BAE Systems (Operations) Limited

Directors' report and financial statements
For the year ended 31 December 2009

Registered Number 1996687

Directors' report and financial statements for the year ended 31 December 2009

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Directors' report

The directors present their report together with the audited financial statements for the year ended 31 December 2009

Business overview

The outlook for UK defence spending remains difficult but the Company has a large order book reflecting the firmly contracted long-term programmes that are a feature of BAE Systems UK-based business Market conditions will continue to be challenging and uncertain whilst awaiting the nature and shape of defence priorities that the 2010 Strategic Defence Review will provide

The largest of those programmes, the Typhoon combat aircraft is set for further growth with increasing deliveries to both the four European partner nations and to the Kingdom of Saudi Arabia

New multi-year UK support contracts were awarded in the year Such contracts included support and maintenance of Harrier and Typhoon aircraft in service with the Royal Air Force

The governments of the Kingdom of Saudi Arabia and the United Kingdom also agreed detailed arrangements to provide support for Typhoon operations for a three-year period These arrangements will be operated through a full availability service contract with BAE Systems Eight Typhoon aircraft were delivered in the year to the Saudi customer under the 2007 Salam production contract

In July contracts were agreed by the four European partner nations for 88 Tranche 3A Typhoon aircraft with a contract value to the Company of approximately £2bn The contracts extend visibility of Typhoon production for the next five years

The Company is also a significant participant on the US F-35 (Joint Strike Fighter) programme with the airframe assembly manufacture The F-35 is expected to progress to high volume production over the coming years

The Company identifies unmanned systems as an increasing priority amongst its customers driven by rapidly evolving requirements often to meet urgent operational needs

The Company is developing three unmanned air platforms A small high endurance air system Herti has been operationally deployed A large twin-engined air platform Mantis, commenced flight trials in October just 19 months after conception A third development platform Taranis a stealthy unmanned combat air system, is in-build

People and Total Performance

The Company is dependent on the skills and capabilities of its people It sets high standards for the training and development of employees, and is a major employer of apprentices and graduates It maintains robust processes for career development including succession planning for its senior executives

Programme execution is an important and easily recognisable embodiment of performance but, in addition the Company targets an integrated approach to performance embracing all aspects of its corporate existence The BAE Systems Group (the Group) wants to be recognised as a company committed to developing a culture of Total Performance Successfully embedding this approach will be a key differentiator for the Group Total Performance focuses not just on what we do but also how we do it It is about every aspect of the way we do business Customer Focus Financial Performance Programme Execution and Responsible Behaviour Delivery of the Group s Corporate Responsibility agenda is an essential part of embedding a Total Performance culture across the Group

The Company's focus on safety remains a top priority The tragic loss of Nimrod XV230 over Afghanistan in 2006 and the subsequent Haddon-Cave report published in October have only strengthened the Company's resolve to continuously seek improvements to safety across all aspects of its business The Product Safety Review announced headed by Nigel Whitehead, Group Managing Director, Programmes & Support, further demonstrates the importance the Company places on safety The Company will work with its customer the UK Ministry of Defence to ensure that any learning benefits current and future workload

The Group aims to achieve leadership standards of responsible business conduct through its programme to address the 23 recommendations of the Woolf Report As a consequence all Group policies and governance processes were reviewed during 2009 and appropriate changes have been incorporated in the Operational Framework effective January 2010 A further key focus during 2009 was the rolling-out of a Group-wide Code of Conduct for employees as part of the drive to embed high standards of business conduct

In addition the Group has also launched Responsible Trading Principles All trading is to be undertaken in accordance with these principles and consistency of this approach is key in defining BAE Systems reputation Together with the global Code of Conduct, these underpin the way the Group does business

Principal activities and business review

The Company operates principally in the defence and, to a lesser extent the commercial aerospace markets It is divided into four principal operating groups that reflect the management of the Company as noted below

Programmes & Support

This operating group is responsible for the management of large prime contracts for military programmes and an increasing level of in-service support activities

In 2009, the business secured contracts for availability support on the Typhoon and Harrier aircraft fleets and the Typhoon Tranche 3A production contract for 88 aircraft

Delivery of Typhoon aircraft to the four partner nations and Austria continues with 208 aircraft delivered 50 being Tranche 2 standard aircraft Upgrade work on the Tranche 1 aircraft continues to provide the UK Royal Air Force (RAF) with increased operational capability

In March, the UK government awarded the business a £430m five-year Typhoon Availability Service (TAS) contract to work with the RAF to ensure aircraft are available to meet operational commitments In September, the Typhoon Support Centre and Maintenance Facility were officially opened at RAF Coningsby marking the official start of the TAS undertaking

Directors' report (continued)

A five-year contract worth in excess of £400m to provide a support service for the Radar and Defensive Aids Sub-System (DASS) for the Typhoon fleets of the air forces of the UK, Germany Italy and Spain was awarded in October

On the Tornado and Harrier programmes operational requirements continued to be met through both the delivery of contractual milestones and Urgent Operational Requirements to support aircraft in theatre

The UK MoD also awarded the Harrier Platform Availability Contract worth in excess of £550m to support the UK s Joint Force Harrier Fleet until their planned out of service date

During the year six Gripen aircraft were accepted by the South African customer Hawk aircraft deliveries for South Africa are now complete and the programme is in the support phase

Aircraft acceptances of the Hawk Mk128 Advanced Jet Trainer for the RAF are progressing with 17 of 28 now accepted

Support continues to Hindustan Aeronautics Limited of India to conclude negotiations on the requirement for a further 57 Hawks in India

The first production Nimrod MRA4 made a successful maiden flight from Woodford in September Formal customer acceptance was received in early 2010

On F-35 Lightning II major airframe units and systems for all three aircraft variants under development and initial production contracts have been delivered The first F-35 airframes are in the UK for structural testing and the UK government has committed to order three of the Short Take Off and Vertical Landing (STOVL) aircraft for operational test and evaluation

The Company continues to leverage its expertise and capabilities in Unmanned Aircraft Systems and position itself in this growth market with Mantis making its first flight in October Good progress is being made on Herti with ongoing flight trials of the production standard variant Final assembly of the Taranis advanced technology demonstrator is underway

In September consultations started on a programme of approximately 1,100 potential job losses across UK sites at Woodford, Samlesbury Warton and Farnborough

