Annual Report 2000

BAE SYSTEMS

Contents

Overview of 2000

2000 has been an exciting and exacting year in successfully bringing together two outstanding companies to form a global systems, defence and aerospace company. The integration of British Aerospace and Marconi Electronic Systems is now delivering the planned synergies. This combined business has grown the order book 12% in the year to close at £41.0bn.

A significant issue affecting the 2000 results is the major reassessment of the Nimrod contract, which resulted in a charge of £300m. This has the impact of reducing diluted earnings per share[1] from 25.8p to 19.2p (1999 27.6p).

Important achievements during the year included:

- £1.6bn acquisitions of the US-based Control Systems and AES electronics businesses from Lockheed Martin
- Agreement to form an integrated joint Airbus company to manage the entire Airbus business effective from 1 January 2001
- Strong operating cash flow of £1.9bn, more than covering the cost of the US acquisitions
- Launch by Airbus of the A380 family of 480–650 seater long range aircraft

Looking to the future the results in 2001, excluding restructuring provisions, are expected to be broadly unchanged compared with the underlying performance in 2000 before the Nimrod charge. This has arisen from a downturn in UK MoD engineering order intake together with lower than planned Hawk export orders. A resumption of growth in 2002 and beyond is confidently anticipated as the company benefits from its investments in the US and from Airbus growth, together with the progression of Eurofighter Typhoon and naval programmes into the production phase.

Order book
£41.0bn
up 12%

Sales
£12.2bn
down 2%[3]

Operating cash flow
£1.9bn
up 196%[3]

Profit[2]
£950m
down 15%[3]

Net debt
£899m
up 9%

Dividend per share
8.5p
up 6%

1 Before goodwill amortisation and exceptional items.
2 Profit before interest, goodwill amortisation and exceptional items.
3 Compared to published 1999 pro forma results.

Chairman's letter to **shareholders**

Dear Shareholders,

The first full year of trading for BAE SYSTEMS has been one of contrasts. Your company has achieved its key long standing objective of being a world leader in systems, defence and aerospace. In the short-term, however, we have had to face some significant challenges.

BAE SYSTEMS has successfully completed a fundamental restructuring to maximise value following the merger in 1999 of British Aerospace and Marconi Electronic Systems. The anticipated synergies for 2000 from this transaction have been realised ahead of plan at £60m.

However, during the course of the year the immediate outlook for our Programmes business group became more difficult. The company experienced difficulties on the Nimrod programme and a detailed review completed at the end of 2000 identified the need for higher costs to complete the programme. This has led to a £300m charge against operating profits in 2000. Against these difficulties, we have made headway on the programme, which will deliver a system of unrivalled capability to the customer. Importantly, agreement has been reached with the UK MoD for through-life support of the programme, which has the potential to double the scale of this business and generate good returns.

Order intake from the UK MoD is falling short of expected levels which, with lower than anticipated Hawk export orders, is resulting in a lower level of activity. As a consequence, capacity (primarily in Programmes) is being reduced, and a restructuring programme has resulted in exceptional charges to profits for 2000 and 2001. This restructuring programme, which was announced in January 2001, will strengthen the business as it bridges the period between production of Tornado and Eurofighter Typhoon military aircraft.

The combination of these business prospects means that underlying results in 2001, before goodwill amortisation and exceptional items, are expected to remain broadly unchanged compared with 2000 before the Nimrod charge. A resumption of growth in 2002 and beyond is confidently anticipated.

BAE SYSTEMS is a well-balanced company underpinned by a strong order book, robust balance sheet and good cash generation.

Progress has been made in other areas. The Avionics and North America business groups are expected to deliver good profitable growth - the latter boosted by the acquisitions in 2000 of the Control Systems and AES electronics businesses of Lockheed Martin. At the year end, and following these major acquisitions in the US, the company employed some 23,000 people in North America and has emerged as an important competitor in the key US aerospace and defence market.

Recovery in the Operations business group is expected to continue, and a strong order book is driving good forward momentum in our International Partnerships business group.

Airbus continues to be outstandingly successful in the large commercial jet market and this success is now reflected in the financial performance of the business. Further benefits are anticipated from the already announced restructuring of Airbus as an integrated joint company, which became effective on 1 January 2001.

BAE SYSTEMS is a well-balanced company underpinned by a strong order book and robust balance sheet. We have low levels of debt and this enabled us to move quickly with the Control Systems and AES acquisitions. The £1.6bn acquisition cost of these businesses was more than covered by our operating cash flow for the year.

This has been a year of great change across the whole of the business and I would like to extend my thanks to all members of the BAE SYSTEMS team for their combined contribution, which has ensured that we can now build from a solid base.

Sir Richard Evans
Chairman
28 February 2001

Chief executive's review

Through the course of 2000, BAE SYSTEMS has undergone a transformation. Not many years ago, the company would have been best recognised as a UK-based aircraft manufacturer. The strategy to transform the company into a global systems, defence and aerospace business was substantially achieved during 2000. BAE SYSTEMS is now a business with excellent global coverage and high levels of capability in delivering integrated system solutions for our customers.

As these integrated system solutions become ever more complex, the defence market is consolidating around fewer, higher value programmes. It is these programmes, which often involve high levels of international participation, that are dictating much of the shape of the defence and aerospace industry going forward. The systems skills and capabilities necessary to deliver such solutions lie at the heart of BAE SYSTEMS and we are now ideally placed to participate fully in these major programmes.

From an operational perspective, 2000 has been a year of contrasts. On the one hand, the integration of the business has gone extremely well. A progressive management structure is now in place, many of the cultural issues of integrating the two businesses are well advanced and, importantly, we are now delivering the planned synergies.

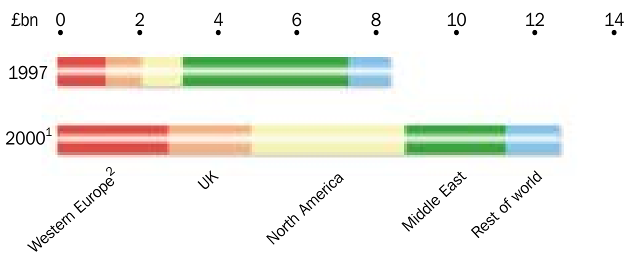
On the other hand, there has been the disappointment of a market downturn on Hawk export and on UK MoD orders, and a material reassessment of Nimrod. An in-depth review has been undertaken on Nimrod, providing us with a good level of assurance that adequate allowance has been made for any potential loss on this contract. Lessons have been learned and a series of measures have been undertaken to avoid repetition of this problem.

Within the rest of the business, we have continued to make good progress. The agreement with our partner EADS to form an integrated joint Airbus company to manage the Airbus business became effective 1 January 2001. Airbus is entering a phase of strong, profitable growth built on a forward order book of 1,626 aircraft valued at $121bn. In addition, further growth will be achieved with the launch of the A380 family of very large, long range aircraft typically seating 480-650 passengers. The new Airbus company, into which we are transferring our wing manufacturing facility in return for a 20% interest, will

John Weston, Chief executive standing in front of the 12,500 tonne auxiliary oiler Wave Knight at its launch in September 2000.

At the heart of BAE SYSTEMS lie the systems skills and capabilities necessary to deliver the ever more complex integrated system solutions demanded by our customers.

Geographic diversity - sales by destination



The re-balancing of the geographic spread of BAE SYSTEMS from a company heavily dependent on both Middle East exports and the UK market, to a company with good positions in all principal market sectors, including a strong presence in the US, has been a major achievement.

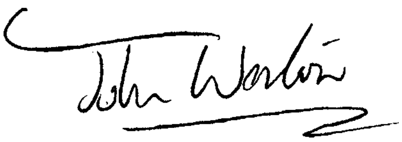
generate substantial savings and enhance customer focus from a streamlined organisation and result in a significant uplift in value for BAE SYSTEMS.

The acquisition of the US-based Control Systems and AES electronics businesses from Lockheed Martin is a major step forward. These businesses, which were acquired for a total of $2.3bn (£1.6bn), make BAE SYSTEMS a significant competitor in the key US defence market. The AES business complements BAE SYSTEMS existing surveillance, information and electronics systems and further enhances our ability to meet the growing electronics systems requirements of our customers. The Control Systems business extends our established flight controls business and adds an industry-leading presence in digital control systems.

Good progress has been made in developing other parts of our portfolio with the acquisitions of the US-based businesses of Watkins Johnson and Femtometrics for a total of $73m (£45m) as well as the disposal of non-core businesses, which raised £115m. Further non-core disposals were announced subsequent to the year end with the agreements to sell our majority stake in BAE SYSTEMS Canada and our Florida-based Flight Simulation and Training business.

Order book at the year end is again strong at £41bn, benefiting from a £1.2bn contract to design, develop, manufacture, test and deliver the first three Type 45 destroyers for the Royal Navy, and from the strong market performance of Airbus.

This is a high technology company that thrives on the innovation, commitment and drive of its people. I am proud to head such a team and would like to extend my thanks to all of our employees for their support in a year of significant change.



John Weston
Chief executive
28 February 2001

Michael Lester,
Group legal director

Sir Charles Masefield,
Group marketing director

Steve Mogford,
Chief operating officer

George Rose,
Group finance director

Mike Turner,
Chief operating officer

Notes
1 includes a full year of the US-based Control Systems and AES businesses on a pro forma basis
2 excluding UK

Operating and financial review

In the emerging defence market, we are increasingly focusing on providing customers with integrated system solutions.

Growth and our markets

BAE SYSTEMS continues to pursue its strategy of focus on its core skills in systems, defence and aerospace.

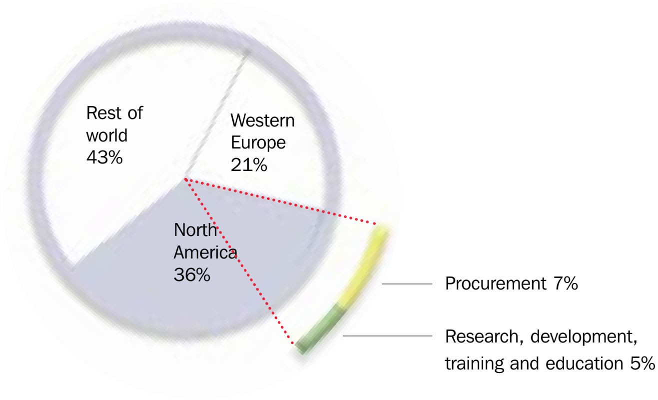
Defence spending world-wide is flat, but within that overall spend there are growth opportunities. Many customers are working to achieve savings within their organisations. This is enabling procurement to grow at around 2.4%, and outsourcing of defence services is growing at over 5%. BAE SYSTEMS targets sectors within that market where opportunities for growth are apparent, for example by identifying opportunities to improve market share, or by focusing on areas where there are changes in priorities within the overall defence spend. The acquisition of the US-based Control Systems and AES businesses is part of this strategy for growth.

The world's largest defence markets are the US and Western Europe. In Western Europe, overall defence budgets have now stabilised after some years of significant decline and are expected to continue to be flat for some time. In the US, where defence spending has also declined markedly in recent years, equipment procurement is expected to show modest growth in the near term.

Speed and precision of response are important differentiators in conflict. The need to deploy an appropriate response in real time using 'Sensor to Shooter' systems is driving important growth opportunities. These systems involve the integrated management of many sub-systems and equipments from initial detection through to platforms for weapons delivery.

The US is by far the largest defence market with spend running close to twice that of the Western European nations combined. Importantly, US investment in research and development is significantly

The defence markets in Western Europe differ in scale to those in the United States, both in the volume of equipment procurement and with a greater emphasis on R&D investment.



Percentage of world defence spend

higher than in Western Europe. BAE SYSTEMS recognises that participation in the US market is a prerequisite to establishing and growing a leading position in the global defence industry.

Elsewhere, growth is apparent in defence markets such as the ASEAN region and the Middle East, albeit from a low base relative to the US and Western Europe.

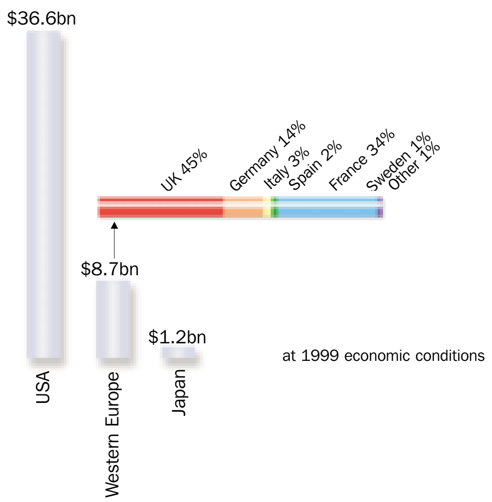
In the UK, a change in the mix of defence spending is apparent, with a greater emphasis being placed on equipment interoperability and with resources being focused on ‘front line’ capability. A number of major new programmes are being procured and planned with savings targeted through innovative approaches to cost reduction. These new programme activities, and the opportunity to involve industry in providing wide-ranging support to the armed forces at lower cost, represent good business growth opportunities.

In the global commercial aircraft market, demand for large commercial jets continues to grow strongly, supported by sustained growth in passenger traffic, which is estimated to grow by 4.9% per annum on average over the next 20 years. In addition to meeting the demand from rising passenger traffic, replacement of over 5,000 ageing large jet aircraft will be required over this period. Despite some cyclicality in ordering patterns of airlines, such growth is expected to result in demand for in the region of 14,000 aircraft of 100 seats and above.

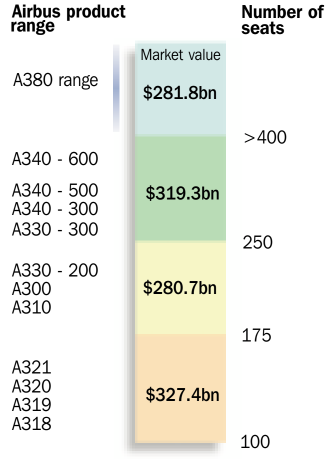
The combination of strong growth in airline markets and limited scope for increased aircraft movements at many of the world’s busiest airports is leading to demand for larger aircraft as well as the establishment of new routes requiring smaller long-range aircraft.

Airbus, which is one of only two manufacturers serving this global market, expects strong growth in airfreight traffic, fed by global manufacturing and e-commerce procurement trends.

Defence R&D expenditure



New passenger aircraft deliveries 2000-2019



Source: Airbus

The value of passenger aircraft with 100 plus seats to be delivered over the next 20 years is forecast to total $1.2 trillion. With the launch of the A380, Airbus is now able to derive value across the whole market from 100 to more than 400 seats.

In 2000 Larry Kruhmin of BAE SYSTEMS North America received a Chairman's Gold Award for Innovation for developing complex mission planning algorithms which provide automatic route collision analysis and resolution.

Emerging technologies

Many of our company's products rely on the effective use of appropriate advanced technology for their competitiveness in the global marketplace. Leading edge technology may be found in many places throughout BAE SYSTEMS, both in product applications, such as advanced radar, and also in processes where, for instance, the effective use of laser alignment is dramatically reducing the manufacturing costs of combat aircraft.

An illustration of the use of our technology during 2000 is in aircraft routing. Until recently mission planners had no reliable, fast method for generating routes that avoided mid-air collisions. Larry Kruhmin from BAE SYSTEMS North America developed a new, simplified set of calculations which divide the aircraft routes into segments and speed up the process of identifying potential collisions and working out safe routes. These calculations are in four dimensions (including a time dimension) and use spherical trigonometry. Using these algorithms, safe routes for a mission including tens of aircraft can be calculated within the same time it used to take to deconflict just two routes. Clearly, with increasing congestion on commercial airlines, this technology has wider implications.

If the success of our current products is to be sustained in the future, we must stay at the forefront of progress in science and technology. Each new generation of products necessitates access to the most advanced, appropriate technology at the relevant time. Many of the technologies that will be needed for the next generation of products are already being developed in the company's Advanced Technology Centres and in our business groups, ready for low risk deployment at the appropriate time.

A good example of this is the potential future demand for unmanned vehicles and platforms in all defence sectors. While the initial products may be remotely guided, the ultimate objective is total autonomy. To achieve this aim requires a wide range of complementary technologies. Our global reach has, for instance, allowed BAE SYSTEMS to identify leading expertise in one of these technologies in a group at Sydney University. Our links with academia through our Virtual University significantly enhance our access to knowledge.

Discoveries in science often have the potential to transform products and businesses, and even society itself. Our aim is to identify these emerging technologies at the early experimental stage in the university research laboratories. For instance, the convergence of nanotechnology - the art of fabricating ultra-miniaturised structures - with recent developments in the biosciences promises to open a whole new range of minute devices, sensors and actuators. These could transform the way in which some system functions are carried out in our products, especially in the area of ultra-small air vehicles. This technology area is being closely examined.

Overall, we aim to be the first to identify new breakthroughs and adopt them for our business advantage. We shall assure commercial protection through patenting, wherever possible.

A high performance culture

We have highly talented people, on whom the company's success depends. In leading our people, it is a high priority to provide clarity on the strategic direction and priorities of the company, to ensure that there is a high level of consistency across the group in order to maximise shareholder value. In managing the business, we seek to avoid unnecessary centralisation and we have clear, group-wide processes that avoid undue reliance on short term initiatives. These processes are contained in the BAE SYSTEMS Operational Framework, which sets out the requirements for business planning, regular contract and business reviews, as well as the implementation of Lifecycle Management (LCM).

During 2000, LCM was rolled out across the company and provides a rigorous template for assessing the performance of a contract at every stage of its maturity, from concept definition through to overall contract completion. Of particular importance is the initial bidding phase, where we have instituted a robust tender vet process to avoid contracts being accepted that do not meet the company's target returns.

The award-winning team, Ian Cockram, Ken Jackson and Simon Taylor from BAE SYSTEMS Aircraft Services Group, replaced the traditional steel reaction blocks with tungsten blocks significantly reducing vibration during riveting.

There is a strong focus on continuing to develop key skills, in particular for engineering, systems and software. The company requires that all employees have personal development reviews with their manager and agree plans where specific development needs are identified. We continue to develop group-wide opportunities for personal development and fast-track career progression.

Feedback is an important embedded principle within the company and regular employee surveys, together with 360º appraisal and peer recognition processes, are key to our development strategies. We use similar techniques in measuring performance with our customers.

We place considerable emphasis on the global recruitment of the world's best people and cultivating in them an insatiable desire to learn, to stretch and to improve. Our early-career programmes, which around 1,400 people will join in 2001, start the process of continuing career development and are the key to our future success.

We aim to provide through-life learning which includes the use of on-site learning resource centres providing a wide variety of courses and material. These centres also offer access to the resources of our Virtual University (VU). Operating in partnership with academic and research centres world-wide, the VU provides an innovative approach to acquiring and deploying knowledge throughout our business.

table 1 **Summarised financial performance**

	Year to 31 December 2000 £m	Pro forma Year to 31 December 1999 £m
Sales	**12,185**	12,389
Profit before interest[1]	**950**	1,115
Operating cash flow	**1,894**	639

	Year to 31 December 2000	Year to 31 December 1999
Diluted EPS	**19.2p[1]**	27.6p[2]
Dividend per share	**8.5p**	8.0p
Net debt	**£899m**	£825m

1 excluding goodwill amortisation and exceptional items
2 restated

Finance

The most significant issue affecting the 2000 result was the major reassessment of the Nimrod contract, which resulted in a charge of £300m. This had the impact of reducing diluted earnings per share[1] from 25.8p to 19.2p.

The company incurred total exceptional charges of £307m in the year. This covers the costs of rationalisation programmes announced in January 2001 (£109m) and in 1999 (£47m), together with the integration costs of the merger of £151m. In previous years, we have treated the interest adjustment to certain aircraft finance net present value recourse provisions as exceptional. This charge is now included within the normal interest payable by the group. The adjustment for 2000 amounted to £32m. Comparative figures have been restated accordingly.

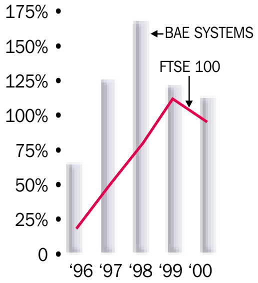
The tax charge on profits before exceptional items was £258m. This represents a 30% tax rate at this level. After the US acquisitions and Airbus restructuring, our tax-planning rate is expected to increase to 32% in 2001, with likely marginal increases thereafter. A new UK Financial Reporting Standard (FRS 19), dealing with new arrangements on deferred tax, was issued at the end of 2000 and will be addressed in our next accounts. The implementation of this standard is not expected to have a material impact on the forward tax-planning rate.

In line with the Board's confidence in the resumption of growth, a 6.25% increase in the dividend per share for the year to 8.5p (1999 8.0p) is being proposed. This dividend payment is covered 3.0 times against diluted earnings per share before taking into account the Nimrod charge.

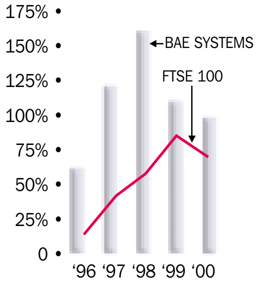
There was strong cash generation during 2000. The company ended the year with net debt of £899m, only marginally up on 1999 (£825m). This was after the payment of £1.6bn for the Lockheed Martin acquisitions. Year end net debt remains low at a prudent level of 13% of total shareholders funds, which provides us with a strong balance sheet and a consequent competitive advantage.

The group's principal currency exposure is the US$/£ Sterling exchange rate arising from the group's manufacturing and sales activities relating to commercial aircraft. US$ cover exists for 47% of the group's anticipated exposure to 2005 at rate in line with the five year planning rate. The group has an additional 20% of cover over the period to 2005, which is contingent on the path of the US$/£ Sterling exchange rate during the period.

Increase of shareholder return



Share price increase



Over the last five years BAE SYSTEMS has outperformed the FTSE 100 on both total shareholder return and share price growth.

