

General Dynamics United Kingdom Limited

Annual report and financial statements

Registered number 1911653

31 December 2019



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Strategic Report

Business Review

General Dynamics United Kingdom Limited (“the Company”) operates in the defence sector offering a broad portfolio of products and service. Throughout 2019, the Company has focused on its key strategies of customer first, delivering on order book, whilst positioning for key pursuit wins for the future through investment in research and new product development. 2019 saw a number of highlights on some key programmes including:

- Delivery of 6 AJAX armoured fighting vehicles to the British Army as part of the program to produce 589 vehicles in six variants.
- The EvO programme completed ten of the programme increments as planned and demonstrated several key programme objectives:
 - a. The operating software has been integrated with 3rd party software applications to demonstrate new Battle Management and Communication capabilities that can be sourced in a vendor-independent manner.
 - b. A replacement tactical router and crew station hardware running the new open-software baseline has been delivered that can be installed in a legacy Bowman vehicle within 30 minutes.
 - c. As EvO moves into the next phase of the programme, the company and UK MoD are working to assess if changes are required to the original contracted baseline. This activity will continue through 2020 and into 2021
- Since 2016, the in-service Bowman Tactical Communications System has been going through a programme to update the software and hardware. At the end of 2019, 75% of the updates had been installed into the Army’s fleet of vehicles on time and with positive feedback from the Army User.
- During 2019, the Avionics team completed the development activities for the Initial Operational Capability (IOC) variant of the Wildcat Stores Management System (SMS). This SMS variant adds Martlet missile capability to the helicopter as well as maintaining the existing Stingray Torpedo and depth charge functionality. Once cleared through flight trials in 2020, the updated Wildcats will enter service with the Royal Navy in 2021 as part of Carrier Strike Group 21.

In May 2019, the company successfully concluded a period of activity with UK MoD to recast the AJAX Programme. The Recast modification made changes to the technical baseline for the vehicles, extended design and validation efforts to run concurrent with Production, introduced the use of production vehicles in Reliability Growth Trials (RGT), provides for capability drops which will retrofit design changes into previously produced production vehicles and extends the vehicle delivery schedule. The modification also increases the value of the contract in recognition of new scope, which includes Cannon Lethality Upgrade, Barrel Bend Study, Muzzle Blast and BCIP 5.6.

Also, in May 2019, the Company was awarded a 5-year contract from the UK MoD for the ongoing support of the current in-service Bowman Tactical Communications system. This service contract will provide the UK MoD with a service helpdesk, integrated logistics support, security accreditation and safety governance.

In the fourth quarter of 2019, the company undertook some restructuring activity driven by two factors: firstly, some specialised customer funded research and development activity had concluded, which resulted in the closure of a site in Chippenham and secondly, as some of the competitions pursued by the company moved out of the year, 27 staff members left the business via a redundancy programme. This represented 2% of total headcount at that time. These decisions had been taken prior to the close of 2019 and a provision of £2.5m is included within these accounts to cover the costs of this restructuring and site closure.

The year ended 31 December 2019 with profit 6.8% above target driven by more Bowman product sales than planned and strong programme execution.

Strategic Report *(continued)*

Total turnover decreased by 2% to £720m in 2019 compared to 2018 driven by reduced sales on the BCIP5.6 programme as the project moved from development in 2018 into fielding during 2019. Total operating profit decreased by £30.3m to a profit of £58.7m in 2019 compared to profit of £89.1m in 2018. The single biggest contributor of the change in operating profit is due to a non-recurring credit to income following the closure of certain legacy contract exposures in 2018. In addition to this, a restructuring provision was raised in 2019 that negatively impacted profit. The business also saw an increased amount of sales in 2019 from contracts that were awarded on a sole source basis under the 2014 Defence Reform Act conditions. The available profit under these contracts is lower than what the company has seen on previous sole source contracts, which is impacting the 2019 profit when compared to 2018.

Net current assets increased to £383m compared to £335m in 2018. This was principally caused by:

A reduction in Current Liabilities of £178m linked to:

1. £50m reduction in taxation and social security creditors. This arose due to a catch-up customer milestone invoice, which was raised in December 2018. This generated output VAT and was included as a creditor at year-end.
2. £86m reduction in trade creditors compared to 2018 where a large volume of invoices were received late in the year driving a higher trade creditor balance at the 2018 year-end.
3. £39m reduction in payments due under contracts when compared to 2018 driven by trading WIP movements on the AJAX contract.

A reduction in Assets of £127m primarily due to:

1. A £117m reduced debtor balance, as the amounts owed to GDUK under the GD Group Cash Pooling arrangement were lower than that in 2018. This was due to the company utilising cash it had received on contracts in previous years.
2. A reduction in the fair value of cash flow hedges of £14m in 2019 as those hedges matured on the AJAX project during the year and were not replaced until after the year-end.

In December 2019, the Pension Trustees entered into a binding agreement with Legal & General Assurance Ltd to insure the liabilities of the Defined Benefits Pension Scheme, known as a “buy-in” thereby removing exposure to the significant risks within the scheme. The scheme’s insurer is now responsible for ensuring that there are sufficient assets to meet all future pension obligations and is subject to EU solvency regulations. There is no volatility associated with the insurance policy asset as under IAS19 its value is considered to match the scheme liabilities. Asset volatility is limited only to those assets remaining in the scheme and included as a pension surplus on the balance sheet as the Company intends to convert to a full buy-out so the impact of the transaction of £4.5m has been included as a cost in the Income Statement.

Business performance is assessed using several key performance indicators above the traditional financial measures. These are focused on delivery performance in development and production contracts, staff turnover, the success rate of new business pursuits and the measurement of cost effectiveness and productivity. The company continues to focus on productivity and has a specific group that reviews and advises on areas for improvement with a target of enhancing productivity on some contracts by 3%. During the year, the company exceeded its productivity target on the C4 programmes and is implementing further measures to enhance this further in 2020. The Company also places an emphasis on having highly skilled people, which is imperative for successful programme delivery. In terms of staff turnover for 2018, the number of voluntary leavers as a percentage of headcount stood at 6.8% compared to 5% in 2018. This slight increase in the metric is due to a small number of leavers from the company when some Research and Development work neared completion. In 2019, the company continued to attract new and future talent. The Graduate and Apprentice scheme operated by the Company attracted another successful intake of future talent that will assist the Company in its strategy to grow the business and foster new ideas for growth.

Strategic Report *(continued)*

Principle Risks and Uncertainties

Individual programme and business segment level risk reviews are undertaken regularly. Key risks to the business include the impact of the United Kingdom's exit from the European Union. The company established a BREXIT working group in 2018 and has been working closely with the UK Government on mitigation actions. The company considers its biggest BREXIT risk to be delays at UK Borders impacting material deliveries. The company obtained Authorised Economic Operator (AEO) status in 2019 to assist with UK border checks. The company is confident that its BREXIT planning is robust to support it through this change.

The company's approach to Business Continuity Planning ensured that it was ready to respond to the Coronavirus pandemic in March 2020. The UK Government classified programmes in the Mission Systems and Land Systems business segments as critical programmes to continue. All employees who could work outside of the office were moved to homeworking. The company implemented strict social distancing measures along with onsite audits to ensure that employees who were unable to fulfil their roles from home, due to working on a production line or in a laboratory, could be at a GD location safely. There will be some delays to programme deliveries because of this pandemic and the company are working with the UK MoD on this matter.

Regulatory Matters

Some of the company's contracts are Qualifying Defence Contracts, as defined by the UK Defence Reform Act 2014. The company is an active member of the Single Source Regulator's Operational Working Groups and reports into the regulator on contract performance quarterly and annually.

Financial Risk Management

Foreign Exchange Rate Risk: Change in foreign exchange rates are dealt with by the Company as follows:

- To the extent possible, the foreign currency exchange rate risk relating to receipts from customers, payments to suppliers and inter-company transactions denominated in foreign currencies are sought to be mitigated via the terms and conditions within contracts.
- The Company will also seek to reduce the impact of foreign exchange risk by concluding transactions in the Company's functional currency or naturally hedging income and expenses in a foreign currency.
- Alternatively, the Company will enter into derivative instruments, principally foreign currency forward purchase and sale contracts, designed to offset and minimise risk. The Company does not use derivatives for trading or speculative purposes.

Credit Risk: Credit risk is considered by the Company to be low given that the majority of sales are to the UK Government.

Liquidity and Cash-flow Risk: The Company's liquidity is ensured by means of regular group-wide monitoring and planning of liquidity coordinated by the Group's centralised treasury department. In order to facilitate cash management activities, the Company has entered into a cash pool agreement with other General Dynamics companies within Europe. The cash pooling arrangement and regular forecasting of cash needs by the cash pool members significantly reduces any cash flow risk to the Company.

Section 172 (1) Statement

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

Strategic Report *(continued)*

- a. The likely consequences of any decision in the long term
- b. The interests of the company's employees
- c. The need to foster the company's business relationships with suppliers, customers and others
- d. The impact of the company's operations on the community and the environment
- e. The desirability of the company maintaining a reputation for high standards of business conduct, and
- f. The need to act fairly

The need to act fairly

GDUK is a wholly owned subsidiary of the General Dynamics Corporation. This topic is largely covered throughout the other sections of the Strategic report.

Decision Making

The business units within GDUK reports into two of the five operating segments within the General Dynamics Corporation; Mission Systems into the Mission Systems segment and Land Systems into the Combat Systems segment. The GD Corporate team sets the overall strategy for the business with each business unit being responsible for the execution of its own strategy and operational performance, whilst also adhering to GDUK's robust policies and processes. Decisions taken affecting each business unit are taken in line with the Company Delegation of Authority and GDUK's policies and processes.

As part of its operational performance, the business units produces a strategic plan alongside a 5-year financial projection. This is produced annually and reviewed for the preceding 18 months every quarter. The Directors and their senior delegates of the business contribute towards this process for their respective business units including the development and review of risks and opportunities to this strategy and the financial projections. In conducting this process, the Directors and their delegates have regard for the business, its stakeholders and the long-term implications of the decisions that they are undertaking.

Employees

Employee engagement is a key focus for the Directors and Management of the company to ensure its connecting employees to the Company's strategy and empowering them to contribute to its operational performance. In addition to the employee engagement described within the Director's report, the Company continues to invest in training development and involvement of employees across the business. A comprehensive employee communications programme is active which includes bi-annual all-employee briefings in addition to monthly 'flow-down' meetings and the weekly e-bulletin. Topics covered include market forecasts, product development, facilities and Company financial status. The Company encourages participation and involvement in matters, which affect their interests as employees. Encouragement is given to employees to provide feedback using organisation wide questionnaires with the aim of achieving a common awareness on all aspects affecting the performance of the Company. The Employee Consultation Group provides a safe forum for elected employee representatives to openly discuss business and employment matters with senior management. The Company's implemented policies and processes also provide a means to give employees their views and feedback. Through the implementation by the Company of these policies and processes, the Directors and Management have regard to the interests of the Company's employees.

Fostering business relationships with suppliers, customers and other

The Board of Directors and Management of the company believes that the prime value of the company is generated from its employees, supply chain and customer relationships. Fostering business relationships with key stakeholders, such as customers and suppliers is considered as essential to the Company's success. The Directors, Senior Management and the Supply Chain team within the company meets with key suppliers in order to develop and enhance strategic relationships with them. The company also works closely with its supply chain through several forums and

Strategic Report *(continued)*

continues to pledge support to the UK Government's Small- Medium Sized enterprise agenda. In 2019, the Company signed up to the Prompt Payment Code (PPC) and through the year paid 97% of the volume of its invoices within 60 days (*2018: not applicable*). The Directors recognise the importance of paying suppliers promptly and actively monitors and reviews the company's payment practices. The EDGE UK® is a concept developed by GD which provides Small and Medium Sized Enterprises, academia and customers with access to virtual and physical collaboration environments. This enables Small and Medium Sized Enterprises with a route to market and also provides customers with potential solutions to complex engineering problems.