International
This operating group has a major presence in the Kingdom of Saudi Arabia (KSA) It acts as prime contractor for the UK/KSA government-to government defence agreement It also holds certain direct contracts with the Saudi government Progress is ongoing to modernise the Saudi armed forces in line with the Understanding Document signed in December 2005 between the UK and KSA governments

The business continues to develop its presence in Saudi Arabia and remains committed to developing a greater indigenous capability in the Kingdom This is being enhanced by the entry into service of the Typhoon aircraft and the subsequent development of the Typhoon industria base in Saudi Arabia

Of the 72 Typhoon aircraft contracted in 2007 under the Salam programme, eight were delivered in the year to the customer in line with programme The initial support solution contract was also agreed and flying operations commenced

The business continues to support the operational capability of both the Royal Saudi Air Force and Royal Saudi Naval Forces Significant incremental orders were received in the period for the Tornado Sustainment Programme (TSP) weapons contract

Electronics, Intelligence & Support
This operating group designs, develops, produces and services systems and subsystems for a wide range of military and commercial applications These include head-up head-down and helmet mounted displays as well as mission computers, digital maps flight controls and associated subsystems

HQ and Other Businesses
This operating group is primarily involved in the in-service support and secondary marketing of commercial aircraft property management and related activities

The commercial aircraft market continues to prove challenging in the global economic downturn New lease lease extensions and aircraft sale discussions with operators are ongoing with regard to current and future fleet requirements Marketing activity is focused on both the existing uncontracted idle aircraft as well as those returning off lease

Whilst support revenues have reduced due to lower demand for aircraft components, this has been partially offset by increased revenues from engineering and technical support services Whilst market conditions have impacted the general level of financing available to airlines globally the portfolio customer base remains relatively robust and the business continues to closely monitor operator performance against default risk

Directors' report (continued)

Principal risks and uncertainties

The management of the business and the execution of the Company's strategy are subject to a number of risks

The Company is dependent on defence spending and reductions in such spending could adversely affect the Company
The Company's core businesses are primarily defence-related selling products and services directly and indirectly primarily to the UK the Saudi Arabian and other national governments In any single market defence spending depends on a complex mix of political considerations, budgetary constraints and the ability of the armed forces to meet specific threats and perform certain missions Because of these factors defence spending may be subject to significant fluctuations from year to year

The UK defence equipment budget is expected to continue to be constrained having potential implications for the sustainability of long-term funding for future defence technologies and engineering capabilities in the UK Saudi Arabia is expected to remain one of the heaviest defence spenders in the world

Certain parts of the Company's business are dependent on a small number of large contracts
A significant proportion of the Company s revenue comes from a small number of large contracts These contracts individually are typically worth or potentially worth £1bn or more

The Company's largest customer contracts are government contracts
The governments of the United Kingdom and the Kingdom of Saudi Arabia are the Company's largest end customers Any significant disruption or deterioration in the relationship with these governments and a corresponding reduction in government contracts would significantly reduce the Company s revenues Moreover companies engaged in the supply of defence-related equipment and services to government agencies are subject to certain business risks particular to the defence industry These governments could unilaterally cancel suspend or amend their contractors funding under existing contracts or eligibility for new contracts potentially at short notice Terms and risk sharing agreements can also be amended In addition the Company as a government contractor is subject to financial audits and other reviews by some of its governmental customers with respect to the performance of and the accounting and general practices relating to government contracts As a result of these audits and reviews costs and prices under these contracts may be subject to adjustment

The timing of contracts could materially affect the Company's future results of operations and financial condition
The Company's operating performance and cash flows are dependent to a significant extent on the award of defence contracts

The Company has fixed-price contracts
A portion of the Company s revenue is derived from fixed-price contracts although the Company has reduced its exposure to fixed-priced design and development activity which is in general more risk intensive than fixed-price production activity An inherent risk in these fixed price contracts is that actual performance costs may exceed the projected costs on which the fixed prices for such contracts are agreed

The Company is dependent upon component availability, subcontractor performance and key suppliers
The Company is dependent upon the delivery of materials by suppliers and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner and in full compliance with applicable terms and conditions

The Company is exposed to risks inherent in operating in a global market
The Company conducts business in a number of regions including the Middle East and as a result, assumes certain risks associated with businesses with a broad geographical reach In some countries these risks include, and are not limited to the following government regulations and administrative policies could change quickly and restraints on the movement of capital could be imposed governments could expropriate the Company's assets burdensome taxes or tariffs could be introduced political changes could lead to changes in the business environment in which the Company operates and economic downturns political instability and civil disturbances could disrupt the Company s business activities

The Company is subject to export controls and other restrictions
A portion of the Company s sales is derived from the export of its products Many of the products the Company designs and manufactures for military or dual use are considered to be of national strategic interest The export of such products outside the jurisdictions in which they are produced is normally subject to licensing and export controls and other restrictions No assurance can be given that the export controls to which the Company is subject will not become more restrictive that new generations of the Company's products will not also be subject to similar or more stringent controls or that political factors or changing international circumstances will not result in the Company being unable to obtain necessary export licences

The Company's business is subject to significant competition
Most of the Company s businesses are focused on the defence industry and subject to competition from national and multi-national firms with substantial resources and capital and many contracts are obtained through a competitive bidding process The Company s ability to compete for contracts depends to a large extent on the effectiveness and innovation of its research and development programmes its ability to offer better programme performance than its competitors at a lower cost to its customers and the readiness of its facilities equipment and personnel to undertake the programmes for which it competes

Additionally, in some instances governments direct to a single supplier all work for a particular programme commonly known as a sole-source programme Although governments have historically awarded certain programmes to the Company on a sole-source basis they may in the future determine to open such programmes to a competitive bidding process Government contracts for defence-related products can in certain countries be awarded on the basis of home country preference Therefore other defence companies may have an advantage over the Company for some defence-related contracts on the basis of the jurisdiction in which they are organised, where the majority of their assets are located or where their officers or directors are located

The Company is exposed to funding risks in relation to the defined benefits under its pension schemes
The Company participates in certain defined benefit pension schemes At present in aggregate there is an actuarial deficit between the value of projected liabilities of these schemes and the value of the assets they hold Deficit recovery plans are being implemented for these schemes in line with agreements reached with the respective scheme trustees based on actuarial advice and valuation results

