



# Annual Report 2020 BAE Systems plc

[baesystems.com](https://baesystems.com)

**BAE SYSTEMS**

# 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 04  
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 and we have a deep commitment to supporting the communities in which we work and to reduce the environmental impacts of our activities.
- At the heart of our business we are performance driven and values led.

 Page 08  
Our stakeholders

Further information can be found online by visiting  
[baesystems.com](https://baesystems.com)

We have announced recently that Dame Carolyn Fairbairn and Dr Ewan Kirk will join the Board as non-executive directors on 1 March and 1 June respectively. Dame Carolyn, who was until recently Director-General of the Confederation of British Industry, brings extensive business leadership and commercial experience across multiple business sectors, and Ewan brings a deep insight and knowledge of emergent digital technologies, that have been the basis for a successful business career. We are looking forward to them joining the Board and adding further to the quality of our deliberations and oversight. To complete the planned changes to the Board, we will be looking to make one further non-executive appointment later this year.

### Executive directors

During the course of the year, Jerry DeMuro retired from the Board as the Chief Executive Officer of BAE Systems, Inc., and Peter Lynas retired as the Group Finance Director. Both executive directors contributed enormously to strengthening the rigour, discipline and performance of the Company and their service was valued and appreciated.

Following their retirement, there was a seamless transition in the US through the promotion of Tom Arseneault from President and Chief Operating Officer to President and Chief Executive Officer of BAE Systems, Inc., and to Brad Greve as Group Finance Director, who had been recruited for that role some months before.

Charles Woodburn completed his third year as an outstanding and highly effective Chief Executive, with the newly-appointed directors now fused into a strong leadership team. The complete refreshment of the executive board in recent times has been an important step in reinvigorating the Company and providing a secure platform on which to build a promising future in the interests of all stakeholders.

### Summary

In summary, we are pleased to have delivered another year of strong performance, especially against the backdrop of a global pandemic, with sales of £20.9bn, underlying earnings per share of 46.8p, underpinned by an order backlog of £45.2bn and free cash flow of £367m.

In a challenging environment, the business has performed well and my thanks go to all of our colleagues, suppliers, customers and stakeholders who have made this possible.

None of us will ever forget 2020, but as the new year begins, I am confident that the Company has stronger foundations than at any time during my tenure as Chairman, and is well placed to face whatever is ahead.

The Board, therefore, has recommended a final dividend of 14.3p for a total of 23.7p for the full year. Subject to shareholder approval at the May 2021 Annual General Meeting, the dividend will be paid on 1 June 2021 to holders of ordinary shares registered on 23 April 2021.



**Sir Roger Carr**  
Chairman

There are good prospects in existing and new international markets for our products and services in air, maritime, land and cyber security. Defence and security remain high on national agendas with the need in many cases to recapitalise or upgrade ageing equipment.

The US continues to represent the world's largest defence budget and accounts for around 45% of our sales. The Group's US-based portfolio remains well aligned to customer priorities, growth areas, and the US National Defense Strategy, which we expect to continue under the new administration. The backlog for the US-based business has continued to grow both organically and through the two acquisitions successfully closed during the year. This backlog provides good visibility of growth in the US business.

In the UK, where we are the largest defence contractor, defence and security spending is set to increase over the next four years. The Integrated Foreign Policy, Defence and Security Review is due to be published early in 2021, and the UK government has made a series of recent programme announcements related to the review. Similarly in Australia, where we are the leading defence contractor, the business is set to grow significantly in the coming years as the Hunter Class Frigate programme matures. The government announcement in July to increase its ten-year investment in new and upgraded defence capabilities from A\$195bn to A\$270bn should provide further opportunities to enhance and extend our growth profile.

In Europe, a number of nations are increasing their defence budgets to address the threat environment and move towards their 2% of GDP NATO commitments. We remain well placed through our positions on the Eurofighter Typhoon, our shareholding in MBDA and our BAE Systems Hägglunds Sweden-based land vehicles business.

In our Middle East markets, our long-standing relationships at government and company levels, continued regional instability and in many areas the nature of our long-term contracts, mean we expect defence and security to remain a priority despite the impacts of the current low oil price.

The civil aerospace market accounts for around 5% of Group sales. COVID-19 significantly impacted this market, and a recovery to 2019 levels is likely to be some years away. Despite the near-term challenges, 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.

### Brexit

BAE Systems will support the UK government in achieving its aim to ensure that the UK maintains its key role in European security and defence post-Brexit and to strengthen bilateral relationships with key partners in Europe. This will be important for ongoing collaboration in the development of defence capabilities.

The Group has relatively limited UK-EU trading and the majority of persons employed in the UK are UK nationals, with only limited movement of EU nationals into and out of the Group's UK businesses. We have been working with our supply chain throughout the Brexit process to mitigate any major disruptions. Accordingly, the resulting impacts of Brexit across the business are expected to be limited.

### Balance sheet and capital allocation

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.

Consistent with this approach, the Group expects to continue to meet its pension obligations, invest in research and technology and pursue 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. Investment in value-enhancing acquisitions and returns to shareholders through a share buyback will be considered in line with our clear and consistent strategy and capital allocation policy.

In April, BAE Systems issued \$1.3bn (£1.0bn) of ten-year bonds to fund the £1bn contribution into the BAE Systems Pension Scheme. In September, BAE Systems issued \$2.0bn (£1.5bn) of bonds, the proceeds of which were applied in the repayment of the \$1.9bn bridge loan facility that had been drawn to fund the acquisition of the Military GPS business.

### Post-employment benefits schemes

The Group's share of the pre-tax accounting net post-employment benefits deficit remained in line with the prior year at £4.5bn. The impact of significantly lower discount rates increased liabilities, which offset asset returns and the Group's contributions into the schemes.

Under the funding deficit recovery plan agreed in February 2020, a one-off payment of £1bn was made in April. Approximately £261m of funding was paid in the year, and in December, we also took the opportunity to make our March 2021 deficit payment of £161m ahead of schedule. The next triennial review is scheduled for 2022.

### Executive Committee changes

At the start of 2020 Ben Hudson was appointed as Chief Technology Officer, replacing Nigel Whitehead who announced his intention to retire.

### Summary

As demonstrated this year, through execution of our strategy, BAE Systems is well placed to maximise opportunities, deal with the challenges, and deliver a business focused on sustainability and generating shareholder value.

In this challenging year we have built resilience into the business, returned the defence business to a near normal operational tempo, and completed our two US acquisitions smoothly. Relationships with, and support from our customers remains strong, with governments in our key markets continuing to prioritise defence and security. We are investing in technology aligned to our customers' priorities. Our large order backlog, incumbent programme positions and evolving pipeline of opportunities mean we are well placed to deliver profitable top-line growth with increasing cash conversion in the coming years.



**Charles Woodburn**  
Chief Executive

# Environment

Our goal is to develop and implement a long-term strategy that reduces the impact of our activities and products on the environment, whilst progressing our ambition of net zero greenhouse gas emissions across our operations and value chain. We aim to improve energy efficiency, introduce cleaner technologies, collaborate across our value chain, and mitigate climate-related risk, both physical and transitional.

## Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD was founded in 2015 by the Financial Stability Board, to improve and increase reporting of climate-related financial information. In 2017, the TCFD made its first recommendations designed to help companies provide better information to support stakeholders in understanding a company's exposure to climate-related risk.

We are committed to implementing the recommendations of the TCFD, to ensure we are aligned to them by the end of 2021 and beginning to report our status in 2022. They are an important step towards enabling a net zero economy.