The Company also continued to focus on building collaborative relationships with customers and external stakeholders. The Directors and their delegates sit on a number of UK Government Defence supplier groups and work directly with its customer base to build strong relationships. In 2019, the company was awarded the ISO 44001 Collaborative Business Relationship Management accreditation, which is utilised across its programmes.

The community and the environment

The Directors recognise and agree the importance of leading a company that not only generates value for the shareholders but also contributes to the wider community. The Company is committed to the Armed Forces Covenant and to maintaining its Employer Recognition Scheme Gold Award. The Company has formed an Armed Forces Network for employees meeting each quarter as an open forum to discuss ways to further support the armed forces community.

In addition, the Company regularly supports Armed Forces charities, including ABF – The Soldiers' Charity, Combat Stress and SSAFA. In 2019, the Company employees actively supported the Reservist Day and Armed Forces Day, which the Directors of General Dynamics UK were very proud to sponsor.

Charitable donations and community involvement are encouraged across all sites and employees are supported by well-developed policies and practices.

Corporate Sustainability is rooted in the company Ethos. Climate change is a concern to the Directors who are committed to reducing any global environmental impact and striving to be a leader in improving environmental quality. Through existing robust governance and reporting, with a keen focus on data collation, analytics, understanding risk and identifying energy efficiency opportunities, the company is prepared and able to fulfil obligations for Streamlined Energy and Carbon Reporting (SECR).

Maintaining a reputation for a high standard of conduct

The Directors and the Management of the company promote the GD Corporate policy of Ethos, which demonstrates distinguishing moral nature. The company prides itself on values of Honesty, Transparency, Trust and Alignment throughout its workforce and operations. These values drive how the company operates its business, governs how to interact with each other including customers, partners and suppliers, guide the way employees are treated and determines how to connect with the community.

The company has a Standards of Business Ethics and Conduct Handbook that applies to all employees. This handbook, known as the Blue Book. This ethics program also includes periodic training on ethics and compliance topics for all employees and a 24-hour ethics helpline, which employees can access via telephone or online to communicate any business-related ethics concerns. The company has implemented an Ethics code specifically applicable to the Board of Directors, which embodies the commitment to manage the business in accordance with the highest standards of ethical conduct.

The Directors periodically review and approve frameworks such as its Modern Slavery Statements, to ensure that its high standards are maintained both internally and within external business.

The tax strategy is developed by General Dynamics Corporation and is applicable to General Dynamics United Kingdom Ltd for which General Dynamics Corporation (GDC) has ultimate control. The tax strategy is publically available on the website of the Company to enable external stakeholders to understand the Group's approach to tax.

Strategic Report *(continued)*

2019 Summary

The Company closed the year with programmes achieving key milestones and extensions, coupled with investment activities, which position the Company well for future growth opportunities. Employees, customers and suppliers continue to be at the forefront of the Company's prime value generation and the ongoing focus on these key relationships will ensure a vibrant future for the Company, already recognised as a central part of the UK Defence landscape. The company faced a restructuring activity in 2019 which will support its long term strategy for winning new business.


Lieutenant General A C Figgures
Director

21 Holborn Viaduct

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Date 23 December 2020

Directors' Report

The Directors present their annual report and the audited financial statements for the year ended 31 December 2019.

Principal Activities

General Dynamics United Kingdom Limited ("the Company") has two operating segments:

1. **Mission Systems** which specialises primarily in the design, delivery and through-life support of solutions in the Command, Control, Communications, Computing and Information (C4I) domain.
2. **Land Systems** which designs, manufactures and sustains land combat platforms; most notably the AJAX armoured fighting vehicle.

C4I is the delivery of vital information via the integration of technology and networks. This information is used to observe and act decisively in the field of battlespace management. In 2004 the Company delivered Bowman, one of the world's most advanced battlefield communication systems, to the United Kingdom Ministry of Defence (UK MoD). In 2017, the Company was awarded the first phase of the MORPHEUS contract, known as Evolve to Open (EvO), which aims to modernise the UK's communications and command and control systems by evolving the Bowman network into a more open system, able to maintain pace with ever-advancing technology. The company has also been successful in providing a Tactical Communications System for the Dutch Marines.

The Company is contracted for the Demonstration, Production and Extended Support Phases of the AJAX programme for the UK Army. The AJAX armoured fighting vehicle, a next generation medium weight tracked combat vehicle, offers advanced electronic architecture and proven technology for an unparalleled balance of survivability, lethality and mobility along with high reliability for a vehicle in its weight class. Work on the AJAX programme has transitioned from engineering to test and then full production. Steady state production will continue through to 2024. The company will produce 589 vehicles in six different variants.

The Company also provides a range of best-in-class avionics products including tactical processors, tactical data links, weapon management computer systems and secure data recorders. This wealth of experience in the avionics business has made the Company a key supplier to programmes such as Typhoon and Wildcat.

Research and development

To foster innovation, product development and evolution, the Company has a policy of targeted investment in the design and development of new technologies and capabilities that support business growth and the pursuits that the business is planning to win in future periods.

Major areas of interest include the development of new products for future MORPHEUS competitions and an export version of the MORPHEUS EvO system. The Company is also focussing on experimental work to extend the MORPHEUS EvO baseline software to work with future radios, applications and platform architectures. Experimental work included development of new software and system patterns to enable integration between different locations.

Further areas of focus in the Land sector are joint AJAX capability growth experimentation with the UK Army (including so-called Manned/Unmanned Teaming or MUM-T), AFV sustainment related technologies such as Health and Usage Monitoring Systems (HUMS), ensuring vehicle electronic architectures are aligned with MORPHEUS and helping develop the Land Environment's latest ISTAR thinking.

In the air sector, the company is investing in the Typhoon mid-life update as well as future unmanned combat air platforms, such as TEMPEST.

Financial Instruments risk, policy and exposure

The Company is subject to foreign exchange rate risk which is detailed in the Strategic Report. Where receipts and disbursements cannot be denominated in the functional currency or offset by an equal amount with identical timing to create a natural hedge, it is company practice to enter into hedge contracts that reduce the impact of currency movements over a period of time.

Directors' Report (*continued*)

Foreign exchange exposure is reviewed on a monthly basis and explanation provided for any unhedged transactions greater than \$1m. As a result, the Company's exposure to foreign exchange risk is considered low.

Results and proposed dividend

Profit after taxation for the year ended 31 December 2019 was £46m compared to £75.8m for the year ended 31 December 2018. The directors do not recommend the payment of a dividend for the year (2018: *£nil*).

Directors

The directors who held office during the year were as follows:

Non-Executive Directors:

Sir Andrew Cahn (*Resigned March 5 2019*)
Lieutenant General Andrew Collingwood Figgures (*Appointed June 5 2019*)
Lord Levene of Portsoken - Chairman (*Resigned December 31 2019*)

Executive Directors:

Christopher Marzilli (*Resigned January 10 2019*)
C Brady (*Appointed January 10 2019; Resigned February 25 2019*)
Gary Lee Whited
Steven Edward Rowbotham (*Appointed March 5 2019*)

In addition, there have been changes to the Directors who held office in the period from 31 December 2019 to the signing of the accounts as detailed below:

Resignations:

Gary Lee Whited (*Resigned April 1 2020*)

New Appointments:

Danny Deep (*Appointed Executive Director April 1 2020*)
Lieutenant General Andrew Collingwood Figgures - Non-Executive Director (*Appointed Chairman May 1 2020*)

Corporate Responsibility

During 2019, the Company continued to build on its solid progress and actively ensured delivery of stakeholder commitments. The Company website explains to stakeholders the Company policies, strategies and business progress and is updated on a regular basis. Employees receive frequent updates on progress and the latest Company initiatives through a weekly e-newsletter. In addition, the Company has introduced a new social media communication platform that enables employees to connect and share information about the latest news and activities across the business.

The Company strives to maintain the highest standards of ethical conduct and corporate responsibility. Employees receive annual training on this subject, and support mechanisms are in place for employees through an information telephone line, which is operational 24 hours a day, 365 days of the year. By operating proactive policies, the Company manages its customer and supplier relationships responsibly.

The Company is committed to the Armed Forces Covenant, and to maintaining its Employer Recognition Scheme Gold Award. The Company has formed an Armed Forces Network for employees meeting each quarter as an open forum to encourage employee engagement with the covenant and to discuss ways to further support the armed forces community. Service leavers are supported by attending Transition Fairs designed to promote employment opportunities, contribute to military thought leadership and support existing employees undertaking Reserve service and cadet instructors with a period of paid leave.

Directors' Report *(continued)*

The single greatest contribution to the communities in which the Company operates is the sustained wealth created by providing hundreds of highly skilled jobs. Charitable donations and community involvement are encouraged across all our sites and employees are supported by well-developed policies and practices.

Employees

Employees are considered by the company as the key part to the success of the business. Employee engagement is assessed through a formal survey each year in addition to regular one to one sessions between Employees and Management. Employee Communication is considered a key attribute to enhanced employee engagement and the company's approach to this is laid out in the Section 172 disclosure within the Strategic Report.

The Company is committed to promoting diversity and creating a fully inclusive working environment, where every employee can fulfil their potential. The Company recognises that diversity of experience, perspectives and capabilities is good for the team, wider stakeholders and it is critical to future success. The Company has a commitment to a comprehensive inclusion and diversity strategy; a working group has been established across the UK and is investing in areas that foster an inclusive, diverse and transparent working environment for all colleagues.

During 2019, the company became one of the founding members of the Women in Defence Group led by the United Kingdom Ministry of Defence. This compliments the many activities already undertaken across the inclusion and diversity agenda through the steering group. This includes being a Stonewall Diversity Champion in support of the LGBTQ+ community and being awarded a Silver "Fair Play Employer" award via partnership with a leading gender equality charity in Wales, 'Chwarae Teg'. The company has also reduced its reported gender pay gap in 4 out of 5 of the statutory metrics in the year to April 2019.

On December 31, 2019, the company employed 1,250 employees across its sites in Oakdale in South Wales, Merthyr Tydfil in South Wales, Hastings in East Sussex, Chippenham in Wiltshire and Bristol. Of these employees 50 are covered by the UNITE Union Recognition Agreement.

Post Balance Sheet Events

During 2020, the Company acquired the trade and assets of a sister company, Force Protection Europe Ltd, which ceased to trade in 2019.

The Company's response to COVID has been discussed in the Strategic Report.

Going Concern Assessment

Following assessment and review, the Directors have a reasonable expectation that the Company has sufficient resources to continue to operate for at least the next 12 months from the date of approval of these financial statements. The impact of the COVID-19 pandemic provides uncertainty but the financial projections combined with possible outcome based risk assessments and a letter of support from the parent company provides the Directors with sufficient confidence that the financial statements should be prepared on a going concern basis.

Disclosure of information to auditor

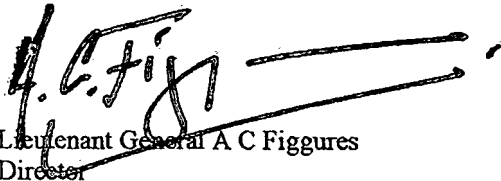
The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company auditor is unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company auditor is aware of that information.

Directors' Report (continued)

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

By Order of the Board



Lieutenant General A C Figgures
Director

21 Holborn Viaduct

London

EC1A 2DY

Date... 23 December 2020

Statement of directors' responsibilities in respect of the annual report and financial statements

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent auditor's report to the members of General Dynamics United Kingdom Limited

Opinion

We have audited the financial statements of General Dynamics United Kingdom Limited ("the company") for the year ended 31 December 2019, which comprise the Income Statement and Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework* and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the company or to cease its operations, and as they have concluded that the company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the directors' conclusions, we considered the inherent risks to the company's business model and analysed how those risks might affect the company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the company will continue in operation.