Directors' report (continued)

The Company is subject to risk from a failure to comply with laws and regulations
The Company s operations are subject to numerous domestic and international laws, regulations and restrictions Non-compliance with these laws regulations and restrictions could expose the Company to fines penalties suspension or debarment which could have a material adverse effect on the Company The Company has contracts and operations around the world and operates in a highly regulated environment The Company is subject to the laws and regulations of many jurisdictions, including those of the UK and US These include, without limitation regulations relating to import-export controls money-laundering false accounting anti-bribery and anti-boycott provisions From time to time, the Company is subject to government investigations relating to its operations

The Company is exposed to volatility in currency exchange rates
The nature of the Company's business means it is exposed to volatility in currency exchange rates in respect of foreign currency denominated transactions The Company is exposed to a number of foreign currencies the most significant being the Euro

Additional risks and uncertainties currently unknown to the Company, or which the Company currently deems immaterial, may also have an adverse effect on the financial condition or business of the Company

Going concern

The Company has considerable financial resources together with long-term contracts with a number of customers and suppliers across different geographic areas As a consequence the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook

The directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Thus they continue to adopt the going concern basis in preparing the annual financial statements

Key performance indicators

The key financial performance indicators used to review and monitor the business are set by the directors and are shown below

	2009	2008
	£	£
Order intake	**8 1bn**	4 5bn
Turnover	**6,031m**	4 526m
Operating profit	**628m**	596m

Order intake represents the value of funded orders received from customers in the year It is a measure of in-year performance and supports future years sales performance The year's intake includes the Typhoon Tranche 3A production order, support orders for Typhoor and Harrier and the three-year Saudi Typhoon availability service contract

Turnover represents the amounts derived from the provision of goods and services The increase in turnover this year has primarily been driven by increased deliveries of Typhoon Tranche 2 standard aircraft and initial deliveries of Typhoon aircraft and support to the Kingdom of Saudi Arabia

Operating profit is used for internal performance analysis as a measure of operating profitability that is comparable over time Whilst the improved 2009 sales performance generated an increase in operating profit operating profit as a percentage of turnover reduced primarily due to the low margin traded in the early stages of the Salam programme

Looking forward

Programmes & Support is driven by its existing strong order book and the level of future UK Ministry of Defence (MoD) funding to meet current UK armed forces operational requirements and delivery of the Defence Industrial Strategy In the UK, a Strategic Defence Review has been initiated by the newly elected government It is anticipated that this will have a significant influence on UK defence spending from 2011 onwards

In Military Air Solutions, growth is linked to increased combat aircraft production activity and in-service support performance

The Company seeks to sustain its long-term presence in the Kingdom of Saudi Arabia through delivering on current programmes and industrialisation commitments, and developing new business

Market conditions for the commercial aircraft market continue to provide a challenging trading environment due to the impact of the global economic downturn and tightened availability of funding to operators

Directors and their interests

The directors who served during the year and at the date of this report were as follows

Mr G W Rose	
Mr I G King	
Mr P R Earl	(appointed 27 March 2009)
Mr G R Griffiths	(appointed 27 March 2009)
Mr M J Wills	(appointed 27 March 2009, resigned 30 March 2010)
Mr P J Lynas	(appointed 27 March 2009)
Mr N G Whitehead	(appointed 27 March 2009)
Mr K B Taylor	(appointed 30 March 2010)

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

Overseas branch offices

The Company has overseas branch offices in the following countries
India
Spain

Directors' report (continued)

Resources
The Company's key resources and arrangements include the people it employs its relationships with customers subcontractors and other suppliers research and development, and intellectual property These resources together with the application of the mandated policies and processes in the Group's Operational Framework, help the Company to achieve its strategy

Operational Framework
The Operational Framework sets out how the Group will meet its Group Strategic Objective of achieving Total Performance, which together with its values underpins the Group s ability to deliver the strategy It is mandatory across all wholly-owned and majority-owned businesses and describes the Group's approach to Total Performance organisation governance, core business processes mandated policies, processes and charters and delegated authorities

Employment
The contribution of the Company s employees is fundamental to its success The workforce encompasses the broad spectrum of skills and experience needed to deliver its products and services

Safety
The Company s commitment to embed a safety culture contributes to strong employee relations and business performance

Diversity and Inclusion
The People Policy in the Operational Framework obliges each employee to contribute to the creation of an inclusive work environment where individuals are respected and the value of having a diverse workforce is recognised The Company is committed to giving full and fair consideration to applications for employment from disabled people who meet the requirements for roles, and making available training opportunities and appropriate accommodations to disabled people employed by the Company Unlawful discrimination against individuals with disabilities is not tolerated This policy is subject to relevant legislative regulatory and security requirements

Capability development
Training and development help the Company to deliver world class business performance and service excellence, keep up with changing technology and meet customers needs A culture of life-long learning is encouraged through flexible training and development tools for employees at all levels

Developing leadership capability
The Total Performance Leadership (TPL) process drives business success by linking individuals goals with the wider goals of the organisation TPL includes objective setting performance assessment and the determination of reward, development needs and potential

Education and early careers
The Company works in partnership with education providers to facilitate a continued supply of talented and qualified graduates and apprentices for its early career programmes The Company supports education schemes with an emphasis on science technology engineering and mathematics

Employee engagement
The Company engages regularly with employees via employee representative bodies and trade unions meetings, employee surveys global regional and departmental newsletters and a global intranet site The effectiveness of this communication is assessed regularly Employees are encouraged to become shareholders in the Group by way of employee share schemes

Customers
Customer Focus is a key element of the Group Strategic Objective of Total Performance

The Company's core businesses are mostly defence-related, selling products and services primarily in its home markets and to other national governments both directly and indirectly through other defence and aerospace companies In many cases these relationships extend over decades and span the full product and service lifecycle from initial concept definition through the system development phase, into production and then on to support for the system in service

Throughout the product and project lifecycles the Company engages extensively with its customers and undertakes customer satisfaction surveys as part of its drive for continuous performance improvement, aligning with the Group Strategic Objective of Total Performance

The Company's largest customers are the governments of the United Kingdom and the Kingdom of Saudi Arabia Agreements between the governments of the United Kingdom and Kingdom of Saudi Arabia relating to defence co-operation programmes remain essential to the development of the Company's business in Saudi Arabia