## Environmental strategy

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 are committed to high standards of environmental management and undertake activities with the aim of reducing the environmental impact of our operations, products and supply chain.

To do this, we have taken a business-led approach to setting reduction targets and driving improvement programmes and activities to reduce our environmental impacts.

Activities have included installing a solar array on company land, moving to LED lighting systems, decommissioning carbon intensive coal fired boilers, installing a reed bed to clean effluent, designing buildings to meet BREEAM standards, re-using heat in a maritime platform and installing a Combined Heat and Power plant at the Portsmouth Naval Base and changing behaviours through implementing energy management systems.

## Our ambition to achieve net zero

We recognise the need to accelerate our response in relation to climate change including the alignment of our business with the goals of the Paris Agreement. As a result, during 2020, environmental leads and functional representatives from across the business worked together to scope a net zero ambition for the Group. Following this first phase of work, BAE Systems can now outline its ambition to get to net zero.

## We define net zero as achieving a state in which our activities result in no net impact on the climate from greenhouse gas emissions.

We have set ourselves the target of:

- achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030. We aim to do this by reducing our emissions as a minimum in line with the 1.5°C pathway; and
- working towards a net zero value chain by 2050.

We recognise we cannot do this alone. We intend to collaborate with our suppliers and customers, and partner with researchers and technologists to innovate for a net zero future.

During 2021 we will move to the next phases of our net zero programme.

Phase two of our programme will focus on developing a net zero roadmap and will consider the use of several strategic levers, to enable emissions to be reduced as far as possible, including activities relating to:

- low/zero carbon products;
- our supply chains;
- renewable energy;
- energy efficiency in our facilities and buildings; and
- business travel.

In phase three our operating model and the capabilities that will be required to transition to a net zero organisation will be assessed and key performance metrics and interim targets identified.

Phase four will involve implementing the changes required to deliver our net zero strategy.

## Governance of environment

Responsibility for climate change and environmental issues sits with our Chief Executive. He is the owner of our Environmental Policy, which details our commitment to addressing environmental impacts related to our products and activities, including climate change.

He is supported by the Board and Corporate Responsibility Committee in ensuring that an appropriate climate change and environment programme and performance objectives are set and flowed down across the business. These objectives are intended to reduce the Group's environmental impact, including climate change impact, in the immediate and long term, to enable the Group to deliver against its climate change and environmental commitments. The Corporate Responsibility Committee monitors progress in this area.

## Our net zero programme





Our Environmental Policy mandates that we have an environmental management system (EMS) in place for all of our businesses. Short- and long-term risks outlined below are built into business EMS systems. Part of the EMS process is to define issues and set appropriate targets for the reduction of environmental and climate change impacts and risks.

### Environmental risk management

Our approach to identifying and assessing environmental risks is embedded within our approach to risk management (see page 90). 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.

The Group operates in a highly regulated environment across many jurisdictions and is subject to regulations relating to environmental factors including but not limited to climate change, therefore consideration of current and emerging regulation within our environmental management system is key to mitigating risk. Identified regulatory risks include energy-related taxes and the increased costs of compliance with energy-related schemes.

Understanding how the business may be impacted by its environmental factors is also a key component of mitigating emerging, medium- and longer-term risk. Water scarcity is an example of an environmental factor that has the potential to impact our operations, for example, if a site extracts water for process use.

Extreme weather events are another key environmental factor. These weather events, primarily flood risks, have the potential to directly impact our operations and, in turn, programme schedules. BAE Systems uses analytical tools to apply natural catastrophe classifications to each of its sites worldwide. This has informed our strategy as to where to target a programme of specific flood, windstorm and earthquake assessments of our sites and implement the subsequent risk reduction recommendations. The relocation of our Fort Wayne site is a good example of where we have worked to mitigate the risk of future river flood events. In 2020, we conducted a refresh of this data and during 2021 we will be modelling climate scenarios for 2030, 2050 and 2085.

Other direct environmental risks include:

- breaches of environmental requirements resulting in fines and/or the termination of permits;
- advancing technology and innovation;
- changes in regulatory requirements; and
- social and political change, differing legislation and policy in our various markets.

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

Risks associated with the transition towards net zero are also identified and these will be further assessed as part of our net zero programme via the phased approach outlined above. We also continue to take into account opportunities associated with climate change, including the ways in which we can use our advanced engineering capabilities to develop new products and services that support low carbon or reduced emissions requirements.

### Our approach to environmental targets

Due to the differences in geography and stage of manufacture of platforms and programmes, each business implements its own environmental targets and initiatives. Businesses set objectives to improve the performance of their operations and reduce energy used and the generation of waste, emissions and other discharges, such as effluents. Our businesses also set targets to reduce water consumption.

During 2020 we have implemented energy efficiency measures at a number of sites across multiple business units and geographies. The most notable include the continuation of a steam rationalisation project to reduce energy consumption associated with steam, LED lighting replacements at several sites, replacement of current single panel windows with double glazed units and improvements to HVAC controls. Additionally, several sites continue to implement ISO<sup>1</sup> 50001 which demonstrates their commitment to energy management and energy efficiency best practices. We purchased 173,502 MWh of renewable energy attributes under the Renewable Energy Guarantees of Origin scheme during 2020.

Across the Group, we aim for the efficient use of resources and a reduction in waste across the full lifecycle of our products, from design through to manufacturing, use and end-of-life.

## 2020 key environment data<sup>1</sup>

### Water consumption

	2020 cubic metres	2019 cubic metres
Mains	2,039,777	2,264,302
Abstracted	3,584,015	90,607,341
<b>Total</b>	<b>5,623,792</b>	<b>92,871,643</b>
<b>Recycled</b>	<b>19.3%</b>	<b>1.3%</b>

### Waste production

	2020 tonnes	2019 tonnes
Non-hazardous	39,211	67,719
Hazardous	15,922	88,549
<b>Total</b>	<b>55,133</b>	<b>156,268</b>
<b>Recycled<sup>2</sup></b>	<b>80%</b>	<b>70%</b>

### Electricity consumption<sup>3</sup>

	2020 kWh	2019 kWh
Grid	752,188,305	880,610,015
Renewable <sup>4</sup>	7,288,830	13,093,192
<b>Total</b>	<b>759,477,135</b>	<b>893,703,207</b>

1. While operational performance improvements have contributed to the downward trend for 2020 across the environmental data, the most significant factor in the reductions seen is the removal of two facilities from our reporting boundary as noted on page 38.

2. Includes both non-hazardous and hazardous waste recycling.

3. Includes only those facilities that record their electricity consumption via the Group's environmental database.

4. Includes only directly-produced renewable electricity.

1. International Organization for Standardization.

### Greenhouse gas emissions

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

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

During 2020, we removed two facilities from our organisational reporting boundary, as we do not have operational control of these facilities. Another business entity includes the emissions from these facilities within their environmental reporting obligations. As a result of these changes energy and emissions for the Group have reduced and our top ten site listing has been revised.

Our top ten largest sites accounted for 54% of our total energy consumption. By these sites setting energy reduction targets, they have the biggest influence in reducing our energy use and, in turn, our direct and indirect greenhouse gas emissions.

The majority of these sites operate environmental management systems certified to ISO 14001, with an aim to reduce their energy consumption and in turn greenhouse gas emissions. Other sites certified to 14001 will set appropriate objectives and targets to improve environmental performance.

During the financial year, Group-wide greenhouse gas emissions have reduced by 50% and total greenhouse gas emissions per employee by 55%. While the implementation of energy efficiency projects has contributed to this decrease, the most significant factor in the Group-wide reductions is the removal of two sites from our reporting boundary. Reported Scope 3 emissions have been effected by a decrease in business travel due to COVID-19. We will continue our focus on improving and reducing emissions going forwards.