Notes
1 January 1996 = 0
Source: Datastream

During 2000, launch aid repayments charged to the profit and loss account in respect of our Airbus programmes reduced substantially to £122m (1999 £176m). Launch aid repayment was completed in 1999 on single aisle programmes, with repayments moving onto a royalty basis from 2000. The charge to the profit and loss account for these programmes amounted to £22m (1999 £74m), while on the A330/340 programme, repayments amounted to £100m (1999 £102m).

table 2 **Segmental analysis**

	Sales		Profit/(loss)[1]	
	Year to 31 December 2000	Year to 31 December 1999 (Pro forma)	**Year to 31 December 2000**	Year to 31 December 1999 (Pro forma)
	£m	£m	**£m**	£m
Programmes	**2,415**	2,608	**3**	390
Customer Solutions & Support	**1,820**	1,958	**434**	444
International Partnerships	**1,858**	1,779	**117**	71
Avionics	**1,060**	1,184	**107**	95
North America	**1,663**	1,436	**165**	149
Operations	**1,308**	1,183	**(33)**	-
Commercial Aerospace	**2,868**	2,970	**149**	(10)
Centre	**42**	35	**8**	(24)
	13,034	13,153		
Less: intra group	**(849)**	(764)		
	12,185	12,389	**950**	1,115

1 before interest excluding goodwill amortisation and exceptional items

In March 2000, the UK government announced it was making £530m of repayable launch aid available to cover a substantial part of the UK's £2bn investment in the Airbus A380 programme. The first drawdown of funds is expected in April 2001. In September 2000, the Welsh National Assembly confirmed a package of financial support totalling up to £19.5m for the Broughton site supporting its role as the centre of excellence for Airbus wing manufacture.

The formation of the new joint integrated Airbus company results in a sharing of liabilities to repay launch aid, dependent on aircraft deliveries.

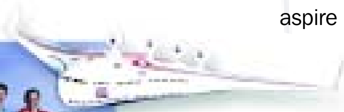
In 1999, the company issued a 3.75% Senior Unsecured Exchangeable Bond, due 2006. As at 31 December 2000, the amount outstanding was £676m (1999 £686m). In summary, the Bonds are exchangeable into the Exchange Property held by the group which, at 31 December 2000 and subsequent to Orange plc ultimately being acquired by Vodafone Group Plc during the year, represented the group's holding in the ordinary share capital of Vodafone Group Plc.

The company's acquisitions in the US account for the increase in goodwill of £1.4bn in the year. Goodwill amortisation of £373m has been charged against profits in the year, of which £328m is attributable to a full year's charge in respect of the Marconi Electronic Systems acquisition.

Our social commitments

We actively strive to comply with our responsibilities towards our people, our customers and the environment. We have developed a series of plans to enable us to achieve these objectives.

BAE SYSTEMS runs internal and external communications programmes to help raise awareness of the contribution that engineering makes to the success of the company and the global economy. We aspire to raise the status of engineering and to make the name BAE SYSTEMS synonymous with engineering excellence. The company realises that many of today's children will be tomorrow's engineers and also runs education programmes promoting science and technology to school children including school visits by some 500 BAE SYSTEMS engineers.



In an exciting project, young people worked in mixed school teams to design and model a future passenger aircraft capable of carrying more than 500 passengers. The youngsters, assisted by teachers, parents and BAE SYSTEMS employees, had to agree a final design and workshare to make a large-scale model of their concept aircraft. The smiling faces say it all, and achieving gold in the Chairman's Innovation Award confirmed it as both unique and leading edge.

BAE SYSTEMS recognises that protection of the environment requires industrial activity to be conducted in a sustainable manner. With a growing culture of environmental care, we believe that sound environmental management systems are a priority. We have developed a 'Cleaner Performance' strategy, aimed at achieving financial and environmental savings by reducing energy consumption, minimising waste and encouraging more efficient use of materials and resources.

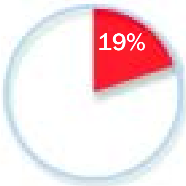
Our work in this area is well-supported by our employees and, without their participation, many of the improvements could not be made. There has been an eagerness among many members of staff to support local environmental projects.

The company runs structured fund raising through its 'Charity Challenge' activity which to date has raised in excess of £7m for good causes. The aim is to raise funds whilst at the same time providing development opportunities to employees, who contribute a significant amount of their personal time to these activities. Every 18 months a charity is selected by employees for which funds will be raised, with BAE SYSTEMS pledging £0.1m to the chosen charity. £0.7m was raised in this way for the latest charity selected, Leukaemia Research Fund. In addition, employees raise funds for charities local to their employment around the world. Approximately 50% of funds are raised each year in respect of the group's chosen charity, with the balance being raised for local charities.

Business group reviews

Business group review

Programmes
Commercial Aerospace
North America
Customer Solutions & Support
Avionics
International Partnerships
Operations



Percentage share of sales

Order book	£10.1bn
Sales	£2,415m
Profit	£3m
Number of employees	13,100

Programmes

In 2000, there was, as planned, a significant weighting of this business group's results to the second half year. This was due to the timing of Eurofighter Typhoon milestones and deliveries of Hawk aircraft.

As announced in January 2001 the Programmes business group is being restructured. This follows an unprecedented 63% shortfall in order intake for routine engineering work on in-service aircraft compared to the average of the previous three years. This, together with lower than anticipated Hawk export orders, has resulted in lower capacity requirements.

The Eurofighter production programme is progressing well with first deliveries on track to meet the planned 2002 delivery schedule. Eurofighter will be a mainstay of activity for this business group well into the next decade. There is strong interest in the aircraft from a number of export customers, including the Greek government, which has selected Eurofighter to meet its requirements.

The operating result was impacted by a £300m contract loss charge for the Nimrod programme. This programme has been analysed in depth and the charge is expected to cover all the costs of completion of the current contract. Headway has been made in other aspects of this programme, including agreeing Heads of Agreement with the UK MoD for the future through-life support of the programme, which has the potential to double the scale of this business and generate good returns.

Two major naval programmes are also set to make substantial contributions. First, assembly has now started for the first of three, next generation, Astute class attack submarines under a £1.9bn prime contract. Second, in December 2000, a £1.2bn prime contract was secured for the design and construction of the first three, of a potential class of 12, Type 45 destroyers.

The Hawk programme has seen a record year for deliveries in 2000 with aircraft deliveries to the NATO flying training programme in Canada and first deliveries to Australia. In addition, work commenced on a three-year programme to supply airframe kits to upgrade early Royal Air Force Hawk aircraft.

While work is progressing well in securing further Hawk order intake, throughput is set to reduce from current levels before deliveries to South Africa start in 2005. This is expected to result in lower profits for Programmes in 2001 and again in 2002. However, the medium term outlook for Programmes remains good, with growth expected to return in 2003. Sales in Programmes are expected to be some 40% higher in 2004 than in 2001.

Many of the company's boundary-stretching technologies are brought together in projects that define how future requirements might be addressed.
Concept definition work includes studies by the company's Future Systems Group into a replacement for the Tornado strike aircraft to enter service from 2018.

Commercial Aerospace

Our Airbus operations performed strongly in 2000 with a combination of an improved result from the partnership and better operating performance from the UK business, primarily engaged in wing design and manufacture. The latter resulted from productivity improvements and volume benefits along with the substantial reduction in launch aid repayments to the UK government in respect of the A320 family of single aisle aircraft.

Among the most notable achievements during 2000 was the agreement in June to restructure Airbus Industrie from its partnership structure, which has been in operation since its formation in 1970, to create a new joint integrated Airbus company. This new joint company, owned by BAE SYSTEMS (20%) and EADS (80%), effectively commenced trading on 1 January 2001.

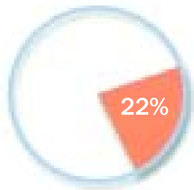
The Airbus restructuring agreement recognises higher value from delivery of the new larger wing sets for the A340-500/600 programme. Over the 10 year period to 2012, BAE SYSTEMS will receive an additional dividend, provided that specified production rates are achieved for this programme. The creation of the joint integrated Airbus company results in a sharing of liabilities to repay government launch aid, dependent on deliveries of aircraft. The net effect of this arrangement represents significant value to BAE SYSTEMS shareholders.

The restructuring of Airbus will enable significant savings to be made. The streamlined organisation heralds a new phase in the evolution of Airbus, which is entering a stage of strong, profitable growth.

Airbus continued to strengthen its position in the market during 2000. Orders for 520 aircraft were received valued at $37bn. The forward order book at the end of December 2000 amounted to 1,626 aircraft valued at $121bn. In addition, there were 50 orders for the new A380 which was formally launched in December 2000 following a period of technical and financial assessment and customer consultation. It is a family of very large, long range, aircraft typically seating 480-650 passengers. The UK government has agreed to contribute £530m of launch aid under commercially priced terms to be repaid as aircraft are delivered.

The Avro regional jet (RJ) activity sustained its recent record of achieving a break-even performance on a low volume of RJ aircraft deliveries. Although market conditions remain difficult, the order book was maintained, closing the year at 11 aircraft. Orders are being pursued for the new RJX variant, which is currently being developed.

The asset management activity continued to ensure a high utilisation of the company's aircraft portfolio and was also successful during the year in generating additional revenues by selling related services to the aircraft market.

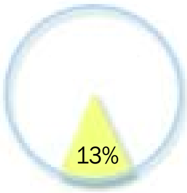


Percentage share of sales

Order book	£16.1bn
Sales	£2,868m
Profit	£149m
Number of employees	10,900

Business group review

Programmes
Commercial Aerospace
North America
Customer Solutions & Support
Avionics
International Partnerships
Operations



Percentage share of sales

Order book	£2.4bn
Sales	£1,663m
Profit	£165m
Number of employees	23,000

North America

Four acquisitions in 2000 have enhanced the company's position in the US market. Early in the year, the relatively small acquisitions of Femtometrics and Watkins Johnson expanded the company's involvement in chemical agent detection and communications equipment respectively. These additions were followed in the second half of the year by the acquisition of two former Lockheed Martin businesses, Control Systems and AES, the latter primarily comprising the Sanders electronics systems business. Together, these acquisitions contributed £6m to operating profits, consistent with a contribution of £77m on a pro forma basis for the full year.

The North American business has strong positions in information systems, defence electronics and systems integration and engineering. Combined with the capabilities of our UK-based Avionics business, the new acquisitions have established BAE SYSTEMS as a world leader in digital engine controls, flight controls, and electronic warfare solutions for both the US and Europe. With the anticipated growth in US defence spend, we are well positioned to build on the good profitability and strong cash flow of this business.

BAE SYSTEMS North America also has a strong, well-established presence in the services and support market. It is the largest single technical support contractor for the US Navy, with a legacy relationship of more than 35 years. In 2000, it was awarded a $450m contract to provide systems engineering and technical assistance for the Federal Aviation Administration's air traffic control programme.

Its strong indigenous presence allows the North American business to compete for prime contract opportunities. Such opportunities include the company's bid for the potentially large C-130 AMP avionics modernisation programme, the outcome of which is anticipated shortly.

BAE SYSTEMS is producing the F-22 Electronic Warfare suite for the US Air Force. Key team members in Nashua, N.H., include (from left) Brian Walters, Greg Griffin and Mike Dow.

Customer Solutions & Support

This business group is the largest military services and support provider in the UK and one of the leading players world-wide.

The Al Yamamah programme in Saudi Arabia integrates operational support with services capability to provide a total solutions package to the customer. This involves some 5,000 people and is expected to continue to contribute substantially to the performance of the company. Investment is planned to expand our Saudi relationships and other international prospects to support future growth.

In the UK, the MoD is well advanced in utilising innovative Private Public Partnerships (PPP) in the provision of defence support, and linked to this a successful early step was the company's financing of a synthetic training facility for flying instructors at RAF Valley.

The RAF has now gone out to tender under a similar PPP service provision to replace its ageing tanker aircraft fleet. BAE SYSTEMS and Boeing will team to support this bid and look to extend the partnership beyond the UK to the world-wide tanker aircraft market. Additionally, the company is developing a partnering approach with the UK Defence Logistics Organisation (DLO) to deliver more cost effective and efficient ways of providing integrated platform support packages. Key programmes have been identified and jointly resourced through Integrated Project Teams.

The business group has extensive training and support activity for the UK Royal Navy. We have already formed a joint venture with Vosper Thornycroft, which is being extended and developed in particular for surface ship logistic support.

During 2000, the Victoria-Class submarines were successfully introduced into the Canadian Navy. Activity is high in providing integrated logistics support capability to the major naval programmes for Astute-Class submarines and Type 45 destroyers.

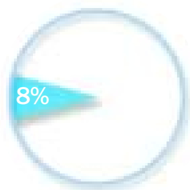
Overall, there is excellent potential to develop this business group. The activity is underpinned by strong cash flow from existing Customer Solutions & Support activities.

Percentage share of sales

Order book	£2.8bn
Sales	£1,820m
Profit	£434m
Number of employees	8,700

BAE SYSTEMS enjoys strong ties and relationships with the Kingdom of Saudi Arabia that have grown from our partnership over the last 30 years.

BAE SYSTEMS is committed to the principles of 'Saudisation' as outlined in the Kingdom's five year development plans. We achieve this through the development and delivery of comprehensive training programmes, the transfer of technology and the structured assumption of responsibility of functions by Saudi nationals across a wide spectrum of operations in support of Al Yamamah and other projects of national importance.



Percentage share of sales

Order book	£2.6bn
Sales	£1,060m
Profit	£107m
Number of employees	11,400

Avionics

In 2000, Avionics made good progress, with the Eurofighter Typhoon radar moving from the development stage into production, and the first system being delivered on schedule in early 2001. The high value-added content of Avionics-supplied equipment on each Eurofighter Typhoon aircraft will benefit this business group as aircraft production deliveries commence.

Avionics is a major supplier of equipment to other prime contractors. In 2000, the business group delivered its 1,000th primary flight control system for the Boeing 777. Avionics has substantial equipment selected on several US military aircraft programmes, including the Boeing (X-32) and Lockheed Martin (X-35) contenders in the competition to produce the next generation Joint Strike Fighter (JSF).

Strong advances were made in the aircraft displays market. During the year the business won its first production contract for a helmet mounted system, on the Tiger helicopter. In the commercial sector, to date three airlines have selected our head up displays for their Boeing 737 aircraft.

During the early weeks of 2000, the business group was awarded a contract to supply a communications system for the UK forces in the Balkans under an Urgent Operational Requirement. It delivered a solution in just 28 weeks.

Important contract awards were also achieved to update GR4 Tornado aircraft with state-of-the-art liquid crystal displays. The programme involved a close working relationship with the customer, the DLO, through an integrated project team. This was identified as one of the best examples of process within the UK MoD's Smart Procurement initiative.

One of the smallest Avionics products potentially has a large future market. The vibrating silicon gyro is a miniaturised, robust, and relatively low cost, motion sensor, which is finding applications in mass markets such as automotive, where first production contracts have now been won.

The performance of this business group is expected to benefit in 2001 from a recovery of BAE SYSTEMS Australia, for which Avionics has responsibility.

Business group review

Programmes
Commercial Aerospace
North America
Customer Solutions & Support
Avionics
International Partnerships
Operations

International Partnerships

Good progress has been made in improving the profitability of our international partnerships.

Saab AB, in which we have a 35% interest, has been enlarged as a result of its acquisition of Celsius. The enlarged business is progressing well and generating the anticipated synergy savings. BAE SYSTEMS is also partnered with Saab to offer the Gripen combat aircraft in the export market. Following early success with aircraft ordered by South Africa, strong interest has emerged in a number of other markets.

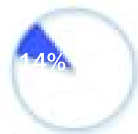
One of our larger international partnerships is the Matra BAE Dynamics (MBD) guided weapons business. MBD has a good growth outlook as future missile programmes move from the development phase to production within an order book of £2.5bn.

A significant MBD programme is Meteor, which won an important UK selection competition. Meteor is a beyond visual range, air-to-air missile (BVRAAM), which will arm Eurofighter Typhoon and other combat aircraft in Europe, from later this decade. It will be the technology leader in a wider market for this class of weapon.

In conjunction with EADS, the company's space systems activity was enhanced by the expansion of the former Matra Marconi Space (MMS) to form Astrium, in which BAE SYSTEMS now has a 27.5% economic interest. Astrium's £2.2bn order book at the end of 2000, provides a good platform for future growth.

Discussions continue with the company's partner Alenia on the restructuring of our Alenia Marconi Systems (AMS) joint venture. This restructuring involves the injection of our combat and radar systems business into AMS, and the contribution to MBD of AMS's UK and Italian-based missile business. These moves give opportunity for value creation, in both AMS and MBD, through the alignment of complementary businesses and the resultant synergies.

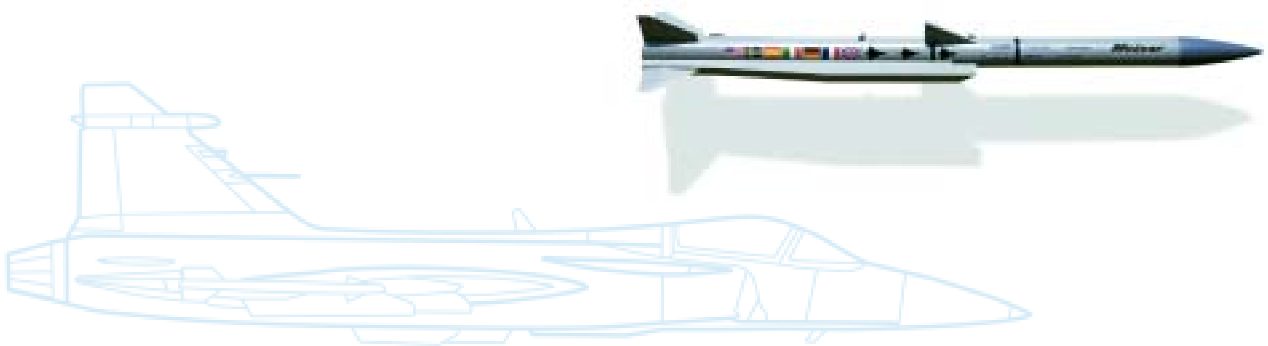
The Thomson Marconi Sonar (TMS) naval sonar systems business, in which BAE SYSTEMS has a 49.9% interest, is in discussions about a revised programme with the UK MoD for the challenging 2076 sonar.

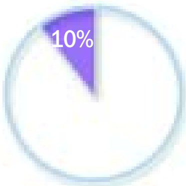


Percentage share of sales

Order book	£6.3bn
Sales	£1,858m
Profit	£117m
Number of employees[1]	18,300

[1] pro rata based on economic share





Percentage share of sales

Order book	£3.6bn
Sales	£1,308m
Loss	(£33m)
Number of employees	15,300

Operations

The Operations business is progressing in line with plan, and had strong cashflow in 2000. At the end of 1999, RO Defence (formerly Royal Ordnance) secured a long-term agreement with the UK MoD for the supply of ammunition and explosives. This agreement, valued at £1bn over a ten-year period, has enabled the business to plan against a stable workload and, with substantial restructuring, its performance is recovering.

The aerostructures activity is progressing well with the award of multi-year orders for wing sub-assemblies for Airbus and Boeing aircraft. Migration of workload from regional aircraft activities to the higher value-added, increased volumes of this activity has resulted in an underlying improvement in the near term outlook.

The shipyard operations have seen a good level of activity over the past year. In September 2000, the auxiliary oiler Wave Knight was launched and its sister vessel Wave Ruler followed in February 2001. These ships at 12,500 tonnes are the largest vessels produced for some years. During the year, the last of the Type 23 class frigates, HMS St Albans, was launched. In January 2001, the first of three offshore patrol vessels for Brunei was launched.

The commissioning of two new Frigates for the Malaysian Navy continued in-country and these high specification vessels are performing well. An important system integration milestone, the firing of their MBD-supplied Seawolf air defence missile system, was successfully achieved.

In October 2000, Operations was selected for a contract for two ALSL (Alternative Landing Ship Logistics) vessels for the Royal Navy.

The Operations business group loss included a £16m contract loss provision on landing craft. Performance improvement is expected to result from an improved quality of business in aerostructures. RO Defence and Underwater Weapons performed satisfactorily, to plan.

Tornado fin refurbishment being undertaken at Chadderton.

Spearfish torpedo under final assembly. Spearfish is the world's most advanced heavyweight torpedo. It has been developed for delivery to the UK MoD for service in the most modern submarines of the Royal Navy.

Statutory information

page

Board of directors

Executive directors

Sir Richard Evans CBE (1987)
Chairman
Assumed his current position on 1 May 1998. He joined the company in 1969 and has held a number of senior positions in the group. He was appointed non-executive chairman of United Utilities plc in 2001 having been a non-executive director since 1997.
Age 58.

John Weston CBE (1994)
Chief executive officer
Appointed Chief executive on 1 May 1998 having held a number of senior positions since joining the company in 1970. He is a member of the CBI Council, the Advisory Board to the Royal College of Defence Studies and the Council of the Royal United Services Institute.
Age 49.

Michael Lester (1999)
Group legal director
Appointed a member of the Board following the merger with the MES business. Prior to the merger he was a director and vice chairman of The General Electric Company, p.l.c. He is a non-executive director of Premier Farnell plc.
Age 60.

Sir Charles Masefield (1999)
Group marketing director
Appointed a member of the Board following the merger with the MES business. Prior to the merger he was a director of The General Electric Company, p.l.c.
Age 61.

Steve Mogford (2000)
Chief operating officer
Appointed a member of the Board on 1 April 2000. He has held a number of senior positions within the company including group managing director Programmes and Eurofighter, and managing director of the former BAe Military Aircraft and Aerostructures business.
Age 44.

George Rose (1998)
Group finance director
Appointed Group finance director on 1 April 1998 having joined the company in 1992. On completion of the creation of the new integrated joint Airbus company, he will be a member of that company's Shareholder Committee. He previously held senior positions in the Rover Group and Leyland DAF. He is a non-executive director of Saab AB and Lattice Group plc and a member of the Financial Reporting Review Panel.
Age 48.

Mike Turner CBE (1994)
Chief operating officer
A member of the Board since 1994 and a member of the Airbus Industrie GIE Supervisory Board. On completion of the creation of the new integrated joint Airbus company, he will be a member of that company's Shareholder Committee. He is a non-executive director of Babcock International Group Plc.
Age 52.

Non-executive directors

Sir Robin Biggam (1994) * †
Chairman of the Independent Television Commission and the Fairey Group plc. Also a non-executive director of British Energy Plc.
Chairman of the Nominations and Compensation Committee.
Age 62.