Delivery of the Group s corporate responsibility agenda supports its reputation and contributes to successful long-term relationships with customers Its commitment to be recognised as a leader in responsible business conduct and to achieve leadership safety performance is particularly important

Lifecycle Management (LCM) which is mandated under the Operational Framework provides a structured approach to managing the Company s commitments and investments throughout product and project lifecycles, promoting the application of best practice management and facilitating continuous improvement Programme margin variation and schedule adherence are regularly reviewed to monitor contract profitability and milestone achievement

Subcontractors and other suppliers
Expenditure on subcontracts can represent a significant portion of project cost with effective management of this expenditure being a key value driver for the Company

The benefits of capability-based contracting, combined with ongoing budget pressures, have led many customers to demand a more integrated partnering approach to meet their requirements Best practice in managing major subcontracts is embedded in the Company's processes, guidance and training to help deliver on commitments to customers aligning with the Group s Strategic Objective of Total Performance through programme execution

Directors' report (continued)

Managing relationships with suppliers is an essential part of developing systems integration and through-life management capabilities The Company is committed to improving supply chain relationships and working together with other companies large and small to deliver better value and innovation for its customers The performance of the suppliers the Company works with could potentially impact the Company s reputation and financial performance and it is putting measures in place to encourage high standards of corporate responsibility in the supply chain

Supplier payment policy

It is Company policy that suppliers should be paid in accordance with the payment terms and conditions stated in the applicable purchase order The Company together with other BAE Systems companies in the UK is a signatory to the government's Prompt Payment Code under which it has undertaken to pay suppliers on time, give clear guidance on payment procedures and encourage the adoption of the code throughout its supply chain

The average number of days credit provided by suppliers to the Company during the year was 31 days (2008 28 days)

Research and technology (R&D)

The Company is engaged in significant R&D programmes in support of the platforms systems services and capabilities that it provides to its customers It invests in its engineering future through the development of new technology processes skills and facilities The Company s Advanced Technology Centre is dedicated to the study of future discriminating technologies for the business

Intellectual property

The Company s intellectual property can make a significant contribution to its competitive advantage

Intellectual property is created every day taking many forms both in tangible products and know how The Operational Framework mandates a policy to protect intellectual property through appropriate use and observance of intellectual property law, so that returns made from the investment in R&D and technological innovation are protected, and commercial and business innovations are adequately safeguarded

Financial instruments

The Company s objective is to reduce its exposure to volatility in earnings and cash flows as a result of movements in foreign currency exchange rates The Company is exposed to a number of foreign currencies, the most significant being the US dollar and the Euro

The Company is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions To mitigate this risk the Company s policy is to hedge all material firm transactional exposures Further details on the Company's foreign exchange contracts are set out in note 20 to the accounts

Results and dividends

The Company's profit for the financial year is £403m (2008 £378m) The directors paid an interim dividend of £209m (2008 £nil) and propose a final dividend of £201m (2008 £382m) subject to necessary approvals

Auditors

KPMG Audit Plc the auditors for the Company, have indicated their willingness to continue in office and a resolution proposing their re-appointment will be put to the Annual General Meeting

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

By order of the Board

I G King
Director

23 June 2010

Registered number 1996687

Registered office
BAE Systems (Operations) Limited
Warwick House
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England

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

The directors are responsible for preparing 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)

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 judgments 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 and

• prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They 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 auditors' report to the members of BAE Systems (Operations) Limited

We have audited the financial statements of BAE Systems (Operations) Limited for the year ended 31 December 2009 set out on pages 9 to 26 The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice)

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 auditors 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

Respective responsibilities of directors and auditors
As explained more fully in the Directors' Responsibilities Statement set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board s (APB s) Ethical Standards for Auditors

Scope of the audit of the financial statements
A description of the scope of an audit of financial statements is provided on the APB s web-site at www frc org uk/apb/scope/UKNP

Opinion on financial statements
In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its profit for the year then ended,
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us 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

Paul Sawdon (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc Statutory Auditor

Chartered Accountants

London

23 June 2010

Profit and loss account

for the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Turnover	2	**6,031**	4 526
Operating costs	3	**(5,403)**	(3,930)
Operating profit		**628**	596
(Expense) / income from participating interests		**(1)**	11
Profit on disposal of fixed assets		**3**	13
Profit on ordinary activities before interest and taxation		**630**	620
Interest receivable and similar income	4	**17**	125
Interest payable and similar charges	5	**(42)**	(34)
Profit on ordinary activities before taxation		**605**	711
Taxation	7	**(202)**	(333)
Profit for the financial year		**403**	378

No note of historical cost profits has been prepared as the historical cost profits and losses are not materially different to those detailed in the above profit and loss account

Balance sheet
as at 31 December 2009

	Notes	2009 £m	2008 £m
Fixed assets			
Intangible assets	9	**48**	53
Tangible assets	10	**414**	377
Investments	11	**33**	32
		495	462
Current assets			
Stocks	12	**642**	582
Debtors due within one year	13	**8,220**	8 714
Debtors due after one year	13	**89**	125
Cash at bank and in hand		**44**	53
		8,995	9,474
Creditors amounts falling due within one year	14	**(7,002)**	(7 444)
Net current assets		**1,993**	2 030
Total assets less current liabilities		**2,488**	2 492
Creditors amounts falling due after one year	14	**(40)**	(71)
Provisions for liabilities and charges	15	**(349)**	(346)
Net assets		**2,099**	2,075
Capital and reserves			
Called up share capital	18	**1,008**	1 008
Share premium account	19	**25**	25
Non-distributable reserve	19	**31**	35
Profit and loss account	19	**1,035**	1 007
Equity shareholders' funds		**2,099**	2 075

Approved by the Board on 23 June 2010 and signed on its behalf by

G W Rose
Director

Statement of total recognised gains and losses
for the year ended 31 December 2009

	2009 £m	2008 £m
Profit for the financial year	**403**	378
Total recognised gains and losses relating to the year	**403**	378

Reconciliation of movements in equity shareholders' funds
for the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Profit for the financial year		**403**	378
Adjustment in respect of employee share schemes		**3**	2
Dividends paid	8	**(382)**	(600)
Net increase/ (reduction) in shareholders' funds		**24**	(220)
Opening equity shareholders' funds		**2,075**	2 295
Closing equity shareholders' funds		**2,099**	2 075