### Greenhouse gas emissions data

#### Absolute energy consumption

	2020		2019	
	Global kWh	UK kWh	Global kWh	UK kWh
Energy consumption Scope 1 and 2	1,700,834,942	669,133,482	3,351,428,765	690,707,464

#### Greenhouse gas emissions data<sup>1</sup>

Scope definition	2020		2019	
	Global tonnes CO <sub>2</sub> e	UK tonnes CO <sub>2</sub> e	Global tonnes CO <sub>2</sub> e	UK tonnes CO <sub>2</sub> e
1 Emissions from activities which BAE Systems owns or controls (Scope 1)	151,190	69,948	480,392	84,206
2 Emissions from the electricity and steam purchased for BAE Systems' use (Scope 2 – location-based)	336,207	73,221	484,504	82,896
<b>Total gross Scope 1 and 2 emissions</b>	<b>487,397</b>	<b>143,169</b>	<b>965,436</b>	<b>167,102</b>
3 Emissions from employee business travel which BAE Systems does not own or control (Scope 3) <sup>2</sup>	54,769	11,941	138,020	47,705

#### Greenhouse gas emissions per employee<sup>3</sup>

	2020		2019	
	Global tonnes CO <sub>2</sub> e	UK tonnes CO <sub>2</sub> e	Global tonnes CO <sub>2</sub> e	UK tonnes CO <sub>2</sub> e
Per each full-time equivalent employee (Scope 1 and 2)	5	4	11	5

1. 2020 emissions data has been subject to limited assurance verification by Ramboll US Consulting, Inc.

2. Relevant reporting period 1 November 2019 to 31 October 2020.

3. Including share of equity accounted investments.

1. International Organization for Standardization.

## Methodology

The greenhouse gas emissions data is reported in line with the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard 'Operational Control' method. Emission factors for fuels and electricity are published at [www.gov.uk/government/collections/government-conversion-factors-for-company-reporting](http://www.gov.uk/government/collections/government-conversion-factors-for-company-reporting), and emission factors for US electricity are published at [www.epa.gov/energy/emissions-generation-resource-integrated-database-egrid](http://www.epa.gov/energy/emissions-generation-resource-integrated-database-egrid).

For the 2020 reporting cycle, the 2020 UK government emissions factors published by the Department for Business, Energy and Industrial Strategy (BEIS) have been utilised. The most up-to-date Emissions and Generation Resource Integrated Database (eGRID) factors published by US Environmental Protection Agency (EPA) are utilised for US electricity. For the 2020 reporting cycle, the most up-to-date US factors are from the year 2018.

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

Energy consumption figures are calculated using energy consumption records reported via the Group's global environmental database or, where actual usage data is not available, by estimating consumption based on the type of building. The energy consumption figures are used to calculate greenhouse gas emissions.

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 and joint ventures 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.

The Scope 2 Greenhouse Gas Emissions associated with the Greenhouse Gas Protocol 'Market-Based' Method have been calculated as 413,434 tCO<sub>2</sub>e. Supplier-specific emission factors have been sought for our most significant operating regions but were either deemed of insufficient quality to use at present or were unavailable. Therefore, 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.

## UK Streamlined Energy & Carbon Reporting (SECR)

The SECR requirements are mandatory reporting standards that build on the existing UK greenhouse gas reporting requirements to encourage businesses to implement energy efficiency measures and reduce greenhouse gas emissions.

### 2021 priorities

During 2021, we will aim to:

- progress our net zero programme including developing our net zero road map and developing our net zero operating model;
- continue to set environmental goals and undertake supporting initiatives to reduce environmental impacts at a business level; and
- model climate scenarios for 2030, 2050 and 2085.



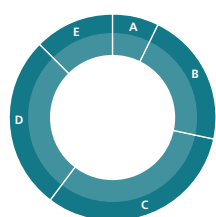
## Gender pay gap

We have published our fourth annual gender pay gap report in line with UK regulations. For 2020, the average gender pay gap for our UK workforce was 9.1% (2019 10.3%) which is 6.4% lower than the current UK national average of 15.5%. 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.

## Gender diversity

	Male	Female
Board	8	3
	73%	27%
Senior managers <sup>1,2</sup>	269	69
	80%	20%
Total employees <sup>3,4</sup>	63,000	18,000
	78%	22%

## Age diversity<sup>3,4</sup>



A 24 years and younger	6,000
B 25–34 years	17,000
C 35–49 years	26,000
D 50–59 years	22,000
E 60 years and older	10,000

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. Excludes executive directors.
3. Excluding share of equity accounted investments and rounded to the nearest thousand employees.
4. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes and controls are in place to collate and validate this data.

Through 2020 we intensified our focus on creating a diverse and inclusive environment in which colleagues from any background can fulfil their potential.

Our Company Behaviours, launched in 2019, build on our organisational strengths and focus us, individually and collectively, on the characteristics that will underpin our success into the future. They define the way we want to work – with each other and with our partners and customers – and are key to creating an inclusive culture in which everyone can thrive. During the pandemic, these Behaviours came to the fore. Qualities such as adaptability, creativity, collaboration and integrity enabled us to meet unprecedented challenges.

During 2020, we have further embedded our Behaviours in our performance management, talent management, recruitment and reward processes as we continue to measure, recognise and reward not just what our people achieve but also how they achieve it.

Our line managers across the world play a key role in inspiring individuals and teams to perform at their best and support them in this ongoing priority. In 2020 we launched a comprehensive new line manager development programme which is being rolled out across our markets outside of the US. This programme and its established equivalents in our US business, help set the specific standards expected of line managers at BAE Systems, supporting them in role-modelling our Company Behaviours to enhance engagement and performance.

Increasing the diversity of our workforce and building diversity and inclusion into our processes, practices, policies, systems and training remains an area of strategic focus for the organisation. We have clear, common objectives focused on attracting and retaining a diverse workforce that reflects market availability at all levels of the organisation, and advancing an inclusive workplace where employees feel that their differences are valued.

Our leaders are held accountable for progress against these objectives through targets, measured through robust data analysis of the demographic profile of our workforce. We are working with our employees to obtain data to help us to build a rich picture of our diversity today and set meaningful targets and improvement plans.

In line with our diversity targets for 2020, we increased female representation across our global workforce by 0.5%. In Saudi Arabia, we met our target to increase female representation in the workforce and launched our two-year fast-track development programme for women, preparing them for senior roles and supporting the country's Vision 2030. Additionally, BAE Systems, Inc. met its goal to increase representation of both women and people of colour at leadership levels.

Attracting and bringing on board candidates from a diverse range of backgrounds and experiences is a key focus of our recruitment practices. In 2020 we launched additional diversity training for recruiting managers in the UK and realigned our recruitment suppliers' objectives to increase their focus on identifying diverse talent. We also enhanced our early careers selection process to ensure it opens opportunities to applications from all groups, including those from disadvantaged backgrounds. Through our ongoing commitment to the Movement to Work programme in the UK we provide a pathway into employment or training for disadvantaged and unemployed young people through quality work experience (see page 45). Having also welcomed apprentices made redundant from other organisations as a result of the pandemic in 2020, we are extending our support to the young unemployed in 2021 by taking on 30 young people through the UK government's Kickstart initiative.

