committee

Members

Sir Roger Carr (Chairman)
Nick Anderson
Crystal E Ashby
Dame Elizabeth Corley
Jane Griffiths
Chris Grigg
Ewan Kirk
Stephen Pearce
Nicole Piasecki
Ian Tyler

Dear Shareholders

During 2021, the Nominations Committee spent time dealing with both long-term and shorter-term succession planning priorities, all based on a well-developed understanding of the future skills and experience required for both executive and non-executive members of the Board. In particular, all directors appreciate that executive succession planning for the most senior roles in the Company – and that of the Chief Executive in particular – is one of our highest priorities.

Board changes

As detailed in last year's Annual Report, Dame Carolyn Fairbairn and Ewan Kirk joined the Board as non-executive directors on 1 March and 1 June 2021 respectively. I am also delighted that, in the second half of the year we were able to appoint Crystal E Ashby to the Board as a non-executive director, with effect from 1 September.

Dame Carolyn has a deep understanding of business and government, having been Director General of the CBI, prior to joining the Company and having also enjoyed a long business career before that. Dame Carolyn will succeed Ian Tyler shortly as chair of our Remuneration Committee, a role she is well qualified for based on her business and board experience, including chairing and serving on the remuneration committees of other UK listed companies.

As we are a technology company, it is essential that the Board has a good understanding of the key technologies that will be critical to our future success and how workplace culture is critical in supporting the development of new technology and allowing innovation to flourish. Within the senior executive team, we have a deep understanding of the future capabilities our customers will require and the technologies that underpin them, but the Board recognised a particular need to enhance the level of technological awareness within the non-executive members. That led us to appoint Ewan Kirk as a non-executive director. He has extensive experience in identifying and leveraging emergent scientific research and know-how, and insight into the successful commercial exploitation of innovative technologies.

Ewan Kirk will chair a new committee established in 2021, the Innovation and Technology Committee, which will allow non-executives to engage in developing a deeper understanding of the technologies shaping our future and support the Board in making sound decisions in this area.

Given the very significant size and importance of our US business, I am pleased that we were able to increase the number of Americans on the Board with the appointment of Crystal E Ashby as a new non-executive director. She brings a wealth of experience, gained in a complex global business, having had a long career with BP America. Until recently, she spent some time as the interim President and Chief Executive of the Executive Leadership Council – a non-profit organisation that supports inclusive leadership principles and the development and advancement of black executives.

During 2021, the Committee continued to use the services of Julia Budd at the search consultants Russell Reynolds Associates to assist in identifying suitable candidates for appointment to the Board as non-executive directors. They provide other recruitment services to the Company but are not connected to any individual director.

We announced at the end of last year that Ian Tyler would be standing down from the Board as a non-executive director at the close of the Company's AGM in May this year, having served for nine years. Ian has been an excellent non-executive director, chairing both the Corporate Responsibility and Remuneration Committees during his time on the Board. Looking ahead, the Board will also be losing the valuable services of Chris Grigg, a non-executive director and our Senior Independent Director, who is planning to step down at next year's AGM. The Committee will be looking to appoint an additional non-executive director during 2022 to maintain the strength of the non-executive presence on the Board, and we are well advanced in this process.

Nominations Committee report continued

The Nominations Committee's year

January> March> July> October> December

Committee

Committee

Committee

Committee

Committee

Board evaluation 2021/2022

Evaluation provider

The evaluation was undertaken by Independent Board Evaluation (IBE), led by Ffion Hague. IBE is a standalone consultancy of independent practitioners, working solely on board effectiveness reviews. IBE do not provide other services to the Company and have no connections with any of the directors.

Period of evaluation

The evaluation was undertaken in the period between November 2021 and February 2022 with the report being presented by IBE at a meeting of the Board held on 23 February 2022.

Scope

The evaluation comprised a formal and rigorous annual evaluation of the performance of the Board, its committees, the Chairman and individual directors.