Notes to the accounts

1 Accounting policies

Basis of preparation
The financial statements have been prepared on the historical cost basis in accordance with applicable accounting standards in the United Kingdom The going concern basis has been applied in these accounts

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

Cash flow statement
BAE Systems (Operations) Limited is a wholly owned subsidiary of BAE Systems plc and consequently, the Company is exempt under the terms of Financial Reporting Standard (FRS) 1 'Cash flow statements' paragraph 5a, from the requirement to publish its own cash flow statement, as its cash flows are included within the consolidated cash flow statement of BAE Systems plc

Turnover and profit recognition
Turnover comprises the value of work completed goods supplied or services rendered during the year, net of value added tax

Long-term contracts
Turnover is recognised when the Company can reliably estimate the outcome of a long-term contract and has obtained the right to consideration in exchange for its performance This is usually when title passes or a separately identifiable phase (milestone) of a contract or development has been completed

No profit is recognised on contracts until the outcome of the contract can be reliably estimated Profit is calculated by reference to reliable estimates of contract revenue and forecast costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved When it is probable that total contract costs will exceed total contract revenue the expected loss is recognised immediately as an expense

Goods supplied and services rendered
Sales of goods and the provision of services not under a long-term contract are recognised in the profit and loss account when the significant risks and rewards of ownership have been transferred to the buyer and revenue and costs can be reliably measured

Profit is recognised at the time of sale

Goodwill
On the acquisition of a business fair values are attributed to the net assets/liabilities acquired Goodwill represents the difference between the purchase consideration and the fair values Positive goodwill arising on such acquisitions is capitalised in the financial statements as an intangible asset and amortised on a straight-line basis over its useful economic life To date all goodwill capitalised has been assessed as having a 20-year estimated useful economic life

Impairment reviews are undertaken at the end of the first full financial year following each acquisition and also if events or changes in circumstance indicate that such a review is necessary

On the subsequent disposal or termination of a previously acquired business the profit and loss on disposal or termination is calculated including any remaining capitalised goodwill

Research and development
Company funded revenue expenditure on research and development is written off as incurred and charged to the profit and loss account except where supported under contract

Foreign currencies
Transactions in overseas currencies are translated at the exchange rate ruling at the date of the transaction or where forward cover contracts have been arranged at the contracted rates Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date or at a contracted rate if applicable and any exchange differences arising are taken to the profit and loss account

Tangible fixed assets
Depreciation is provided on a straight-line basis, to write off the cost or valuation of tangible fixed assets over their estimated useful economic lives to the estimated residual value using the following rates

Buildings	- up to 50 years, or the lease term if shorter
Research equipment	- 8 years
Computing equipment, motor vehicles and short life works equipment	- 3 to 5 years
Aircraft	- up to 15 years, or the lease term if shorter
Other equipment	-10 to 15 years or the project life if shorter

No depreciation is provided on freehold land and assets in the course of construction

Impairment reviews are undertaken if there are indications that the carrying values may not be recoverable

Notes to the accounts (continued)

1 Accounting policies (continued)

Leases
Rental payments under operating leases are charged to the profit and loss account on a straight-line basis in arriving at operating profit

Assets held for leasing out under operating leases are included in tangible fixed assets at cost less depreciation Rental income from aircraft operating leases is recognised in sales as the receipts fall due

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

Stocks
Stocks are stated at the lower of cost including all relevant overhead expenditure and net realisable value

Long-term contract balances are stated at cost less provision for anticipated losses Appropriate provisions for any losses are made in the year in which they are first foreseen The amount of profit attributable to the stage of completion of a long-term contract is arrived at by reference to the estimated overall profitability of the contract

Cash received on customers' account and customer stage payments
Amounts received from customers in accordance with the terms of contracts which specify payments in advance of delivery are credited, as progress payments, against any expenditure incurred upon stocks or work in progress for the particular contract Any unexpended balance is held in creditors as customer stage payments or if the amounts are subject to advance payment guarantees unrelated to company performance, as cash received on customers' account

Aircraft financing
The Company is exposed to actual and contingent liabilities arising from commercial aircraft financing both from financing arranged directly by the Company and from that arranged by third parties where the Company has provided guarantees or has other recourse obligations Provision for these risks is made on a systematic basis

Tax
The charge for taxation is based on the profit for the year and takes account of taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes Deferred tax is recognised on an undiscounted basis in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date where there is an obligation to pay more tax, or a right to pay less tax in the future

Pensions
The Company contributes to Group pension schemes operated in the UK that provide benefits based on final pensionable salary Details of the principal schemes including the value of the deficit that exists for the schemes and the financial assumptions used are contained in the consolidated accounts of the Group As permitted by FRS 17 'Retirement benefits' the schemes are accounted for as defined contribution schemes as the employer cannot identify its share of the underlying assets and liabilities of the schemes

Share options
BAE Systems plc issues equity-settled share options to employees of the Company In accordance with the requirements of FRS 20 'Share-based payments' the Company has recognised a charge for the equity settled share options issued to its employees

Equity-settled share options are measured at fair value at the date of grant using an option pricing model The fair value is expensed on a straight-line basis over the vesting period, based on the Company s estimate of the number of shares that will actually vest

Financial instruments
As the Company is a wholly owned subsidiary of BAE Systems plc it is exempt from presenting disclosures in line with FRS 29 'Financial Instruments Disclosures' as full equivalent disclosures are presented on a group basis within the consolidated financial statements

Notes to the accounts (continued)

2 Segmental analysis

Turnover by business group

	Turnover	
	2009	2008
	£m	£m
Electronics Intelligence & Support	**229**	241
Programmes & Support	**4,136**	2,935
International	**1,973**	1 514
HQ & Other Businesses	**186**	196
	6,524	4,886
Intra-Company	**(493)**	(360)
	6,031	4 526

Turnover by geographical destination

	Turnover	
	2009	2008
	£m	£m
United Kingdom	**1,502**	1 182
Rest of Europe	**1,252**	1,055
Middle East	**2,570**	1 518
USA and Canada	**330**	343
Asia and Pacific	**28**	193
Africa Central and South America	**349**	235
	6,031	4,526