Strategic report and directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Independent auditor's report to the members of General Dynamics United Kingdom Limited *(continued)*

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 11, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.



Huw Brown (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
66 Queen Square
Bristol
BS1 4BE
23 December 2020

Income statement

for the year ended 31 December 2019

	Note	2019 £000	2018 £000
Turnover	2	720,454	735,632
Cost of sales		(613,729)	(608,242)
		<hr/>	<hr/>
Gross profit		106,725	127,390
Administrative expenses		(47,987)	(38,313)
		<hr/>	<hr/>
Operating profit		58,738	89,077
Interest receivable and similar income	5	261	474
Interest payable and similar expenses	6	(5,676)	(4,418)
Other gains and losses	7	-	4,046
		<hr/>	<hr/>
Profit before taxation	8	53,323	89,179
Tax on profit	10	(7,336)	(13,378)
		<hr/>	<hr/>
Profit for the financial year		45,987	75,801
		<hr/>	<hr/>

The profit for the year and the preceding year arises entirely from continuing operations.

The notes on pages 17 to 52 form part of these financial statements.


Other Comprehensive Income

		2019 £000	2018 £000
Profit for the financial year		45,987	75,801
Items that will not be reclassified subsequently to profit and loss:			
Actuarial loss recognised on the pension scheme	24	(188)	(85)
Recognition of pension surplus (inclusive of deferred tax)	24	-	7,352
Items that will be reclassified subsequently to profit or loss:			
Change in fair value of cash flow hedges (inclusive of deferred tax)	21	(8,598)	(17,003)
		<hr/>	<hr/>
Total comprehensive income for the year		37,201	66,065

Balance sheet
At 31 December 2019

	<i>Note</i>	2019 £000	2018 £000
Fixed assets			
Intangible assets	11	1,016	2,248
Tangible assets	12	35,462	30,651
		<hr/>	<hr/>
		36,478	32,899
Current assets			
Stock and work in progress	13	154	158
Debtors	14	592,460	709,424
Other financial assets	17	1,151	14,763
Cash at bank		2,200	2,598
		<hr/>	<hr/>
		595,965	726,943
Creditors: amounts falling due within one year	15	(212,648)	(391,453)
		<hr/>	<hr/>
Net current assets		383,317	335,490
		<hr/>	<hr/>
Total assets less current liabilities		419,795	368,389
Creditors: amounts falling due after more than one year	16	(8,202)	(5,500)
Provisions for liabilities and charges	19	(28,629)	(17,373)
		<hr/>	<hr/>
Net assets		382,964	345,516
		<hr/>	<hr/>
Capital and reserves			
Called up share capital	20	9,262	9,262
Capital redemption reserve		88	88
Other reserves		1	1
Cashflow hedge reserve	21	821	9,419
Profit and loss account		372,792	326,746
		<hr/>	<hr/>
Shareholders' funds		382,964	345,516
		<hr/>	<hr/>

These financial statements were approved by the board of directors on 23 / 12 / 2020 and were signed on its behalf by:


Lieutenant General A C Figgures
Director

The notes on pages 17 to 52 form part of these financial statements.

Statement of Changes in Equity

	Called up Share capital £000	Capital redemption reserve £000	Other reserves £000	Cash flow hedge reserve £000	Profit and loss account £000	Total £000
Balance at 1 January 2019	9,262	88	1	9,419	326,746	345,516
Other Comprehensive income for the year	-	-	-	(8,598)	45,799	37,201
IFRS 2 share based payment charges	-	-	-	-	37	37
Pension adjustment	-	-	-	-	210	210
At 31 December 2019	<u>9,262</u>	<u>88</u>	<u>1</u>	<u>821</u>	<u>372,792</u>	<u>382,964</u>

	Called up Share capital £000	Capital redemption reserve £000	Other reserves £000	Cash flow hedge reserve £000	Profit and loss account £000	Total £000
Balance sheet as at 1 January 2018	9,262	88	1	26,422	242,826	278,599
Other Comprehensive income for the year	-	-	-	(17,003)	83,068	66,065
IFRS 2 share based payment charges	-	-	-	-	852	852
At 31 December 2018	<u>9,262</u>	<u>88</u>	<u>1</u>	<u>9,419</u>	<u>326,746</u>	<u>345,516</u>

Notes

(forming part of the financial statements)

1 Accounting policies

General Dynamics United Kingdom Limited (the “Company”) is a private company incorporated, domiciled and registered in England and Wales. The registered number is 1911653 and the registered address is 21 Holborn Viaduct, London, EC1A 2DY.

Basis of Preparation

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (“FRS 101”). In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU (“Adopted IFRSs”), but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

As the Company’s ultimate parent undertaking, General Dynamics Corporation, includes the Company in its consolidated financial statements which are intended to give a true and fair view of the assets, liabilities, financial position and profit and loss, the Company qualifies for the preparation of accounts using FRS101 with reduced disclosures. The consolidated financial statements of General Dynamics Corporation are prepared in accordance with US GAAP and are available to the public and may be obtained from 11011 Sunset Hills Road, Reston, VA 20190.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- Cash Flow Statement and related notes;
- Disclosures in respect of capital management;
- Disclosures in respect of the compensation of Key Management Personnel;
- Disclosures in relation to new standards not yet applied;
- Disclosures in respect comparatives of Fixed Assets and Intangibles; and

As the consolidated financial statements of General Dynamics Corporation include the equivalent disclosures, the Company has also taken the exemptions under FRS 101 available in respect of the following disclosures:

- IFRS 2 Share Based Payments in respect of group settled share based payments, excluding the Save As You Earn scheme;
- Certain disclosures required by IAS 36 Impairment of assets in respect of the impairment of goodwill and indefinite life intangible assets; and
- Certain disclosures required by IFRS 13 Fair Value Measurement and the disclosures required by IFRS 7 Financial Instrument Disclosures.

The Company proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

Change in accounting policy

The Company has adopted the following IFRSs in these financial statements:

Leases

The Company applied IFRS16 using the modified retrospective approach, under which the comparative information presented for 2018 is not restated and is presented as previously reported, under IAS17. Since asset values are equal to the lease liability, there is no adjustment recognised in retained earnings. The details of the changes in accounting

Notes (continued)

1 Accounting policies (continued)

policies are disclosed below. Additionally, the disclosure requirements in IFRS16 have not been applied to comparative information.

Recognition of a lease

Previously, the Company determined at contract inception whether an arrangement was or contained a lease under IFRIC4 *Determining whether an Arrangement contains a lease*. The Company now assesses whether a contract is or contains a lease based on the definition of a lease, as explained below.

The Company has applied IFRS16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS17 and IFRIC4. The details of accounting policies under IAS17 and IFRIC4 are disclosed separately.

At inception of a contract, the Company assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Company uses the definition of a lease in IFRS16.

This policy applies to new and existing contracts as at 1 January 2019.

The Company recognises a right-of-use asset and a lease liability at the lease commencement date (or, for leases existing at 1 January 2019, the transition date). The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date / transition date. The future lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate ('IBR'). Generally, the Company uses its incremental borrowing rate as the discount rate.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date / remaining lease term following the transition date, to the end of the lease term.

The Company determines its incremental borrowing rate by adopting the rates utilised at the corporate level. The Treasury function is managed at the European Treasury level. This function exists to provide expediency and convenience for foreign operations; however any action, including additional borrowing, requires Corporate Treasury approval. As such, European Treasury functions are not autonomous, cannot borrow funds independently and are extensions of the Corporate Treasury function. Since all funding is managed by the Corporate Treasury function, all leases of a similar term have similar risk characteristics from the lessor's perspective, regardless of the business unit. Additional funding is obtained through the Corporate Treasury function regardless of the functional currency of the lease. As such, risk is based on the consolidated treasury function and rates would remain uniform. It is considered that use of the Corporate borrowing rate is appropriate due to the centralised nature of the treasury function.

Additional funding is obtained through the Corporate Treasury function regardless of the functional currency of the lease. As such, risk is based on the consolidated treasury function and rates would remain uniform.

The IBR is based on the NSS (Nelson, Sigel, Svensson) yield curve obtained from Bloomberg. The NSS curve is a specialised yield curve with five components that account for the shapes found in yield curves and most accurately reflects the cost of borrowing. Varying rates are applied for varying lease terms with rates published monthly.

Lease payments included in the measurement of the lease liability comprise the following:

- Fixed payments
- Extensions only where the contract contains an option to extend and it is reasonably certain to be exercised.
- Where variable lease payments may be possible due to the contractual existence of lease pricing reviews, the payments have been assumed to remain at their current fixed amount over the lease term given the uncertainty of future changes.

Notes (continued)

1 Accounting policies (continued)

Short-term leases and leases of low-value assets

The Company has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases. An asset is considered to be low-value where it has a value of less than \$5k when new. Short-term leases are those with a lease term of 12 months or less. Where a right-of-use asset exists, the Company recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

The Company leases many assets including property, motor vehicles and IT equipment. The Company previously classified leases as operating or finance leases based on its assessment of whether the lease transferred significantly all of the risks and rewards incidental to ownership of the underlying asset. Under IFRS16, the Company recognises right-of-use assets and lease liabilities for some of these leases resulting in their recognition on the balance sheet.

At commencement or on modification of a contract that contains a lease component, the Company allocates the consideration in the contract to each lease component on the basis of its relative stand-alone price. The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date / remaining lease term following the transition date, to the end of the lease term.

Leases classified as operating leases under IAS17

Previously the Company classified property leases as operating leases under IAS17. On transition, for these leases, lease liabilities were measured at the present value of the remaining lease payments, discounted at the incremental borrowing rate as at 1 January 2019.

Right of use assets are measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments.

The Company used a number of practical expedients when applying IFRS16 to leases previously classified as operating leases under IAS17. In particular, the Company:

- Does not recognise right-of-use assets and liabilities for leases for which the lease term ends within 12 months of the date of initial application;
- Does not recognise right-of-use assets and liabilities for leases of low value assets (where the asset value is below \$5,000).
- Excluded initial direct costs from the measurement of the right-of-use asset at the date of initial application

Leases classified as finance leases under IAS17

At the date of transition there were no leases being accounted for as finance leases.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Measurement Convention

The financial statements are prepared on the historic cost basis except for derivatives which are stated at fair value.

The financial statements are presented in round thousands.

Going Concern

The financial statements have been prepared on a going concern basis which the Directors consider to be appropriate for the following reasons.

The Directors have prepared cash flow forecasts for a period of 48 months from the date of approval of these financial statements which indicate that, taking account of reasonably possible downsides and the anticipated impact of COVID-19 on its operations and its financial resources, the Company will have sufficient funds, through funding from its

Notes (continued)

1 Accounting policies (continued)

ultimate parent company, General Dynamics Corporation, to meet its liabilities as they fall due for that period.

In preparing the forecasts the Directors have considered reasonably possible downside scenarios.