Our award-winning apprenticeship and graduate programmes bring new talent into our business and help individuals develop foundational skills for a rewarding career. In the 2020 cycle we recruited around 750 apprentices and nearly 180 graduates into our UK businesses – one of our highest intakes in recent years. We have just over 420 graduate scheme members in the UK and 63 undergraduate students on a 12-month industrial placement.

In 2020, 40% of our global hires (almost 3,700 positions) were into Science, Technology, Engineering and Maths (STEM) roles.

## Balance sheet

### Summarised balance sheet

	2020 £m	2019 £m
Intangible assets	11,745	10,371
Property, plant and equipment, right-of-use assets and investment property <sup>1</sup>	3,158	3,188
Equity accounted investments and other investments	409	441
Working capital <sup>1</sup>	(3,021)	(2,854)
Lease liabilities	(1,203)	(1,291)
Group's share of net IAS 19 post-employment benefits deficit	(4,485)	(4,455)
Net tax assets and liabilities	906	690
Net other financial assets and liabilities	36	34
Net debt	(2,718)	(743)
Net assets held for sale	94	130
<b>Net assets</b>	<b>4,921</b>	<b>5,511</b>

### Components of net debt

	£m	£m
Cash and cash equivalents	2,768	2,587
Debt-related derivative financial instruments (net)	(62)	67
Loans – non-current	(4,957)	(3,020)
Loans and overdrafts – current	(467)	(377)
<b>Net debt</b>	<b>(2,718)</b>	<b>(743)</b>

## Exchange rates

### Year end

	2020	2019
£/\$	1.367	1.324
£/€	1.117	1.180
£/A\$	1.770	1.884

## Accounting net pension deficit – bridge (£bn)

2019	(4.5)
Add back 2019 allocation <sup>2</sup>	(0.3)
UK scheme funding contributions	1.3
Interest on liabilities	(0.7)
Return on assets	2.4
Real discount rate	(3.6)
Other	0.5
Deduct 2020 allocation <sup>2</sup>	0.4
2020	(4.5)

 **Page 229**  
Note 24 to the Group accounts

## Maturity of the Group's borrowings (£bn)

2020	(5.4)
2021	(4.9)
2022	(4.5)
2023	(4.5)
2024	(3.9)
2025	(3.4)
2026	(3.4)
2027	(3.0)
2028	(3.0)
2029	(3.0) <sup>3</sup>

 **Page 227**  
Note 21 to the Group accounts

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

## Balance sheet

The £1.3bn increase in **intangible assets** to £11.7bn (2019 £10.4bn) mainly reflects goodwill and intangible assets arising on the US acquisitions.

**Property, plant and equipment, right-of-use assets and investment property** is £3.2bn (2019 £3.2bn).

**Equity accounted investments and other investments** was £409m (2019 £441m) mainly reflecting the Group's share of profit for the year (£69m), offset by the pension deficit allocation (£70m) and dividends received (£27m).

The **Group's share of the net IAS 19 post-employment benefits deficit** was in line with the prior year at £4.5bn. The £1bn contribution into the UK pension scheme and favourable asset returns were offset by an increase in liabilities driven by lower discount rate assumptions. The major movements in the net deficit are shown in the bridge chart on this page.

Details of the Group's post-employment benefits schemes are provided in note 24 to the Group accounts on page 229.

A net deferred tax asset of £0.8bn (2019 £0.8bn) relating to the Group's pension deficit is included within **net tax assets and liabilities**.

In aggregate, there was a £0.2bn decrease in **working capital** largely reflecting the strong focus on liquidity in the year.

The Group's **net debt** at 31 December 2020 is £2,718m, a net increase of £1,975m from the position at the start of the year. This is primarily a result of funding the two US acquisitions and the contribution to the UK pension scheme, partly offset by strong operational cash generation. The maturity of the Group's borrowings is shown in the chart on this page.

**Cash and cash equivalents** of £2,768m (2019 £2,587m) are held primarily for the repayment of debt securities, pension deficit funding, payment of the 2020 final dividend and management of working capital.

**Net assets held for sale** represent the Advanced Electronics Company in Saudi Arabia. The 2019 net assets held for sale comprised the Applied Intelligence US-based software-as-a-service business, the disposal of which completed in October 2020, and Advanced Electronics Company.

1. Funding received of £678m (2019 £524m) from the UK government for property, plant and equipment at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme included in working capital in the Consolidated balance sheet is presented here in property, plant and equipment, and investment property.

2. Amounts allocated to equity accounted investments.

3. Repayable in 2030 (£0.9bn), 2031 (0.7bn), 2041 (£0.3bn), 2044 (£0.4bn) and 2050 (£0.7bn).

# Board of directors



**Sir Roger Carr**  
Chairman



**Dr Charles Woodburn**  
Chief Executive



**Brad Greve**  
Group Finance Director



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



**Nick Anderson**  
Non-executive director



**Dame Elizabeth Corley**  
Non-executive director



**Dr Jane Griffiths**  
Non-executive director



**Chris Grigg CBE**  
Non-executive director and Senior Independent Director



**Stephen Pearce**  
Non-executive director



**Nicole Piasecki**  
Non-executive director



**Ian Tyler**  
Non-executive director

- Chairman
- Executive directors
- Non-executive directors

## **A Sir Roger Carr Chairman**

**Appointed to the Board:** 2013 **Nationality:** UK

### **Skills, competence and experience**

Having joined the Board in 2013, Sir Roger was appointed Chairman in 2014. He is an experienced company chairman with a wealth of knowledge gained across a number of business sectors. With over three decades of boardroom experience, Sir Roger has a deep understanding of corporate governance and what is required to lead an effective board.

Sir Roger is a Senior Advisor to KKR, Chairman of the English National Ballet and Vice President of the Royal Navy and Royal Marines Charity.

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

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

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

### **Other non-executive appointments**

None.

### **Committee membership**

Chairman of the Nominations Committee.

## **B 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.

Based on strong engineering and technology credentials, Charles 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 the Far East, Australia, Europe and the US. He is a Fellow of the Royal Academy of Engineering.

### **Non-executive appointments**

None.

## **C 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 over 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 United States.

### **Non-executive appointments**

None.

**D 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 held 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.

**E 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 joining Spirax-Sarco Engineering plc in 2011, Nick worked for Smiths Group plc as Vice-President of John Crane Asia Pacific and previously President of John Crane Latin America.

**Other non-executive appointments**

None.

**Committee membership**

Nominations Committee and Corporate Responsibility Committee.

**F Dame Elizabeth Corley Non-executive director**

**Appointed to the Board:** 2016 **Nationality:** UK

**Skills, competence and experience**

Dame Elizabeth brings investor, governance and boardroom experience to the Board. She currently chairs the board of the Impact Investment Institute, having previously chaired the industry Taskforce on Social Impact Investing for the UK government. She served as Chief Executive Officer of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016. Prior to that, she worked for Merrill Lynch Investment Managers. Dame Elizabeth is active in representing the investment industry and developing standards within it.

She is a member of the CFA Future of Finance Advisory Council, the AQR Institute of Asset Management at the London Business School, the Committee of 200 and the 300 Club; and is a former member of the board of the UK Financial Reporting Council.

Dame 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.

**Other non-executive appointments**

Non-executive director of Pearson plc and Morgan Stanley.

**Committee membership**

Audit Committee, Nominations Committee and Remuneration Committee.

**G Dr Jane Griffiths Non-executive director**

**Appointed to the Board:** 2020 **Nationality:** UK

**Skills, competence and experience**

Appointed to the Board on 1 April 2020, Jane brings experience in leading high technology businesses and international corporate leadership to the Board. During her 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, the group'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**

Non-executive director of Johnson Matthey Plc.