Evaluation process

The findings of the evaluation were principally based on information gathered through a series of structured interviews undertaken by Ffion Hague and held with all the directors, Company executives that support the Board and its committees, and also certain individuals from outside the Company that attend Board committee meetings on a regular basis. Also, IBE undertook a data-based benchmarking exercise reviewing the Board relative to similar sized companies in the FTSE 100 and also the companies in the Aerospace & Defence sector.

Ffion Hague was an observer at one of the Board's scheduled meetings and also at meetings of the Audit, ESG and Nominations committees.

The evaluation covered a wide range of matters including the following:

Board

- Shareholders: oversight and relationship
- Strategy: oversight and implementation
- Governance
- Board focus and priorities, use of time
- Risk management
- Succession planning for key board and management roles
- Composition of board – skills, diversity and experience
- Employee engagement
- Selection and induction of new members
- Meetings: frequency, quality, duration
- Quality of papers and presentations
- Resourcing levels: timeliness of papers, support functions

Board committees

- Membership: skills, experience, competence and induction
- Meetings: frequency, quality, duration
- Chairmanship
- Clarity of objectives and terms of reference

Chairman

- Quality of contribution
- Board leadership
- Independence and objectivity
- Understanding of own/others' roles
- Chairing skills
- Agenda setting
- Time commitment

Individual Board members

- Quality of contribution
- Skills, experience, competence
- Time commitment
- Quality of perspective brought to Board discussion

Feedback

A comprehensive report evaluating the Board's performance was produced by IBE, which was provided to Directors ahead of the Board meeting held on 23 February 2022. The principal findings and recommendations from the report were presented to the Board by Ffion Hague. The report provided feedback on the areas covered by the evaluation. Reports were also provided to each of the committees on the findings from the evaluation as they apply to them. The Chairman will provide feedback from the evaluation to individual directors. The Senior Independent Director will provide feedback on the Chairman's own performance after he has met with all the non-executive directors to consider the report provided by IBE.

Key resulting actions

Succession planning – continue to focus on executive development and succession planning and provide the Board with opportunities to engage with high-potential individuals.

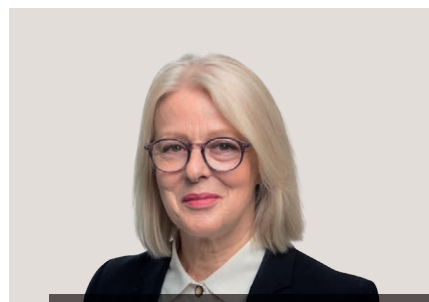
Culture – ensure that we continue to evolve the culture of the Company to reflect wider society and drive the pace at which we aim to meet our diversity and inclusion ambitions.

Strategy – engage further in developing our understanding of the key attributes and technologies required for the long-term success of the Company.

Employee engagement – ensure that we maximise opportunities for directors to engage directly with employees and develop further the means by which Board members receive direct feedback from our workforce.

Induction – ensure that the induction process for new non-executive directors is tailored to individual needs and that, post pandemic restrictions, such directors have the opportunity to visit our sites and learn more about the business.

Environmental, Social and Governance Committee report



Jane Griffiths
Chair of the
Environmental, Social and
Governance Committee

Members

Jane Griffiths (Chair)
Nick Anderson
Crystal E Ashby
Chris Grigg
Nicole Piasecki

Dear Shareholders

When I wrote to you last year, I stated that in addition to keeping the impact of COVID-19 on our stakeholder groups under review, our priorities were to monitor our progress against the net zero target, and continue to focus on health and safety performance, and on diversity and inclusion. In this report, I hope to provide an overview of the workings and discussions of the Committee in 2021.

During the year, we welcomed Nick Anderson and Crystal E Ashby to the Committee. Our refreshed composition provided an opportunity to review the Committee name, Terms of Reference and our employee engagement approach.

At our meeting in February, we reflected on the evolution of activities formally described as Corporate Responsibility, to a more integrated approach, which focused environmental, social and governance (ESG) themes as the building blocks to the creation of long-term sustainable success for the Company. We considered that to truly succeed, these activities must be embedded and confirmed as integral to the Company and the remit of the Committee should reflect this. Accordingly, in July, the Committee changed its name from the Corporate Responsibility Committee, to the Environmental, Social and Governance Committee, to reflect the intrinsic nature of ESG themes to good governance practice.