Specifically, they have considered the following factors:

- The Company has been able to trade throughout the period since the beginning of the first lockdown as its activities in supporting the UK MoD were designated as critical;
- The activity to support the majority of the Company's contracts has been and continues to be successfully delivered though remote working. As a result, the downside scenario assumes that these contracts continue to be fulfilled successfully under remote working;
- Those activities which require on-site activity (principally production of vehicles on the AJAX contract) have been adapted to meet social distancing and other requirements in order to operate in a COVID secure manner. While the rate of delivery has slowed as a result of these changes and contract alleviations for this have been sought from the MoD, the downside scenario does not assume that these claims are successful and that payments are therefore delayed from 2021 to 2022;
- The Company's contracts contain defined payment plans under which the Company receives cash through the life of the contract to fund activities on those contracts. The Company remains in negotiation with the MoD in relation to one of its significant contracts. The Company has assumed in the downside case that the negotiation completes during 2021 but that this does not result in any benefit to the Company either in terms of timing or quantum of cash receipts.
- The significant majority of the Company's trade is with the MoD and there has been no evidence of deterioration in recovery of receivables on these contracts. Contracts with counterparties other than the MoD have similarly not seen a deterioration in the timeliness of receivables settlements noting that while they are with third parties, substantially all relate to either government bodies or are related to underlying contracts with government bodies (both UK and International). Consequently, the downside scenario assumes that all receivables are collected in line with actual experience during the COVID period to date;
- The Company has seen signs that future contract awards and competitions are being adversely affected and the decisions to either open such contract competitions or award contracts have been postponed. As a result, the downside scenario assumes that no new contracts are won during the forecast period;
- The Company continues to monitor its supply chain closely to mitigate the risk of a failure in the supply chain as a failure of a supplier could result either in delays to the affected contract(s) or increased costs. The majority of the Company's key suppliers are either other subsidiaries of the General Dynamics Corporation or significant Tier 1 suppliers to the UK MoD. As a result, the Company considers the risk of a significant supplier failure to be low.
- The Company has initiated strategies to reduce its cost base, however, the downside scenario does not assume that any cost savings which are outside of the Company's control will be achieved.

The Company finances its activities through its cash balances. These cash balances are held in a cash pool operated by its intermediate parent company General Dynamics European Finance Limited ("GDEF"). Under the terms of the cash pooling agreement with GDEF the Company and any other member of the cash pool may drawdown funds from GDEF. The agreement does not restrict the cash pool members to drawing down only those funds already deposited but allows cash pool members to borrow further funds from the cash pool up to GDEF's external borrowing limits. In the downside scenario described above, the Company would need to borrow from the cash pool in excess of the cash balances deposited during the forecast period. The directors are not able to assess whether GDEF would be able to provide the extent of funding which the Company requires given they cannot assess the borrowing requirements of the other cash pool members. In the event the Company cannot borrow the amounts required from the GDEF cash pool, it would instead need to rely on the support of General Dynamics Corporation, the Company's ultimate parent undertaking ("the parent").

Therefore, those forecasts are dependent on the parent not seeking repayment of the amounts currently due to the group, which at 31 December 2019 amounted to £19,809,000, and providing additional financial support during that period. The parent has indicated its intention to continue to make available such funds as are needed by the Company, and that it does not intend to seek repayment of the amounts due at the balance sheet date, for the period covered by the forecasts. Having made enquiries of the directors of the parent and assessed the financial position of the parent

Notes (continued)

1 Accounting policies (continued)

the directors are satisfied the parent has the ability, intent and economic rationale to continue to support the Company. As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so. Consequently, the directors are confident that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

Intangible assets

(i) Goodwill

Goodwill represents the future economic benefits arising from assets acquired in a business combination that are not individually identified and separately recognised. Such benefits include future synergies expected from the combination and intangible assets not meeting the criteria for separate recognition. Goodwill is carried at cost less accumulated impairment losses. Goodwill is not amortised and is tested annually for impairment at country level, representing the lowest level at which it is monitored for internal management purposes, by assessing the recoverable amount of each cash generating unit or groups of cash generating units to which the goodwill relates. The recoverable amount is assessed by reference to the net present value of expected future pre-tax cash-flows ('value-in-use') or fair value less costs to sell if higher. When the recoverable amount of the goodwill is less than its carrying amount, an impairment loss is recognised immediately in the income statement which cannot be subsequently reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill had been fully impaired by 31 December 2018.

(ii) Customer relationships

Customer relationships represent the future economic benefits arising from specific supplier or customer lists, or are party to supplier or customer relationships that are valuable. Customer relationships are held at cost less any provisions for impairment, with impairment reviews being performed annually. Amortisation commences when the Customer Relationship assets are available and is over the estimated useful life of 8 years. Customer relationships were fully amortised / impaired by 31 December 2018.

(iii) Other Intangibles

The other intangibles are a royalty-free licence for relief from royalty. Royalty-free licence relief is held at cost less any provisions for impairment, with impairment reviews being performed annually. Amortisation commences when the royalty-free licence relief is available and is over the estimated useful life of 8 years. Other intangibles were fully amortised / impaired by 31 December 2018.

(iv) Computer software

Where software is not an integral part of a related item of computer hardware, it is classified as an intangible asset. Costs that are directly associated with the acquisition or production of identifiable software products controlled by the Group, which are expected to generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Capitalised costs include those of software licences and development, including costs of employees, consultants and an appropriate portion of relevant overheads. Costs that are directly associated with identifying, sourcing, evaluating or maintaining computer software are recognised as an expense as incurred. Software under development is held at cost less any provisions for impairment, with impairment reviews being performed annually. Amortisation commences when the software assets are available for use and is over their estimated useful lives of three to four years.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Where parts of an item of tangible fixed assets have different useful lives, they are accounted for as separate items of tangible fixed assets. The Company recognises a right-of-use asset and a lease liability at the lease commencement date (or, for leases existing at 1 January 2019, the transition date). The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date / transition date. The future lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate ('IBR'). Generally the Company uses its incremental borrowing rate as the discount rate.

Notes (continued)

1 Accounting policies (continued)

Tangible fixed assets and depreciation (continued)

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date / remaining lease term following the transition date, to the end of the lease term.

Depreciation is charged to the profit and loss account on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are as follows:

Freehold Buildings:	50 years
Right-of-use assets	Life span of lease
Plant, Machinery and Motor Vehicles:	4-8 years

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

Fixed asset investments

Investments in subsidiaries are carried at cost less provision for impairment (if any).

Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of goodwill; the initial recognition of assets or liabilities that affect neither accounting nor taxable Current tax is the expected tax payable or receivable on the profit other than in a business combination, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Deferred taxation at 35% is applied to UK pension surplus, being the rate applicable to refunds from a scheme.

Stocks and work in progress

Stocks are stated at the lower of cost and net realisable value. Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the stocks, production or conversion costs and other costs in bringing them to their existing location and condition.

Foreign Currencies

Transactions in foreign currencies are translated to the Company's functional currencies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined. Foreign exchange differences arising on translation are recognised in the profit and loss account, except for differences arising on the retranslation of qualifying cash flow hedges, which are recognised in other comprehensive income.

Notes (continued)

1 Accounting policies (continued)

Research and Development

Expenditure on research activities is recognised in the profit and loss account as an expense as incurred. Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Company intends and has the technical ability and sufficient resources to complete development, future economic benefits are probable and if the Company can measure reliably the expenditure attributable to the intangible asset during its development. Development activities involve a plan or design for the production of new or substantially improved products or processes. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads and capitalised borrowing costs. Other development expenditure is recognised in the profit and loss account as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and less accumulated impairment losses.

Employee Benefits

Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the profit and loss account in the periods during which services are rendered by employees.

Where members retire during the year and the value of their money purchase funds did not cover their defined benefit underpin benefits, the net shortfall would be recognised as a liability whilst they are deferred members.

Upon retirement, the money purchase funds are transferred to the defined benefit assets and the full liability for these members is recognised.

Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company's net obligation in respect of defined benefit pension plans and other post-employment benefits is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any plan assets (at bid price) are deducted. The Company determines the net interest on the net defined benefit liability/(asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability/(asset).

The discount rate is the yield at the reporting date on bonds that have a credit rating of at least AA that have maturity dates approximating the terms of the Company's obligations and that are denominated in the currency in which the benefits are expected to be paid.

Re-measurements arising from defined benefit plans comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest). The Company recognises them immediately in other comprehensive income and all other expenses related to defined benefit plans in employee benefit expenses in profit or loss.

The calculation of the defined benefit obligations is performed by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Company, the recognised asset is limited to the present value of benefits available in the form of any future refunds from the plan or reductions in future contributions and takes into account the adverse effect of any minimum funding requirements.

Notes (continued)

1 Accounting policies (continued)

Employee Benefits (continued)

General Dynamics Retirement and Death Benefit Scheme (the Scheme)

The Company sponsors a hybrid arrangement that includes both a defined contribution section and a defined benefit section. The defined benefit section was closed from 6th April 1997, at which time members ceased to accrue benefits on a defined benefit basis. The assets of the scheme are held separately from the assets of the Company.

The defined benefit section costs and obligations depend on several assumptions and estimates. The key assumptions include mortality and interest rates used to discount estimated future liabilities. The Company determines the long-term expected rate of return on cash by reference to bank base rates, the long-term return on bonds by reference to UK long dated government and corporate bond yields, and the long-term rate of return on equities based on the rate of return on bonds allowing for forward-looking returns.

These retirement scheme estimates are based on our best judgement, including consideration of current and future market conditions. In the event any of the assumptions change, pension and post-retirement benefit cost could increase or decrease. In line with the requirements of the Scheme regulator any shortfalls in asset value in the actuarial valuation for the defined benefit section are met by the Company over an agreed period. For additional information on the Pension Scheme, see note 24 of the Annual report and financial statements.

Paragraph 11(b) of IFRIC 14 states that if the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset. The Company does have an unconditional right to a refund and the pension surplus has been recognised as an asset on the balance sheet.

The Trustees of the pension fund are required by law to act in the best interests of the plan participants and during 2019 entered into a binding agreement with Legal and General to insure the liabilities of the scheme known as a buy-in. The Company is committed to convert to a buy-out and the loss on buy-in has therefore been recognised in the Income Statement in full.

Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Termination benefits

Termination benefits are recognised as an expense when the Company is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Company has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting date, then they are discounted to their present value.

Employee share schemes

The share option programme allows employees to acquire shares in the Company's ultimate parent. The fair value of options granted after 7 November 2002 and those not yet vested as at the effective date of IFRS 2, is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a Black - Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where variations are due only to share prices not achieving the threshold for vesting.

For cash settled share based payment transactions, the fair value of the amount payable to the employee is recognised as an expense with a corresponding increase in liabilities. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value is measured based on an option pricing model taking into account the terms and conditions upon which the instruments were granted. The liability is revalued at each balance sheet date and settlement date with any changes to fair value being recognised in the profit and loss account.

Notes (continued)

1 Accounting policies (continued)

Financial Instruments

Recognition and initial measurement

Trade receivables and debt securities are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Company becomes a party to the contractual provisions of the instrument.

A financial asset (unless it is a trade receivable without a significant financing component) or financial liability is initially measured at fair value plus, for an item not at 'fair value through profit or loss' (FVTPL), transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

Classification and subsequent measurement

Financial assets

Classification

On initial recognition, a financial asset is classified as measured at amortised cost; Fair Value through OCI ('FVOCI') or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

A financial asset is measured at amortised cost if it meets both of the following conditions:

- It is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- Its contractual terms give rise on specified dates to cash flows that are solely principal and interest on the principal amount outstanding.

A debt instrument is measured at fair value through other comprehensive income (FVOCI) if it meets both of the following conditions:

- It is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in OCI. This investment is made on an investment-by-investment basis.

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. This includes all derivative financial assets.

Investments in joint ventures are carried at cost less impairment.

Subsequent measurement and gains and losses

Financial assets at FVTPL – these assets (other than derivatives designated as hedging instruments) are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in profit or loss.

Financial assets at amortised cost – these assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on de-recognition is recognised in profit or loss.

Notes (continued)

1 Accounting policies (continued)

Financial Instruments (continued)

Debt instruments at FVOCI – these assets are subsequently measured at fair value. Interest income calculated using the effective interest method, foreign exchange gains and losses and impairment are recognised in profit or loss. Other net gains and losses are recognised in OCI. On de-recognition, gains and losses accumulated in OCI are reclassified to profit or loss.

Equity investments at FVOCI – these assets are subsequently measured at fair value. Dividends are recognised as income in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment. Other net gains and losses are recognised in OCI and are never reclassified to profit or loss.