**Committee membership**

Chair of the Corporate Responsibility Committee and member of the Nominations Committee.

**H Chris Grigg CBE Non-executive director and Senior Independent Director**

**Appointed to the Board:** 2013 **Nationality:** UK

**Skills, competence and experience**

Chris recently retired as Chief Executive of The British Land Company PLC, a position he held for over 11 years. He brings extensive public company business leadership experience to the Board. He is currently a senior adviser to HM Treasury.

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**

None.

**Committee membership**

Corporate Responsibility Committee, Remuneration Committee and Nominations Committee.

**I Stephen Pearce Non-executive director**

**Appointed to the Board:** 2019 **Nationality:** AU

**Skills, competence and experience**

Appointed to the Board on 1 June 2019, Stephen has more than 20 years of public company experience and over 30 years of financial and commercial experience in the mining, oil and gas, and utilities industries. Stephen is currently Finance Director of Anglo American plc, a role he has held since April 2017, and a director of Anglo American Platinum Limited and De Beers plc, both of which are non-wholly-owned subsidiaries of Anglo American plc.

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**

Chairman of the Audit Committee and member of the Nominations Committee.

**J Nicole Piasecki Non-executive director**

**Appointed to the Board:** 2019 **Nationality:** US

**Skills, competence and experience**

Nicole was appointed to the Board on 1 June 2019 and brings 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. 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**

Nominations Committee and Corporate Responsibility Committee.

**K 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. Having qualified as a chartered accountant, Ian subsequently held a number of senior finance and operational positions within industrial companies before being appointed Finance Director of Balfour Beatty plc in 1996. He was subsequently appointed as Chief Executive in 2005. He is currently Chairman of the UK housebuilding company, Vistry Group PLC.

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 and non-executive director of Amey plc, a subsidiary of Ferrovial, S.A., AWE Management Limited and Affinity Water Limited.

**Committee membership**

Chairman of the Remuneration Committee, and member of the Audit Committee and Nominations Committee.

# Board information

- Chairman
- Non-executive director
- Executive director
- Committee chair
- Audit Committee
- Corporate Responsibility Committee
- Nominations Committee
- Remuneration Committee
- First term
- Second term
- Third term

## Membership

	Committee membership	Nationality	Tenure
			2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027
<b>Sir Roger Carr</b> Chairman <sup>1</sup>	N	UK	
<b>Nick Anderson</b> Non-executive director	C N	UK	
<b>Dame Elizabeth Corley</b> Non-executive director	A N R	UK	
<b>Jane Griffiths</b> Non-executive director	C N	UK	
<b>Chris Grigg</b> Non-executive director	C N R	UK	
<b>Stephen Pearce</b> Non-executive director	A N	AU	
<b>Nicole Piasecki</b> Non-executive director	C N	US	
<b>Ian Tyler</b> Non-executive director	A N R	UK	

The average length of appointment of non-executive members of the Board (as at 31 December 2020) was four years.

	Date of appointment to the Board of executive members
<b>Charles Woodburn</b> Chief Executive	9 May 2016
<b>Brad Greve</b> Group Finance Director	1 April 2020
<b>Tom Arseneault</b> President and Chief Executive Officer of BAE Systems, Inc.	1 April 2020

The average length of appointment of executive members of the Board (as at 31 December 2020) was two years.

1. Sir Roger Carr joined the Board in October 2013 and was appointed as Chairman in February 2014.

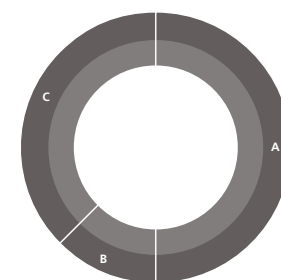
## Attendance

Individual directors' attendance at meetings of the Board and its committees in 2020

	Board	Audit Committee	Corporate Responsibility Committee	Nominations Committee	Remuneration Committee
Revathi Advaiti <sup>1</sup>	4/4	—	1/2	1/1	—
Nick Anderson <sup>2</sup>	2/2	—	—	1/1	—
Tom Arseneault <sup>3</sup>	6/6	—	—	—	—
Sir Roger Carr	8/8	—	—	4/4	—
Dame Elizabeth Corley	8/8	5/5	—	4/4	8/8
Jerry DeMuro <sup>4</sup>	1/2	—	—	—	—
Brad Greve <sup>3</sup>	6/6	—	—	—	—
Jane Griffiths <sup>3</sup>	6/6	—	2/2	1/1	—
Chris Grigg	8/8	—	4/4	4/4	8/8
Peter Lynas <sup>4</sup>	1/2	—	—	—	—
Stephen Pearce	8/8	5/5	—	4/4	—
Nicole Piasecki	8/8	—	2/2	3/4	—
Paula Rosput Reynolds <sup>5</sup>	8/8	—	—	4/4	8/8
Nick Rose <sup>5</sup>	8/8	—	—	4/4	—
Ian Tyler	8/8	5/5	4/4	4/4	8/8
Charles Woodburn	8/8	—	—	—	—

- Retired on 25 June 2020.
- Appointed on 1 November 2020.
- Appointed on 1 April 2020.
- Retired on 31 March 2020.
- Retired on 31 December 2020.

## Tenure – independent non-executive directors



A Up to three years	4
B Over three and up to six years	1
C Over six years	3

## Board diversity





# Nominations Committee report



**Sir Roger Carr**  
Chairman of the  
Nominations Committee

## Members

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

## Dear Shareholders

Last year we saw a significant number of changes to membership of the BAE Systems Board, with five directors leaving and four joining. In terms of Board succession planning, a good deal was achieved, particularly with regard to executive directors, where we successfully completed our succession planning for the Group Finance Director and US President & Chief Executive Officer roles. We also accomplished the first part of our planned non-executive director changes in 2020, with the appointment of Jane Griffiths and Nick Anderson. This year, following the retirement of two experienced non-executives, we have announced that Dame Carolyn Fairbairn will be joining the Board on 1 March and Dr Ewan Kirk will join shortly afterwards on 1 June 2021.

At Executive Committee level, our Chief Executive has continued to strengthen his senior management team and we have seen further changes as a result. In recognition that there is more work to be done, we are actively addressing and making progress on our succession plans below Executive Committee level, and also in completing our non-executive director changes, to ensure our Board maintains the right balance of skills, experience, knowledge and diversity. These matters are being actively addressed and progress is being made.

## Board succession

In last year's report, we detailed how Brad Greve had been recruited with the intention that he would succeed Peter Lynas as Group Finance Director at the beginning of April 2020. Peter had served in that position since 2011 and had provided Brad with an excellent legacy, including a robust control environment and strong financial discipline. I would like to thank Peter for the professional and collaborative manner in which he managed the handover of responsibilities to Brad, the two having worked together for seven months prior to his appointment to effect a seamless handover on 1 April. Additionally, from that date, Tom Arseneault succeeded Jerry DeMuro as head of our US business and joined the Board. His appointment was the culmination of a succession management process going back a number of years and one which saw Tom developing and showing excellent leadership credentials in a number of roles, initially in leading our US Electronic Systems business and more recently in taking on the operational management of BAE Systems, Inc. as a whole.

Following their new appointments, Brad Greve and Tom Arseneault could not have had a more difficult start, immediately having to deal with the unprecedented impact of the COVID-19 pandemic. It proved to be a good – but unexpected – test of the work the Committee had undertaken in planning executive director succession over the last few years. I am pleased to report that, led by our Chief Executive, Charles Woodburn, they have shown excellent leadership, resourcefulness and adaptability in the management of the Company during 2020 and into the new year.