We also reviewed the Committee's Terms of Reference, and sought to codify our responsibilities in respect of monitoring the Company's progress against its net zero, decarbonisation strategy, and more broadly, to reflect the work of the Committee within recent years. The revised Terms of Reference of the Committee may be found on the Company website¹.

Environment and climate transition

The Board oversees, through the Committee, the Company's ESG performance. We monitor the Company's performance against selected external sustainability indices and review its performance on ESG matters. Climate change is one such matter and the Committee oversees the Company's response in respect of its own impacts on the environment and its response to the potential impacts of climate change on the Company's future and current operations.

The Board has the responsibility to ensure that climate-related risks and opportunities are appropriately addressed. We understand that without effective climate governance structures, it will be difficult to make informed strategic decisions, manage climate transition risks and monitor the associated metrics to achieve our climate-related goals. The Committee supports the Board in overseeing the progress of the executive in ensuring that the Company takes an integrated, strategic approach to addressing climate transition risks and opportunities.

In order to effectively discharge our oversight duties, we regularly engage with, and challenge members of the executive team – the Chief Executive, President and CEO of BAE Systems Inc., Group Finance Director, Group General Counsel and Group Human Resources Director are invited to attend all the meetings of this Committee. Additionally, we receive updates from internal subject matter experts, and training from PwC partners, with climate-related expertise. We do this in order to develop and maintain our collective understanding and awareness of climate change as it pertains to the Company. These insights in turn, allow us to oversee the work of the executive team, who are responsible for the operational management of climate transition risks and opportunities.

In 2020, the Company set a target of achieving net zero greenhouse gas emissions across its operations by 2030 and during 2021, and at our February and July meetings, we received updates on the progress against this target. In September, the Board received training from PwC on sector-specific climate matters which supported the development of our understanding regarding The Financial Stability Board's Task Force on Climate-Related Financial Disclosures. During 2022, we will continue to work with external and internal subject matter experts, to develop our understanding of climate change, emerging climate risks and opportunities.

1. https://investors.baesystems.com/~/_media/Files/B/Bae-Systems-Investor-Relations-V3/PDFs/board-committees/esg-committee-terms-of-reference.pdf

Workforce engagement

Following the publication of the Financial Reporting Council's findings on Workforce Engagement, we reviewed contemporary employee engagement practices and effectiveness of the model adopted by the Company.

In accordance with Provision 5 of the UK Corporate Governance Code (the Code), the Board is required to maintain an effective mechanism to engage with the workforce. In 2019, the Board agreed that the most appropriate and effective method of undertaking employee engagement was for the Committee to take up this responsibility.

This decision was made on the basis that engaging with employees had been a part of the Committee's activities since it was established. The non-executive membership of the Committee met the same independence criteria as appointing a single non-executive director, as proposed in the Code. The size and complexity of the business, with 89,600 employees across more than 40 countries, meant that there were practical advantages to the role being performed by more than one director.

The Committee reflected on the changing nature of employee engagement, particularly in light of the COVID-19 pandemic and the efficacy of our employee engagement framework. We agreed that the Committee was still best placed to undertake employee engagement on behalf of the Board, as the reasons outlined above were still applicable.

Through our employee engagement framework, we maintain an overview of the perspectives of the global workforce. The mix of data and engagement with employees, operational and senior management, provide different lenses which in turn are represented at the Board table. This allows us to have meaningful conversation about how strategic decisions may affect members of the global workforce. From 2022, in addition to my Committee report to the Board, I will provide a separate employee engagement update, to ensure the employee voice and their considerations continue to be represented during boardroom discussion.

As a result of COVID-19 restrictions during the year, the Committee was limited on opportunities for physical employee interaction but below are the details of discussions regarding workforce matters and where we were able to meet with employees physically in 2021. In 2022, we will continue to build on our employee engagement programme and will approach our workforce engagement thematically, focusing on elements of environment, social (safety, diversity and inclusion, community engagement etc) and governance, to lead our engagement with the workforce.