De-recognition of financial assets

The Company recognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

Financial liabilities and equity

Classification

Financial instruments issued by the Company are treated as equity only to the extent that they meet the following two conditions:

- They include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and
- Where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Financial liabilities are classified as measured at amortised cost or FVTPL. A financial liability is classified as at FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including interest expense, are recognised in profit or loss. Other financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in profit or loss. Any gain or loss on de-recognition is also recognised in profit or loss.

De-recognition of financial liabilities

The Company derecognises financial liabilities when the Company's obligations are discharged, cancelled or they expire.

Effective Interest Method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the debt instrument, or, where appropriate, a shortened period, to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for debt instruments other than those financial assets classified as at FVTPL.

Derivative financial instruments and hedging

Derivative financial instruments

The Company enters into forward contracts as derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risk.

Notes (continued)

1 Accounting policies (continued)

Derivative financial instruments (continued)

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

Hedge accounting

The Company designates certain hedging instruments in respect of foreign currency risk as cash flow hedges where the hedges are of foreign exchange risk on firm commitments.

At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument is highly effective in offsetting changes in cash flows of the hedged item.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised in profit or loss, and is included in the 'other gains and losses' line item.

Amounts previously recognised in other comprehensive income and accumulated in equity are reclassified to profit or loss in the periods when the hedged item is recognised in profit or loss, in the same line of the income statement as the recognised hedged item. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously accumulated in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

Hedge accounting is discontinued when the Company revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. Any gain or loss recognised in other comprehensive income at that time is accumulated in equity and is recognised when the forecast transaction is no longer expected to occur, the gain or loss accumulated in equity is recognised immediately in profit or loss.

Certain ineffectiveness can arise during the hedging process. The main sources of hedge ineffectiveness are considered to be timing differences between entering into the hedged items and into the hedging instruments and differences between the maturity profile of the hedged items and the hedging instruments.

Impairment

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been affected.

When determining whether credit risk of a financial asset has increased significantly since initial recognition and when estimating Expected Credit Losses (ECL), the Company considers reasonable and supportable information which is relevant and available without undue cost of effort. This includes both quantitative and qualitative information and analysis, based on the Company's historical experience and informed credit assessment, including forward looking information.

Objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation.

Loss allowances for trade receivables and contract assets (as defined in IFRS 15) are always measured at an amount equal to lifetime ECL. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument. 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a short period if the expected life of the instrument is less

Notes (continued)

1 Accounting policies (continued)

Impairment (continued)

than 12 months). The maximum period considered when estimating ECLs is the maximum contractual period over which the Company is exposed to credit risk.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

In a subsequent period, if the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Measurement of ECLs

ECLs are probability-weighted estimates of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between cash flows due to the entity in accordance with the contract and the cash flows the Company expects to receive). ECLs are discounted at the effective interest rate of the financial asset.

Credit-impaired financial assets

At each reporting date, the Company assesses whether financial assets carried at amortised cost and debt securities at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Write-offs

The gross carrying amount of a financial asset is written off to the extent that there is no realistic prospect of recovery.

2 Turnover

Turnover has been wholly derived from the operation of design, production and support of armoured vehicles, avionic, communications and associated electronic equipment, which originates in the United Kingdom. The analysis of turnover by geographical destination is as follows:

	2019 £000	2018 £000
United Kingdom	709,835	723,542
Europe	4,907	8,641
North America	3,092	1,761
Rest of the World	2,620	1,688
	<u>720,454</u>	<u>735,632</u>

Notes (continued)

3 Staff numbers and costs

The average number of persons employed by the Company (including directors) during the year, analysed by category, was as follows:

	2019	2018
	Number of employees	
Administration	291	251
Production	959	909
	<u>1,250</u>	<u>1,160</u>

The aggregate payroll costs of these persons were as follows:

	2019	2018
	£000	£000
Wages and salaries	58,160	53,527
Social security costs	6,614	6,040
Other pension costs (see note 24)	14,150	7,936
	<u>78,924</u>	<u>67,503</u>

4 Leases

The Company leases commercial property for its operations. The leases typically run for a period of 5 years with no option to renew. One lease is for the land on which a Company owned commercial building is located. This lease does contain an option to renew and runs for 125 years. The lease payments on the land are negotiated every 10 years to reflect market rentals and were last agreed on 1 January 2015. The value recognised in the accounts assumes that lease payments are fixed as it is not possible to accurately forecast changes in value as a result of future inflationary adjustments. All commercial land and property leases were previously classified as operating leases under IAS17.

Other leases that represent right-of-use-assets include vehicles, IT equipment and property utilised by certain business travellers. All leases were previously classified as operating leases under IAS17.

The Company has elected not to recognise right-of-use assets and lease liabilities for leases of low value or term (where the lease is for a period of less than 1 year or had less than a year to run at the transition date).

Right-of-use assets

	Long leasehold Land & buildings £000	Short leasehold Land & buildings £000	Vehicles £000	IT Equipment £000
Additions to right-of-use assets	1,271	3,280	147	1,207
Depreciation of right-of-use assets	(14)	(556)	(85)	(416)
Balance at 31 December 2019	<u>1,257</u>	<u>2,724</u>	<u>62</u>	<u>791</u>

Notes (continued)

4 Leases (continued)

Amounts recognised in profit and loss

Leases under IFRS16

	2019
	£000
Interest on lease liabilities	171
Expenses relating to short term leases	545
Expenses relating to leases of low value assets	152

Expenses relating to short term leases are shown in the profit and loss account within the expense category associated with the nature of the expense.

Operating leases under IAS17

	2018
	£000
Lease expense	779

5 Other interest receivable and similar income

	2019	2018
	£000	£000
Bank interest	123	281
Pension interest	138	193
	<u>261</u>	<u>474</u>

6 Interest payable and similar charges

	2019	2018
	£000	£000
On all other loan interest payable	(732)	(824)
Loss on foreign exchange	(4,773)	(3,594)
IFRS16 Finance Charge	(171)	-
	<u>(5,676)</u>	<u>(4,418)</u>

7 Other gains and losses

	2019	2018
	£000	£000
Gains on hedge ineffectiveness	-	4,046
	<u>-</u>	<u>4,046</u>

Notes (continued)

8 Profit on ordinary activities before taxation

	2019 £000	2018 £000
The profit on ordinary activities before taxation is stated after charging/(crediting):		
Short-term Leases/Operating leases		
• Land and buildings	178	735
• Motor vehicles and office equipment	519	44
Research and development	2,501	1,396
Depreciation of owned fixed assets	2,195	1,799
Depreciation of leased assets	1,071	273
Goodwill impairment	-	600
Intangible amortisation	1,261	2,255
IFRS 2 share based payment charges	37	852
Restructuring charge	1,984	-
Defined benefit buy-in	4,522	-

Auditor's Remuneration

Audit of these Financial Statements	356	224
Taxation compliance services	143	126

9 Directors' remuneration

	2019 £000	2018 £000
Directors' emoluments	438	240
Company contributions to money purchase pension schemes	9	12

Two Directors exercised share options in the ultimate parent company in the year (2018: two). The above amounts do not include any gains made on the exercise of share options. Gains made on the exercise of share options by these Directors were £4.8mk (2018:£0.3m). These shares had an average market price of £138.86 (2018:£156.15). Three of the Directors' emoluments represent the intercompany recharge of their salary for time spent on affairs of the Company.

Pensions

The number of Directors who were members of pension schemes was as follows:

	2019 Number	2018 Number
Hybrid pension	2	2

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid Director:

	2019 £000	2018 £000
Directors' emoluments	147	84
Company contributions to pension schemes	-	-

No Director had a direct or indirect interest in any transaction, arrangement or agreement, which in the opinion of the other Directors requires disclosure under the provisions of the Companies Act 2006.

Notes (continued)

10 Taxation

	2019 £000	2018 £000
UK deferred tax (see note 19)	674	605
UK current tax	7,640	11,975
Adjustments in respect of prior periods	(978)	798
	<hr/>	<hr/>
Income statement	7,336	13,378
	<hr/>	<hr/>
Reconciliation of effective tax rate	2019 £000	2018 £000
Profit for year	45,987	75,801
Total tax expense	7,336	13,378
	<hr/>	<hr/>
Profit excluding taxation	53,323	89,179
Tax using the Corporate tax rate of 19% (2018: 19%)	10,131	16,944
Non-deductible expenses	(2,043)	(4,649)
Tax exempt revenues	(502)	(510)
Capital allowances for year in excess of depreciation	54	190
Under/(over) provided in prior years	(978)	798
Deferred tax	674	605
	<hr/>	<hr/>
Total tax expense	7,336	13,378
	<hr/>	<hr/>
Income tax recognised in other comprehensive income		
Deferred tax		
Net gain/ (loss) on revaluation of cash flow hedges	1,762	(1,930)
	<hr/>	<hr/>
Total income tax recognised in other comprehensive income	1,762	(1,930)
	<hr/>	<hr/>

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. A further reduction to the UK Corporation tax rate was announced in the 2016 Budget to further reduce the tax rate to 17% (to be effective from 1 April 2020). At budget 2020, the government announced that the corporation tax main rate for the years starting 1 April 2020 and 2021 would remain at 19%. The deferred tax liability at 31 December 2019 has been calculated on the rate of 17%.

Notes (continued)

11 Intangible assets

	Goodwill	Customer relationships	Other	Software	Total
	£000	£000	£000	£000	£000
Cost	17,141	14,200	1,820	6,880	40,041
At 1 January 2019					
Transfer to tangible fixed assets	-	-	-	(28)	(28)
Additions	-	-	-	57	57
At 31 December 2019	17,141	14,200	1,820	6,909	40,070
Accumulated amortisation and impairment	17,141	14,200	1,820	4,632	37,793
At 1 January 2019					
Transfer to tangible fixed assets	-	-	-	7	7
Amortisation charge for the year	-	-	-	1,254	1,254
Amortisation and impairment	17,141	14,200	1,820	5,893	39,054
At 31 December 2019					
Net book value	-	-	-	1,016	1,016
At 31 December 2019					
Net book value	-	-	-	2,248	2,248
At 31 December 2018					

Investments

Investment entity	Holding company	Share capital	Proportion held	Loss in year £000
General Dynamics Information Systems and Technology Arabia Company, Olaya Area, Al-Munajem Building, PO Box 30505, Riyadh 11361	General Dynamics UK Ltd	SAR12,000,000	49%	-

All investments have been written down to zero in prior years.

Notes (continued)

12 Tangible fixed assets

	Premises land and buildings £000	Long leasehold land and Buildings £000	Short leasehold land and buildings £000	Plant machinery and vehicles £000	Leased plant machinery and vehicles £000	Total £000
Cost						
At 1 January 2019	28,946	-	6,276	37,124	-	72,346
Adjustment to opening balance	-	-	-	34	-	34
Reclassification	-	1,662	(1,662)	28	-	28
Additions	-	-	-	2,157	-	2,157
Recognition of right of use assets on initial application of IFRS 16 (note 4)	-	1,271	3,280	-	1,354	5,905
Disposals	-	-	(160)	(912)	-	(1,072)
At 31 December 2019	28,946	2,933	7,734	38,431	1,354	79,398
Depreciation						
At 1 January 2019	4,463	-	6,120	31,112	-	41,695
Reclassification	-	1,521	(1,521)	(7)	-	(7)
Charge for year	729	51	13	1,400	-	2,193
Charge for year IFRS16	-	14	556	-	501	1,071
Disposals	-	-	(145)	(871)	-	(1,016)
At 31 December 2019	5,192	1,586	5,023	31,634	501	43,936
Net book value						
At 31 December 2019	23,754	1,347	2,711	6,797	853	35,462
At 31 December 2018	24,483	-	156	6,012	-	30,651

Land not depreciated was valued at £2,204k (2018:£6,147k). The reduction in the year is a result of building costs consolidated with land value.