Professor Sue Birley (2000)
Appointed a non-executive director on 22 November 2000. Professor Birley is Professor of Entrepreneurship at Imperial College, University of London, and has held a number of academic positions at INSEAD, London Business School and Cranfield Institute of Technology. She was formerly a non-executive director of National Westminster Bank plc.
Age 57.

Keith Brown (1989) * † ~
A former managing director of Morgan Stanley Dean Witter. Chairman of the International Advisory Board Bipop - Carier (Italy). Chairman of the Racecourse Association.
Chairman of the Audit Committee.
Age 58.

Dr Ulrich Cartellieri (1999)
A member of the Supervisory Board of Deutsche Bank AG, a director of Robert Bosch GmbH, Henkel KGaA and deputy chairman of DEG, the Federal Government owned German Investment and Development Company.
Age 63.

Sir Ronald Hampel (1989) * †
Chairman of United Business Media plc, former chairman of ICI plc and a non-executive director of Aluminium Company of America.
Age 68.

Lord Hesketh KBE (1994) * †
A non-executive deputy chairman of Babcock International Group Plc. A former Government Chief Whip in the House of Lords and a Privy Councillor.
Age 50.

Paolo Scaroni (2000)
Appointed a non-executive director on 22 November 2000. Mr Scaroni is group chief executive of Pilkington plc and was formerly a non-executive director of Burmah Castrol plc.
Age 54.

Dates in brackets show the year of each director's appointment to the Board of BAE SYSTEMS plc.

* member of the Nominations and Compensation Committee
† member of the Audit Committee
~ UK government appointed director

Directors' report

The directors of BAE SYSTEMS present their report, together with the accounts, for the year ended 31 December 2000.

Change of name

The company changed its name from British Aerospace Public Limited Company to BAE SYSTEMS plc effective from 5 May 2000.

Principal activities

The principal activities of the company are the design and manufacture of civil and military aircraft, surface ships, submarines, space systems, radar, avionics, communications, electronics, guided weapon systems and a range of other defence products. Further details of the principal activities of the company and likely future developments in the business are set out in the operating and financial review on pages 6 to 20.

Research and Technology

Research and Technology has focused on key enabling technologies to meet the current and future needs of the business. This has ranged from cost and timescale reducing manufacturing technologies on current programmes, such as laser jig alignment on Eurofighter, to differentiating technologies for the next generation of products, such as radar system technologies.

The former research centres of British Aerospace (BAe) and Marconi Electronic Systems (MES) have been combined into the Advanced Technology Centre of the company linking with academia, through the Virtual University and partners to provide the technology of tomorrow. The emphasis on further developing capability in systems engineering and integration has continued.

Office of Fair Trading undertakings

As a consequence of the merger between BAe and MES, the company is required to comply with certain undertakings given to the Secretary of State for Trade and Industry. Compliance with the undertakings is monitored by an independent compliance officer who was appointed during the year. Further information regarding the undertakings and the contact details of the compliance officer may be obtained through the Company secretary at the company's registered office.

Treasury policy

The group's treasury activities are directed by the Treasury Review Management Committee (TRMC). Two executive directors are members of the TRMC, including the Group finance director who is the chairman. The TRMC also has representatives with legal and taxation expertise.

The group operates a centralised treasury department that is accountable to the TRMC for managing treasury activities in accordance with the framework of treasury policies and guidelines approved by the Board. An overriding policy is that trading in financial instruments for the purpose of profit generation is prohibited, with all financial instruments being used for risk management purposes. Other key policies are:

(i) to maintain a balance between continuity of funding and flexibility through the use of borrowings with a range of maturities, currencies and fixed/floating rates of interest reflecting the group risk profile;
(ii) to maintain adequate undrawn committed borrowing facilities;
(iii) to mitigate the exposure to interest rate fluctuations on borrowings and deposits by utilising interest rate swaps, interest rate options and forward rate agreements; and
(iv) to hedge economically both contracted and anticipated foreign currency cash flows over a five year period, having first matched receipts and payments.

Within this policy framework the treasury department's principal responsibilities are:

- to manage the group's core funding and liquidity;
- to manage exposure to interest rate movements;
- to manage exposure to foreign currency movements; and
- to control and monitor bank credit risk and credit capacity utilisation.

With respect to the last point, the department transacts with an extensive range of counter-party banks and financial institutions, and adopts a systematic approach to the control and monitoring of counter-party credit risk. A credit limit is allocated to each counter-party with reference to its relevant credit rating. For internal credit risk purposes, all transactions are marked to market and the resultant exposure is allocated against the credit limit.

A Compliance Manager monitors compliance against the principal policies and guidelines (including the utilisation of credit) and is required formally to report any exceptions found to the TRMC. Further disclosure on financial instruments is set out on pages 10 and 11 of the operating and financial review and in note 30 to the accounts.

Supplier payment policy

It is group policy that each business unit is in compliance with local best practice in the country of operation in respect of supplier payment policies. Agreed payment schedules are maintained provided that the supplier complies with all relevant terms and conditions. Group policy is that changes to the agreed payment schedule are made with the prior agreement of the supplier.

In the UK it is group policy to support the CBI Prompt Payment Code regarding the payment of suppliers.

The average number of days credit provided during 2000 by suppliers was 39 days (1999 40 days). The company does not have any trade creditors.

Directors' report

Employment

The group has a programme in place to assist employees to achieve their full potential and to develop the skills necessary to meet the current and future expectations of our customers. The programme focuses on both personal and technological development within the group and is project managed by the Virtual University.

All employment policies include a commitment to equal opportunities regardless of sex, race, colour, nationality, ethnic origin, religion, age or disability, subject only to considerations of national security. The company's policy is to provide, wherever possible, employment opportunities for disabled people and to ensure that disabled people joining the company and employees who become disabled whilst in our employment benefit from training and career development opportunities.

The company has put into place a number of ways of providing employees with information on the performance of the company and other matters that affect them. The effectiveness of the communication process is assessed regularly with the aim of ensuring continual improvement so as to provide employees with the information they want by the most effective means.

Employees are actively encouraged to become shareholders in the company by way of SAYE Share Option Schemes and a Profit Sharing Scheme. Currently, over 40,000 employees participate in the company and Joint Venture SAYE Share Option Schemes and over 45,000 in the Profit Sharing Scheme.

Honours

The following individuals were honoured in the 2000 Birthday Honours and the 2001 New Year Honours lists:

OBE

Philip Lee
John Cockburn

MBE

Ian Ansell
Joseph Bennett
Richard Buchta
Julie Cadd
Murdo Ross Campbell
Robert Hartley
Frank Moyes
Robin Sleight

Safety, health and environment

The company is committed to high standards of health and safety at work and encourages active concern for the environment. There are clearly structured procedures and initiatives in place that recognise the contribution employees can make in these areas. An environmental policy is in place, and we are in year four of a five year improvement plan.

Share capital

As at 28 February 2001 the company had been advised of the following significant interests in the issued ordinary share capital of the company:

Franklin Resources, Inc and its affiliates:	6.2%
CGNU plc:	3.2%
Brandes Investment Partners, L P:	4.0%

The number of ordinary shares shown in the Register of Members as at 31 December 2000 as foreign-held pursuant to Article 43 of the company's Articles of Association was 1,128,507,283 (37.1%). Article 43 contains provisions that restrict the aggregate number of foreign-held shares at any one time to 49.5% of the issued ordinary share capital. The Articles also contain an individual shareholding restriction, which restricts any one foreign shareholder or group of related foreign shareholders to a holding of no greater than 15% of the issued ordinary share capital.

At the Annual General Meeting held on 4 May 2000 the company was given authority to purchase up to 296,889,616 of its ordinary shares. The authority will expire at the Annual General Meeting held in 2001. Although no ordinary shares have been purchased by the company during the period from 4 May 2000 to the date of this report, a resolution will be put to shareholders at this year's Annual General Meeting to renew the authority to make market purchases of the company's shares up to a maximum of 10% of the share capital of the company. Further details of the resolution will be included with the Notice of the Annual General Meeting to be enclosed with this report.

Results and dividends

The loss after taxation and minority interest was £13m (1999 profit £324m). The directors propose a final dividend of 5.2p per ordinary share, amounting to £158m, which, together with the interim dividend, amounts to a total annual dividend of 8.5p per ordinary share (1999 8.0p), at a total cost of £257m (1999 £202m). After deducting £21m, which represents the total for the preference share dividend, the total retained loss for the year is £291m (1999 profit £101m).

Post balance sheet events

Details of events which have occurred since the end of the financial year are provided in note 32 to the accounts.

Charitable donations

During 2000 the amount donated for charitable purposes in the UK was £1,213,218 (1999 £1,150,969).

It is the company's policy not to make contributions for political purposes.

Statement of directors' responsibilities

Directors
The names of the current directors are listed on page 22.

Steve Mogford was appointed as a director of the company on 1 April 2000 and elected at the Annual General Meeting held on 4 May 2000. Professor Sue Birley and Paolo Scaroni were appointed directors of the company on 22 November 2000.

Peter Gershon resigned as a director of the company on 31 March 2000.

In accordance with Article 85 of the company's Articles of Association Sir Robin Biggam, Lord Hesketh, George Rose and John Weston will retire by rotation at the Annual General Meeting, and all being eligible, will offer themselves for re-election. In accordance with Article 91, Professor Sue Birley and Paolo Scaroni will offer themselves for election.

Details of unexpired periods of service contracts for the above mentioned directors are shown in the Remuneration report on page 33.

Beneficial and non-beneficial interests, including family interests, in the share capital of the company, for those persons who were directors at the end of the financial year are detailed on page 32. There have been no changes in the beneficial or non-beneficial interests in the share capital of the company in the period from the year end to 28 February 2001. The Board is not aware of any contract of significance (other than service contracts or as disclosed in the Remuneration report or in note 5 to the accounts) in relation to the company or its subsidiaries in which any director has, or has had, any material interest. During the year the company has purchased for a number of directors and officers of group companies insurance against certain liabilities in relation to the group.

Annual General Meeting
The company's Annual General Meeting will be held on 3 May 2001. Details of the resolutions to be proposed at that meeting will be included with the Notice of the Annual General Meeting to be enclosed with this report.

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.

By order of the Board

D S Parkes
Company secretary
28 February 2001

Company law requires the directors to prepare accounts for each financial year that give a true and fair view of the state of affairs of the company and the group and of the profit or loss for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the accounts comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Corporate governance

The Combined Code, issued by the Financial Services Authority, provides principles of good governance and a code of best practice for fully listed UK registered companies.

This statement on corporate governance, together with the Remuneration report, describes the way in which the principles and practices detailed in the Combined Code are applied within the company.

The Board
A board of directors with a wide range of experience and competencies heads the company. There are presently seven executive and seven non-executive directors. The Board considers all of the non-executive directors to be independent as they are independent of the company's executive management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Sir Robin Biggam has been nominated as the senior independent director.

The Board is scheduled to meet six times each year with additional meetings called as required (nine meetings were held in 2000). All directors receive regular information on the company's operational and financial performance and the Board as a whole regularly reviews *inter alia* the group's business plan, future strategy, and risk assessment. The Board has agreed a schedule of matters that are reserved to it for decision.

The directors have adopted a number of policies and procedures to help them operate effectively. These cover, amongst other things, access to independent professional advice, training, the provision of information and the role of the Company secretary.

Separate individuals have been appointed to the positions of Chairman and Chief executive officer and there is a clear division of responsibilities between the two positions. The Chairman is responsible for the effective working of the Board and ensuring that all directors are properly informed of matters affecting the company. The Chief executive officer is responsible for all operational matters.

Directors are initially appointed by the Board. Following such appointment, the director is required to retire and seek election at the next Annual General Meeting. All directors, with the exception of the UK government appointed director, retire by rotation such that approximately one-third of the Board seeks reappointment each year. Under the company's Articles of Association the UK government has the right to appoint one director, presently Keith Brown, who is specifically excluded from the re-election provisions of the Articles. These provisions can only be changed with the authority of the UK government.

Board committees
The Board has two committees:

Audit Committee
The Audit Committee meets twice a year and its terms of reference cover reviewing the findings of the audit work undertaken by the company's auditors and the internal audit function, review of the company's accounts prior to submission to the Board and considering the appointment of the auditors and the payment of their fees. Executive directors are invited to attend meetings of the Audit Committee, however for part of every meeting the Committee also meets with the external auditors without executive directors being present.

Nominations and Compensation Committee
The Nominations and Compensation Committee is responsible for all matters relating to the engagement and remuneration of executive directors (see Remuneration report). It is also responsible for nominating, for the Board's consideration, suitable individuals for appointment to the Board.

Relations with shareholders
BAE SYSTEMS has a comprehensive investor relations programme through which the company maintains a regular dialogue with major shareholders. The Chief executive officer and Group finance director lead the programme, although the Chairman of the Nominations and Compensations Committee deals with major shareholders when there is a need for a dialogue on matters concerning the remuneration of the executive directors.

The Chief executive officer reports to shareholders at the company's Annual General Meeting on the performance of the company and the Board is present to answer questions asked by shareholders.

Compliance with the Combined Code
The company complied with the provisions of the Combined Code during the year except that, as reported above, the director appointed by the UK government is not required to submit himself for re-election.

Management of business risk
The company is committed to the protection of its assets, which include human, property and financial resources through an effective risk management process, underpinned where appropriate by insurance. The responsibility for controlling risk rests with management, which is supported by the group risk and internal audit functions. These controls enable the group to operate a policy of partial self-insurance.

Internal control

The overall responsibility for the systems of internal control within BAE SYSTEMS rests with the directors of the company. The responsibility for establishing and operating detailed control procedures lies with the Managing director of each operating business.

In order to establish benchmark processes and behaviours across the company, an 'Operational Framework' was developed and rolled out to all parts of the business during the year. This forms an important part of a continuing drive to embed internal control and risk management further into the operations of the business. The Operational Framework will also deal with areas of improvement which come to management's and the Board's attention and it will be reviewed and updated on a regular basis to incorporate these where appropriate.

The Operational Framework sets out the group's organisational structure, together with the attendant delegated authorities. It sets out management's responsibility in identifying, evaluating and managing risk, with clear procedures for the regular reporting of operational risk and performance (including financial) throughout the year. Reporting is structured to ensure that key issues are escalated through the management team and ultimately to the Board as appropriate. It has established a common framework across the company for operational and financial controls, as well as setting out key principles in terms of culture, behaviour and ethics.

The Operational Framework draws on best practice and rolls out such processes across the organisation. Lifecycle Management (LCM) is such a process. Rolled out during 2000, it now governs all aspects of project management across the business. LCM is being applied to all material projects and provides an effective control from inception (including the bid process) through to product delivery and ultimately customer support.

As disclosed elsewhere in these accounts, a material issue arose on the Nimrod programme, resulting in a contract loss of £300m being recognised this year. Lessons have been learned following an extensive review of the programme. The directors are confident that the new LCM processes would have ensured that the risks were fully analysed before the contract was entered into.

Further key processes are the Integrated Business Plan (IBP), the Quarterly Business Reviews (QBRs) and Monthly Finance Reviews. The IBP, approved annually by the Board, results in an agreed long term strategy for each business group, together with detailed near term budgets. The QBRs evaluate progress against the IBP and are chaired by the Chief operating officers. The Monthly Finance Reviews are a high level review of performance for each sector chaired by the Chief executive officer.

As in the past, the internal audit team will independently review the risk identification procedures and control processes implemented by management and it provides objective assurance as to the operation and validity of the systems of internal control through a programme of cyclical reviews. The Audit Committee, to which it reports on a regular basis, monitors its performance.

The Audit Committee reviews the corporate governance assurance procedures, together with the strategy of both the internal and external auditors, assessing their findings and monitoring actions taken. The Audit Committee is also required to review this statement on internal controls.

The directors have completed a formal review of the effectiveness of BAE SYSTEMS internal controls. In order to assist the Board in this review a formal assessment of each operating business has been undertaken, signed off by the relevant managing director, to confirm compliance against the Operational Framework, including operational and financial controls and risk management processes. This assessment, the Operational Assurance Statement, is completed every half year and includes a formal notification of the business unit's risk assessment.

In line with any system of internal control, the policies and procedures which are mandated in the Operational Framework are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The responsibility for internal control procedures within joint ventures and other collaborations rests, on the whole, with the senior management of those operations. BAE SYSTEMS normally monitors its investments and exerts influence through Board representation.

Going concern

After making enquiries, the directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Remuneration report

The Board of directors has delegated to the Nominations and Compensation Committee (the Committee) responsibility for remuneration policy and specific packages for individual executive directors and other senior executives of the company. All members of the Committee are non-executive directors and are detailed on page 22. It is chaired by Sir Robin Biggam; the Chairman and the Chief executive officer attend Committee meetings except where their individual positions and remuneration are discussed.

The Committee also has responsibility for nominating suitable candidates for appointment to the Board; when acting in this role the Chairman is also a member of the Committee.

Remuneration policy

Following the merger between BAe and MES, and as a result of the acquisitions made since then, the company has a far greater presence outside the UK than was previously the case. Consequently the Committee felt that it would be appropriate to commission independent consultants to undertake a thorough review of the total remuneration packages for executive directors and other senior executives. This review has led the Committee to look to make certain changes to the remuneration policy. The Committee's policy of setting basic salaries at median competitive levels and to reward upper quartile performance with potential upper quartile remuneration has been confirmed as a result of this review. However, it is recognised that this also needs to reflect the market in which the individual executive is generally based and to achieve this the Committee believes that the following changes should also be made:

• The maximum annual bonus for executive directors should be increased from 50% to 60% of annual basic salary. Whilst introducing this change the Committee will continue to set demanding targets against which performance will be assessed and continue to encourage executive directors to invest such bonuses in company shares through the Restricted Share Plan.

• A new Executive Share Option Scheme should be introduced to be used in place of the existing Performance Share Plan. This will provide the long term incentive element of the total remuneration package that the Committee wishes to provide for the executive directors. Shareholder approval for this new scheme will be sought at this year's Annual General Meeting and details of the new scheme will be included with the Notice of the Annual General Meeting to be enclosed with this report.

The Committee looks to structure remuneration packages so as to both incentivise and reward executives whilst maintaining an appropriate balance between long and short-term performance. Executive directors are allowed to hold external non-BAE SYSTEMS related non-executive directorships with the prior approval of the Committee and the directors may retain any fees received for such appointments.

The Board believes that the company's remuneration policy is compliant with the Combined Code which has sought to establish best practice in this area for UK companies. The Committee will continue to consult with principal shareholders when it is considering changes to the structure of the company's executive director remuneration policy.

Remuneration

Remuneration for executive directors typically consists of basic salary, a bonus based on annual performance, executive share options, participation in the long term incentive plan and retirement benefits. The following provides more detail of these elements.

Basic salary and benefits

Executive directors' salaries are reviewed each year by the Committee and adjusted to reflect performance and the competitiveness of salaries relative to the market. Information on the market for comparable management positions is obtained from independent sources and is provided to the Committee so that it can form a view as to where to position basic salaries and benefits relative to comparable companies. All reviews of salaries and benefits for executive directors are made having taken full account of the performance of the company as a whole and the pay and conditions of group employees in particular. It is the company's stated aim to create an environment with fair reward policies, which recognise and reward individual performance against business objectives; this applies equally to all employees.

The Committee has reviewed regularly the split between basic salary and performance related elements of remuneration in order properly to incentivise executive directors and believes that a significant proportion of remuneration should be based on schemes that encourage them to perform at the highest level. In addition, through the use of share based incentive schemes, it seeks to align the interests of executive directors with those of other shareholders.

Bonus Scheme

The executive directors and other senior executives participate in a Bonus Scheme that rewards those individuals if targets agreed by the Committee for Earnings Per Share (EPS) and cash performance are met.

In 2000 the Bonus Scheme was structured such that the bonus payable was equal to 5% of basic salary for the achievement of budgeted EPS targets and 25% for the achievement of more stretching EPS targets. Likewise a bonus of 10% was payable for achievement of budgeted cash levels and 20% for achieving a more stretching target. A maximum of 5% of basic salary was payable on performance against non-financial measures. Pro rata payments were payable for achievements between these targets.

As was the case in previous years, individuals who participated in the Bonus Scheme were given the option of taking the bonus partly or wholly in shares

Directors' remuneration

All figures £'000

	Executive directors									Non-executive directors						
	Sir Richard Evans	P O Gershon*	R D Lapthorne****	M Lester	Sir Charles Masefield	S L Mogford**	G W Rose	M J Turner	J P Weston	Sir Robin Biggam	Professor S Birley***	K C Brown	Dr U Cartellieri	Sir Ronald Hampel	Lord Hesketh	P Scaroni***
2000																
Basic salary	600	112	n/a	471	417	263	420	448	500	—	—	—	—	—	—	—
Fees	—	—	n/a	—	—	—	—	—	—	35	3	35	30	30	30	3
Bonus	120	—	n/a	94	83	70	84	90	100	—	—	—	—	—	—	—
Benefits	10	4	n/a	16	16	16	16	17	19	—	—	—	—	—	—	—
Relocation allowance	—	—	n/a	—	—	158	—	—	—	—	—	—	—	—	—	—
Total	**730**	**116**	**n/a**	**581**	**516**	**507**	**520**	**555**	**619**	**35**	**3**	**35**	**30**	**30**	**30**	**3**
1999																
Basic salary	520	37	243	39	35	n/a	301	302	429	—	n/a	—	—	—	—	n/a
Fees	—	—	—	—	—	n/a	—	—	—	35	n/a	35	2	30	30	n/a
Bonus	175	—	—	—	—	n/a	122	130	146	—	n/a	—	—	—	—	n/a
Benefits	10	1	11	1	1	n/a	17	17	19	—	n/a	—	—	—	—	n/a
Total	**705**	**38**	**254**	**40**	**36**	**n/a**	**440**	**449**	**594**	**35**	**n/a**	**35**	**2**	**30**	**30**	**n/a**

* Resigned 31 March 2000
** Appointed 1 April 2000
*** Appointed 22 November 2000
**** Retired 30 September 1999

The emoluments of the directors and the Chairman during the year are shown above.

The remuneration of the highest paid director, Sir Richard Evans, excluding company pension contributions, was £730,327 (1999 £704,767) or £1,096,372 including unrealised gains on share options exercised during the year (1999 £704,767).

The main benefits received by the directors consist of company cars, and petrol allowances.