Health and safety

The safety and health of our workforce is a priority and in 2021, we regularly reviewed global safety performance. It was disappointing to see that the year began with poor safety performance in Q1 but we were glad to see continued improvement throughout the year. In 2021, the Group had a recordable injury rate of 493 (485 in 2020) and had 32 (37 in 2020) major injuries. We noted that, there were operational initiatives to reverse the recordable injury rate but there was a lack of clarity as to the root cause. Further work was undertaken by the executive team, which subsequently reported that the increase in injuries was largely due to the primary focus of the businesses being on COVID-19 safety and the associated restrictions such as mask wearing. There was also evidence that changes in the workplace may have distracted employees from traditional safety messaging.

The introduction of behaviour-based workplace safety programmes has provided a more consistent framework against which to monitor outcomes, compare sectoral performance and provide better visibility of near-misses and opportunities to develop proactive reporting. During the year, communications were also refreshed to re-emphasise safety practices, and we were pleased to see safety performance improve from Q2.

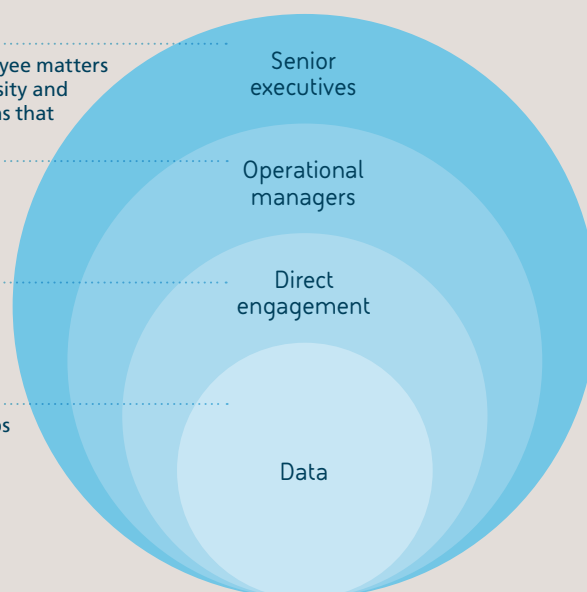
Employee engagement framework

Hear from executives on employee matters such as safety, wellbeing, diversity and inclusion and company decisions that could impact employees.

Review employee sentiment and wellbeing surveys and other data sources evidencing employee views.

Learn from operational management teams on the practical application and impact of workforce policies.

Direct engagement with groups of employees.



Workforce matters

Culture
Business conduct
Diversity and inclusion
Environment
Health and safety

Workforce interaction by members of the Committee

April
Visit to Warton and Samlesbury
May
Visit to Portsmouth
September
Visit to Govan
October
Video messages
November
Visit to Govan to attend COP26
Throughout the year
Attendance at the CEO/TU forums

Statutory and other information

Company registration

BAE Systems plc is a public company limited by shares registered in England and Wales with the registered number 1470151.

Directors

The current directors who served during the 2021 financial year are listed on pages 115 to 117. Dame Carolyn Fairbairn, Ewan Kirk and Crystal Ashby were appointed to the Board as non-executive directors on 1 March, 1 June and 1 September 2021, respectively.

On 20 October 2021 the Company announced that Ian Tyler would retire from the Board at the conclusion of the Company's Annual General Meeting on 5 May 2022.

Dividend

An interim dividend of 9.9p per share was paid on 30 November 2021. The directors propose a final dividend of 15.2p per ordinary share. Subject to shareholder approval, the final dividend will be paid on 1 June 2022 to shareholders on the share register on 22 April 2022.

Annual General Meeting (AGM)

The Company's AGM will be held on 5 May 2022.