13 Stocks and work in progress

	2019 £000	2018 £000
Raw materials and consumables	154	158

Notes (continued)

14 Debtors

	2019 £000	2018 £000
Amounts falling due within one year:		
Amounts owed by fellow subsidiaries	113,064	231,089
Amounts recoverable on contracts	438,426	430,903
Trade debtors	6,144	6,064
Prepayments and other debtors	14,956	20,621
	<hr/>	<hr/>
Total amounts falling due within one year	572,590	688,677
	<hr/>	<hr/>
Debtor amounts greater than one year		
Trade debtor	15,678	15,678
Pension surplus	3,869	4,438
Foreign exchange hedge asset	323	631
	<hr/>	<hr/>
Total debtors	592,460	709,424
	<hr/>	<hr/>

Debtors falling due within one year are all expected to be recoverable within one year. The trade debtor greater than one year relates to the award of a default judgement against the State of Libya in favour of the Company. Substantial work is being undertaken to recover the debt and recovery is not expected within one year.

15 Creditors: amounts falling due within one year

	2019 £000	2018 £000
Obligations under right of use assets (see note 18)	1,118	-
Payments on account on long term contracts	81,738	120,333
Trade creditors	81,282	166,468
Taxation and social security	24,632	74,790
Accruals	23,318	25,624
Deferred tax liability (see note 19)	-	3,863
Amounts owed to subsidiary undertakings	375	375
Foreign exchange hedge liability (see note 17)	185	-
	<hr/>	<hr/>
	212,648	391,453
	<hr/>	<hr/>

16 Creditors: amounts falling due after more than one year

	2019 £000	2018 £000
Foreign exchange hedge liability (see note 17)	301	-
Obligations under right of use assets (see note 18)	3,782	-
Welsh Development Agency grant	4,119	5,500
	<hr/>	<hr/>
	8,202	5,500
	<hr/>	<hr/>

The £7.7m Welsh Development Grant was received in 2016 in order to help fund the development of the Merthyr Tydfil site. The grant is repayable in equal instalments over 7 years.

Notes (continued)

17 Other financial asset and liabilities

	2019	2018
	Assets	Assets
	£000	£000
Current		
Gross cashflow hedges held at fair value – foreign exchange asset	1,151	14,763
Gross cashflow hedges held at fair value – foreign exchange liability (see note 15)	(185)	-
Non-current		
Gross cashflow hedges held at fair value – foreign exchange asset	323	631
Gross cashflow hedges held at fair value – foreign exchange liability (see note 16)	(301)	-
	<hr/>	<hr/>
	988	15,394
	<hr/>	<hr/>

Financial risk management

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its holdings of financial instruments.

The foreign currency exchange rate risk relates to receipts from customers, payments to suppliers and inter-company transactions denominated in foreign currencies. To the extent possible, the Company include terms in its contracts that are designed to protect it from this risk. The Company will also seek to reduce the impact of foreign exchange risk by concluding transactions in the Company's functional currency or naturally hedging income and expenses in a foreign currency. Otherwise, it enters into derivatives, principally foreign currency forward purchase and sale contracts, designed to offset and minimise its risk. The Company does not use derivatives for trading or speculative purposes.

To further reduce market price risk resulting from changes in price, the Company enters into fixed price contracts with customers and suppliers.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer fails to meet its contractual obligations and arises principally from the Company's receivables from customers.

Credit risk is considered to be low given that the majority of sales are to UK and overseas governments.

Liquidity risk and cash flow risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. Cash flow risk is the risk that the Company's available cash will not be sufficient to meet its financial obligations.

The Company's liquidity is ensured by means of regular group-wide monitoring and planning of liquidity coordinated by the Group's centralised treasury department.

In order to facilitate cash management activities, the Company has entered into a cash pool agreement for which General Dynamics European Finance Ltd operates as the cash pool leader. The zero balancing cash pool consists of four underlying pools of different currencies (Euro, Swiss Francs, USD and GBP). Cash pool members pool their accounts to obtain a reduction in external financing costs and can obtain more favourable credit and debit interest rates due to economies of scale. The cash pooling arrangement and regular forecasting of cash needs by the cash pool members significantly reduces any cash flow risk to the Company. As a cash pool member, the Company has requested that General Dynamics Worldwide Holdings Inc (the guarantor) guarantees potential claims for payment of funds to General Dynamics European Finance Ltd in accordance with the terms of the cash pool agreement. As such, the guarantor unconditionally, absolutely and irrevocably guarantees the payment obligations of the Company arising from the cash pool.

Notes (continued)

Financial risk management (continued)

18 Obligations under right of use assets

The maturity of obligations under right of use assets is as follows:

	2019 £000	2018 £000
Within one year	1,117	-
In the second to fifth years	2,328	-
Later than five years	1,454	-
	<u>4,899</u>	<u>-</u>

19 Provisions for liabilities and charges

	01-Jan-19 £'000	Recognised in income £'000	Recognised in equity £'000	31-Dec-19 £'000
Deferred tax	1,474	3,063	(1,762)	2,775
Warranty provision	19,762	6,092		25,854
	<u>21,236</u>	<u>9,155</u>	<u>(1,762)</u>	<u>28,629</u>

Deferred tax assets and liabilities

	01-Jan-19 £'000	Recognised in income £'000	Recognised in equity £'000	31-Dec-19 £'000
Tangible fixed assets	2,132	(688)		1,444
Tax value of loss carry-forwards utilised	95	(95)		-
Share-based payments	(294)	103		(191)
Pension*	(2,389)	3,743		1,354
Hedge Gain	1,930		(1,762)	168
	<u>1,474</u>	<u>3,063</u>	<u>(1,762)</u>	<u>2,775</u>

In 2018, deferred tax on the pension surplus was netted against the pension surplus on the balance sheet. In 2019, the opening pension surplus was restated to gross in line with the requirements of IAS19 resulting in the 2018 deferred tax of £2,389 being moved to the profit and loss account. As a result, the profit and loss movement in the year in respect of pension was £1,354 which represents the 35% charge arising on the closing scheme surplus giving a total profit and loss account movement of £674k in respect of deferred tax as reflected in note 10.

The deferred tax on the pension scheme surplus was calculated at a rate of 35% which reflects the rate of tax payable on any return of the defined benefit pension surplus rather than the 17%.

Notes (continued)

19 Provisions for liabilities and charges (continued)

The elements of deferred taxation are as follows:

	2019 £000	2018 £000
Deferred tax on pension scheme surplus	1,354	(2,389)
Income Statement		
Difference between accumulated depreciation and capital allowances	1,444	2,132
Other timing differences	(191)	(199)
Other Comprehensive income		
Other timing differences	168	1,930
	<hr/>	<hr/>
Deferred tax liability	2,775	1,474
	<hr/>	<hr/>

20 Share capital

The share capital of the Company comprises ordinary shares of 50p each.

	2019 Number of Shares	£000	2018 Number of Shares	£000
Allotted, called-up and fully paid	18,523,150	9,262	18,523,150	9,262
	<hr/>	<hr/>	<hr/>	<hr/>

21 Hedging reserve

	2019 £000	2018 £000
Opening balance	9,419	26,422
Loss recognised on cash flow hedges		
Foreign currency forward contracts	(8,430)	(11,028)
Income tax related to losses recognised in other comprehensive income	(168)	(2,617)
Transfer to income statement:		
Foreign currency forward contract ineffectiveness	-	(4,046)
Income tax related to gains / (losses) transferred to income	-	688
	<hr/>	<hr/>
Closing balance	821	9,419

The fair value of foreign currency forward contracts is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity in the contract using a risk-free interest rate.

The hedging reserve represents the cumulative amount of gains and losses on hedging instruments deemed effective in cash flow hedges. The cumulative deferred gain or loss on the hedging instrument is recognised in profit or loss when the hedge transaction impacts the profit or loss. The gain or loss relating to the ineffective portion is recognised in the income statement and is included in the 'other gains and losses' line item.

Notes (continued)

21 Hedging reserve (continued)

The ineffectiveness shown in the 2018 comparatives was due to an expectation that a new subcontract would be signed with a supplier in September 2019 resulting in a change to the future timing and amount of cash flows for which a foreign currency forward contract had been entered into in order to hedge foreign currency exposure. As a result, the hedged forecast transaction was no longer expected to occur resulting in all cumulative gains / losses in reserves relating to these hedge relationships beyond the anticipated amendment signing of September 2019, to be reclassified to the income statement.

Where identification of hedged items are performed by reference to time buckets and a hedge transaction occurs outside of that time bucket, it cannot be considered to be the same hedged item. If there are no cash flows within a time bucket, then there can be no hedged item. To the extent that insufficient cash flow is able to be allocated against a hedge instrument within the "time bucket," hedge ineffectiveness is recognised on the remaining deficit with the corresponding gain / loss moved from reserves to the profit and loss account.

Implementation Guidance in the previous IAS39 suggests that a 3 month layering approach for the designation of highly probable forecast transactions designated in cash flow hedging relationships may be appropriate. In the absence of specific implementation guidance in IFRS9, consideration has also been given to commercial considerations and a desire to settle invoices within 30 days. As a result, a time bucket of 30 days prior to hedge maturity and 30 days after hedge maturity has been adopted.

22 Financial commitments

a) Capital commitments at the end of the financial year, for which no provision has been made, are as follows:

	2019 £000	2018 £000
Contracted	555	170
Authorised but not contracted	1,562	13
	<u> </u>	<u> </u>

(b) Aggregate commitments for low value and short term leases are as follows:

	2019		2018	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
Non right-of-use assets which expire:				
Within one year	115	156	224	160
In the second to fifth years inclusive	-	114	32	48
Over five years	-	-	6,841	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	115	270	7,097	208
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Notes (continued)

23 Contingent liabilities

	2019 £000	2018 £000
Performance guarantees	-	£114k
Offset bond expressed in AED -expressed in GBP	AED 4,195k £880k	AED 4,416k £948k

The offset bond was a requirement of a contract that the company held in the United Arab Emirates where as part of the terms and conditions of the contract, the company is required to provide in country services such a knowledge transfer or invest in local product development activity. If the company were unsuccessful with these activities, the bond would be retained. The value has been converted into GBP at a rate of 0.21.

24 Pension scheme

The Company sponsors the General Dynamics Retirement and Death Benefit Scheme ('the Scheme'). The Scheme is a hybrid arrangement which includes both a defined contribution section and a defined benefit section comprising of current and deferred pensioners. The defined benefit section of the Scheme was closed from 6 April 1997, at which time members ceased to accrue benefits on a defined benefit basis and were given the option to transfer their benefits to the defined contribution section of the Scheme. The assets of the Scheme are held separately from those of the Company, being invested with an external fund manager. The expenses of the Scheme are borne by the Company.

The defined benefit pension scheme of General Dynamics Information Technology Ltd (GDIT: a related party) was transferred to the Company following the cessation of trade of GDIT and remains an entirely separate scheme to that of General Dynamics United Kingdom Ltd. A binding agreement was entered into with Legal and General to insure the liabilities of the scheme known as a buy-in with the full intention to convert to a buy-out. The detail contained in this note excludes the GDIT scheme due to immateriality other than where certain financial disclosures are required to reconcile to the financial statements. Where GDIT disclosures have been included, the notes reflect the consolidated position for both schemes.

Defined contribution element

The pension cost for the year was £9,627,595, (2018: £7,935,814). There were no outstanding or prepaid contributions at 31 December 2019 (2018: £nil).

Defined Benefit Section

A full actuarial valuation of this scheme was carried out by a qualified independent actuary as at 5 April 2015. This has been updated on an approximate basis to 31 December 2019.

During 2019, the trustees purchased an insurance policy that covers all the retirement benefit obligations within the scheme, thereby removing exposure to the significant risks within the scheme. The impact of this buy-in has been accounted for as a settlement within the disclosures. There have been no other plan amendments, curtailments or settlements in the accounting period.