Mr Mogford was paid an allowance as a result of relocating home at the company's request on his appointment to the Board on 1 April 2000.

No payments were made to former directors of the company in 2000, except for pension payments made to Mr Lapthorne (1999 £528,658 paid to Mr Kirk and £21,789 paid to Mr Gillibrand).

through the Restricted Share Plan. If an election is made to take shares through the plan, they are to be held in trust for a period of three years after which the company will give the individual an equal number of shares. The table above details cash bonuses earned in the year, and where executive directors elect to use such bonuses through the Restricted Share Plan, details of the shares held are set out on page 30.

The Committee has retained the right to vary the bonus should there be exceptional events that affect the bonus targets. Non-executive directors do not participate in the Bonus Scheme.

Long term incentive schemes

Through the Performance Share Plan, conditional awards of shares are made to executive directors. The maximum value of such awards in any one year is equal to the basic salary paid to a director, who at the end of the performance period receives a proportion of the award conditional on the performance of the company. Performance is measured relative to the other constituent members of the FTSE 100 over a three year period as follows:

- Total Shareholder Return (TSR)

This is the principal measure and, against a sliding scale, 100% of the conditional shares are awarded to directors if the company's TSR is in the top 20% of TSRs achieved by FTSE 100 companies, with 10% vesting if the TSR is in the top 50%. Intermediate positions will be calculated on a straight line pro rata basis. No awards will be made if the company's TSR performance is outside the top 50%. Awards will be made in three equal installments at the end of years three, four and five; and

Remuneration report

Restricted Share Plan

	2000				1999			
	Shares purchased and held in trust during the year	Additional shares purchased during the year to be available after three years	Shares released to the director in the period	Value of shares released in the period £*	Shares purchased and held in trust during the year	Additional shares purchased during the year to be available after three years	Shares released to the director in the period	Value of shares released in the period £*
Sir Richard Evans	**30,992**	**30,992**	**5,116**	**17,446**	26,044	21,768	4,104	17,360
G W Rose	**8,875**	**8,875**	**—**	**—**	13,524	11,304	—	—
M J Turner	**23,151**	**23,151**	**1,608**	**5,483**	14,860	12,421	—	—
J P Weston	**25,827**	**25,827**	**5,628**	**19,191**	19,506	16,304	8,404	35,549

* Value based on price on date of release from trust.

• Earnings Per Share (EPS)

EPS is used as a second measure and requires the average value of EPS excluding exceptional items over the performance period to be no less than the average value for the three years prior to the performance period.

Both sets of performance criteria must be met in order for an award to be made under the Schemes.

Both of the above measures may be adjusted for exceptional items as appropriate at the discretion of the Committee.

Prior to the introduction of the Performance Share Plan, executive directors were regularly granted share options through the Executive Share Option Scheme. Directors were granted options to the value of four times the level of their basic salary in any ten year period. The scheme is now only used in exceptional circumstances. It was used in 1999 following the MES merger to grant options to directors transferring to the company from GEC and to incentivise directors to achieve synergy cost savings resulting from the merger. In addition, it was used last year to grant options to Mr Mogford following his appointment to the Board.

Executive share options granted in 1994 and 1995 can only be exercised if growth in the pre-exceptional EPS for any three year period exceeds the sum of the increase in RPI for that period and a real growth requirement of 7.5%. Options granted to former GEC directors in 1999 are subject to similar performance criteria but the real growth requirement is 9% for any three year period. Other options granted to executive directors in 1999 are conditional upon the achievement of merger cost savings as validated by the company's auditors. Options cannot be exercised within three years of the date of grant.

Details of directors' interests in the Executive and SAYE Share Option Schemes and options and conditional awards made under the Performance Share Plan are shown on page 31. Option prices are set at the average of the middle market quotes for the three days preceding the date of their grant.

The Committee is of the opinion that to give a full statement of directors' share options would result in a statement of excessive length. It has therefore adopted the alternative recommendation proposed by paragraph A3 of the Urgent Issues Task Force Abstract 10. The company's register of directors' interests (which is open to inspection) contains full details of directors' share holdings.

Details of the Performance Share Plan rights exercised by executive directors during 2000 are shown on page 31.

The profit before dealing costs inherent in unexercised options capable of being exercised at a surplus and granted under the Executive Share Option Scheme, SAYE Share Option Scheme and rights under the Performance Share Plan as at 31 December 2000 were, subject to meeting any applicable performance criteria, as follows:

	2000	1999
	£'000	£'000
Sir Richard Evans	**1,814**	1,864
M Lester	**438**	—
Sir Charles Masefield	**387**	—
S L Mogford	**536**	n/a
G W Rose	**1,294**	1,040
M J Turner	**1,084**	1,345
J P Weston	**1,656**	4,031

At 31 December 2000 directors held the following options at prices greater than the market value of the shares:

	Option price(s)	No. of options
M Lester	4.21	223,800
Sir Charles Masefield	4.21	198,099
S L Mogford	3.98-4.21	199,579
G W Rose	4.21	199,524
M J Turner	4.21	212,921
J P Weston	4.21	237,529

The figures have been calculated by reference to a mid-market price for the company's ordinary shares at 29 December 2000 of 382p (1999 410p). The range during 2000 was 453p to 281p.

Directors' share options

	1 January 2000	Granted during the year	Exercised during the year	Lapsed during the year	31 December 2000	Weighted average exercise price £	Range of exercise prices £	Date from which exercisable	Expiry date
Executive Share Option Scheme									
Sir Richard Evans	58,060	—	—	—	58,060	1.86	1.86	05.10.98	06.10.05
P O Gershon*	212,921	—	—	212,921	—	—	—	—	—
M Lester	223,800	—	—	—	223,800	4.21	4.21	20.12.02	21.12.09
Sir Charles Masefield	198,099	—	—	—	198,099	4.21	4.21	20.12.02	21.12.09
S L Mogford**	166,195	87,940	—	—	254,135	3.82	2.75-4.21	02.10.99	21.12.09
G W Rose	435,617	—	—	—	435,617	3.05	1.22-4.21	16.03.98	21.12.09
M J Turner	397,917	—	184,996	—	212,921	4.21	4.21	20.12.02	21.12.09
J P Weston	1,227,745	—	802,276	—	425,469	3.03	1.24-4.21	03.03.97	21.12.09
SAYE Share Option Scheme									
Sir Richard Evans	9,504	—	1,924	—	7,580	2.05	1.75-2.70	01.06.01	01.01.03
M Lester	—	1,103	—	—	1,103	2.57	2.57	01.06.05	01.12.05
Sir Charles Masefield	—	633	—	—	633	2.57	2.57	01.06.03	01.12.03
S L Mogford**	4,897	—	—	—	4,897	2.85	2.71-3.21	01.06.02	01.06.05
G W Rose	8,108	633	3,464	—	5,277	1.85	1.75-2.57	01.06.01	30.11.03
M J Turner	9,127	604	1,772	—	7,959	2.16	1.75-2.90	01.06.01	30.11.05
J P Weston	7,928	1,103	1,848	—	7,183	2.10	1.75-2.90	01.06.01	30.11.05
Performance Share Plan									
Sir Richard Evans	417,710	145,631	96,311	25,595	441,435	—	—	02.05.99	01.03.07
M Lester	—	114,344	—	—	114,344	—	—	01.03.03	01.03.07
Sir Charles Masefield	—	101,213	—	—	101,213	—	—	01.03.03	01.03.07
S L Mogford**	123,648	—	—	—	123,648	—	—	02.05.99	01.03.07
G W Rose	132,168	101,941	—	6,466	227,643	—	—	02.05.99	01.03.07
M J Turner	222,245	108,786	36,034	14,818	280,179	—	—	02.05.99	01.03.07
J P Weston	271,008	121,359	59,554	14,818	317,995	—	—	02.05.99	01.03.07

* resigned 31 March 2000.

** at date of appointment.

Option prices are set at the average of the middle market quotes for the three days preceding the date of their grant and, where they have been subject to adjustment, are shown rounded to the nearest penny.

Options exercised

	Date of exercise	Number of options exercised	Number of shares sold following exercise	Realised gain on shares sold £*	Unrealised gain on retained shares £
Executive Share Option Scheme					
M J Turner	23.06.00	184,996	159,996	387,190	60,500
J P Weston	07.04.00	648,376	—	—	1,683,651
	28.04.00	153,900	153,900	366,497	—
SAYE Share Option Scheme					
Sir Richard Evans	11.01.00	1,924	—	—	5,216
G W Rose	17.03.00	1,924	—	—	5,231
	09.06.00	1,540	—	—	1,994
M J Turner	26.05.00	1,772	—	—	5,920
J P Weston	17.04.00	1,848	—	—	4,834
Performance Share Plan					
Sir Richard Evans	31.03.00	58,963	—	—	208,729
	02.05.00	37,348	—	—	152,100
M J Turner	25.05.00	36,034	—	—	149,721
J P Weston	06.04.00	36,034	36,034	134,046	—
	02.05.00	23,520	23,520	95,609	—
				983,342	2,277,896

* Shares were sold immediately on exercise of options. Gain before dealing costs.

The total realised gain on shares sold in 1999 was £111,720. The total unrealised gain on retained shares was £57,537.

Remuneration report

Directors' interests

	At 1 January 2000*						At 31 December 2000					
	Shares	Share Options	Restricted Share Plan**	Warrants	Conditional awards of shares under the Performance Share Plan	Capital Amortising Loan Stock	Shares	Share Options	Restricted Share Plan**	Warrants	Conditional awards of shares under the Performance Share Plan	Capital Amortising Loan Stock
Sir Robin Biggam	888	—	—	—	—	—	888	—	—	—	—	—
Professor S Birley*	—	—	—	—	—	—	—	—	—	—	—	—
K C Brown	8,884	—	—	88	—	—	38,884	—	—	—	—	—
Dr U Cartellieri	—	—	—	—	—	—	—	—	—	—	—	—
Sir Richard Evans	246,521	67,564	26,884	1,503	417,710	—	390,193	65,640	52,760	—	441,435	—
Sir Ronald Hampel	3,108	—	—	31	—	—	3,232	—	—	—	—	—
Lord Hesketh	6,000	—	—	—	—	—	6,000	—	—	—	—	—
M Lester	456,428	223,800	—	—	—	144,157	458,123	224,903	—	—	114,344	144,692
Sir Charles Masefield	22,537	198,099	—	—	—	1,354	22,967	198,732	—	—	101,213	1,354
S L Mogford*	54,885	171,092	3,777	—	123,648	—	55,566	259,032	3,777	—	123,648	—
G W Rose	96,499	443,725	11,304	—	132,168	—	109,383	440,894	20,179	—	227,643	—
P Scaroni*	—	—	—	—	—	—	—	—	—	—	—	—
M J Turner	167,502	407,044	15,037	—	222,245	—	221,378	220,880	36,580	—	280,179	—
J P Weston	128,843	1,235,673	26,376	170	271,008	—	811,595	432,652	46,575	—	317,995	—

* At date of appointment.

** Matching shares only.

Mr Lester acquired a non-beneficial interest in 14,860,000 ordinary shares and 5,190,100 CALS during the year which were still held at the year-end.

The executive directors, in common with all employees of the company, have an interest in the unallocated shares held in employee share ownership trusts. As at 31 December 2000 261,495 (1999 95,324) such shares were held in the ESOP trust, 320,791 (1999 189,128) shares in the Profit Sharing Scheme trust and 4,178,935 (1999 8,227,044) shares in the BAE SYSTEMS QUEST.

Personal shareholding policy

The Committee has agreed a policy whereby all executive directors are required to establish and maintain a minimum personal shareholding equal to 100% of basic salary. As a minimum standard this must be achieved as quickly as possible from shares vested from the annual bonus, exercised through the Executive Share Option Scheme or Performance Share Plan, by using 50% of the shares that vest or 50% of the options which are exercised on each occasion. Thereafter, executive directors will be expected to increase their personal shareholding gradually, on each occasion using 25% of the shares that vest or 25% of the options exercised each year, until a personal shareholding equal to 200% of annual salary is achieved and maintained. These limits are reviewed periodically.

Post retirement benefits

The executive directors are members of group pension schemes and have a normal retirement age of 60, with the exception of Mr Lester and Sir Charles Masefield who have a normal retirement age of 62.

Of the executive directors, Mr Rose is affected by the Inland Revenue earnings cap on approved pensions and has an unapproved pension arrangement to top up his benefits from the approved schemes.

Mr Rose's unapproved arrangement is partly funded and partly unfunded. The accrued benefits shown on page 33 include the benefits from the approved and unapproved arrangements.

Details of pensions earned by the directors are shown on page 33.

Mr Gershon resigned as a director of the company on 31 March 2000. He was affected by the Inland Revenue earnings cap and had an unapproved pension arrangement to top up his benefits from the approved scheme. The unapproved pension arrangement is partly funded and partly unfunded. No contributions were made to the funded arrangement in the year. The unfunded pension payable by the company to Mr Lapthorne amounted to £77,389 during the year (£19,463 in 1999).

Service contracts

All the executive directors have contracts requiring the company to give not less than 12 months' notice of termination. Sir Richard Evans, Mr Weston, Mr Rose and Mr Turner have contracts requiring them to give the company not less than six months notice of termination. All of the other executive directors are required to give not less than 12 months notice of termination.

Post retirement benefits

	Age	Directors' contributions in the year* £	Amount of additional pension accrued in 2000 payable at normal retirement age £	Accrued pension at 31.12.2000 payable at normal retirement age* £
Sir Richard Evans	58	29,910	48,599	380,760
P O Gershon	54	3,361	4,737	165,272
M Lester	60	14,133	33,801	310,550
Sir Charles Masefield	61	20,760	80,813	278,000
S L Mogford	44	13,057	41,709	124,484
G W Rose	48	4,575	39,929	122,360
M J Turner	52	19,365	79,435	255,847
J P Weston	49	24,910	33,667	235,696

* As at 31 March 2000 for Mr Gershon.

- The amount of additional pension in 2000 excludes any increase for inflation.
- On death before retirement, a lump sum is payable equal to 4 times basic salary plus the director's own contributions. A survivor's pension (if applicable) would also be payable equal to two thirds of the pension that the director would have accrued had he stayed in service until normal retirement age. If the director has an eligible child or children, a further pension would be payable.
- On death after retirement, the pension benefits are paid in the same proportions as described above, based on the pension payable at the date of death. A lump sum will be paid if the director dies within 5 years of retirement equal to the pension payments that would have been made during the remainder of the 5 year period if the director had not died.
- The executive directors do not have a right to an early retirement pension.
- Pensions in payment increase by the lower of 5% per annum and the change in the RPI.
- There are no discretionary benefits.

It is the Board's policy that non-executive directors do not have service contracts. They are proposed by the Committee and appointed by the Board on the basis of their experience to provide independent judgement on issues of strategy, performance, resources and standards of conduct. Fees payable to non-executive directors are recommended to the Board by the Committee chairman after discussion with the executive directors. The level of non-executive director's fees is set after reviewing practice in other comparable companies.

Both of the executive directors retiring by rotation at the Annual General Meeting have service contracts requiring the company to give not less than 12 months' notice of termination and the individual six months. Sir Robin Biggam and Lord Hesketh are also retiring by rotation at the Annual General Meeting but are non-executive directors and do not have service contracts. Professor Birley and Mr Scaroni are offering themselves for election, and being non-executive directors they also do not have service contracts.

Directors' interests

As at 31 December 2000 the directors of the company and their families had the beneficial interests in the company's securities as shown on page 32.

There have been no changes in the interests of the directors between 31 December 2000 and 28 February 2001.

By order of the Board

Sir Richard Evans
Chairman
28 February 2001

Report of the auditors on the accounts

Auditors' report to the members of BAE SYSTEMS plc

We have audited the accounts on pages 36 to 65.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report. As described on page 25 this includes responsibility for preparing the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the accounts, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the group is not disclosed.

We review whether the statement on pages 26 and 27 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority, and we report if it does not. We are not required to consider whether the directors' statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the company and the group as at 31 December 2000 and of the loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

Chartered Accountants
Registered Auditor

London

28 February 2001

Index to the accounts

Consolidated profit and loss account

for the year ended 31 December	Notes	Continuing operations Ongoing 2000 £m	Continuing operations Acquisitions 2000 £m	Total 2000 £m	Restated* Total 1999 £m
Sales	2	**12,055**	**130**	**12,185**	8,929
Less: adjustment for share of joint venture sales	2	**(2,539)**	**—**	**(2,539)**	(1,886)
Turnover	2	**9,516**	**130**	**9,646**	7,043
Operating costs	3				
Excluding goodwill amortisation and exceptional items		**(8,722)**	**(117)**	**(8,839)**	(6,274)
Goodwill amortisation		**(323)**	**(7)**	**(330)**	(43)
Exceptional items	6	**(288)**	**—**	**(288)**	(210)
		(9,333)	**(124)**	**(9,457)**	(6,527)
Operating profit/(loss)		**183**	**6**	**189**	516
Share of operating profit/(loss) of joint ventures					
Before goodwill amortisation and exceptional items		**143**	**—**	**143**	(6)
Goodwill amortisation		**(43)**	**—**	**(43)**	(20)
Exceptional items		**(19)**	**—**	**(19)**	—
		81	**—**	**81**	(26)
Profit before interest	2				
Excluding goodwill amortisation and exceptional items		**937**	**13**	**950**	763
Goodwill amortisation and exceptional items		**(673)**	**(7)**	**(680)**	(273)
		264	**6**	**270**	490
Interest	4				
Net interest arising on activities excluding exceptional items		**(105)**	**(9)**	**(114)**	(33)
Share of net interest of joint ventures		**23**	**—**	**23**	24
Exceptional finance charges	6	**—**	**—**	**—**	(22)
		(82)	**(9)**	**(91)**	(31)
Profit/(loss) on ordinary activities before taxation	2				
Excluding goodwill amortisation and exceptional items		**855**	**4**	**859**	754
Goodwill amortisation and exceptional items		**(673)**	**(7)**	**(680)**	(295)
		182	**(3)**	**179**	459
Tax	7				
Tax on profit excluding exceptional items				**(258)**	(177)
Tax on exceptional items				**72**	46
				(186)	(131)
(Loss)/profit on ordinary activities after taxation				**(7)**	328
Equity minority interests	26			**(6)**	(4)
(Loss)/profit for the financial year				**(13)**	324
Dividends	8				
Equity: ordinary shares				**(257)**	(202)
Non-equity: preference shares				**(21)**	(21)
				(278)	(223)
Retained (loss)/profit	24			**(291)**	101
Basic earnings per share	9				
Including goodwill amortisation and exceptional items				**(1.1p)**	16.2p
Excluding goodwill amortisation and exceptional items				**19.2p**	29.4p
Diluted earnings per share	9				
Including goodwill amortisation and exceptional items				**(1.1p)**	15.6p
Excluding goodwill amortisation and exceptional items				**19.2p**	27.6p

* see note 1.

Balance sheets

as at 31 December	Notes	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Fixed assets					
Intangible assets	10	**7,356**	6,365	**—**	—
Tangible assets	11	**2,356**	2,167	**59**	35
Investments	12				
Share of gross assets of joint ventures		**5,676**	5,208		
Share of gross liabilities of joint ventures		**(4,988)**	(4,573)		
Share of joint ventures		**688**	635		
Others		**40**	25	**4,124**	3,575
		728	660		
		10,440	9,192	**4,183**	3,610
Current assets					
Stocks	13	**1,536**	1,559	**8**	8
Debtors due within one year	14	**2,210**	3,647	**5,325**	4,636
Debtors due after one year	14	**573**	512	**162**	189
Investments	15 & 28	**1,159**	1,713	**580**	1,084
Cash at bank and in hand	28	**1,475**	811	**734**	355
		6,953	8,242	**6,809**	6,272
Liabilities falling due within one year					
Loans and overdrafts	16 & 28	**(2,397)**	(2,025)	**(1,029)**	(886)
Creditors	18	**(4,743)**	(4,871)	**(8,203)**	(7,083)
		(7,140)	(6,896)	**(9,232)**	(7,969)
Net current (liabilities)/assets		**(187)**	1,346	**(2,423)**	(1,697)
Total assets less current liabilities		**10,253**	10,538	**1,760**	1,913
Liabilities falling due after one year					
Loans	16 & 28	**(1,063)**	(1,155)	**(464)**	(536)
Creditors	18	**(619)**	(542)	**(2)**	(2)
		(1,682)	(1,697)	**(466)**	(538)
Provisions for liabilities and charges	19	**(1,319)**	(1,396)	**—**	(38)
	2	**7,252**	7,445	**1,294**	1,337
Capital and reserves					
Called up share capital	23	**143**	140	**143**	140
Shares to be issued	24	**—**	255	**—**	2
Share premium account	24	**341**	212	**341**	212
Statutory reserve	25	**202**	202	**202**	202
Other reserves	24	**5,440**	5,212	**199**	216
Profit and loss account	24	**1,026**	1,339	**409**	565
Shareholders' funds					
Equity: ordinary shares		**6,886**	7,091	**1,028**	1,068
Non-equity: preference shares	23	**266**	269	**266**	269
		7,152	7,360	**1,294**	1,337
Equity minority interests	26	**100**	85	**—**	—
		7,252	7,445	**1,294**	1,337

Approved by the Board on 28 February 2001 and signed on its behalf by:

J P Weston — Chief executive officer

G W Rose — Group finance director

Consolidated cash flow

for the year ended 31 December	Notes	2000 £m	1999 £m
Net cash inflow from operating activities			
Operating profit		**189**	516
Tangible fixed assets depreciation and impairment		**309**	211
Goodwill amortisation		**330**	43
Profit on disposal of fixed assets		**(29)**	(4)
Movement in provisions for liabilities and charges *excluding deferred tax*		**(215)**	(116)
Decrease/(increase) in working capital:			
Stocks		**47**	100
Debtors		**1,620**	122
Creditors		**(580)**	(409)
Customer stage payments		**223**	(44)
		1,894	419