Having served as a non-executive director for just over nine years, Paula Rosput Reynolds stood down from the Board at the end of the year. In planning for her retirement, Ian Tyler joined the Remuneration Committee from the beginning of 2020 ahead of succeeding Paula as Chair of the Committee, with effect from 1 January 2021. Our longest serving non-executive director, Nick Rose, was due to retire from the Board in April 2020 but I am very grateful that he agreed to stay on until the end of the year to help the Company navigate the challenges of the COVID-19 pandemic. Sadly, in June, Revathi Advaiti stepped down from the Board and retired as a non-executive director for personal reasons.

Using the services of Julia Budd at the search consultants Russell Reynolds Associates, the Committee identified two excellent candidates for appointment as non-executive directors in 2020, with Jane Griffiths joining the Board in April and Nick Anderson in November. Jane has an impressive record of leading research-led high-technology businesses and brings a wealth of international corporate experience to the Board. Nick is the Chief Executive of the FTSE 100 industrial engineering company Spirax-Sarco Engineering plc, and has extensive experience in growing and leading international manufacturing and engineering businesses.

The forthcoming appointments of Dame Carolyn Fairbairn and Dr Ewan Kirk will further strengthen the Board, and the timing of their joining will allow them to develop their understanding and knowledge of the Company ahead of anticipated non-executive retirements in the next year or so. Dame Carolyn, who recently stepped down as Director General of the CBI, brings a deep understanding of business and government. Ewan has extensive experience in identifying and leveraging emergent scientific research, and know-how and insight into the successful commercial exploitation of digital technology.

# Remuneration Committee report



**Ian Tyler**  
Chairman of the Remuneration Committee

## Members

**Ian Tyler (Chairman)**  
**Dame Elizabeth Corley**  
**Chris Grigg**

## Dear Shareholders

On behalf of the Board, I am pleased to present the Remuneration Committee's report for 2020. I assumed the chairmanship on 1 January 2021, succeeding from Paula Rospot Reynolds who has chaired this Committee for over five years. Together with my colleagues, we have appreciated the quality of shareholder consultation you have provided, which led, among other things, to the strong support we received for the renewal of our Directors' Remuneration Policy at the 2020 Annual General Meeting (97.5% in favour).

Whilst the market for BAE Systems' capabilities has mostly remained strong so far through the COVID-19 pandemic, delivering our customers' needs whilst keeping all our employees safe against such a challenging backdrop has called on all the ingenuity, determination and innovation of our management teams and our workforce. We could not have asked more from them. As a result of their efforts, the Company has not taken advantage of the UK government's funded furlough scheme and we have not borrowed any money under government COVID-19 borrowing facilities. Overall the Company has delivered a year of strong performance. Our employees across the Group have demonstrated fantastic commitment and contribution to delivering our customers' priorities, and the Committee has ensured its continued focus on the wellbeing and remuneration of the wider workforce in its considerations over the year.

## The year in review

### Impact of COVID-19 pandemic

In making remuneration decisions in relation to 2020, the Committee, whilst mindful of the impact of COVID-19 on the cost of delivering service and product to our customers, chose to make no allowance for these additional challenges when assessing the performance and reward outcomes for the executive directors. The Committee believed that achievements should be assessed against performance hurdles established prior to the pandemic without adjustment, and respecting that the Company has paid all dividends, has not taken advantage of the UK government's funded furlough scheme, nor any government COVID-19 borrowing facilities and has not raised additional equity.

### 2020 incentives outcome

After the close of 2020, the Committee met and reviewed performance under the short-term annual incentive for all the executive directors and Executive Committee members. The Committee has not made any adjustment to the performance conditions in respect of the vesting outcome of the 2020 annual incentive or 2018 long-term incentive awards to account for the impact of COVID-19. Group financial results for the 2020 annual incentive were achieved at between target and stretch; performance for the non-financial element varied for the executive directors and Executive Committee members and was between target and stretch overall.

As set out on page 205 of our report, the 2020 fully diluted underlying EPS is 46.5p. Pursuant to the strict definition set out in the Annual Incentive Plan and Long-Term Incentive Plan (LTIP) documentation, this figure excludes a non-recurring benefit of 1.7p resulting from the buy-out of certain US defined benefit pension liabilities. During the course of the year, in discussion with the Board, management undertook to re-examine a number of areas, including pensions, to seek additional value enhancement. A market opportunity was identified to reduce a material element of the Company's US defined benefit pension liability through a buy-out, delivering an immediate improvement in earnings and an enduring benefit in cost and cash outflow. Through what the Committee saw as highly effective action taken by the leadership team, after a period of prolonged negotiations, a buy-out was successfully completed in the third quarter of 2020. As a result, the Committee exercised its discretion and agreed that the final incentives' vesting outcome should reflect the 2020 fully diluted underlying EPS result including the 1.7p of earnings associated with this achievement.

The Committee used its judgement in evaluating non-financial performance, including the executives' commitment to safety, diversity and inclusion, as well as overall leadership contributions. A discussion of that evaluation and the bonuses earned by the executive directors are reported on pages 144 to 147.

The Performance Shares granted in 2018 to Tom Arseneault, Peter Lynas and Jerry DeMuro under our long-term incentives will partially vest in early 2021. In addition, the 2018 Restricted Shares granted to our US-based executive directors will vest. The awards due to Peter Lynas and Jerry DeMuro, are subject to time pro-rating as set out on page 154. The vesting of the 2018 Performance Shares awarded granted to Charles Woodburn is described separately in the section regarding 2021 remuneration. The details of the vesting outcomes and amounts awarded are also described in the following report.

Having thoroughly reviewed annual and three-year performance, and the related remuneration outcomes, the Committee is satisfied that the Policy operated as intended during 2020.

### Granting of long-term incentives

Last year, in relation to the grant of the 2020 long-term incentive awards, the Company followed its normal practice of using the closing share price immediately prior to the date of grant to determine the number of shares awarded. However, given the volatility in the market in March 2020, we attached an additional condition to retain the ability to exercise discretion to ensure that the value of the awards in three years' time at vesting is appropriate. Given the continued uncertainty in the broad market, we intend, in the grant of 2021 performance shares, to include the same condition regarding the ultimate vesting of shares.

### Executive director changes

Brad Greve was appointed Group Finance Director and joined the BAE Systems plc Board on 1 April 2020, succeeding Peter Lynas who retired after a distinguished career of over 35 years with BAE Systems, including nine years as Group Finance Director. Tom Arseneault joined the BAE Systems plc Board on 1 April 2020, succeeding Jerry DeMuro as President and Chief Executive Officer of BAE Systems, Inc. The retirements of Peter Lynas and Jerry DeMuro were both handled according to our approved Policy and were disclosed previously.

### 2020 Directors' Remuneration Policy

The Committee has implemented the 2020 Directors' Remuneration Policy (the Policy) that was approved by shareholders at the 2020 AGM, and includes the following key changes. The Policy maintained our three-part construct of base salary, annual incentive and long-term incentives (LTIs), with no changes to the target or maximum annual incentive opportunity or LTI award levels.

- from 2021, safety and diversity and inclusion measures within non-financial annual incentive will apply as a 'downward' underpin if performance is not achieved at the high levels expected;
- from 2021, metrics applicable to award of Performance Shares will include a cash-generation measure and strategic progress measures, in addition to existing EPS growth and relative TSR, all with an equal weighting of 25%;

- any new UK executive directors will be offered employer pension contribution of 8% into a defined contribution scheme, or cash alternative, in line with the wider UK workforce;
- current Chief Executive pension allowance to be fixed in monetary terms at the employer pension contribution level of £186,200 per annum;
- introduction of five-year time period for achieving Minimum Shareholding Requirement with effect from the AGM and confirmation of consequences of not meeting it; and
- establishment of a formal post-cessation shareholding policy:
  - 100% of full MSR to be held for two years by UK executive directors; and
  - 300% of salary to be held for one year applicable to US executive directors.