The scheme's insurer is now responsible for ensuring that there are sufficient assets to meet all future pension obligations, and is subject to EU solvency regulations. There is no volatility associated with the insurance policy asset as under IAS19 its value is deemed to match the scheme liabilities. Asset volatility is limited only to the assets remaining in the scheme which are expected to meet additional costs with any balance returned to the Company on wind-up of the scheme. Additional assets invested with Legal & General remain within the scheme. These assets represent the balance

Notes (continued)

24 Pension scheme (continued)

from the premium paid to complete the buy-in and will be used to meet the cost of any potential GMP equalisation adjustment required to the insured members and expenses. Tax of 35% has been recognised on the remaining surplus which is payable on any amount returned to the Company on the winding-up. The value of insured assets of £25.3m are matched against the value of liabilities calculated as at 31 December 2019 of £21.9m with the difference of £3.5m recognised as a cost in the income statement. A further settlement cost of £1m has been recognised in the income statement in connection with the defined benefit pension scheme of GDIT. The contributions made by the Company totalled £500k. An additional £500k was paid in connection with the GDIT scheme. (2018: £900k).

Assumptions

The mortality assumptions are based on the CMI 2018 model.

The mortality assumptions adopted at 31 December 2019 imply the following life expectancies:

Male retiring at age 65 in 2019	21.8
Female retiring at age 65 in 2019	23.6
Male retiring at age 65 in 2039	23.1
Female retiring at age 65 in 2039	25.2

Expected long term rates of return

The long-term expected rate of return on cash is determined by reference to bank base rates at the balance sheet dates. The long-term expected return on bonds is determined by reference to UK long dated government and corporate bond yields at the balance sheet date. The long-term expected rate of return on equities is based on the rate of return on bonds with an allowance for out-performance.

The expected long term rates of return applicable for each period are as follows:

	Period commencing 01/01/2020 % per annum	Period commencing 01/01/2019 % per annum
Buy-in policy	1.30%	-
Equity	-	5.82%
Bonds	-	2.87%
Gilts	1.30%	1.82%
Property	-	5.32%
Cash	-	2.87%
Overall for scheme	1.30%	3.80%

The assets of the scheme have been taken at market value and the liabilities have been calculated using the following principal actuarial assumptions:

	2019	2018	2017
Revaluation rate for deferred pensioners	2.18%	2.41%	2.40%
Rate of increase in pensions in payment and deferred pensions	2.18%	2.41%	2.40%
Discount rate applied to scheme liabilities	2.09%	2.89%	2.50%
Inflation assumption	2.88%	3.31%	3.30%

In valuing the liabilities of the pension fund at 31 December 2019 mortality assumptions have been made as indicated above. If life expectancy had been changed to assume that all members of the fund lived for one year longer, the value of the reported liabilities at 31 December 2019 would have increased by £900k before deferred tax. The value of the reported assets will also increase by this same amount due to the insurance policy on buy-in.

The table below sets out the fair value of assets, a breakdown of the assets into the main asset classes, the present value of the IAS 19 liabilities and the surplus of assets below the IAS 19 liabilities (which equals the gross pension asset). Following the year end there have been significant movements in financial markets precipitated by, amongst other things, the outbreak of the COVID-19 virus. While there remains considerable uncertainty due to the nature of the assets (as a

Notes (continued)

24 Pension scheme (continued)

majority of the funds are annuities which match liabilities held) we would not expect there to be a material impact on the position at the current date compared to that shown in the report.

Scheme assets

None of the fair values of the assets shown below include any direct investments in the Company's own financial instruments or any property occupied by, or other assets used by, the Company. All of the scheme assets have a quoted market price in an active market with the exception of the Trustee's bank account balance. There are no additional assets pledged, and no additional arrangements agreed between the Company and trustees to secure members' benefits under the plan.

	2019 £000	2018 £000
Fair value of plan assets	27,595	26,308
Present value of funded deferred benefit obligations	(23,779)	(19,534)
Historic contribution adjustment	53	53
Surplus	3,869	6,827
Deferred tax at 35%	(1,354)	(2,389)
Net pension asset	2,515	4,438

Following a review of the pension scheme and in accordance with IFRIC 14, the pension surplus is deemed to be recoverable and the gross pension debtor has been recognised in the 2019 accounts together with deferred tax of 35%. Reconciliation of opening and closing balances of the present value of the scheme liabilities

	2019 £000	2018 £000
Scheme liabilities at start of year - GDUK	19,534	18,588
Scheme liabilities at start of year - GDIT	1,714	-
Interest cost	618	469
Actuarial gains	1,834	(1,196)
Benefits paid, death in service insurance premiums and expenses	(615)	(714)
Past service costs	-	1,483
Impact of Defined Benefits underpin member retirements	694	904
Defined benefit obligation at end of period	23,779	19,534

Notes (continued)

24 Pension scheme (continued)

Reconciliation of opening and closing balances of the fair value of scheme assets

	2019 £000	2018 £000
Fair value of scheme assets at start of year	26,308	25,887
Fair value of scheme assets at start of year - GDIT	1,958	-
Interest income	756	662
Actuarial gains/(losses)	1,646	(1,281)
Contributions by employer	1,370	850
Benefits paid	(615)	(714)
Impact of Defined Benefits underpin member retirements	694	904
Loss from settlement	(4,522)	-
	<hr/>	<hr/>
Fair value of scheme assets at end of year	27,595	26,308
	<hr/>	<hr/>

Movement in the surplus during the year

	2019 £000	2018 £000
Surplus in the Scheme at 1 January	6,827	7,299
Surplus in the Scheme at 1 January - GDIT	244	-
Contribution	1,370	850
Other finance expense	138	193
Past Service Cost	-	(1,483)
Lost from settlement	(4,522)	-
Actuarial losses	(188)	(85)
Historic contribution adjustment	-	53
	<hr/>	<hr/>
Surplus in the Scheme at 31 December	3,869	6,827
	<hr/>	<hr/>

Contributions include £0.879k paid into the GDIT scheme of which £0.5k was settled by General Dynamics United Kingdom Ltd and the balance by GDIT.

Analysis of amounts included in income statement:

	2019 £000	2018 £000
Loss from settlement	(4,522)	-
Past service cost	-	(1,483)
Interest income	705	662
Interest on pension scheme liabilities	(567)	(469)
	<hr/>	<hr/>
	(4,384)	(1,290)
	<hr/>	<hr/>

Notes (continued)

24 Pension scheme (continued)

Analysis of amount recognised in Other Comprehensive Income:

	2019 £000	2018 £000
Return on plan assets (excluding amounts included in net interest cost)	1,646	(1,281)
Experience gains arising on Scheme liabilities	1,491	(1,044)
Changes in assumptions underlying the present value of Scheme liabilities	(3,325)	2,240
Recognition of pension surplus	-	7,352
	<u>(188)</u>	<u>7,267</u>

On buy-in, the value of the General Dynamics United Kingdom Ltd insurance policy was £35.2m.

The fair value of plan assets and return on those assets were as follows:

	2019 £000	2018 £000
Equity	-	6,011
Bonds	-	8,120
Gilts	3,697	6,737
Property	-	1,818
Cash	119	422
Diversified growth	-	3,200
Total	<u>3,816</u>	<u>26,308</u>
Actual return on plan assets (loss)/gain	<u>1,519</u>	<u>(1,281)</u>

The expected contribution to be paid to the scheme in the next financial year is nil (2019: £0.5m).

The total amount recognised in the statement of total recognised gains and losses in respect of actuarial gains and losses is (£0.1m loss) (2018: £0.1m loss).

Notes (continued)

25 Leases - Impact on transition

On transition to IFRS16, the Company recognised additional right-of-use assets, relating to property, vehicles and IT equipment and additional lease liabilities of the same amount. The impact on transition is summarised below:

	1 Jan 2019 £000
Right-of-use assets – property	4,551
Right-of-use assets – IT equipment	1,207
Right-of-use assets – motor vehicles	147
	<hr/>
Total	<u>5,905</u>

For the impact of IFRS16 on profit or loss for the period, see Note 4. For details of accounting policies under IFRS16 and IAS 17, see Note 1.

When measuring lease liabilities for leases that were classified as operating leases, the Company discounted lease payments using its incremental borrowing rate at 1 January 2019. The weighted-average rate applied is 3.6506%.

Operating lease commitments as disclosed under IAS17 in the Company's financial statements:

	1 Jan 2019 £000
Operating lease commitments discounted using the incremental borrowing rate at 31 Dec 2018	6,485
Finance lease liabilities recognised as at 31 December 2018	-
Recognition exemption for leases of low-value assets	(261)
Recognition exemption for leases with less than 12 months of lease term at transition	(319)
	<hr/>
Lease liabilities recognised at 1 January 2019	<u>5,905</u>

26 Related party disclosures

The Company is controlled by its immediate parent undertaking General Dynamics Ltd. The ultimate controlling party is General Dynamics Corporation (See note 29).

27 Employee benefits

Share based payments

The Save As You Earn (SAYE) scheme is offered to all employees of General Dynamics United Kingdom Ltd (GDUK) once a year and employees have the option of entering either a 3 year or 5 year scheme.

The terms and conditions of grants are as follows:

Grant date/ Employees entitled/ nature of scheme	Number of instruments	Vesting conditions	Contractual life of options
2013 Cash-settled 5 year SAYE award to GDUK employees. Granted by parent on 5/12/13.	2,448	5 years from start of contract	2019
2014 Cash-settled 5 year SAYE award to GDUK employees. Granted by parent on 3/12/14.	1,838	5 years from start of contract	2020
2015 Cash-settled 3 year SAYE award to GDUK employees. Granted by parent on 30/11/15.	16,297	3 years from start of contract	2019

Notes (continued)

27 Employee benefits (continued)

Share based payments (continued)

2015 Cash-settled 5 year SAYE award to GDUK employees. Granted by parent on 30/11/15.	2,961	5 years from start of contract	2021
2016 Cash-settled 3 year SAYE award to GDUK employees. Granted by parent on 30/11/16.	16,689	3 years from start of contract	2020
2017 Cash-settled 3 year SAYE award to GDUK employees. Granted by parent on 30/11/17.	15,278	3 years from start of contract	2021
2017 Cash-settled 5 year SAYE award to GDUK employees. Granted by parent on 30/11/17.	2,801	5 years from start of contract	2023
2018 Cash-settled 3 year SAYE award to GDUK employees. Granted by parent on 27/11/18.	22,285	3 years from start of contract	2022
2018 Cash-settled 5 year SAYE award to GDUK employees. Granted by parent on 27/11/18.	4,227	5 years from start of contract	2024
2019 Cash-settled 3 year SAYE award to GDUK employees. Granted by parent on 29/11/19.	18,980	3 years from start of contract	2023
2019 Cash-settled 5 year SAYE award to GDUK employees. Granted by parent on 29/11/19.	1,960	5 years from start of contract	2025

The number and weighted average exercise prices of SAYE share options are as follows:

	2019 Weighted Average exercise price £	2019 Number of options	2018 Weighted Average exercise price £	2018 Number of options
Outstanding at the beginning of the year	106.99	74,636	97.37	69,133
Forfeited during the year	118.25	(5,906)	112.31	(9,523)
Exercised during the year	73.57	(14,982)	149.72	(11,804)
Granted during the year	118.29	23,502	117.94	26,830
Outstanding at the end of the year	115.08	77,250	106.99	74,636
Exercisable at the end of the year	117.88	915	102.42	506

The weighted average share price at the date of exercise of share options exercised during the period was £111.86 (2018: £149.72).

The options outstanding at the year-end have an exercise price in the range of £76.11 to £127.66 and a weighted average remaining contractual life of 2.6 years.