Cash flow statement

	Notes	2000 £m	1999 £m
Net cash inflow from operating activities		**1,894**	419
Dividends from joint ventures		**18**	30
Returns on investments and servicing of finance	29	**(97)**	(62)
Taxation	29	**(59)**	(81)
Capital expenditure and financial investment	29	**(283)**	(132)
Acquisitions and disposals			
Acquisitions - Lockheed Martin businesses		**(1,560)**	—
Acquisitions - MES	29	**—**	(1,357)
Acquisitions - other		**(45)**	(18)
Disposal of subsidiary undertakings and joint ventures	12	**115**	42
Equity dividends paid		**(202)**	(100)
Net cash outflow before financing and management of liquid resources		**(219)**	(1,259)
Management of liquid resources	29	**497**	234
Financing	29	**(123)**	1,686
Net increase in cash available on demand		**155**	661

	Notes	2000 £m	1999 £m
Reconciliation of net cash flow to net movement in net funds			
Net increase in cash available on demand		**155**	661
Net decrease in liquid resources		**(497)**	(234)
Decrease/(increase) in other loans included within net funds		**194**	(957)
Change in net funds from cash flows		**(148)**	(530)
Investments, loans and finance leases assumed on acquisition of MES		**—**	(435)
Other non cash movements	28	**48**	27
Net decrease in net funds		**(100)**	(938)
Net funds at 1 January		**(726)**	212
Net funds at 31 December	28	**(826)**	(726)
Reconciliation to movement in net debt as defined by the group			
Net decrease in net funds		**(100)**	(938)
Decrease/(increase) in cash on customers' account		**26**	(83)
Net movement for the year	28	**(74)**	(1,021)

Other group statements

Statement of total recognised gains and losses

for the year ended 31 December

	2000 £m	1999 £m
(Loss)/profit for the financial year		
Group, excluding joint ventures	**(91)**	339
Joint ventures	**78**	(15)
Total (loss)/profit for the financial year	**(13)**	324
Currency translation on foreign currency net investments, including joint ventures	**(20)**	(9)
Revaluation of current asset investment	**—**	563
Impairment of land and buildings	**(14)**	(10)
Other recognised gains and losses relating to the year (net)	**(34)**	544
Total recognised gains and losses relating to the year	**(47)**	868

Note of historical cost profits and losses

for the year ended 31 December

	2000 £m	1999 £m
Reported profit before tax on ordinary activities	**179**	459
Difference between historical cost and revalued amount:		
Depreciation on land and buildings	**2**	2
Historical cost profit before tax on ordinary activities	**181**	461
Historical cost (loss)/profit for the year retained after tax, minority interests and dividends	**(289)**	103

Reconciliation of movements in shareholders' funds

for the year ended 31 December

	2000 £m	1999 £m
(Loss)/profit for the financial year	**(13)**	324
Dividends	**(278)**	(223)
	(291)	101
Other recognised gains and losses relating to the year (net)	**(34)**	544
New share capital subscribed	**—**	29
Merger reserve arising on the issuance of shares relating to the MES acquisition	**—**	4,336
Shares to be issued in relation to the MES acquisition	**—**	255
Issuance of shares to QUEST	**17**	7
Exercise of share options, warrants and dividend scrip issue	**100**	68
Net (decrease)/increase in shareholders' funds	**(208)**	5,340
Opening shareholders' funds	**7,360**	2,020
Closing shareholders' funds	**7,152**	7,360

Notes to the accounts

1 Accounting policies

Basis of preparation
The accounts are drawn up in accordance with applicable accounting standards under the historical cost convention as modified by the revaluation of certain land and buildings and the treatment adopted in respect of the valuation of certain current asset investments (note 17). Financial Reporting Standard 15 - Tangible Fixed Assets and Financial Reporting Standard 18 - Accounting Policies have been adopted for the first time in these accounts. As permitted by FRS 15 the company's policy in respect of the revaluation of tangible fixed assets is to continue to carry those assets which have been subject to prior period revaluations at their depreciated revalued amounts, but not to undertake any revaluation of tangible fixed assets in this or future reporting periods. Financial Reporting Standard 17 - Retirement Benefits and Financial Reporting Standard 19 - Deferred Tax were both issued by the Accounting Standards Board close to the end of 2000, and will be addressed in the preparation of the 2001 accounts.

As required by the Companies Act 1985 the directors have adopted the true and fair override in respect of the accounting for the Exchange Property (see note 17).

The profit and loss account presentation of certain adjustments to exceptional net present value provisions has been amended, and prior years restated, as described on page 41.

Basis of consolidation
The accounts of the group consolidate the results of the company and its subsidiary undertakings, and include its share of its joint ventures' results on the gross equity method, all of which are made up to 31 December.

The acquisition method of accounting has been adopted. Under this method, the results of businesses acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition, or up to the date of disposal. Goodwill arising on consolidation, and on acquisition of joint venture interests, is capitalised in respect of all acquisitions from 1 January 1998 and amortised on a straight line basis through the profit and loss account over its estimated useful economic life, based upon assessments of the durability of markets, product ranges and projected future profitability of the businesses concerned. Prior to 1998, goodwill was either capitalised and amortised through the profit and loss account or was written off directly to reserves depending upon the circumstances of each acquisition. 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 the gross amount of any related goodwill previously written off directly to reserves or the net amount of goodwill remaining unamortised, as appropriate.

Company accounts
In the company's accounts, all fixed asset investments (including subsidiary undertakings and joint ventures) are stated at cost (or valuation in respect of certain listed investments) less provisions for permanent diminutions. Dividends received and receivable are credited to the company's profit and loss account to the extent that they represent a realised profit for the company. In accordance with Section 230(4) of the Companies Act 1985 the company is exempt from the requirement to present its own profit and loss account. The amount of the profit for the financial year of the company is disclosed in note 24 to these accounts.

Revenue recognition
Sales comprise the net value of deliveries made, work completed or services rendered during the year and include the group's net share of sales of joint ventures. Sales are recognised when title passes or a separately identifiable phase of a contract or development has been completed. Turnover represents sales made by the company and its subsidiary undertakings, excluding the group's share of sales of joint ventures.

Profit is recognised at the time of sale. In the case of contracts with extended delivery programmes, it is arrived at by reference to the estimated overall profitability of the contract and appropriate provision is made for any losses in the year in which they are first foreseen.

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.

For consolidation purposes the assets and liabilities of overseas subsidiary undertakings and joint ventures are translated at the closing exchange rates. Profit and loss accounts of such undertakings are consolidated at the average rates of exchange during the year. Exchange differences arising on these translations are taken to reserves.

Aircraft financing
The group is exposed to actual and contingent liabilities arising from commercial aircraft financing, both from financing arranged directly by the group and from that arranged by third parties where the group has provided guarantees or has other recourse obligations. Provision for these risks is made on a systematic basis, having regard to the ability to re-lease or re-sell the underlying aircraft.

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

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 using the following rates:

Buildings	— 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
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.

Leases
Assets obtained under finance leases are included in tangible fixed assets at cost and are depreciated over their useful economic lives, or the term of their lease, whichever is shorter. Future installments under such leases, net of finance charges, are included within loans.

1 Accounting policies continued

Rental payments are apportioned between the finance element, which is charged as interest to the profit and loss account, and the capital element, which reduces the outstanding obligation for future installments, so as to give a constant rate of charge on the outstanding obligation.

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.

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

Long term contracts – 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. Appropriate provisions are made for any losses in the year in which they are first foreseen. Work in progress relating to long term contracts is stated at cost less provision for anticipated losses.

Development properties – The net realisable value is based on advice received from independent valuers and assumes the grant of relevant planning consent but excludes any development profit.

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.

Financial instruments
The group uses derivative financial instruments to hedge its exposures to fluctuations in interest and foreign exchange rates. Instruments accounted for as hedges are designated as a hedge at the inception of contracts. Receipts and payments on interest rate instruments are recognised on an accruals basis, over the life of the instrument. Gains and losses on foreign currency hedges are recognised on maturity of the underlying transaction, other than translational hedges of foreign currency investments which are taken to reserves. Gains and losses arising from retiming of foreign exchange transactional cover are deferred to match the maturity of the underlying exposure. Gains or losses arising on hedging instruments which are cancelled due to the termination of underlying exposure are taken to the profit and loss account immediately. Finance costs associated with debt issuances are charged to the profit and loss account over the life of the instruments.

Short term debtors and creditors that meet the definition of a financial asset or liability respectively have been excluded from the FRS 13 analysis where permitted by that Standard.

Launch costs
The costs of launching an aircraft project fall into two principal categories: design, development and education; and jigs and tools.

Design, development and education – In the case where the project is fully funded by the group, the expenditure is charged to the profit and loss account as incurred. In the case where the project has specific external funding, the relevant expenditure is carried forward within stocks and amortised by reference to an assessment of sales.

Jigs and tools – Expenditure on jigs and tools is capitalised into fixed assets and depreciated over its useful life.

Externally funded launch aid
Externally funded launch aid has been provided to the group for various Airbus projects from both HM Government and certain financial institutions. In all cases repayments are made by way of levies on aircraft sales, with any outstanding amounts included in creditors.

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. Provision for deferred tax is made using the liability method to the extent that the net deferred tax asset or liability is likely to crystallise in the foreseeable future.

Pensions and other post retirement benefits
The expected cost of providing pensions and other post retirement benefits, as calculated periodically by independent actuaries, is charged to the profit and loss account so as to spread the cost over the expected average remaining service lives of current employees. The group operates several pension schemes providing benefits based on final pensionable pay. The assets of the schemes are held separately from those of the group.

Share options
In accordance with Urgent Issues Task Force Abstract 25 - National Insurance Contributions on share option gains - the company provides in full for the employers national insurance liability estimated to arise on the future exercise of share options granted.

The company has taken advantage of the exemption offered in Urgent Issues Task Force Abstract 17 - Employee Share Schemes from charging to the profit and loss account the 20% discount offered to employees partaking in such company operated schemes.

Restatement of results
As described in note 20, long term recourse provisions are established on a discounted net present value basis, and accordingly an adjustment is made in the year, and charged to interest, to maintain the net present value of these provisions. In prior years that part of the adjustment relating to provisions established as exceptional items had been treated as an exceptional charge within interest. The directors have reconsidered this presentation in the light of the more common treatment of such adjustments to discounted provisions and accordingly this charge is now included within the normal interest payable for the group. The presentation of comparative 1999 figures has been restated in consequence and in accordance with FRS 18.

There is no net impact on profit reported for the year, or on net assets. The adjustment for 2000, amounting to £32m, is included within the net interest charge of £114m as disclosed in note 4. The 1999 adjustment amounted to £36m and is re-presented within the net interest charge of £33m for that year. The associated tax credit of £10m (1999 £11m) and the earnings per share excluding exceptionals and goodwill amortisation have been restated for this change of presentation. The effect of the change is to reduce profit before tax excluding goodwill amortisation and exceptional items by £32m (1999 £36m).

Notes to the accounts

2 Segmental analysis

Analysis by business group

	Sales		Turnover		Sales to JVs		Share of JV sales		Intra group sales	
		Restated		Restated		Restated		Restated		Restated
	2000	1999	**2000**	1999	**2000**	1999	**2000**	1999	**2000**	1999
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m	**£m**	£m
Programmes	**2,415**	2,599	**2,348**	2,499	**632**	864	**699**	964	**93**	136
Customer Solutions & Support	**1,820**	1,712	**1,783**	1,712	**24**	18	**61**	18	**37**	31
International Partnerships	**1,858**	983	**150**	149	**18**	12	**1,726**	846	**33**	—
Avionics	**1,060**	317	**1,132**	334	**74**	17	**2**	—	**319**	72
North America	**1,663**	202	**1,667**	204	**34**	2	**30**	—	**29**	23
Operations	**1,308**	731	**1,331**	755	**23**	24	**—**	—	**269**	280
Commercial Aerospace	**2,868**	2,970	**2,048**	1,980	**1,400**	1,220	**2,220**	2,210	**57**	55
Centre	**42**	16	**36**	11	**5**	5	**11**	10	**12**	4
	13,034	9,530	**10,495**	7,644	**2,210**	2,162	**4,749**	4,048	**849**	601
Less: intra group	**(849)**	(601)	**(849)**	(601)						
	12,185	8,929	**9,646**	7,043						

	Profit/(loss) before tax excluding exceptional items		Profit/(loss) before tax		Goodwill amortisation		Net assets	
		Restated		Restated		Restated		Restated
	2000	1999	**2000**	1999	**2000**	1999	**2000**	1999
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Programmes	**3**	390	**(112)**	260	**19**	3	**(114)**	85
Customer Solutions & Support	**434**	409	**426**	409	**2**	2	**68**	601
International Partnerships	**117**	33	**92**	33	**51**	29	**927**	976
Avionics	**107**	1	**65**	1	**130**	13	**2,527**	2,743
North America	**165**	22	**159**	22	**162**	13	**4,596**	3,224
Operations	**(33)**	(67)	**(87)**	(135)	**6**	2	**64**	408
Commercial Aerospace	**149**	(10)	**141**	(10)	**—**	—	**(58)**	(176)
Centre	**8**	(15)	**(41)**	(27)	**3**	1	**141**	409
Profit before goodwill and interest	**950**	763	**643**	553	**373**	63	**8,151**	8,270
Less: goodwill	**(373)**	(63)	**(373)**	(63)				
interest	**(91)**	(9)	**(91)**	(31)		Less: debt	**(899)**	(825)
Profit before tax	**486**	691	**179**	459		Net assets	**7,252**	7,445

Following the merger with MES in 1999 the business sectors reported for segmental purposes have now been revised to reflect the new company organisation. The business sectors follow the company's business group management control and reporting structure. Comparative figures have been restated in consequence.

Sales are stated after the inclusion of £4,749m (1999 £4,048m) in respect of the group's share of joint venture sales and after the elimination of sales made to the joint ventures of £2,210m (1999 £2,162m).

Rental income in 2000 from aircraft operating leases included within turnover is £62m (1999 £80m).

Net assets include dividends declared by the business groups.

The allocation of exceptional items to business groups is analysed further in note 6.

Included within the North America business group results are the results of the Lockheed Martin businesses acquired in 2000. These results are disclosed separately on the face of the profit and loss account on page 36.

The company's principal joint venture interests comprise those in the International Partnerships business group, and its interest in Airbus Industrie GIE (AI), and related AI entities, within the Commercial Aerospace Business Group. The company's share of AI's sales was £2,220m (1999 £2,135m), its share of AI's profit before interest was £22m (1999 loss £54m), and its share of AI net liabilities was £111m (1999 £140m).

Centre includes profits arising on the sale of development properties and sundry business disposals.

2 Segmental analysis continued

Analysis by geographical location

	Geographical destination				Geographical origin					
	Sales		Turnover		Sales	Turnover	Profit before interest*		Net assets	
							Excl JVs	*Inc JVs*	*Excl JVs*	*Inc JVs*
	2000	1999	**2000**	1999	**2000**	**2000**	**2000**	**2000**	**2000**	**2000**
	£m	£m	**£m**	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
United Kingdom	**2,135**	1,471	**1,751**	1,250	**6,666**	**7,690**	**214**	**204**	**4,149**	**4,138**
Rest of Europe	**2,914**	2,522	**2,439**	2,416	**3,611**	**96**	**1**	**89**	**59**	**740**
Middle East	**2,579**	2,461	**2,326**	2,225	**—**	**—**	**—**	**—**	**—**	**—**
USA and Canada	**3,166**	1,522	**2,209**	711	**1,720**	**1,708**	**7**	**8**	**2,364**	**2,367**
Australasia and Pacific	**536**	443	**510**	345	**127**	**102**	**(35)**	**(33)**	**5**	**10**
Other	**855**	510	**411**	96	**61**	**50**	**2**	**2**	**(7)**	**(3)**
	12,185	8,929	**9,646**	7,043	**12,185**	**9,646**	**189**	**270**	**6,570**	**7,252**

* Including goodwill amortisation and exceptional items.

Turnover, profit before interest and net assets (excluding joint ventures) originated in the main from the United Kingdom during 1999.

3 Operating costs

	Ongoing 2000 £m	Acquired 2000 £m	**Total 2000 £m**	1999 £m
Raw materials and other bought in stock	4,097	6	**4,103**	3,763
Change in stocks of finished goods and work in progress	(345)	56	**(289)**	(163)
Staff costs (note 5)	2,851	42	**2,893**	1,652
Depreciation, amortisation and impairment	629	10	**639**	254
Net provisions created (excluding pensions and deferred tax)	590	(2)	**588**	175
Other operating charges	1,634	13	**1,647**	934
Other operating income	(123)	(1)	**(124)**	(88)
	9,333	124	**9,457**	6,527

Included within the above analysis are the following expenses:

	2000 £m	1999 £m
Operating lease charges – within other external charges		
Plant and machinery	**5**	4
Other, including aircraft	**119**	135
Exceptional items (note 6):		
Change in stocks of finished goods and work in progress	**—**	4
Staff costs	**113**	51
Depreciation, amortisation and impairment	**3**	22
Net provisions created	**111**	117
Other external charges	**61**	16

Research and development expenditure was £1,503m (1999 £871m) of which £516m (1999 £178m) related to joint ventures.

The remuneration of the group's principal auditors for the year ended 31 December 2000 for statutory audit work was £3,028,000 (1999 £2,989,000), including £525,000 (1999 £512,000) in relation to the company. In addition £14,307,000 (1999 £9,046,000) was paid in the United Kingdom to the principal auditors and their associates in respect of non-audit work. This related to corporate transactions, tax advisory and compliance work, consultancy services and support in establishing compliance with the Office of Fair Trading undertakings. £1,913,000 (1999 £597,000) was paid overseas.

Notes to the accounts

4 Interest

	2000 £m	Restated* 1999 £m
Interest receivable and similar income	**149**	107
Interest payable and similar charges:		
On bank loans and overdrafts	**(48)**	(25)
On finance leases	**(2)**	(2)
On bonds and other financial instruments	**(181)**	(77)
Adjustment to exceptional net present value provisions	**(32)**	(36)
Net interest arising on activities excluding exceptional items and joint ventures	**(114)**	(33)
Share of net interest of joint ventures	**23**	24
Exceptional finance charges relating to the MES acquisition (note 6)	**—**	(22)
	(91)	(31)

* As set out in note 1, the adjustment to the exceptional net present value provisions of £32m (1999 £36m) is now included within the net interest charge excluding exceptional items and joint ventures. In prior years the adjustment was included as an exceptional interest charge.

5 Employees and directors

The weekly average and year end numbers of employees were as follows:

	Weekly average		At year end	
	2000 Number '000	1999 Number '000	**2000 Number '000**	1999 Number '000
Programmes	**14.0**	15.3	**13.1**	15.3
Customer Solutions & Support	**8.5**	7.8	**8.7**	8.3
International Partnerships	**1.6**	1.7	**1.5**	1.7
Avionics	**13.0**	5.2	**11.4**	13.6
North America	**20.9**	2.5	**23.0**	16.8
Operations	**15.7**	7.7	**15.3**	16.7
Commercial Aerospace	**10.1**	9.7	**10.9**	9.8
Centre	**1.1**	0.6	**1.1**	1.2
Group employees excluding joint venture employees	**84.9**	50.5	**85.0**	83.4

The aggregate payroll costs of group employees excluding joint venture employees were:

	2000 £m	1999 £m
Wages and salaries	**2,467**	1,405
Social security costs	**208**	116
Other pension costs (note 27)	**218**	131
	2,893	1,652

Included within the above 2000 amounts are £37m wages and salaries, £3m social security costs, and £2m other pension costs relating to acquired businesses.

The increase in other pension costs in 2000 compared to prior year is due primarily to the impact of the MES acquisition in November 1999, and additional pension levies incurred in 2000 arising as a result of redundancies in the group's rationalisation programmes.

Total directors' emoluments, excluding company pension contributions, were £4,309,496 (1999 £2,688,694). No amounts were paid this year or last year to past directors relating to pensions other than those disclosed in the Remuneration report. Fuller disclosures on directors' remuneration are set out in the Remuneration report on pages 28 to 33.

Transactions

At 31 December 2000 there was an aggregate balance of £229,688 (1999 £71,477) outstanding on house purchase loans made to, or arranged for, five officers (1999 three officers) to assist with their relocation at the company's request.

6 Exceptional items

	2000 £m	Restated* 1999 £m
Exceptional loss included within profit before interest		
2000 rationalisation programme	**(109)**	—
1999 defence sector rationalisation	**(47)**	(198)
MES integration costs	**(151)**	(12)
	(307)	(210)
Exceptional finance charges		
Finance charges relating to the MES acquisition	**—**	(22)
Net exceptional loss included within profit before tax	**(307)**	(232)

* see note 1.

2000 rationalisation programme

As a result of capacity excesses across a number of business groups a rationalisation programme has been initiated.

The total cost of this rationalisation is estimated at £225m before a tax credit of £52m, of which £109m (including joint ventures charges of £19m) before a tax credit of £23m (joint ventures £nil) has been charged at 31 December 2000. The balance is expected to be charged in 2001. The associated net cash outflow in 2000 amounted to £33m.

1999 defence sector rationalisation

On 24 June 1999 the group announced a rationalisation of defence sector activities including redundancy programmes across a number of business units.

The total cost of this rationalisation was estimated at that time at £250m before a tax credit of £60m, of which £198m before a tax credit of £43m was charged at 31 December 1999. The profit and loss impact of this rationalisation has been finalised in 2000 with £47m charged before a tax credit of £12m. There was an associated net cash outflow of £84m related to this rationalisation programme.

BAe/MES integration costs

Following the merger of BAe and MES on 29 November 1999 the group has embarked on a process of integrating this business within the enlarged organisation. Costs in 2000 associated with this process amounted to £151m before a tax credit of £37m. A net cash outflow of £125m arose in 2000 in respect of these costs.

Further integration costs are expected to be incurred in the next two financial years.

The profit & loss account impact of these exceptional charges by business group is as follows:

Charged in 2000	2000 rationalisation programme £m	1999 defence sector rationalisation £m	MES integration costs £m	Total £m
Programmes	90	12	13	115
Customer Solutions & Support	—	—	8	8
International Partnerships	19	—	6	25
Avionics	—	—	42	42
North America	—	—	6	6
Operations	—	35	19	54
Commercial Aerospace	—	—	8	8
Centre	—	—	49	49
Total	109	47	151	307

In 1999, the 1999 defence sector rationalisation costs were incurred in Programmes (£130m) and Operations (£68m), and MES integration costs and finance charges were incurred in Centre.