Rental income in 2009 from aircraft operating leases included within turnover is £22m (2008 £20m)

3 Operating costs

	2009	2008
	£m	£m
Raw materials and other bought in stock	**3,643**	3,328
Change in stocks of finished goods and work in progress	**(212)**	(1 525)
Staff costs (note 6)	**1,217**	1 161
Depreciation, amortisation and impairment	**102**	111
Other operating charges	**703**	886
Other operating income	**(50)**	(31)
Operating costs	**5,403**	3,930

Included within the above analysis are the following expenses, all of which relate to continuing activities	**2009**	2008
	£m	£m
Operating lease charges including aircraft	**12**	10

The remuneration of the auditors for the year ended 31 December 2009 for statutory audit work was £0 8m (2008 £0 8m) In addition £nil (2008 £nil) was paid to the auditors in respect of non-audit work

Research and development expenditure including amounts funded under customer contracts was £496m (2008 £506m)

Notes to the accounts (continued)

4 Interest receivable and similar income

	2009 £m	2008 £m
Receivable from group undertakings	13	33
Foreign exchange gains	4	92
	17	125

The foreign exchange gain in 2008 primarily relates to the retranslation of a Saudi Riyal denominated loan to a Group undertaking

The foreign exchange loss in 2009 (note 5) primarily reflects the retranslation of this loan

5 Interest payable and similar charges

	2009 £m	2008 £m
On bank loans and overdrafts	-	(1)
Foreign exchange losses	(37)	(5)
Net present value adjustments	(5)	(28)
	(42)	(34)

6 Employees

The average weekly number of employees was as follows	2009	2008
Electronics, Intelligence & Support	1,620	1 682
Programmes & Support	15,217	15,093
International	4,486	4 461
HQ & Other Businesses	1,130	1 108
	22,453	22,344

The aggregate payroll costs of the employees were as follows	2009 £m	2008 £m
Wages and salaries	957	908
Social security costs	72	68
Additional pension contributions	40	41
Other pension costs	145	142
Cost of employee share schemes (note 23)	3	2
Staff Costs	1,217	1,161

In 2006 the Group announced it had agreed a programme of measures to address the funding deficit in its principal UK pension schemes

None of the directors received any emoluments from the Company during the year All directors who served during the year were employed by BAE Systems plc and were remunerated through that company

Notes to the accounts (continued)

7 Tax

	2009 £m	2008 £m
Current tax		
Current tax charge for the year	(76)	(211)
Double tax relief	1	2
Overseas tax	(2)	(4)
Adjustment in respect of prior years	(91)	(88)
	(168)	(301)
Deferred tax		
Origination and reversal of timing differences	(35)	(32)
Adjustment in respect of prior years	1	-
	(34)	(32)
Tax on the results	(202)	(333)
Current tax charge for the year	(168)	(301)
Deferred tax charge for the year	(34)	(32)

The current tax charge for the year is lower (2008 - higher) than the standard rate of corporation tax in the UK (2009 - 28%, 2008 - 28 5%) The differences are explained below

	2009 £m	2008 £m
Profit before taxation	605	711
Tax on profit at UK rate of 28% (2008 - 28 5%)	(169)	(203)
Expenses not tax effected	(5)	(21)
Accelerated capital allowances	1	(6)
Pensions / retirement plans additional contributions	25	26
Share-based payment	5	3
Group losses received free of charge	69	-
Adjustments in respect of prior years	(91)	(88)
Provisions	13	10
Other	(16)	(22)
	(168)	(301)

Notes to the accounts (continued)

8 Equity dividends

	2009 £m	2008 £m
Final for 'A and 'B ordinary shares paid	382	600

The 2009 interim dividend paid in 2010 was £209m (2008 £nil), and the final dividend proposed for 2009 is £201m (2008 £382m) subject to necessary approvals

9 Intangible assets

	Goodwill £m
Cost	
At 1 January and 31 December 2009	88
Amortisation	
At 1 January 2009	35
Amortisation charge	5
At 31 December 2009	40
Net book value	
At 31 December 2009	**48**
At 31 December 2008	53

Notes to the accounts (continued)

10 Tangible assets

	Land and buildings £m	Plant and equipment £m	Total £m
Cost or valuation			
At 1 January 2009	399	898	1,297
Additions	42	93	135
Disposals	(1)	(23)	(24)
At 31 December 2009	440	968	1 408
Depreciation and impairment			
At 1 January 2009	181	739	920
Depreciation charge for the year	27	41	68
Impairments	-	30	30
Disposals	(1)	(23)	(24)
At 31 December 2009	207	787	994
Net book value			
At 31 December 2009	**233**	**181**	**414**
At 31 December 2008	218	159	377

The amounts at 31 December 2009 include

Assets let under operating leases			
Cost	-	129	129
Accumulated depreciation	-	(95)	(95)

Non-depreciated assets			
Assets under the course of construction	-	30	30
Land	26	-	26
	26	30	56

Net book value of			
Freehold land and buildings	233	-	233
Purchased software	-	6	6
Plant and machinery	-	97	97
Fixtures fittings and equipment	-	37	37
Aircraft	-	41	41
	233	181	414

Notes to the accounts (continued)

10 Tangible assets (continued)

Land and buildings comprise

- freehold and long leasehold land and buildings excluding certain overseas properties revalued at 30 June 1996 The majority of the Company's operational properties were valued on a depreciated replacement basis owing to their specialisation, with the remainder on an existing use value basis Other non-operational properties were valued on the basis of open market value and

- additions subsequent to 30 June 1996 at cost

Following the adoption in 2000 of Financial Reporting Standard 15 - Tangible fixed assets (FRS 15) the Company has elected that no further revaluation of land and buildings will be undertaken for statutory reporting purposes

Analysis of cost or valuation of land and buildings

	2009 £m
Land and buildings	
At valuation - 1996	258
At cost	182
	440

If land and buildings had not been revalued the following would have been included in the balance sheet

	2009 £m
Historical cost	409
Depreciation	(207)
Net book value	
At 31 December 2009	**202**
At 31 December 2008	181

The depreciation charge for the year based on the historical cost would have been £23m (2008 £24m)

Capital commitments

Capital expenditure for tangible fixed assets contracted for but not provided for in full in the accounts comprised £16m (2008 £26m)