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on a Black Scholes model. Measurement inputs and assumptions are as follows:

Notes (continued)

27 Employee benefits (continued)

Share based payments (continued)

	SAYE 3 year		SAYE 5 year	
	2019	2018	2019	2018
Fair value at grant date	29.0993	29.5588	31.6815	32.7216
Weighted average share price	118.8172	118.4147	118.8172	118.4147
Exercise price	118.8172	118.4147	118.8172	118.4147
Expected volatility (expressed as % used in the modelling under Black Scholes model)	21.033	17.893	20.165	17.348
Option life (expressed as weighted average life used in the modelling under Black Scholes model)	39 months	39 months	63 months	63 months
Expected dividends	2.0%	1.8%	2.0%	1.8%
Risk-free interest rate (based on national government bonds)	1.456%	2.848%	1.718%	2.833%

The total expenses recognised for the year arising from share based payments are as follows:

	2019	2018
	£000	£000
Equity settled share based payments (Restricted Stock and EC options for which the Company has applied the exemption)	76	110
Cash settled share based payments (SAYE)	616	(460)
Total carrying amount of liabilities (SAYE)	864	735
Total intrinsic carrying amount of liabilities in respect of vested benefits	-	-

28 Financial Instruments

Fair value of financial instruments

At 31 December, the Company held the following instruments to hedge exposures to changes in foreign currency.

	0-6 months	6-12 months	>12 months	Total
	£000	£000	£000	£000
<i>Foreign currency risk</i>				
<i>Forward exchange contracts</i>				
Net exposure	20,140	20,014	22,833	62,987
Average GBP-USD forward contract rate	1.3613	1.3531	1.2822	
Average GBP-CAD forward contract rate	1.7543	1.7604	1.7522	

Notes (continued)

28 Financial Instruments (continued)

With the exception of the trade debtor greater than one year, where it is not considered that the carrying value and book value are materially different, the carrying value of the following current financial instruments approximates fair value because of the short period to maturity:

- Cash and cash equivalents
- Trade receivables
- Prepayments & other debtors
- Trade payables
- Accruals and deferred income

The fair value measurement of some derivatives requires assumptions and management's assessment of certain market parameters. Where a market price is not available, a valuation model which takes into consideration discounted cash flows is used with consideration for the special characteristics of the underlying asset.

The fair value of foreign currency forward contracts is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity in the contract using a risk-free interest rate.

Carrying amount and fair value of each class of financial assets and liabilities are presented in the table below:

As at 31 December 2019	Financial assets measured at fair value through Other Comprehensive Income (£000)	Financial assets measured at amortised cost (£000)	Financial liabilities measured at fair value through profit or loss (£000)	Financial liabilities measured at amortised cost (£000)	Total carrying amount (£000)	Fair value (£000)
Cash & cash equivalents ¹	-	110,673	-	-	2,200	2,200
Trade debtors within 1 year ²	-	449,162	-	-	557,635	557,635
Prepayments and other debtors	-	13,805	-	-	13,805	13,805
Gross derivative financial assets	1,475	-	-	-	1,475	1,475
Trade debtor greater than 1 year	-	15,678	-	-	15,678	15,678
Total assets	<u>1,475</u>	<u>589,318</u>	<u>-</u>	<u>-</u>	<u>590,793</u>	<u>590,793</u>
Trade creditors ³	-	-	-	163,020	163,020	163,020
Gross derivative financial liabilities	487	-	-	-	487	487
Accruals & deferred income	-	-	-	23,318	23,318	23,318
Total liabilities	<u>487</u>	<u>-</u>	<u>-</u>	<u>186,338</u>	<u>186,825</u>	<u>186,825</u>

¹ Cash and cash equivalents includes £108,472,844 being amounts owed by fellow subsidiary under the cash pooling arrangements.

² Trade debtors includes amounts recoverable on contracts and intercompany receivables.

³ Trade creditors includes amounts owing to a subsidiary and payments on account on long term contracts.

Notes (continued)

29 Ultimate parent company

The Company is a 100% owned subsidiary undertaking of General Dynamics Limited, a company incorporated in Great Britain. General Dynamics Corporation is the ultimate parent company incorporated in the USA.

The largest and smallest group in which the results of the Company are consolidated is that headed by General Dynamics Corporation, incorporated in the USA. The consolidated accounts of the group are available to the public and may be obtained from 11011 Sunset Hills Road, Reston, VA 20190.

30 Accounting Estimates and Judgements

Accounting estimates and judgements

The preparation of the consolidated financial statements in conformity with FRS101 requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The reported amounts and note disclosures reflect management's best estimate of the most probable set of economic conditions and planned course of actions. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in these consolidated financial statements include:

Revenue IFRS 15

Long Term Contracts

The majority of the Company's projects are long-term development or support contracts spanning multiple financial years. Revenue on long-term contracts is recognised over time as work progresses using costs incurred to date relative to total estimated costs at completion to measure progress towards satisfying performance obligations. Incurred cost represents work performed which corresponds with and thereby best depicts the transfer of control to the customer. Contract costs include labour, material, subcontractor costs and G&A expenses. The Company estimates the profit on a contract as the difference between the total estimated revenue and expected costs to complete a contract and recognise that profit over the life of the contract.

Contract estimates are based on various assumptions to project the outcome of future events that often span several years. These assumptions include labour productivity and availability, the complexity of the work to be performed, the cost and availability of materials, the performance of subcontractors and the availability and timing of funding from the customer.

As a significant change in one or more of these assumptions could affect the profitability of contracts, the Company reviews and updates its contract-related estimates regularly. The Company recognises adjustments in estimated profit on contracts under the cumulative catch-up method. Under this method, the impact of the adjustment on profit recorded to date on a contract is recognised in the period the adjustment is identified. Revenue and profit in future periods of contract performance are recognised using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, the Company recognises the total loss in the period it is identified.

The majority of revenue is derived from long-term contracts and programmes that can span several years. Revenue is accounted for, in accordance with IFRS15.

Performance Obligations

An assessment is conducted on contract inception to identify the number of performance obligations pertaining to the contract award using the 5-step methodology defined in IFRS15. A number of contracts have multiple performance obligations, most commonly due to the contract covering multiple phases of the product lifecycle (development, production, maintenance and support). For contracts with multiple performance obligations, the contract's transaction price is allocated to each performance obligation using the best estimate of the standalone-selling price of each distinct good or service in the contract. The primary method used to estimate standalone selling price is the expected cost plus a margin approach for that distinct goods or service performance obligation. The transaction price is allocated to each distinct performance obligation and recognised as revenue as, the performance obligation is satisfied.

Notes (continued)

30 Accounting Estimates and Judgements (continued)

Revenue IFRS 15 (continued)

The nature of the Company's contracts gives rise to some types of variable consideration, including positive incentive adjustments and final contract pricing adjustments. Positive incentive adjustments are included within the estimated transaction price when there is a basis to reasonably estimate the amount of the recovery and there is no significant risk of reversal. These estimates are based on experience, anticipated performance and best judgment at the time of reviewing the contract financials. Variable considerations are re-assessed on significant contracts at least every six months.

Performance obligations are satisfied over time as work progresses or at a point in time. Revenue from products and services transferred to customers over time accounted for 99.1% of revenue in 2019 (2018: 99.97%). Substantially all of the revenue is recognised over time, because control is transferred continuously to customers. The majority of revenue recognised at a point in time is for sales of specialised product. Revenue on these contracts is recognised when the customer receives the product and a billing is raised.

Warranty obligations are accounted for within the contract estimates at completion and the basis of assumptions reviewed quarterly. As programme costs are incurred, an accrual is made based upon the assumptions within the estimate at completion and held on the balance sheet until warranty returns are received.

At December 31 2019, the Company had £2,266m of remaining performance obligations, which is also referred to as total backlog, the majority of which relates to the AJAX contract. The Company expects to recognise approximately 28% of the remaining performance obligations as revenue in 2020, a further 21% by the end of 2021 and the balance thereafter.

The impact of adjustments in contract estimates on operating earnings can be reflected in either operating costs and expenses or revenue. The aggregate impact of adjustments in contract estimates increased revenue and operating profit as follows (£m):

Year Ended December 31	2019	2018
Revenue	3	20
Operating Profit	3	20

Revenue by Category

The portfolio of products and services consists of 165 active profit centres compared to 192 at the end of 2018. The following series of tables presents revenue disaggregated by several categories.

Revenue by major products and services was as follows (£m):

Year Ended December 31	2019	2018
C4	180	183
Avionics	32	44
AJAX	508	509
Total	<u>720</u>	<u>736</u>

Notes (continued)

30 Accounting Estimates and Judgements (continued)

Revenue IFRS 15 (continued)

Revenue by contract type was as follows (£m):

Year Ended December 31, 2019	C4	Avionics	AJAX	Total Revenue
Firm Fixed-Price	180	32	508	720
<i>Firm Fixed Price 2018</i>	<i>181</i>	<i>44</i>	<i>509</i>	<i>734</i>
Time and Materials	-	-	-	-
<i>Time and Materials 2018</i>	<i>2</i>	<i>-</i>	<i>-</i>	<i>2</i>
Other	-	-	-	-
/				
Total revenue	180	32	508	720
<i>Total revenue 2018</i>	<i>183</i>	<i>44</i>	<i>509</i>	<i>736</i>

Each of these contract types presents advantages and disadvantages. Typically, more risk is assumed with fixed-price contracts. However, these types of contracts offer additional profits when work is completed for less than originally estimated. Time and Material contracts generally are lower risk. Accordingly, the associated base fees are usually lower than fees earned on fixed-price contracts. Under time-and-materials contracts, profit may vary if actual labour-hour rates vary significantly from the negotiated rates. In addition, because these contracts can provide little or no fee for managing material costs, the content mix can affect profitability.

Revenue by customer was as follows (£m):

	C4/ Avionics	AJAX	Total Revenue
UK Government	175	507	682
Non-UK Government	37	1	38
Total revenue	212	508	720

Contract Modifications

Contract modifications are routine in the performance of contracts. Contracts are often modified to account for changes in contract specifications or requirements. In most instances, contract modifications are for goods or services that are not distinct and therefore, are accounted for as part of the existing contract on a cumulative catch up basis. An assessment is conducted for every contract modification to determine if the amendment results in a separate performance obligation or if the modification results in the combining of performance obligations.

The revenue traded in 2019 is primarily related to contracts that were awarded pre 1 January 2019. £668m of the revenue recognised in the current period relates to performance obligations, which have been fully or partially satisfied in previous periods.

Contract Balance

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables (Debtors Less than 1 year), and customer advances and deposits (Creditors less than 1 year) on the Balance Sheet. Amounts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals or upon achievement of contractual milestones. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets. However, sometimes advances or deposits from customers can be received before revenue

Notes *(continued)*

30 Accounting Estimates and Judgements *(continued)*

is recognised, resulting in contract liabilities. These assets and liabilities are reported on the Balance Sheet at the end of each reporting period. At 31 December 2018, the Company held £40.9m of contract liabilities. During 2019, £32.8m of this was traded as revenue, primarily related to the EvO, Typhoon, Bowman Support and the Equipment contracts. At the close of 2019, the company held £41m of contract liabilities primarily relating to the EvO and Bowman programmes.

31 Post balance sheet non-adjusting events

The company, through its Business Continuity Planning, ensured that it was ready to respond to the Coronavirus pandemic in March 2020. The UK Government classified programmes in the Mission Systems and Land Systems business segments as critical programmes to continue. All travel, both international and inter-site ceased and all employees who could work outside of the office were moved to homeworking. The company implemented strict social distancing measures along with onsite audits to ensure that employees who were unable to fulfil their roles from home, due to working on a production line or in a laboratory, could be at a GD location safely.

During 2019, a sister company, Force Protection Europe Ltd, ceased to trade and staff transferred to the Company in accordance with the Transfer of Undertaking (Protection of Employment) Regulations 2006. Certain assets and liabilities were acquired by the Company under a Sale and Purchase agreement signed in June 2020.