7 Tax

	2000 £m	Restated* 1999 £m
Current year UK corporation tax at 30% (1999 30.25%)	**(185)**	(170)
Prior year UK corporation tax (charge)/credit	**(12)**	114
Deferred tax (charge)	**(5)**	(104)
Overseas tax	**(30)**	(4)
Joint ventures	**(26)**	(13)
Tax on the results excluding exceptional items	**(258)**	(177)
Tax on exceptional items	**72**	46
	(186)	(131)

* The current year UK corporation tax charge includes a credit of £10m (1999 £11m) related to the adjustment made to exceptional net present value provisions (see note 1). In prior years such adjustments were presented as exceptional interest charges and in consequence the associated tax credits were presented within the net tax credit arising on exceptional items.

8 Dividends

	2000 £m	1999 £m
Equity dividends		
Interim 3.3p dividend per ordinary share paid (1999 3.0p)	**99**	53
Final 5.2p dividend per ordinary share proposed (1999 5.0p)	**158**	149
	257	202
Non-equity dividends		
7.75p dividend per preference share	**21**	21
	278	223

Notes to the accounts

9 Earnings per share

	2000 Basic & diluted £m	Restated* 1999 Basic £m	Restated* 1999 Diluted £m
(Loss)/profit for the financial year	**(13)**	324	324
Preference dividends	**(21)**	(21)	—
Earnings including goodwill amortisation and exceptional items	**(34)**	303	324
Add back goodwill amortisation (notes 10 & 12)	**373**	63	63
Exceptional items (note 6)	**307**	232	232
Tax on exceptional items (note 7)	**(72)**	(46)	(46)
Earnings excluding goodwill amortisation and exceptional items	**574**	552	573
Basic earnings per share			
Including goodwill amortisation and exceptional items	**(1.1p)**	16.2p	
Excluding goodwill amortisation and exceptional items	**19.2p**	29.4p	
Diluted earnings per share			
Including goodwill amortisation and exceptional items	**(1.1p)**		15.6p
Excluding goodwill amortisation and exceptional items	**19.2p**		27.6p

* As described in note 1, the adjustment made to exceptional net present value provisions of £32m (1999 £36m) is now presented within net interest arising. This represents a change from prior periods where such adjustments were presented as exceptional interest charges, and the 1999 figures have been restated accordingly.

As a result, the earnings per share excluding goodwill amortisation and exceptional items for 1999 has been restated.

In accordance with FRS 14 the 2000 diluted earnings per share calculations are without reference to adjustments in respect of options, warrants and preference shares, as assumed conversion would be anti-dilutive.

The reconciliation of the weighted average number of shares used in calculating basic earnings per share and that used in calculating diluted earnings per share is as follows:

	2000 Number m	1999 Number m
Weighted average number of shares used in calculating basic earnings per share	**2,992**	1,876
Incremental shares in respect of options, warrants and preference shares	**—**	197
Weighted average number of shares used in calculating diluted earnings per share	**2,992**	2,073

Earnings per share is calculated by reference to earnings excluding goodwill amortisation and exceptional items in addition to that required by FRS 3 as the directors consider that this gives a more appropriate indication of underlying performance.

10 Intangible fixed assets

Goodwill arising from acquisition of subsidiary undertakings:

	Group £m
Cost or valuation	
At 1 January 2000	6,420
Additions (note 12)	1,374
MES fair value adjustments (note 12)	3
Disposals	(26)
Exchange adjustments	(30)
At 31 December 2000	7,741
Amortisation	
At 1 January 2000	55
Amortisation charge	330
At 31 December 2000	385
Net book value	
At 31 December 2000	**7,356**
At 31 December 1999	6,365

Goodwill represents the excess of the fair value of the consideration given over the fair value of the separable net assets acquired.

Goodwill arising on joint ventures is set out in note 12.

11 Tangible fixed assets

	Group			Company		
	Land and buildings £m	Plant and equipment £m	Total £m	Land and buildings £m	Plant and equipment £m	Total £m
Cost or valuation						
At 1 January 2000	1,346	2,822	4,168	42	9	51
Additions	69	305	374	—	27	27
Arising on acquisitions	173	358	531	—	—	—
Disposals	(34)	(181)	(215)	—	—	—
Stock transfers	—	9	9	—	—	—
Exchange adjustments	8	13	21	—	—	—
At 31 December 2000	1,562	3,326	4,888	42	36	78
Depreciation and impairment						
At 1 January 2000	276	1,725	2,001	8	8	16
Disposals	(15)	(128)	(143)	—	—	—
Arising on acquisitions	88	246	334	—	—	—
Impairment adjustment	14	—	14	—	—	—
Depreciation charge	46	263	309	2	1	3
Exchange adjustments	5	12	17	—	—	—
At 31 December 2000	414	2,118	2,532	10	9	19
Net book value						
At 31 December 2000	**1,148**	**1,208**	**2,356**	**32**	**27**	**59**
At 31 December 1999	1,070	1,097	2,167	34	1	35

The amounts above at 31 December 2000 include:

Capitalised finance leases:						
Cost	—	391	391	—	27	27
Accumulated depreciation	—	188	188	—	5	5
Depreciation charge	—	50	50	—	1	1
Assets let under operating leases:						
Cost	103	69	172	—	—	—
Accumulated depreciation	12	31	43	—	—	—
Non-depreciated assets	190	115	305	—	—	—
Net book value of:						
Freehold property	1,057	—	1,057	10	—	10
Long leasehold property	70	—	70	4	—	4
Short leasehold property	21	—	21	18	—	18
Plant and machinery	—	921	921	—	—	—
Fixtures, fittings and equipment	—	287	287	—	27	27
	1,148	1,208	2,356	32	27	59

11 Tangible fixed assets continued

Land and buildings comprise:

- freehold and long leasehold land and buildings owned by the group as at 30 June 1996, excluding certain overseas properties, revalued at that date. The majority of the group's operational properties at that time were valued on a depreciated replacement basis, due 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;
- short leaseholds at cost;
- additions subsequent to 30 June 1996 at cost; and
- land and buildings owned by subsidiary undertakings acquired since 30 June 1996 at fair value at the date of acquisition.

Following the adoption this year of 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

	Group £m	Company £m
At valuation – 1996	547	11
At cost or fair value at acquisition included in gross cost	1,015	31
	1,562	42

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

	Group £m	Company £m
Historical cost	1,297	37
Depreciation	(300)	(13)
Net book value		
At 31 December 2000	**997**	**24**
At 31 December 1999	903	26

The depreciation charge for the year, based on the historical cost, would have been £44m for the group (1999 £46m).

12 Fixed asset investments

	Joint ventures					
	Share of net assets £m	Purchased goodwill £m	Carrying value £m	Own shares £m	Others £m	Total £m
Group						
Net book value						
At 1 January 2000	(146)	781	635	12	13	660
Arising at acquisition	(18)	18	—	—	—	—
Additions	1	—	1	24	10	35
Share of results, after tax	121	—	121	—	—	121
Disposals	—	—	—	(16)	(3)	(19)
Joint venture funding	(11)	—	(11)	—	—	(11)
Dividends	(18)	—	(18)	—	—	(18)
MES fair value adjustments	(21)	21	—	—	—	—
Amortisation charge	—	(43)	(43)	—	—	(43)
Foreign exchange movement	3	—	3	—	—	3
At 31 December 2000	(89)	777	688	20	20	728

	Subsidiary undertakings £m	Own shares £m	Others £m	Total £m
Company				
Cost or carrying value				
At 1 January 2000	3,550	12	13	3,575
Additions	544	24	—	568
Disposals	—	(16)	(3)	(19)
At 31 December 2000	4,094	20	10	4,124

Joint ventures – share of net assets	**2000 £m**	1999 £m
Share of gross assets		
Fixed assets	**1,715**	1,730
Current assets	**3,961**	3,478
	5,676	5,208
Share of gross liabilities		
Liabilities due within one year	**3,585**	2,889
Liabilities due after one year	**1,403**	1,684
	4,988	4,573
Share of net assets	**688**	635

12 Fixed asset investments continued

Businesses acquired – 2000	Control Systems				AES			
	Acquired book value £m	Accounting policy alignment £m	Provisional fair value adjustment £m	Provisional fair value £m	Acquired book value £m	Accounting policy alignment £m	Provisional fair value adjustment £m	Provisional fair value £m
Tangible fixed assets	21	(9)	—	12	187	(14)	(10)	163
Stocks	49	(7)	(3)	39	80	(1)	(37)	42
Debtors and deferred tax	30	—	(2)	28	334	(31)	(8)	295
Creditors	(33)	—	—	(33)	(138)	(39)	—	(177)
Provisions	(26)	—	(23)	(49)	(34)	—	(15)	(49)
	41	(16)	(28)	(3)	429	(85)	(70)	274
Cash paid				346				1,179
Other costs of acquisition				16				57
Goodwill arising				365				962

Total goodwill arising	
Control Systems	365
AES	962
Businesses acquired 1999 – MES	24
Other acquisitions	65
	1,416
Goodwill allocation	
Subsidiaries	1,377
Joint ventures	39
	1,416

Acquisition of Lockheed Martin Control Systems and Lockheed Martin Aerospace Electronics Systems (AES)
The group acquired two former Lockheed Martin businesses during 2000, the Control Systems business on 25 September for a cash purchase consideration of $510m (£346m) and the AES business on 27 November for a cash purchase consideration of $1.67bn (£1.18bn). In addition to the purchase price other costs associated with these two acquisitions totalled $105m (£73m).

Given the size of the businesses acquired, and the recent date of the acquisitions, provisional fair values have been assigned to the net assets acquired, and these will be reviewed during 2001 and amended as necessary in the light of subsequent knowledge or events to the extent that these reflect conditions as at the date of the respective acquisitions.

The key features of the adjustments made are set out below.

Accounting policies
The accounting policies previously adopted by Controls Systems and AES have been brought into line with those of the company. The most significant adjustment relates to the valuation of stock and long term contract balances, where under the Lockheed Martin policy certain elements of indirect overhead were absorbed into the work-in-progress valuations. Under the company policy such amounts are charged as incurred. As a consequence of this adjustment certain work-in-progress valuations, net of progress payments result in a net credit balance. This balance is recorded within creditors as a customer stage payment. Other significant adjustments are in relation to software costs where capitalised costs within the opening net assets have been removed in line with the company policy of charging when incurred, and the elimination of restructuring costs which had previously been capitalised.

Fair value adjustments
The key adjustments made relate to stock, creditors and provisions to reflect amounts in respect of contract risks, onerous contracts and other commitments existing as at the date of acquisition but not reflected in the acquired net assets.

Reorganisation provisions
No provisions relating to reorganisation and restructuring costs, for programmes and commitments established by the businesses prior to their acquisition, were included in the book values acquired for the Control Systems and the AES businesses.

12 Fixed asset investments continued

Profit after taxation and minority interests
The profit after taxation and minority interests for Control Systems for the period 1 January 2000 to 24 September 2000 totalled £15m (£17m for the financial year beginning 1 January 1999).

The profit after taxation and minority interests for AES for the period 1 January 2000 to 26 November 2000 totalled £39m (£46m for the financial year beginning 1 January 1999).

Other acquisitions
On 14 January 2000 the group acquired 100% of the Watkins Johnson Telecommunications Group in the US for a total consideration of £38m ($59m) cash. Goodwill arising on consolidation amounted to £25m and is being amortised over its expected useful life of 20 years. Watkins Johnson is a producer of electronic communications hardware to the US defence market.

On 3 March 2000 Saab AB, in which the group has a 35% equity interest, acquired 100% of the equity share capital of Celsius AB, a Swedish aerospace and defence company, for a cash consideration of SEK5bn (£385m). BAE SYSTEMS did not contribute cash to Saab AB in relation to this acquisition. The group's share of goodwill arising on the acquisition of Celsius by Saab AB amounted to £18m and is being amortised over its expected useful life of 20 years.

Businesses acquired – 1999
Marconi Electronic Systems (MES)

	1999				2000	
	Acquired book value £m	Accounting policy alignment £m	Provisional fair value adjustment £m	Provisional fair value £m	Revisions to fair value adjustment £m	Finalised fair value £m
Share of joint ventures	(77)	—	(31)	(108)	(21)	(129)
Tangible fixed assets	496	(39)	39	496	21	517
Stocks	404	(4)	(163)	237	(14)	223
Debtors and deferred tax	573	—	159	732	4	736
Current asset investments	40	—	30	70	(15)	55
Net cash	21	—	—	21	—	21
Creditors	(951)	—	(57)	(1,008)	30	(978)
Provisions	(156)	—	(226)	(382)	(29)	(411)
Net assets	350	(43)	(249)	58	(24)	34
Equity minority interests	(83)	—	5	(78)	—	(78)
	267	(43)	(244)	(20)	(24)	(44)
Total consideration						6,534
Total goodwill arising						6,578

Additional goodwill arising on fair value revisions

Subsidiaries	3
Joint ventures	21
	24

Acquisition of MES
The group acquired the Marconi Electronic Systems (MES) businesses from The General Electric Company, p.l.c. on 29 November 1999. As noted in the 1999 accounts, provisional fair values were assigned to the net assets acquired. These have been reviewed during 2000 with amendments made to finalise the fair value adjustments as noted in the table above.

2000 fair value amendments
The main amendments made concern creditors and provisions where amounts were included as provisional fair values in respect of contract risks, onerous contracts and other commitments. These have been updated to more accurately reflect the conditions as at the date of acquisition based on information and knowledge which has subsequently come to light during the review in 2000, and adjustments have also been made to reflect the associated taxation effects. Similar contract related adjustments have been made to the acquired net assets of the joint ventures. In addition amendments have been made to reflect the decision made during 2000 not to hold Precision Aerostructures as a business for resale, and to update the valuation of certain tangible fixed assets disposed in the period.

12 Fixed asset investments continued

Non-trading subsidiary undertakings
Included within subsidiary undertakings is the company's interest in non-trading subsidiary undertakings whose assets comprise loans to the company totalling £187m (1999 £187m) which have been offset against the cost of the company's investment.

Disposals
On 20 March 2000 the group disposed of Actuation Systems Inc. for a net cash consideration of £55m ($87m).

On 29 December 2000 the group disposed of its Avionics Power and Controls business for a net cash consideration of £60m.

Both businesses were acquired by the group as part of the acquisition of the MES businesses on 29 November 1999.

Qualifying Employee Share Ownership Trust (QUEST)
The group has a Qualifying Employee Share Ownership Trust (QUEST) for the purposes inter alia of the SAYE Share Option Scheme (1993). During the year contributions of £13m have been made to QUEST. The contributions reduced reserves of the company and the group, as outlined in note 24. The QUEST used the funds to subscribe for 8,000,000 new ordinary shares in the company issued in two tranches at the market price prevailing on the dates of issue, these being £3.95 per ordinary share on 11 May 2000 and £3.58 per ordinary share on 21 December 2000. At 31 December 2000, included within own shares is £8m (1999 £7m) representing the holding of 4,178,935 shares held at the option price. The market value of shares held at 31 December 2000 was £16m.

In the period from 1 January 2000 to 28 February 2001, 188,249 shares had been transferred to option holders exercising options under the SAYE Share Option Scheme (1993).

BAE SYSTEMS ESOP Trust Limited
Included within own shares is £12m (1999 £5m) representing a holding of 4,698,124 (1999 2,837,240) ordinary shares of 2.5p each in the company, listed on The London Stock Exchange and held by the company's wholly owned subsidiary, BAE SYSTEMS ESOP Trust Limited acting as Trustee to the BAE SYSTEMS ESOP Trust (the ESOP Trust).

The market value of the shares held at 31 December 2000 was £18m (1999 £12m).

At 31 December 2000 a total of 3,782,668 ordinary shares held in the ESOP Trust were the subject of conditional awards under the company's Performance Share Plan, of which 1,390,900 had been granted to executive directors. In addition, 883,867 ordinary shares were held in trust for employees under the rules of the company's Restricted Share Plan, 344,697 of which were held for executive directors.

Dividends on the shares held in the ESOP Trust have not been waived. Finance costs and other administrative charges are dealt with in the profit and loss account on an accruals basis.

12 Fixed asset investments continued

	Principal activities	Principally operates	Country of incorporation
Principal subsidiary undertakings			
BAE SYSTEMS (Operations) Ltd *(Held via BAE SYSTEMS Enterprises Ltd)*	Defence and commercial aerospace activities	UK	England and Wales
BAE SYSTEMS Australia Ltd *(Held via BAE SYSTEMS Australia Holdings Ltd)*	Defence and commercial aerospace activities	Australia	Australia
BAE SYSTEMS Electronics Ltd *(Held via Meslink Ltd)*	Defence electronics	UK	England and Wales
BAE SYSTEMS Marine Ltd* *(Held via VSEL Ltd)*	Shipbuilding	UK	England and Wales
BAE SYSTEMS Avionics Ltd* *(Held via BAE SYSTEMS Electronics Ltd)*	Avionics	UK	England and Wales
BAE SYSTEMS North America Inc. *(Held via BAE SYSTEMS Holdings Inc.)*	Defence systems	US	US
Royal Ordnance plc *(Held by BAE SYSTEMS plc)*	Manufacture of ammunition and weapon systems	UK	England and Wales
Principal joint ventures			
Airbus Industrie GIE (20%) *(Held via BAE SYSTEMS (Operations) Ltd)*	Commercial aerospace activities	Europe	—
Eurofighter Jagdflugzeug GmbH (33%) *(Held by BAE SYSTEMS plc)*	Management and control of Eurofighter Typhoon programme	Germany	Germany
Matra BAe Dynamics SAS (50%) *(Held via BAE SYSTEMS (France) SAS)*	Manufacture of guided weapons	France and UK	France
Panavia Aircraft GmbH (42.5%) *(Held by BAE SYSTEMS plc)*	Management and control of Tornado programme	Germany	Germany
Saab AB (35%) *(Held via BAE SYSTEMS (Sweden) AB)*	Defence and commercial aerospace activities	Sweden	Sweden
Alenia Marconi Systems NV (50%) *(Held via BAE SYSTEMS Electronics Ltd)*	Defence electronics	UK and Italy	Holland
Astrium NV (27.5% economic interest) *(Held via BAE SYSTEMS Electronics Ltd)*	Space systems	Europe	Holland
Thomson Marconi Sonar NV (49.9%) *(Held via BAE SYSTEMS Electronics Ltd)*	Underwater systems	UK and France	Holland
STN Atlas Elektronik GmbH (49%) *(Held via BAE SYSTEMS Deutschland GmbH)*	Manufacture of naval systems	Germany	Germany

The above list includes the company's principal subsidiaries and investments. It does not represent a full list of subsidiaries and investments. All holdings represent 100% of ordinary share capital, except where otherwise indicated.

* Denotes companies subject to specific OFT undertakings. Copies of these companies' accounts may be obtained from the group's Company secretary.

13 Stocks

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Long term contract balances	**2,492**	2,343	**—**	—
Less: attributable progress payments	**(2,019)**	(1,927)	**—**	—
	473	416	**—**	—
Short term work-in-progress	**927**	978	**—**	—
Less: attributable progress payments	**(148)**	(101)	**—**	—
	779	877	**—**	—
Raw materials and consumables	**135**	135	**—**	—
Finished goods and goods for resale	**128**	104	**—**	—
Development properties	**21**	27	**8**	8
	1,536	1,559	**8**	8

Included within short term work-in-progress of the group are unamortised launch costs of £344m (1999 £422m) relating to programmes supported by externally funded launch aid.

14 Debtors

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Due within one year				
Amounts recoverable under long term contracts	**1,024**	2,459	**—**	—
Trade debtors	**529**	529	**—**	—
Corporation tax recoverable	**—**	1	**25**	26
Amounts owed by subsidiary undertakings	**—**	—	**5,042**	4,490
Amounts owed by joint ventures	**142**	159	**28**	28
Other debtors	**365**	303	**190**	53
Prepayments and accrued income	**150**	196	**40**	39
	2,210	3,647	**5,325**	4,636
Due after one year				
Trade debtors	**48**	68	**—**	—
Amounts owed by joint ventures	**5**	—	**—**	—
Deferred tax (note 22)	**60**	146	**—**	—
Other debtors	**43**	80	**16**	62
Pensions	**383**	201	**138**	123
Prepayments and accrued income	**34**	17	**8**	4
	573	512	**162**	189
Total debtors	**2,783**	4,159	**5,487**	4,825

15 Current asset investments

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Investments held by fund managers	**—**	318	**—**	—
Commercial Paper	**139**	99	**—**	—
Term deposits	**262**	486	**170**	398
Exchange Property (note 17)	**676**	686	**410**	686
Other securities	**82**	54	**—**	—
Liquid current asset investments	**1,159**	1,643	**580**	1,084
Businesses held for resale	**—**	70	**—**	—
Total current asset investments	**1,159**	1,713	**580**	1,084

The Exchange Property at the time of the issue of the Exchangeable Bonds in 1999 (see note 17) was represented by the company's underlying interest in Orange plc. Subsequently, Orange plc was subject to a public offer by Mannesmann AG, which was then itself subject to a public offer by Vodafone Group Plc. The shares underlying the Exchange Property have altered as a result of this corporate activity, and at 31 December 2000 the Exchange Property represented 477 million shares in Vodafone Group Plc (1999 45 million shares in Orange plc, together with 2 million shares in Mannesmann AG).

The market value of the Exchange Property held by the group at 31 December 2000 was £1,172m (1999 £1,252m).

The market value of the Exchange Property held by the company at 31 December 2000 was £709m (1999 £1,252m).