Notes to the accounts (continued)

11 Investments

	£m
Carrying value	
At 1 January 2009	32
Impairment reversal	1
At 31 December 2009	33

The impairment reversal relates to the Company s investment in Gripen International KB a Swedish Limited Liability Partnership

Subsidiary undertakings and participating interests at 31 December 2009

Company name	Class of shares	Total number of shares in issue	Proportion of class of shares held (%)	Equity interest held (%)
Aerosystems International Limited	Ordinary shares of £1	40 200	100	100
BAE Systems (Aviation Services) Limited	Ordinary shares of £1	2 000	50	50
BAE Systems (Kazakhstan) Limited	Ordinary shares of £1	2	100	100
Cardprize Limited	Ordinary shares of £1	1	100	100
Cemmnt Hub Limited - Limited by guarantee company	-	-	-	25
CFMS Limited - Limited by guarantee company	-	-	-	16 66
Corda Limited	Ordinary shares of £1	2 000	99 95	99 95
Gripen International KB - Partnership	-	-	-	50
IFS Defence Ltd	'A Ordinary shares of £1	7 500	60	45

12 Stocks

	2009 £m	2008 £m
Long-term contract balances	4,939	4 592
Less attributable progress payments	(4,395)	(4 164)
	544	428
Short-term work in progress	82	123
Raw materials and consumables	4	3
Finished goods and goods for resale	12	28
	642	582

Notes to the accounts (continued)

13 Debtors

	2009 £m	2008 £m
Amounts due within one year		
Trade debtors	406	542
Amounts owed by group undertakings	7,673	7 990
Other debtors	82	96
Prepayments and accrued income	59	86
	8,220	8 714
Amounts due after one year		
Prepayments and accrued income	3	5
Deferred tax (note 17)	86	120
	89	125
Total debtors	8,309	8 839

14 Creditors

	2009 £m	2008 £m
Falling due within one year		
Loans and overdrafts	-	7
Trade creditors	137	163
Customer stage payments		
Long-term contracts	3,574	3 237
Others	3	3
Amounts owed to group undertakings	1,898	2 607
Corporation tax	743	575
Other taxes and social security costs	18	17
Other creditors	87	127
Accruals and deferred income	542	708
	7,002	7,444
Falling due after one year		
Customer stage payments long-term contracts	14	15
Other creditors	26	56
	40	71
Total creditors	7,042	7 515

Notes to the accounts (continued)

15 Provisions for liabilities and charges

	Contracts and other	Reorganisations -continuing operations	Regional Aircraft	Total
	£m	£m	£m	£m
At 1 January 2009	158	41	147	346
Created	74	63	32	169
Released	(77)	(6)	(33)	(116)
Utilised	(6)	(26)	(26)	(58)
Other provision movements	2	-	6	8
At 31 December 2009	**151**	**72**	**126**	**349**

Contracts and other
In respect of ongoing contracts appropriate provisions are made for any losses in the year in which they are first foreseen The associated outflows are estimated to occur over the period of the contract, normally between one and five years

Other provisions include warranties and after-sales service, legal costs insurance and environmental commitments

Reorganisations - continuing operations
The costs associated with reorganisation programmes are supported by detailed plans and based on previous experience as well as other known factors Such costs are generally incurred within one to three years There is limited volatility around the timing and amount of the ultimate outflows related to these provisions

Regional aircraft
The provision is for recourse liabilities in respect of financing arrangements for aircraft previously sold by the company and covers costs to be incurred over the period to 2013 The directors believe it is appropriate to state the recourse provision at its net present value

Other provision movements
Adjustments to net present value are reported within other provision movements

Notes to the accounts (continued)

16 Commercial aircraft financing and operating lease commitments

	2009			2008		
	FRIP aircraft £m	Post FRIP aircraft £m	Total £m	FRIP aircraft £m	Post FRIP aircraft £m	Total £m
Future cash flow payments in respect of aircraft financing obligations	534	68	602	707	97	804
Amounts pre-financed (see below)	(165)	-	(165)	(210)	-	(210)
	369	68	437	497	97	594
Income guaranteed through insurance	(280)	-	(280)	(408)	-	(408)
Anticipated residual values	-	(12)	(12)	-	(37)	(37)
Adjustments to net present value	(15)	(4)	(19)	(2)	(2)	(4)
Exposure at net present value	74	52	126	87	58	145
Amounts included within Provisions	74	52	126	87	58	145

The Company has provided guarantees in respect of residual values or head lease and finance payments in respect of the sale of certain commercial aircraft At 31 December 2009 the Company's exposure to make future payments in respect of these arrangements was £602m (2008 £804m)

As part of a restructuring of its gross obligations through the issue of a limited recourse bond in 2001 the Company pre-financed certain of the residual value guarantees The future cash flows associated with this pre-financing totalled £165m at 31 December 2009 (2008 £210m)

A significant proportion of the net exposure of £437m (2008 £594m) was covered by a Financial Risk Insurance Programme (FRIP) which made good shortfalls in actual lease income against originally estimated future income for a 15-year period from 1998 to 2013 Any anticipated liability in respect of uninsured amounts was accounted for on a net present value basis The Company is insured under the FRIP by BAE Systems Insurance (Isle of Man) Limited another BAE Systems subsidiary company BAE Systems Insurance (Isle of Man) Limited had in turn insured their exposure under the FRIP with external reinsurers In the last 3 years agreements were reached by the BAE Systems Group with all the reinsurers and settlements have been subsequently paid by them to the Group

It is considered that the Company's net exposure to these guarantees is covered by the provisions held, on a net present value basis and the residual values of those aircraft

Committed expenditure arising from aircraft operating leases which expire

	2009 £m	2008 £m
In one year or less	-	2
Between one and five years	8	14
	8	16

Notes to the accounts (continued)

17 Deferred tax

	2009	2008
	£m	£m
Accelerated capital allowances	**24**	26
Pensions / retirement plans additional contributions	**5**	30
Share-based payments	**2**	1
Provisions and accruals	**55**	63
Deferred tax asset	**86**	120
Asset at 1 January	**120**	152
Deferred tax charge in profit and loss account for year		
- ordinary	**(34)**	(32)
Deferred tax asset at 31 December	**86**	120
This asset is included within		
Debtors (note 13)	**86**	120