Certain information in the Strategic report

The following items are set out in the Strategic report on pages 1 to 113:

- disclosures in relation to the use of financial instruments;
- particulars of important events affecting the Group which have occurred since 31 December 2020;
- an indication of likely future developments in the business of the Group;
- an indication of the activities of the Group in the field of research and development;
- actions taken to introduce, maintain or develop arrangements aimed at employees;
- greenhouse gas emissions;
- employee engagement (including regard to employee interests and encouraging employees to be shareholders);
- fostering business relationships with suppliers, customers and others; and
- policy in relation to employment of disabled persons.

Office of Fair Trading undertakings

As a consequence of the merger between British Aerospace and the former Marconi Electronic Systems businesses in 1999, the Company gave certain undertakings to the Secretary of State for Trade and Industry (now the Secretary of State for Business, Energy and Industrial Strategy). In February 2007, the Company was released from the majority of these undertakings and the remainder have been superseded and varied by a new set of undertakings. Compliance with the undertakings is monitored by a compliance officer. Further information regarding the undertakings and the contact details of the compliance officer may be obtained through the Company Secretary at the Company's registered office or through the Company's website.

Profit forecast

In its half-year results announcement on 29 July 2021, the Group made the following statement in respect of the year ending 2021, which is regarded as a profit forecast for the purposes of the Financial Conduct Authority's Listing Rule 9.2.18 (and which replaced the profit forecast made in the Group's Annual Report 2020):

"Whilst the Group is subject to geopolitical uncertainties and there remain uncertainties arising from the COVID-19 pandemic, progress continues in combatting the virus under the vaccination programme in our major markets and our good operational performance underlines our overall confidence in the full year guidance. Our full year guidance, issued earlier this year, was provided on the basis of an exchange rate of \$1.35:£1. Our results for the first half year have been reported at an average rate of \$1.39:£1.

"Given the strong operational performance to date, we continue to expect reported underlying EBIT to increase in the range of 6% to 8% over 2020 and underlying EPS to increase in the range of 3% to 5% over 2020, even if the higher than guided \$:£ exchange rate continues to year-end."

In the Group's Market Update on 8 November 2021, the Group clarified that the Underlying EPS forecast "Excludes the one-off tax benefit of 2.9p".

Underlying EBIT was £2,205m in 2021. Underlying earnings per share was 47.8p in 2021, excluding the one-off tax benefit of 2.9p.

Political donations

No political donations were made in 2021.

Issued share capital

As at 31 December 2021, BAE Systems' issued share capital of £85,092,881 comprised 3,404,167,171 ordinary shares of 2.5p each and one Special Share of £1.

Share buyback

During the year, 65,124,972 ordinary shares of 2.5p each were repurchased under the buyback programme of up to £500m announced on 29 July 2021 and such repurchased shares have been cancelled. The total consideration for the purchase of the shares, including commission and stamp duty, was £371,035,840. The percentage of called up share capital (excluding treasury shares) as at 31 December 2021, which the shares repurchased in 2021 represents, is 2.06%.

Treasury shares

As at 1 January 2021, the number of shares held in treasury totalled 248,995,549 (having a total nominal value of £6,224,889 and representing 7.2% of the Company's called up share capital at 31 December 2020). During 2021, the Company used 12,188,518 treasury shares (having a total nominal value of £304,713 and representing 0.4% of the Company's called up share capital at 31 December 2021) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (6,880,958 shares in aggregate), awards under the Free and Matching elements of the International Share Incentive Plan (773,801 shares in aggregate), awards vested under the Performance Shares element of the Long-Term Incentive Plan (2,415,958 shares), awards vested under the Restricted Shares element of the Long-Term Incentive Plan (1,704,288 shares), and options exercised under the Executive Share Option Plan (413,513 shares). The treasury shares utilised in respect of the Share Incentive Plan, the International Share Incentive Plan, and the Performance and Restricted Shares elements of the Long-Term Incentive Plan were disposed of by the Company for nil consideration. The 413,513 shares disposed of by the Company in respect of the Executive Share Option Plan were disposed of by the Company for an aggregate consideration of £1,637,002. As at 31 December 2021, the number of shares held in treasury totalled 236,807,031 (having a total nominal value of £5,920,176 and representing 7.0% of the Company's called up share capital at 31 December 2021).