16 Loans and overdrafts

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Due within one year				
Bank loans and overdrafts	**638**	259	**269**	130
Medium term notes	**10**	3	**—**	—
European Investment Bank loan	**16**	14	**—**	—
Capital Amortising Loan Stock	**88**	83	**88**	83
Schuldschein 9.2% bond	**—**	34	**—**	—
Exchangeable Bond (note 17)	**665**	673	**665**	673
Commercial Paper	**967**	955	**—**	—
Obligations under finance leases	**13**	4	**7**	—
	2,397	2,025	**1,029**	886
Due after one year				
Medium term notes	**40**	42	**—**	—
US$ 7% note, repayable 2007	**120**	120	**—**	—
Euro-Sterling 11⅞% bond, repayable 2008	**150**	150	**150**	150
European Investment Bank loan, final instalment 2009 (secured)	**127**	143	**—**	—
Euro-Sterling 10¾% bond, repayable 2014	**100**	100	**100**	100
US$ 7.5% bond, repayable 2027	**300**	300	**—**	—
Capital Amortising Loan Stock	**198**	286	**198**	286
Obligations under finance leases	**28**	14	**16**	—
	1,063	1,155	**464**	536

Bank loans and overdrafts are at a floating rate of interest. The medium term notes are at fixed rates of interest between 7.6% and 9.3% and are repayable between 2001 and 2002. The US Commercial Paper is at floating rates of interest, with a weighted average rate of 6.5% and is repayable between 16 and 250 days. The European Investment Bank loan weighted average fixed rate of interest is 6.39% and is secured against the net amounts payable by Airbus Industrie to the group. This security arrangement is to be amended following completion of the AIC transaction. The CALS carry a fixed rate of interest of 7.45% on the principal amount outstanding and remaining amounts are repayable in broadly three equal annual instalments over the period to 2003. Finance lease obligations are generally repayable in periodic instalments (monthly or annual) and incur interest at rates between 6% and 10%. The remaining borrowings identified above are all at the fixed rate shown. At 31 December 2000 borrowings of £1,855m (1999 £1,948m) are at a fixed rate of interest compared to £1,605m (1999 £1,232m) at floating rates of interest. The floating rate borrowings include bank debt bearing interest at rates based on the relevant inter-bank rate or base rates.

Loans and overdrafts are repayable as follows:

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
In one year or less	**2,397**	2,025	**1,029**	886
Between one and two years	**160**	118	**104**	88
Between two and five years	**175**	294	**110**	198
In later years	**728**	743	**250**	250
	3,460	3,180	**1,493**	1,422

The total amount of loans repayable by instalments, where any instalment is due after five years, is £143m for the group (1999 £157m) and £nil for the company (1999 £nil).

17 Exchangeable Bonds

The company has in issue £676m (1999 £686m) 3.75% Senior Unsecured Exchangeable Bonds, due in 2006 (the Bonds). The Bonds are exchangeable with the Exchange Property held by the company, which at 31 December 2000 represented the company's holding in the ordinary share capital of Vodafone Group Plc (1999 ordinary shares in Orange plc and Mannesmann AG) (see note 15). The Bondholders have the right, at any time, to exchange their Bonds; alternatively, at the option of the company, the Bonds may be settled in cash based on the prevailing market value of the Exchange Property.

The company does not anticipate any material change in the Bond holding much before maturity in 2006, and does not intend currently to settle the amounts due to the Bondholders in cash. The substance therefore has been for the company to effect the probable future disposal of the Exchange Property at the issue price of the Bonds: increases in the value of the Exchange Property above the issue price effectively accrue to the Bondholders. To reflect this the Exchange Property is held within current asset investments, and its value is based on the issue price of the Bonds representing the realisable value to the group. The Bonds are recorded at issue price (less unamortised issue costs), being the group's maximum economic exposure. The historical cost of the Exchange Property to the group was negligible, and the uplift is recorded as an unrealised gain within group reserves.

This treatment of the Exchange Property represents a departure from the normal requirements of the Companies Act 1985 under which current asset investments are to be carried at the lower of cost and net realisable value. This basis would, for the reasons set out above, in the opinion of the directors not reflect the economic substance of the transaction nor show a true and fair view.

The Exchange Property is partly held within the company, with the balance held within a subsidiary undertaking (1999 all held within the company).

Notes to the accounts

18 Creditors

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Due within one year				
Customer stage payments:				
Long term contracts	**549**	395	**—**	—
Others	**143**	115	**—**	—
Cash received on customers' account:				
Long term contracts	**37**	42	**—**	—
Other	**8**	7	**—**	—
Trade creditors	**1,538**	1,709	**—**	—
Amounts owed to subsidiary undertakings	**—**	—	**7,738**	6,556
Amounts owed to joint ventures	**153**	132	**140**	92
Corporation tax	**201**	147	**—**	—
Other taxes and social security costs	**53**	66	**—**	—
Dividends	**169**	160	**169**	160
Other creditors	**503**	438	**44**	207
Accruals and deferred income	**1,389**	1,660	**112**	68
	4,743	4,871	**8,203**	7,083

	Group 2000 £m	Group 1999 £m	Company 2000 £m	Company 1999 £m
Due after one year				
Customer stage payments:				
Long term contracts	**146**	57	**—**	—
Others	**16**	—	**—**	—
Cash received on customers' account:				
Long term contracts	**28**	50	**—**	—
Trade creditors	**1**	5	**—**	—
Other creditors	**414**	394	**2**	2
Accruals and deferred income	**14**	36	**—**	—
	619	542	**2**	2
Total creditors	**5,362**	5,413	**8,205**	7,085

Included in other creditors for the group is £320m (1999 £422m) of externally funded launch aid provided to the group on risk sharing terms. Of this £106m (1999 £102m) is due within one year. Company £nil (1999 £nil).

19 Provisions for liabilities and charges

	Group							Company
	Deferred tax note 22 £m	Post retirement benefits note 27 £m	Contracts £m	Warranties and after-sales service £m	Closure and reorganisation costs £m	Recourse note 20 £m	Total £m	Deferred tax note 22 £m
At 1 January 2000	77	47	441	86	303	442	1,396	38
Provisions created	—	3	381	93	136	—	613	—
Provisions released	(6)	(6)	(28)	(23)	(3)	—	(66)	—
Provisions utilised	(40)	(9)	(120)	(51)	(186)	(80)	(486)	(38)
Provisions arising from acquisitions	(8)	41	81	5	—	—	119	—
Other provision movements	—	2	(334)	38	—	37	(257)	—
At 31 December 2000	23	78	421	148	250	399	1,319	—

In respect of ongoing contracts, in assessing profitability, provision is made to cover costs and losses identified where there is a likelihood of crystallisation. The associated outflows are estimated to occur over the period of the contract, normally between one and five years.

Included within contract loss provisions created of £381m is £300m in respect of the re-assessment of the Nimrod contract. In accordance with standard accounting practice this amount has been applied against long term contract balances (note 13), such transfer being included in other provision movements.

Warranties and after-sales service are provided in the normal course of business with provisions for associated costs being made based on an assessment of future claims with reference to past experience. Such costs are generally incurred within one to five years post delivery.

Closure and reorganisation provisions reflect costs to be incurred in respect of committed programmes. Provisions created during 2000 relate primarily to exceptional rationalisation programmes (see note 6). Associated outflows are expected to occur over the next five years.

Included within recourse provisions are other provision movements which comprise adjustments to net present value provisions.

Reclassifications between contracts, and warranties and after-sales services are reported within other provision movements.

20 Commercial aircraft financing

Commercial aircraft are frequently sold for cash with the manufacturer retaining some financial exposure. Aircraft financing commitments of the group can be categorised as either direct or indirect. Direct commitments arise where the group has sold the aircraft to a third party lessor and then leased it back under an operating lease (or occasionally a finance lease) prior to an onward lease to an operator. Indirect commitments (contingent liabilities) may arise where the group has sold aircraft to third parties who either operate the aircraft themselves or lease the aircraft on to operators. In these cases the group may give guarantees in respect of the residual values of the related aircraft or certain head lease and finance payments to be made by either the third parties or the operators. The group's exposure to these commitments is offset by future lease rentals and the residual value of the related aircraft.

The group has entered into arrangements which reduce its exposure from commercial aircraft financing by obtaining insurance cover from a syndicate of leading insurance companies over a significant proportion of the contracted and expected income stream from the aircraft portfolio including those aircraft where the group has provided residual value guarantees.

The net exposure of the group to aircraft financing as at 31 December was:

	2000 £m	1999 £m
Direct operating lease commitments	**600**	722
Direct finance lease commitments	**4**	5
Indirect exposure through aircraft contingent liabilities	**1,414**	1,589
Exposure to residual value guarantees	**693**	542
Income guaranteed through insurance arrangements	**(1,727)**	(1,885)
Net exposure	**984**	973
Expected income not covered by insurance arrangements	**(43)**	(43)
Expected income on aircraft delivered post insurance arrangements	**(388)**	(330)
Adjustment to net present value	**(154)**	(158)
Recourse provision	**399**	442

Income guaranteed through insurance arrangements represents the future income stream from the aircraft assets guaranteed under the insurance arrangements after deducting the policy excess.

Expected income not covered by insurance arrangements represents the amount of additional income assumed by management for the purpose of provisioning.

Expected income on aircraft delivered post insurance arrangements represents the level of future income anticipated on aircraft delivered since the start of the insurance arrangements.

Given the long term nature of the liabilities, the directors believe it is appropriate to state the recourse provision at its net present value. The provision covers costs to be incurred over a forecast period of 12 years from the balance sheet date. The *adjustment to net present value* reduces the expected liabilities from their outturn amounts to their anticipated net present value.

Saab AB

The group is involved in similar transactions through its shareholding in Saab AB including aircraft financing commitments and contingent liabilities arising from guarantees in connection with aircraft sales.

Where Saab AB is exposed to financial risk from the above transactions, it makes provision against the expected net exposure on a net present value basis, after taking into account the expected future sub-lease income and residual values of the aircraft. The group's exposure is limited to its 35% shareholding in Saab AB. Further, in November 2000, Saab AB entered into a Financial Risk Insurance Programme similar in nature to that implemented by BAE SYSTEMS. This programme covers the majority of the Saab aircraft portfolio and in consequence significantly reduces the risk of potential future liabilities in that company.

Airbus

At 31 December 2000 the group was involved in similar transactions through its participation in Airbus Industrie GIE (AI) including aircraft financing commitments and contingent liabilities arising from credit guarantees and financing receivables under customer financing programmes.

Where AI is exposed to financial risk from the above transactions, it makes provision against the expected net exposure, after taking into account future sub-lease rentals and residual values of related aircraft where appropriate. Provision for the net exposure is included within the group's share of the results of AI. As at 31 December 2000 the group's obligations under the financing arrangements of AI were joint and several with its partner EADS.

Notes to the accounts

21 Contingent liabilities and commitments

Aircraft contingent liabilities
Under the arrangements described in note 20, the group is exposed to risk arising from default by individual aircraft operators where the group is unable to re-lease or re-sell the underlying aircraft, and to risk where it has provided residual value guarantees.

At 31 December 2000 the group had guaranteed 20% of the borrowings of Airbus Finance Company Limited totalling £27m (1999 £51m).

Treasury contingent liabilities
Treasury contingent liabilities are set out in note 30.

Company guaranteed borrowings
Borrowings of subsidiary undertakings totalling £1,824m (1999 £1,740m) which are included in the group's borrowings (note 16) have been guaranteed by the company.

Operating lease commitments
The commitments of the group in respect of expenditure in the year ahead arising from operating leases are set out below:

	Property 2000 £m	**Aircraft financing 2000 £m**	**Other 2000 £m**	Property 1999 £m	Aircraft financing 1999 £m	Other 1999 £m
Operating leases which expire:						
In one year or less	4	7	3	—	2	1
Between one and five years	23	36	6	18	25	1
In later years	50	52	6	25	88	9
	77	95	15	43	115	11

The company has an ongoing annual property operating lease commitment for £2m which expires after five years (1999 £nil).

Capital commitments
Capital expenditure for tangible fixed assets contracted for but not provided for in the accounts comprised £40m for the group (1999 £84m) and £nil for the company (1999 £nil).

22 Deferred tax

	Asset 2000 £m	**(Liability) 2000 £m**	Asset 1999 £m	(Liability) 1999 £m
Group				
At 1 January	146	(77)	118	(38)
Arising on acquisition of MES	(3)	8	115	(22)
Other movements	(72)	40	—	—
(Charge)/release to profit and loss account	(11)	6	(87)	(17)
At 31 December	60	(23)	146	(77)

Other movements include £70m relating to the realisation of net deferred tax assets into current tax assets in respect of fair value adjustments arising in 1999 on acquisition of MES, and £38m relating to the realisation of deferred tax provisions into current tax liabilities in respect of the 1999 carried forward Exchange Property deferred tax provision.

Deferred tax balances comprise:

Group				
Accelerated capital allowances and other timing differences	60	(23)	146	(77)

The composition of the net deferred tax asset at 31 December 2000 and of the additional amounts for which no asset has been recognised in the accounts is set out below:

	Recognised in the accounts £m	Not recognised in the accounts £m	Total £m
Accelerated capital allowances	(15)	(45)	(60)
Other timing differences	52	47	99
	37	2	39

No significant potential liability to tax is expected to arise if properties included at valuation in the accounts were realised at their revalued amounts. In respect of rolled over capital gains the potential year end liability amounted to £20m (1999 £6m potential liability).

An £8m deferred tax provision has been created in respect of the anticipated dividend to be received from BAE SYSTEMS Canada Inc. prior to the future disposal of the company's 54% interest in that entity (see note 32). With the exception of this item, no deferred tax has been provided in respect of future remittances of the accumulated reserves of overseas subsidiary undertakings, since the directors believe that no other material remittances will be made for the foreseeable future.

Included within provisions of the company is a deferred tax provision of £nil (1999 £38m) in respect of the Exchange Property.

23 Share capital

	Equity	Non-equity		
	Ordinary shares of 2.5p each m	Preference shares of 25p each m	Special share of £1	Nominal value £m
Authorised				
At 1 January 2000 and 31 December 2000	3,850	275	1	165
Issued and fully paid				
At 1 January 2000	2,914	269	1	140
Increase following MES acquisition	64	—	—	2
Issuance of shares to QUEST (note 12)	8	—	—	—
Exercise of options, warrants, preference share conversion and dividend scrip issue	53	(3)	—	1
At 31 December 2000	3,039	266	1	143

At 1 January 2000 a total of 64,443,839 shares remained to be issued to former GEC shareholders as part of the consideration for the acquisition of MES, pending the receipt of the necessary declaration required pursuant to the company's Articles of Association concerning the nationality of the allotee. All such shares were issued during 2000.

The 7.75p (net) cumulative redeemable preference shares of 25p each are convertible into ordinary shares of 2.5p each at the option of the holder on 31 May in any of the years up to 2007, on the basis of 0.47904 ordinary shares for every preference share. During the year 3,093,328 shares were converted for 1,481,827 ordinary shares.

The company may redeem all of the remaining preference shares at any time after 1 July 2007 and, in any case, will redeem any remaining shares on 1 January 2010, in each case at 100p per share together with any arrears and accruals of dividend. The maximum redemption value of the preference shares, ignoring any arrears or accruals of dividend, is therefore £266m and this amount has been disclosed on the face of the balance sheet as the total of non-equity shareholders' funds.

The preference shares carry voting rights at a general meeting of the company only where the preferential dividend is six months or more in arrears, or where a motion is to be proposed which abrogates, varies or modifies the rights of the preference shareholders, or where a motion is to be proposed for the winding up of the company. On a winding up, holders of the preference shares are entitled, after repayment of the capital paid up on the special share and in priority to any payment to any other class of shareholder, to the return of amounts paid up or credited as paid up on the preference shares together with a premium of 75p per share, and all arrears of preferential dividends.

At 1 January 2000 8,176,158 warrants to subscribe for ordinary shares were outstanding, exercisable at six monthly intervals until 15 November 2000. All such warrants were exercised during the year, at the subscription price of 550p for four ordinary shares.

Under the BAE SYSTEMS Executive Share Option Scheme the BAE SYSTEMS Joint Venture Executive Share Option Scheme (JV) and the BAE SYSTEMS International Executive Share Option Scheme (INT), options to purchase ordinary shares of 2.5p each are exercisable not later than ten years and normally not earlier than three years from the date of the grant. The number of options exercised (in accordance with the Rules of the Scheme) and outstanding at 31 December 2000, together with their exercise prices rounded to the nearest penny, was as follows:

Granted	Exercise price p	Exercised during the year '000	Lapsed during the year '000	Out-standing '000
1990 (April)	122	318	—	—
1991 (March)	150	154	—	—
1992 (March)	76	558	—	127
1994 (March)	124	28	—	210
1994 (November)	112	66	—	245
1995 (March)	122	196	—	707
1995 (October)	186	811	—	1,277
1995 (December)	206	291	—	—
1996 (March)	216	138	—	841
1996 (October)	265	305	—	930
1996 (October)	275	250	—	822
1997 (March)	339	225	8	1,429
1997 (October)	430	—	6	680
1998 (March)	487	—	—	455
1998 (October)	329	—	—	1,299
JV 1998 (October)	329	—	7	556
1999 (March)	395	—	5	1,463
JV 1999 (March)	395	—	—	15
1999 (October)	402	—	—	1,270
JV 1999 (October)	402	—	—	49
1999 (December)	421	—	213	3,662
JV 1999 (December)	421	—	—	209
INT 1999 (December)	421	—	—	1,386
2000 (May)	398	—	64	2,096
JV 2000 (May)	398	—	58	796
INT 2000 (May)	398	—	—	65
2000 (October)	354	—	—	2,428
JV 2000 (October)	354	—	—	291
		3,340	361	23,308

23 Share capital continued

Under the BAE SYSTEMS SAYE Share Option Scheme and the BAE SYSTEMS Joint Venture SAYE Share Option Scheme for employees, options to purchase ordinary shares of 2.5p each are exercisable normally on completion of the related savings contracts. The number of options exercised (in accordance with the Rules of the Scheme) and outstanding at 31 December 2000, together with their exercise prices rounded to the nearest penny, was as follows:

Granted	Exercise price p	Exercised during the year '000	Lapsed during the year '000	Out-standing '000
BAE SYSTEMS SAYE Share Option Scheme				
1994 (November)	89	8,186	49	—
1996 (March)	175	511	344	9,525
1997 (March)	271	3,078	578	8,918
1998 (October)	290	228	956	12,761
1999 (October)	321	31	932	12,880
2000 (March)	257	9	410	19,995
		12,043	3,269	64,079
BAE SYSTEMS Joint Venture SAYE Share Option Scheme				
1998 (November)	353	3	68	1,141
1999 (October)	321	1	33	1,046
2000 (March)	257	1	140	3,507
		5	241	5,694
Total		12,048	3,510	69,773

24 Reserves

	Share premium account £m	Shares to be issued £m	Other reserves £m	Profit and loss account £m
Group				
At 1 January 2000	212	255	5,212	1,339
Retained loss	—	—	—	(291)
Shares issued relating to MES	—	(255)	253	—
Realisation of revaluation reserve	—	—	(25)	11
Exercise of share options, warrants, preference share conversion and dividend scrip issue	99	—	—	—
Shares issued to QUEST	30	—	—	(13)
Exchange adjustment	—	—	—	(20)
At 31 December 2000	341	—	5,440	1,026
Company				
At 1 January 2000	212	2	216	565
Retained loss	—	—	—	(143)
Shares issued relating to MES	—	(2)	—	—
Realisation of revaluation reserve	—	—	(17)	—
Exercise of share options, warrants, preference share conversion and dividend scrip issue	99	—	—	—
Shares issued to QUEST	30	—	—	(13)
At 31 December 2000	341	—	199	409

Other reserves for the group include: revaluation reserve £213m (1999 £228m), Exchange Property £638m (1999 £648m), and merger reserve £4,589m (1999 £4,336m).

Other reserves for the company include: revaluation reserve £175m (1999 £192m), and capital reserve £24m (1999 £24m).

Revaluation reserve
The company's revaluation reserve includes amounts relating to properties sold to other group undertakings as part of operational reorganisations in prior years. This element of the revaluation reserve is realised by the company when the related properties are disposed of outside the group, or written down following a permanent diminution in value.

Amounts taken directly to reserves on acquisitions
The cumulative negative goodwill arising prior to 2000 is £33m (1999 £33m). The cumulative amount of goodwill arising on consolidation is £114m (1999 £114m).

Company profit
The company's profit for the financial year was £135m (1999 £50m).

25 Statutory reserve

Under Section 4 of the British Aerospace Act 1980 this reserve may only be applied in paying up unissued shares of the company to be allotted to members of the company as fully paid bonus shares.

26 Equity minority interests

	2000 £m	1999 £m
At 1 January	85	6
Movements in respect of:		
Saab AB	—	2
MES on acquisition	—	83
Canadian Marconi Company	(6)	(5)
MES fair value adjustments	—	(5)
BAE SYSTEMS - IFS Ltd	5	—
Share of profit for the year	6	4
Exchange adjustments	10	—
At 31 December	100	85

27 Post retirement benefit schemes

Pension schemes

The group operates pension schemes in the UK and overseas. The main schemes are funded defined benefit schemes and the assets are held in separate trustee administered funds. Pension scheme valuations are regularly carried out by qualified independent actuaries to determine pension costs for both pension funding and SSAP 24 purposes.

The principal schemes, and their respective latest valuation dates, are as follows: BAE SYSTEMS Pension Scheme (5 April 1999); BAE SYSTEMS 2000 Pension Plan (no valuation, plan established on 6 April 2000); Royal Ordnance Pension Scheme (31 December 1998); VSEL section - Shipbuilding Industries Pension Scheme (1 April 1998); the Tracor Inc. Employee Retirement Plan (1 January 2000), and the BAE SYSTEMS Information & Electronic Systems Integration Pension Plan (26 November 2000).

On 6 April 2000 the BAE SYSTEMS 2000 Pension Plan received the pension assets and liabilities attributable to the employees of MES and a proportion of the pensioners and deferred pensioners of the GEC 1972 Plan. This plan's first actuarial valuation is to be carried out as at 6 April 2001. The terms of the transfer have been agreed between the company and Marconi plc so as to leave a £nil actuarial surplus or deficit in the Plan as at 6 April 2000.

The BAE SYSTEMS Information & Electronic Systems Integration Pension Plan was assumed by the group on acquisition of the Lockheed Martin AES business in November 2000.

The actuarial method used for the BAE SYSTEMS Pension Scheme and the Royal Ordnance Pension Scheme for SSAP 24 purposes was the projected unit method and the principal assumptions used were that in the long term the average return on investments would exceed:

	%
Average increases in pay by	2.5
Average increases in pensions by	4.25 to 4.75
Dividend growth by	5.25

The actuarial method used for the VSEL section - Shipbuilding Industries Pension Scheme for SSAP 24 purposes was the attained age method and the principal assumptions used were that in the long term the average return on investments would exceed:

	%
Average increases in pay by	2.25
Average increases in pensions by	3.75
Dividend growth by	5.00

The actuarial method used for the Tracor Inc. Employee Retirement Plan and the BAE SYSTEMS Information & Electronic Systems Integration Pension Plan (both operated in the US) for SSAP 24 purposes was the projected unit method and the principal assumptions used were that in the long term the average return on investments would be 9% and 9.5% respectively, and average increases in pay would be 5% on each.