## 2021 remuneration

To confirm, for 2021 no revisions are proposed to our executive remuneration framework that would constitute a change to the Policy. In line with our commitment to continued transparency, we have engaged with our major shareholders and informed them of the decisions for 2021 reported here. As part of this, we informed them of the important remuneration decisions made by the Board and Remuneration Committee in relation to our Chief Executive.

## Chief Executive remuneration

As set out on pages 30 to 33 of this Annual Report, the directors have detailed some of the decisions they made during 2020, and in doing so, how they looked to promote the success of the Company, having regard to key stakeholder interests. One of the key decisions reported, concerns how the directors acted to secure the continued services of our Chief Executive, Dr Charles Woodburn. Given the exceptional nature of the matter, we have written to our major shareholders to provide a detailed explanation and to ask for their support in this matter.

## Background

During the last quarter of 2020, our Chief Executive, Dr Woodburn, received an offer to become chief executive of a major international public company based in the UK. The offer, which resulted from a discussion regarding a potential non-executive role, was unsolicited, attractive, and provided a material opportunity to expand his career horizon and improve his immediate and long-term financial reward. Given his commitment to the Company, prior to accepting the offer, he chose to share the opportunity he had been given with the Board.

The Board valued the significant contribution Dr Woodburn had made since his appointment and recognised the importance of his leadership role at this critical time in the development of the Company. Accordingly, the Board elected to review his remuneration with a view to securing his enthusiastic and enduring commitment to the Company with goodwill on both sides.

## Remuneration Committee and Board considerations

The Board carefully reviewed the Company and stakeholder risks of the potential departure of Dr Woodburn and the challenges of replacing him. Given the nature of our business, the UK government has mandated through the Special Share arrangements that the Chief Executive must be a British citizen and they would have the highest level of security clearance. Most importantly, the Chief Executive must have sufficient intellect and experience to occupy a position that is critical to our important role in the defence and security interests of the UK, US, Australia and the Kingdom of Saudi Arabia. These challenges were weighed against the cost of measures that may be required to retain his services for an extended period.

The Board concluded that in the three years he had served as Chief Executive, considerable progress had been made in the strategic development and operational performance of the business and that he was respected and valued by the Board, his executive team, our shareholders, political leaders and customers in the countries we serve. The Board also recognised that the progress he had made in that period through refreshing management, deepening our order book, strengthening our technology and sharpening our competitive edge, had been substantial. Despite a good deal of work having been undertaken on succession planning, given the exacting requirements for the role outlined above, as yet no internal successor for the Chief Executive role had been sufficiently developed to effect a seamless transition of leadership.

In considering Board composition, it was also noted that of the three Executive Directors, Dr Woodburn had the longest tenure as a Board member, with the Group Finance Director and President and Chief Executive Officer, BAE Systems, Inc. being respectively recruited and appointed only in the last 12 months. In light of the above, the Board also reflected on the past challenges faced by the Company in recruiting a Chief Executive some four years ago, the time taken for him to build a comprehensive understanding of a complex international business, the generational change of leadership that is now in process, and the potential damage that the early departure of Dr Woodburn would inflict on the Company, important government customer relationships and shareholders. Based on close examination of both the defence industry and FTSE 50 median reward levels, it had become increasingly clear that Dr Woodburn's current remuneration no longer reflected his value to the Company or standing in the market.

As a defence company of international importance the Board therefore concluded that the benefit of retaining our existing Chief Executive on improved terms with a long-term commitment to stay, materially outweighed the risk to all stakeholders associated with the turbulence of change and the cost and time associated with finding, hiring and introducing a new leader into the Company.

## Our Directors' Remuneration Policy and options for discretion

The reasonableness discretion afforded to the Committee under the Directors' Remuneration Policy allows the Committee to increase or decrease the number of Performance Shares vesting in exceptional circumstances in light of important factors in the business. The Remuneration Committee and Board considered the immediate and present danger of the loss of Dr Woodburn to be an exceptional circumstance and elected to exercise its discretion in modifying his salary and increasing the number of shares vesting in his 2018 Performance Shares award.

## The basis for the use of Remuneration Committee Policy discretion

The Board and Remuneration Committee considered the potential modification of the reward package by addressing specific criteria:

1. Salary would correspond to the current median level of reward as published for a FTSE 50 chief executive.
2. LTIP award would be paid only if the individual remained in employment as Chief Executive as at December 2023 and market expectations of 2020 performance were achieved.
3. The quantum of the award would align with the now lapsed one-off Performance Shares award allocated at the time of his recruitment, which was intended as buy-out of certain long-term incentives that were forfeited at the time of his departure from his previous company.
4. All of the above adjustments will be made on a one-off basis.

Irrespective of the size of the offer made by the alternative employer, the Board was clear that no further reward adjustment of any kind would be made at any time in relation to such an offer irrespective of circumstance and any future remuneration adjustments would always be subject to the approved remuneration policy at the time and to shareholder approval where required.

# Remuneration Committee report

## continued

### The award

The Committee has therefore applied the following two-step adjustment to Dr Woodburn's salary, which is within the Directors' Remuneration Policy: (i) salary increase of 3.21% with effect from 1 December 2020 and (ii) a further salary increase with effect from 1 January 2021 of 9.5%, to deliver a total base salary of £1,107,538. This salary is in line with median market levels for a FTSE 50 Chief Executive and is a fair reflection of his value, competence, skill and performance having now been in post for over three years.

The Committee additionally agreed the need to strengthen his existing long-term incentive arrangements to recognise more fully the critical nature of the role and the importance of retaining him. By exercising its discretion, the Committee determined that a Performance Share award granted to Dr Woodburn in 2018 will vest in full with the shares being receivable in 2023. Such vesting is conditional on his continued employment as Chief Executive through to December 2023, and the delivery of 2020 performance in accordance with current market expectations. Taking into account the 2020 performance outcome, the additional value of this LTIP award as a result of the discretion applied is approximately £2m, as at the share price stated in the table shown in line with the lapsed Performance Share award agreed at the time of his joining.

#### LTIP award reconciliation

##### Basis of calculation of 2018 LTIP

Number of shares	570,454
Share price (three-month average) as at 31 December 2020	£4.844
TSR	Nil vest
EPS	50% vest

LTIP 2018 grant	Total grant	Shares released for TSR (nil vest)	Shares released for EPS (50% vest)
Number of shares	570,454	0	142,613
Value at £4.844 share price	£2,763,393	–	£690,846

<b>Total possible value of 2018 LTIP</b>	<b>£2,763,393</b>
Earned outturn based on EPS performance	£690,846
Additional share value required to equate to full potential value of 2018 LTIP	£2,072,547
<b>Total</b>	<b>£2,763,393</b>

#### Reward conditionality

- Delivery of the 2020 performance in accordance with the Company's November 2020 EPS guidance (achieved).
- Dr Woodburn to be in role as Chief Executive until at least December 2023.
- All standard terms and conditions associated with LTIP to apply.

### The decision-making process and conclusions

In considering both the importance of retaining Dr Woodburn as Chief Executive and determining a reward package that was proportionate and appropriate, the Board referenced its duties under Section 172(1) of the Companies Act to act in the way that it considered in good faith would be most likely to promote the success of the company for the benefit of its members as a whole.