No significant potential liability to tax is expected to arise if properties included at valuation in the accounts were realised at their revalued amounts and in respect of rolled over capital gains (2008 £nil)

18 Share capital

	£1 'A' Ordinary shares '000	£1 'B' Ordinary shares 000	Nominal value £m
Authorised			
At 1 January and 31 December 2009	1,007 340	180	1 008
Issued and fully paid			
At 1 January and 31 December 2009	1 007 340	180	1,008

The 'A' and B Ordinary shares rank pari passu in all respects

Notes to the accounts (continued)

19 Reserves

	Share premium account £m	Non-distributable reserve £m	Profit and loss reserve £m
At 1 January 2009	25	35	1 007
Adjustment in respect of employee share schemes	-	-	3
Profit for the financial year	-	-	403
Transfer to profit and loss reserve	-	(4)	4
Dividend paid	-	-	(382)
At 31 December 2009	25	31	1,035

20 Foreign exchange contracts

The Company has derivative financial instruments that it has not recognised at fair values These consist of contracts to buy and sell Australian Dollars Euros Saudi Arabian Riyals South African Rand Swedish Krona, Danish Krone Canadian Dollars, Singapore Dollars, Swiss Francs, Bahraini Dinars and US Dollars at agreed future dates at agreed future exchange rates At 31 December 2009, the Company had 1,521 such contracts (2008 1 249) The 1,521 contracts held at 31 December 2009 commit the Company to buy and sell Australian Dollars Euros Saudi Arabian Riyals South African Rand Swedish Krona Danish Krone Canadian Dollars Singapore Dollars, Swiss Francs Bahraini Dinars and US Dollars at various dates between 2010 and 2017 for a total net payment of £1,515m If these same contracts had been entered into on 31 December 2009 the Company would have been committed to buy and sell Australian Dollars, Euros Saudi Arabian Riyals South African Rand Swedish Krona Singapore Dollars, Swiss Francs and US Dollars for a net payment of £1,612m

The 1 249 contracts held at 31 December 2008 commit the Company to buy and sell Australian Dollars Euros Saudi Arabian Riyals South African Rand Swedish Krona, Singapore Dollars Swiss Francs and US Dollars at various dates between 2009 and 2015 for a total net payment of £1 514m If these same contracts had been entered into on 31 December 2008 the Company would have been committed to buy and sell Australian Dollars Euros Saudi Arabian Riyals, South African Rand Swedish Krona Singapore Dollars Swiss Francs and US Dollars for a net payment of £1 902m

21 Related party transactions

As the Company is a wholly owned subsidiary of BAE Systems plc the Company has taken advantage of the exemption contained in FRS 8 - Related Party Disclosures, and has therefore not disclosed transactions or balances with wholly owned subsidiaries which form part of the Group

Related party transactions for the year ended 31 December 2009 were as follows

	Amounts owed by related party	
	2009 £m	2008 £m
Gripen International KB	55	-

22 Ultimate parent undertaking

The ultimate parent company is BAE Systems plc a company incorporated in Great Britain and registered in England and Wales

The consolidated accounts of BAE Systems plc are available to the public and may be obtained from

6 Carlton Gardens
London SW1Y 5AD

Website
www baesystems com

Notes to the accounts (continued)

23 Employee share schemes

Options over shares of the ultimate parent undertaking BAE Systems plc have been granted to employees of the company under various schemes Details of the terms and conditions of each share option scheme are given in the Remuneration Report in the BAE Systems plc Annual Report 2009

Executive Share Option Scheme (ExSOS)

	2009		2008	
	Number of shares '000	Weighted average exercise price £	Number of shares 000	Weighted average exercise price £
Outstanding at 1 January	3,313	3 33	4,986	3 21
Exercised during the year	(300)	2 15	(1 433)	2 80
Lapsed during the year	(400)	4 43	(240)	4 03
Outstanding at 31 December	2,613	3 33	3 313	3 33
Weighted average remaining life (years)	5		5	
Range of exercise price of outstanding options (£)	1 72 4 57		1 72 - 4 57	
Expense / (credit) recognised for the year (£k)	296		(180)	

Save-As-You-Earn Scheme

	2009		2008	
	Number of shares 000	Weighted average exercise price £	Number of shares 000	Weighted average exercise price £
Outstanding at 1 January	3,035	1 56	6 213	1 25
Exercised during the year	(3,032)	1 56	(3,087)	0 94
Lapsed during the year		-	(91)	1 22
Outstanding at 31 December	3	1 56	3 035	1 56
Weighted average remaining life (years)			1	
Range of exercise price of outstanding options (£)	1 56		0 93 - 1 56	
Expense recognised for the year (£k)	227		643	

	Share Matching Plan (SMP)		Restricted Share Plan (RSP)		Performance Share Plan (PSP)	
	2009	2008	2009	2008	2009	2008
	Number of shares '000	Number of shares 000	Number of shares '000	Number of shares '000	Number of shares '000	Number of shares 000
Outstanding at 1 January	243	15	3	31	3,499	3 416
Granted during the year	1,097	229	-	-	1,805	1 045
Exercised during the year	-	-	(3)	(24)	(758)	(800)
Lapsed during the year	(53)	(1)	-	(4)	(316)	(162)
Outstanding at 31 December	1,287	243	-	3	4,230	3 499
Weighted average remaining life (years)	2	2	-	-	4	4
Weighted average fair value of options granted (£)	3 41	4 79	-	-	2 81	3 76
Expense / (credit) recognised for the year (£k)	273	273	(15)	(4)	1,772	1 007

The exercise price for the PSP RSP & SMP is £nil (2008 £nil)

The fair value of equity-settled awards granted in the year has been measured using the weighted average inputs below and the following valuation models

PSP – Monte Carlo
RSP – Dividend valuation model

	2009	2008
Range of share price at date of grant (£)	32 3 - 3 43	4 56 - 4 79
Exercise price (£)	-	-
Expected option life (years)	3 – 4	3 – 4
Volatility	34%	25 – 32%
Spot dividend yield	4 2%	2 4 3 9%
Risk free interest rate	1 7%	3 0 - 4 4%

Volatility was calculated with reference to the Group s weekly share price volatility after allowing for dividends and stock splits for the greater of 30 weeks o for the period until vest date

The Group s average share price in the year was £3 44 (2008 £4 33)