All non-executive directors of the Board were engaged in a step-by-step process in making these decisions through assessing alternative options, risks and comparative marketplace reward levels. The decisions on both the principle of retention and determination of the reward package were achieved only after careful thought and discussion, and were reached unanimously and unequivocally by the Board under the rules of the Directors' Remuneration Policy. All parties agreed that a positive outcome had been achieved. The Company has retained a first class leader on fair market value terms. The three-year commitment enables the development of candidates for internal succession to the post of Chief Executive to be successfully executed. Dr Woodburn, appropriately compensated, is pleased to remain and is enthusiastic to complete the job he had started to make BAE Systems a more competitive, agile, and technically advanced company.

#### Review of other executive director base salaries

The Committee has considered carefully the level of performance of our executive directors, who have been expected to demonstrate exceptional leadership and resilience throughout the COVID-19 crisis. Reflecting the skills, time, performance and experience since appointment in role, the Committee has approved salary increases in line with the wider workforce in the relevant markets, being 2% for our Group Finance Director and 3.5% for our President and Chief Executive Officer of BAE Systems, Inc.

#### Annual incentive plan metrics

As set out in our approved Policy, the structure of the annual incentive plan for 2021 will be 75% financial performance measures and 25% non-financial measures. The annual financial targets will continue to align with the long-term earnings and cash targets based on the same weightings and metrics that applied in 2020. The 25% non-financial element will continue to be based on a combination of personal performance objectives that provide clear line of sight to our key strategic objectives. As previously disclosed, from 2021 forwards, safety and diversity and inclusion (D&I) will operate as an underpin to the non-financial component of the annual incentive. The Committee will use their discretion to modify the annual incentive outturn downwards if they find that safety and/or D&I are not up to the high standards expected of our leadership.

### Long-term incentive plan metrics

In line with our approved Policy, from 2021, Performance Shares will be measured over a three-year period against a cash generation measure and measures reflecting strategic progress, in addition to the existing Earnings per Share (EPS) and relative Total Shareholder Return (TSR) measures; each of these four performance conditions will be equally weighted at 25%.

#### 25% subject to strategic progress metrics

The Committee has previously confirmed that these metrics will be measured against quantifiable targets based on our three key strategic pillars, each with equal weighting. The Committee will disclose the areas of strategic progress applicable in each year, with the specific metrics to be disclosed retrospectively after the end of the relevant financial year due to commercial sensitivity.

#### (i) Drive operational excellence

The focus of this objective is the adherence to project plans of mission-critical projects over the three-year performance period. This objective will be measured by the metric of On Time Delivery, evaluated against an approved set of customer contracts, in a manner consistent with the normal course of business. The contracts to be measured will be representative of each of our main business sectors, having regard to execution risk, scale and duration, and will be approved by the Committee on an annual basis. For our US executive director, On Time Delivery will be measured against BAE Systems, Inc. contracts only. The Company's robust quality and safety processes will continue to apply.

Measurement of On Time Delivery will be derived from our existing systems, which measures progress compared to the contracted project baseline, as modified by any customer-agreed re-baselining. The overall outturn will be based on the aggregated On Time Delivery three-year average. Target performance will be achieved for equal or better than the aggregated On Time Delivery three-year average, with threshold and stretch levels also applying. The final outturn (between 0% and 100%) will be subject to review by Group Internal Audit and approved by the Committee.

#### (ii) Continuously improve competitiveness and efficiency

As a company, we strive to continually improve our competitiveness in order to drive profitable growth to benefit all of our stakeholders. The most effective measure of this is three-year Return on Capital Employed (ROCE). ROCE demonstrates our ability to generate profitable business growth, manage our overhead costs through improved efficiency, and strategically deploy capital to enhance future shareholder return.

The Committee has approved the ROCE metrics applicable to the 2021 Performance Share awards, calibrated in line with the approved Integrated Business Plan (IBP) as follows:

- Threshold set as 25bps reduction in 2023 ROCE, and reflecting an improvement across the three-year period;



# 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 2020 financial year are listed on pages 106 and 107. Brad Greve, Tom Arseneault and Jane Griffiths were appointed to the Board on 1 April 2020 and Nick Anderson was appointed to the Board on 1 November 2020.

Peter Lynas and Jerry DeMuro retired from the Board on 31 March 2020, Revathi Advaiti retired from the Board on 25 June 2020, and Paula Rospot Reynolds and Nick Rose retired from the Board on 31 December 2020.

On 11 February 2021 the Company announced the appointments of Dame Carolyn Fairbairn and Dr Ewan Kirk as non-executive directors, with effect from 1 March and 1 June 2021, respectively.

## Dividend

An interim dividend of 9.4p per share was paid on 30 November 2020. Prior to that, an interim dividend of 13.8p per share was paid on 14 September 2020 being the value of the dividend proposed but subsequently deferred earlier in the year. The directors propose a final dividend of 14.3p per ordinary share. Subject to shareholder approval, the final dividend will be paid on 1 June 2021 to shareholders on the share register on 23 April 2021.

## Annual General Meeting (AGM)

The Company's AGM will be held on 6 May 2021. The Notice of Annual General Meeting is enclosed with this Annual Report and details the resolutions to be proposed at the meeting.

## Certain information in the Strategic report

The following items are set out in the Strategic report on pages 1 to 99:

- 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); and
- fostering business relationships with suppliers, customers and others.

## 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 30 July 2020, the Group made the following statement in respect of the year ending 2020, 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 full-year results announcement on 20 February 2020 and in the Annual Report 2019, such forecast being cancelled by the Company in its announcement on 3 April 2020 due to the COVID-19 pandemic):

"Whilst the Group is subject to geopolitical uncertainties and there remains considerable uncertainty in respect of COVID-19, the following guidance is provided on current expected operational performance under new working practices introduced in recent months. We expect the Group's underlying earnings per share to be a mid-single digit lower than last year's 45.8p, assuming a \$1.25 to sterling exchange rate and a tax rate now expected to be 19%, in line with last year. The final rate is dependent on the geographic mix of profits."

In the Group's Trading Update on 11 November 2020, the Group made the following statement:

"Underlying earnings per share are now expected to be slightly higher than previously guided with good operational performance and an expected lower tax rate offsetting the negative foreign exchange impact."

Underlying earnings per share was 46.8p in 2020.

## Employees

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, and making available training opportunities and appropriate accommodation to everyone employed by the Group, because we firmly believe that 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.

## Political donations

No political donations were made in 2020.

## Issued share capital

As at 31 December 2020, BAE Systems' issued share capital of £86,686,002 comprised 3,467,440,044 ordinary shares of 2.5p each and one Special Share of £1.

## Treasury shares

As at 1 January 2020, the number of shares held in treasury totalled 261,897,751 (having a total nominal value of £6,547,444 and representing 7.6% of the Company's called up share capital at 31 December 2019). During 2020, the Company used 12,902,202 treasury shares (having a total nominal value of £322,555 and representing 0.4% of the Company's called up share capital at 31 December 2020) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (7,886,468 shares in aggregate), awards under the Free and Matching elements of the International Share Incentive Plan (1,043,439 shares in aggregate), awards vested under the Performance Shares element of the Long-Term Incentive Plan (2,005,460 shares), awards vested under the Restricted Shares element of the Long-Term Incentive Plan (1,416,709 shares), and options exercised under the Executive Share Option Plan (550,126 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 550,126 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 £8,712,009. As at 31 December 2020, 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