The aggregate of the market values of the principal schemes operated by the group at the latest date of actuarial valuation (or in the case of the BAE SYSTEMS 2000 Pension Plan the year end market value in the absence of an actuarial valuation) totalled some £9.0bn (1999 £6.0bn) and the market value at 31 December 2000 was approximately £10.1bn (1999 £7.2bn). The actuarial value of the assets covered approximately 98% (1999 95%) of the benefits that had accrued to members after allowing for expected future increases in wages and salaries.

The net deficit is being amortised using the straight line method over the estimated average service lives of the related scheme members of 9 to 14 years. The net charge to the profit and loss account amounted to £218m (1999 £131m).

Pension prepayments included in debtors of the group amounted to £383m (1999 £201m) (note 14) and pension liabilities of the group amounted to £97m (£36m held within provisions - note 19, (1999 £26m)). Cash contributions by the group to the pension schemes totalled £230m (1999 £156m).

Post retirement benefits other than pensions

The group also operates a number of non-pension post retirement benefit plans, under which certain employees and former employees are eligible to receive benefits after retirement, the majority of which relate to the provision of medical benefits to retired former employees of the group's subsidiaries in the US. These schemes are generally unfunded. The latest valuations of the principal schemes, covering retiree medical and life insurance plans in certain US subsidiaries, were performed by independent actuaries as at 31 December 2000. The method of accounting for these is similar to that used for defined benefit pension schemes. The gross liability at 31 December 2000 amounts to £94m (£42m held within provisions - note 19, (1999 £21m)).

28 Consolidated cash flow

The consolidated cash flow statement has been prepared in accordance with FRS 1 (revised) to show the net movement in net cash available on demand. In addition, the cash flow statement shows the movement in net cash/(debt) as defined by the group below:

Net funds	Cash at bank and in hand plus liquid current asset investments less short and long term loans and overdrafts
Net cash/(debt)	Net funds excluding cash on customers' account
Cash on customers' account	Unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to company performance

On the above basis, the group's net funds and net cash/(debt) comprise:

	At 1 January 2000 £m	Cash flows £m	Foreign exchange £m	At 31 December 2000 £m
Current assets				
Investments	1,643	(497)	13	1,159
Cash at bank and in hand:				
Available on demand	791	648	—	1,439
Other	20	16	—	36
Current liabilities				
Loans and overdrafts:				
Repayable on demand	(145)	(493)	—	(638)
Other	(1,880)	82	39	(1,759)
Liabilities falling due after one year				
Loans	(1,155)	96	(4)	(1,063)
Net funds	(726)	(148)	48	(826)
Current liabilities				
Cash on customers' account	(99)	26	—	(73)
Net (debt)/cash	(825)	(122)	48	(899)

The Lockheed Martin AES operating cash outflow in the period from 27 November 2000 to 31 December 2000 was £25m, and the Lockheed Martin Control Systems operating cash inflow in the period from 25 September 2000 to 31 December 2000 was £8m.

29 Analysis of main headings in cash flow statement

	2000 £m	1999 £m
Returns on investments and servicing of finance		
Interest received	145	102
Interest paid	(219)	(106)
Interest element of finance lease rental payments	(2)	(2)
Exceptional interest	—	(22)
Dividends paid on preference shares	(21)	(21)
Issue costs on Exchangeable Bond	—	(13)
	(97)	(62)
Taxation		
UK corporation tax paid	(50)	(79)
Overseas tax paid	(9)	(2)
	(59)	(81)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(374)	(307)
Joint venture funding	11	137
Sale of tangible fixed assets	94	38
Purchase of fixed asset investments	(14)	—
	(283)	(132)
Management of liquid resources		
Net sale/(purchase) of:		
Investments held by fund managers	318	(12)
Commercial Paper and repurchase agreements	(30)	—
Term deposits	224	280
Other securities	(15)	(34)
	497	234
Financing		
Proceeds from exercise of share options	71	43
Capital element of finance lease rental payments	(4)	(4)
(Decrease)/increase in loans	(190)	961
Proceeds from issue of Exchangeable Bond (note 17)	—	686
	(123)	1,686
MES acquisition		
Net debt assumed		(1,444)
Net cash acquired on acquisition		87
		(1,357)
Net funds on acquisition		
Investments		125
Loans and overdrafts		(191)
		(66)
CALS issued as consideration		(369)
		(435)

30 Financial instruments

A discussion of the group's treasury objectives and policies and the use of financial instruments can be found in the operating and financial review and the Directors' report. Financial instruments comprise net borrowings (note 16) together with other instruments deemed to be financial instruments under FRS 13 including long term debtors, long term creditors and provisions for liabilities and charges. Disclosures dealt with in this note exclude short term debtors and creditors where permitted by FRS 13 except for the analysis of net currency exposures.

Interest rate risk management

At 31 December 2000 after taking account of interest rate swaps and cross currency swaps the currency and interest rate profile of the financial assets and liabilities of the group was as follows:

Financial assets

The interest rate profile of the financial assets of the group was:

2000 Currency	Floating rate financial assets £m	Fixed rate financial assets £m	Financial assets on which no interest is paid £m	Total £m
Sterling	**1,531**	**21**	**994**	**2,546**
US Dollar	**203**	**—**	**185**	**388**
Other	**203**	**—**	**10**	**213**
Total	**1,937**	**21**	**1,189**	**3,147**

1999 Currency				
Sterling	1,365	4	562	1,931
US Dollar	200	—	8	208
Other	188	—	8	196
Total	1,753	4	578	2,335

Floating rate financial assets attract interest on short term interbank rates. The weighted average period until maturity for financial assets on which no interest is paid is two to five years.

Fixed rate financial assets carry an interest coupon of 6.41% and mature in 2004.

Interest bearing financial assets comprise cash, money market deposits, certain fixed asset investments, and debtors. Financial assets on which no interest is paid include certain current asset investments, and debtors.

Financial liabilities

The interest rate profile of the financial liabilities of the group was:

2000 Currency	Floating rate financial liabilities £m	Fixed rate financial liabilities £m	Financial liabilities on which no interest is paid £m	Total £m
Sterling	**521**	**2,065**	**859**	**3,445**
Sterling own non-equity shares	**—**	**266**	**—**	**266**
US Dollar	**1,178**	**394**	**280**	**1,852**
Other	**4**	**—**	**74**	**78**
Total	**1,703**	**2,725**	**1,213**	**5,641**

1999 Currency				
Sterling	171	2,283	676	3,130
Sterling own non-equity shares	—	269	—	269
US Dollar	1,153	421	80	1,654
Other	15	1	—	16
Total	1,339	2,974	756	5,069

	Fixed rate financial liabilities		Financial liabilities on which no interest is paid
2000 Currency	Weighted average interest rate %	Weighted average period for which rate is fixed Years	Weighted average period until maturity Years
Sterling	**6.71**	**8.92**	see below
US Dollar	**7.17**	**10.73**	**1 - 2**
Other	**n/a**	**n/a**	see below
1999 Currency			
Sterling	6.66	9.77	see below
US Dollar	7.18	11.81	1 - 2

Floating rate financial liabilities bear interest based on short term interbank rates.

Interest bearing financial liabilities comprise bonds, commercial papers issued, net obligations under finance leases and bank overdrafts. Financial liabilities on which no interest is paid primarily comprise long term creditors and provisions for liabilities and charges.

Maturity of financial liabilities

Non-equity shares are redeemable on 1 January 2010. The maturity profile of loans and borrowings is set out in note 16. For the other financial liabilities, note 19 gives an indication of the nature of the underlying liabilities which in general cover a period of between one and five years from the balance sheet date.

30 Financial instruments continued

Currency exposure

The analysis below shows the net monetary assets and liabilities of group companies that are not denominated in their functional currency and therefore give rise to exchange gains and losses in the profit and loss account. The amounts shown in the table take into account the effect of hedging instruments used to manage these exposures.

	Net currency monetary asset/(liability)			
Functional currency	Sterling	US Dollar	Other	Total
at 31 December	£m	£m	£m	£m
2000				
Sterling	**—**	**(115)**	**147**	**32**
US Dollar	**59**	**—**	**(8)**	**51**
Other	**(6)**	**32**	**—**	**26**
Total	**53**	**(83)**	**139**	**109**
1999				
Sterling	—	29	(5)	24
US Dollar	163	—	1	164
Other	—	45	—	45
Total	163	74	(4)	233

Other relates primarily to exposures to the Euro and the Saudi Riyal.

Fair values

The estimated fair value of financial assets and financial liabilities was:

	Net carrying amount		Estimated fair value	
	2000 £m	1999 £m	**2000 £m**	1999 £m
Primary financial instruments held or issued to finance the group's operations				
External funds management	**—**	318	**—**	322
Other current asset investments	**1,958**	1,447	**1,958**	1,447
Exchange Property	**676**	686	**1,172**	1,252
Loans and overdrafts	**(2,795)**	(2,521)	**(2,932)**	(2,562)
Exchangeable Bond	**(665)**	(673)	**(1,182)**	(1,255)
Derivative financial instruments held to manage the currency and interest rate profile				
Foreign exchange contracts	**(42)**	(18)	**(88)**	(52)
Interest rate contracts	**—**	—	**(7)**	(10)
Interest rate caps	**—**	2	**—**	3
Cross currency swaps	**—**	—	**12**	(6)
Other long term assets/(liabilities)				
BAE SYSTEMS preference shares	**(266)**	(269)	**(483)**	(533)
Other assets	**466**	422	**466**	422
Provisions and other liabilities	**(1,826)**	(1,703)	**(1,826)**	(1,703)

The fair values of quoted assets and borrowings are based on period end mid-market quoted prices. The fair values of other borrowings and derivative financial instruments are estimated by discounting the future cash flows to net present values using appropriate market rates prevailing at 31 December.

Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. The table below shows the extent to which the group has unrecognised gains and losses on financial instruments and deferred gains and losses in respect of financial instruments used as hedges at the beginning and end of the year.

Unrecognised gains and losses

	2000			1999		
	Gains £m	**Losses £m**	**Net £m**	Gains £m	Losses £m	Net £m
At 1 January	**124**	**(83)**	**41**	192	(251)	(59)
Arising on acquisition of MES	**—**	**—**	**—**	7	3	10
Arising in previous years that were recognised in the year	**(56)**	**12**	**(44)**	(62)	53	(9)
Arising before 1 January that were not recognised in the year	**68**	**(71)**	**(3)**	137	(195)	(58)
Arising in year that were not recognised in the year	**157**	**(195)**	**(38)**	(13)	112	99
At 31 December	**225**	**(266)**	**(41)**	124	(83)	41
Expected to be recognised in one year or less	**106**	**(82)**	**24**	56	(27)	29
In later years	**119**	**(184)**	**(65)**	68	(56)	12
	225	**(266)**	**(41)**	124	(83)	41

Deferred gains and losses

	2000			1999		
	Gains £m	**Losses £m**	**Net £m**	Gains £m	Losses £m	Net £m
Retimed cover	**14**	**(23)**	**(9)**	5	(23)	(18)
Net asset hedge deferral	**2**	**(35)**	**(33)**	3	(5)	(2)
	16	**(58)**	**(42)**	8	(28)	(20)
Of which expected to be recognised within one year:						
Retimed cover	**13**	**(16)**	**(3)**	2	(8)	(6)
Net asset hedge deferral	**2**	**(35)**	**(33)**	3	(5)	(2)
	15	**(51)**	**(36)**	5	(13)	(8)
Of which expected to be recognised after one year:						
Retimed cover	**1**	**(7)**	**(6)**	3	(15)	(12)
	1	**(7)**	**(6)**	3	(15)	(12)

30 Financial instruments continued

Interest rate management
The group's current interest rate management strategy is that a minimum of 25% and a maximum of 75% of either net cash or debt is maintained at fixed interest rates. Following the MES acquisition the enlarged group is in a net debt position for the first time in recent years. The aim continues to be to restrict the volatility of interest income/expense below an agreed amount within a mathematical degree of confidence.

Currency management
The group's principal currency exposure is the US$/£ Sterling exchange rate arising from the group's Commercial Aerospace manufacturing and sales activities. The group's overall strategy is designed to hedge, as far as practicable, net US$ receipts by reference to rates representing the group's view of the long term US$/£ Sterling exchange rates using forward contracts.

The group also has transactional currency exposure arising from exports/supplies denominated in currencies other than the US$. The group's policy is to hedge such exposures where appropriate using forward contracts.

Liquidity management
The group's undrawn committed borrowing facilities total £1,403m, of which £114m expire in 2001, £147m expire after 2001 but before the end of 2002, and the remaining £1,142m expire after the end of 2002.

31 Related party transactions

The group has an interest in a number of joint ventures as disclosed in note 12. Transactions occur with these joint ventures in the normal course of business. The more significant transactions are disclosed below:

Related party	Sales to related party £m	Purchases from related party £m	Amounts owed by related party £m	Amounts owed to related party £m
Airbus Industrie GIE	1,400	—	—	—
Eurofighter Jagdflugzeug GmbH	573	—	72	—
Matra BAe Dynamics SAS	56	7	36	140
Panavia Aircraft GmbH	97	78	18	—
Saab AB	10	6	1	—
Alenia Marconi Systems NV	39	47	15	7
Thomson Marconi Sonar NV	1	25	—	5

32 Post balance sheet events

Airbus
An integrated joint Airbus company was formed with effect from 1 January 2001 to take on the combined operations of the Airbus Industrie GIE partners, BAE SYSTEMS and EADS, together with Airbus Industrie GIE itself. BAE SYSTEMS will hold a 20% interest in the new company with EADS holding the balance.

Business divestments
In February 2001 agreement was reached for the sale of the company's 54% subsidiary BAE SYSTEMS Canada Inc. to ONCAP, an investment fund located in Toronto, Canada. The transaction, which is subject to both Canadian and US regulatory approvals, is expected to complete in the first half of 2001.

In February 2001 the company reached agreement to sell its Flight Simulation and Training business based in Tampa, Florida, to CAE, Toronto, Canada. Completion of this transaction is expected in the first half of 2001, subject to regulatory approval in the US.

Five year summary

	2000 £m	Restated** 1999 £m	Restated** 1998 £m	Restated** 1997 £m	Restated** 1996 £m
Profit and loss account					
Sales					
Programmes	**2,322**	2,463			
Customer Solutions & Support	**1,783**	1,681			
International Partnerships	**1,825**	983			
Avionics	**741**	245			
North America	**1,634**	179			
Operations	**1,039**	451			
Commercial Aerospace	**2,811**	2,915			
Centre	**30**	12			
	12,185	8,929	8,611	8,546	7,441
Profit/(loss) before interest*					
Programmes	**3**	390			
Customer Solutions & Support	**434**	409			
International Partnerships	**117**	33			
Avionics	**107**	1			
North America	**165**	22			
Operations	**(33)**	(67)			
Commercial Aerospace	**149**	(10)			
Centre	**8**	(15)			
	950	763	638	558	433
Goodwill amortisation	**(373)**	(63)	(23)	(5)	(1)
Exceptional operating costs	**(307)**	(210)	(51)	—	—
Exceptional (loss)/profit on closure and sale of operations	**—**	—	(22)	(330)	—
Exceptional profit/(loss) on disposal of fixed asset investments	**—**	—	401	—	—
Profit before interest	**270**	490	943	223	432
Interest					
Excluding exceptional items	**(91)**	(9)	30	10	(27)
Exceptional items	**—**	(22)	—	—	—
	(91)	(31)	30	10	(27)
Profit/(loss) before tax on ordinary activities					
Excluding exceptional items	**486**	691	645	563	405
Exceptional items	**(307)**	(232)	328	(330)	—
	179	459	973	233	405
Tax	**(186)**	(131)	(280)	(69)	(114)
(Loss)/profit after tax on ordinary activities	**(7)**	328	693	164	291
Balance sheet					
Fixed assets	**10,440**	9,192	2,522	2,159	2,097
Stocks	**1,536**	1,559	1,442	1,703	1,477
Creditors less debtors	**(1,652)**	(518)	(652)	(1,724)	(1,728)
Customer stage payments	**(854)**	(567)	(390)	(365)	(334)
Net cash *excluding cash on customers' account*	**(899)**	(825)	196	761	726
Provisions for liabilities and charges	**(1,319)**	(1,396)	(1,092)	(1,082)	(819)
Capital and reserves	**7,252**	7,445	2,026	1,452	1,419
Equity minority interests	**(100)**	(85)	(6)	—	(13)
Shareholders' funds	**7,152**	7,360	2,020	1,452	1,406
Cash on customers' account	***73***	*99*	*16*	*27*	*22*

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m
Cash flow statement					
Profit before interest*	**950**	763	638	558	433
Depreciation and impairment	**309**	189	138	161	163
Net capital expenditure	**(280)**	(280)	(280)	(165)	(84)
Movement in provisions excluding deferred tax	**(215)**	(210)	(93)	(63)	(214)
Customer stage payments	**223**	(44)	(31)	31	128
Working capital and sundry items	**685**	(94)	(1,211)	(307)	125
Operating cash flow	**1,672**	324	(839)	215	551
Net (purchases)/sales of operations	**(1,459)**	(1,866)	(493)	(137)	(43)
Matra BAe Dynamics SAS merger	**—**	—	—	—	(80)
Orange Exchange Property	**—**	686	—	—	—
Orange plc loans	**—**	—	—	—	194
Sale of Orange plc shares	**—**	—	764	19	—
Sale of Orion Network Services Inc	**—**	—	87	—	—
Net interest	**(76)**	(6)	115	32	(1)
Tax and dividends	**(282)**	(202)	(217)	(111)	(104)
Net proceeds from equity issues	**71**	43	18	17	6
Movement in net cash	(74)	(1,021)	(565)	35	523

Operating Cash flow by business group	
Programmes	**868**
Customer Support & Solutions	**554**
International Partnerships	**18**
Avionics	**43**
North America	**168**
Operations	**127**
Commercial Aerospace	**31**
Centre	**(137)**
	1,672

	2000	Restated** 1999	Restated** 1998	Restated** 1997	Restated** 1996
Other information					
Basic earnings per share:					
Excluding goodwill amortisation and exceptional items	**19.2p**	29.4p	27.1p	23.0p	15.7p
Including goodwill amortisation and exceptional items	**(1.1p)**	16.2p	38.4p	8.2p	15.6p
Dividend per ordinary share	**8.5p**	8.0p	6.5p	4.9p	3.9p
Personnel numbers at year end	**85,000**	83,400	47,900	43,400	42,400
Capital expenditure *including leased assets*	**£374m**	£307m	£375m	£211m	£194m
Order book *including the group's share of joint ventures*	**£41.0bn**	£36.6bn	£28.1bn	£22.1bn	£19.4bn

* Excluding goodwill amortisation and exceptional items
** See note 1

As a result of the merger between BAe and MES, and the reorganisation of the group's reporting sectors, reporting of results by business group has been amended in the five year summary.

Sales and profit/(loss) before interest analysed by business group has been presented for 2000 and 1999 only. Operating cash flow by business group has been presented for 2000 only.

Shareholder information

Analysis of share register at 31 December 2000

	Ordinary shares of 2.5p				Preference shares of 25p			
	Accounts		Shares		Accounts		Shares	
	Number '000	%	Number million	%	Number '000	%	Number million	%
By category of shareholder								
Individuals	156.0	82.9	161.5	5.3	3.8	44.2	17.7	6.6
Nominee companies	25.0	13.3	2,744.6	90.3	2.7	31.4	232.2	87.2
Banks	0.6	0.3	1.0	—	—	—	0.1	—
Insurance and pension funds	0.1	0.1	69.2	2.3	—	—	3.7	1.4
Other	6.4	3.4	62.3	2.1	2.1	24.4	12.7	4.8
	188.1	100.0	3,038.6	100.0	8.6	100.0	266.4	100.0
By size of holding								
1-99	22.0	11.7	0.9	—	—	—	—	—
100-499	59.1	31.4	16.9	0.6	0.2	2.3	—	—
500-999	46.2	24.6	32.7	1.1	0.2	2.3	0.2	0.1
1,000-9,999	56.9	30.2	130.7	4.3	7.3	84.9	24.3	9.1
10,000-99,999	2.6	1.4	72.3	2.4	0.7	8.1	15.1	5.7
100,000-999,999	1.0	0.5	335.3	11.0	0.1	1.2	41.3	15.5
1,000,000 and over	0.3	0.2	2,449.8	80.6	0.1	1.2	185.5	69.6
	188.1	100.0	3,038.6	100.0	8.6	100.0	266.4	100.0

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Website: www.baesystems.com

(Registered in England & Wales, No. 1470151)

Registrars

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The Causeway
Worthing, West Sussex BN99 6DA
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(+44 1903 502541 from outside the UK)

If you have any queries regarding your shareholding, please contact the Registrars.

Shareholder dealing service

Hoare Govett Ltd offers a low cost dealing facility enabling shareholders to acquire or dispose of BAE SYSTEMS plc ordinary shares. Commission of 1% is charged for both purchases and sales (a minimum charge of £10.00 will apply). Hoare Govett Ltd is a member of the Securities and Futures Authority. If you require further information please contact:

Hoare Govett Ltd, Share Dealing Department, 250 Bishopsgate, London EC2M 4AA Telephone: 020 7678 8300.

Share price information

The middle market price of the company's ordinary shares on 29 December 2000 was 382.0p, the range during the year was 453.0p to 281.0p.

Daily share prices are available on the FT Cityline service as follows:

BAE SYSTEMS plc ordinary shares	0906 003 1890
BAE SYSTEMS plc preference shares	0906 003 5174

(Calls are charged at 60p per minute at all times.)

Alternatively you can view teletext or similar service.

Shareholder information

Capital gains tax

For former GEC shareholders issued with shares in BAE SYSTEMS (formerly named British Aerospace) on completion of the merger the following values will be of assistance in capital gains tax calculations.

Closing price of GEC shares on 26 November 1999 - 962.5p
Opening price of BAE SYSTEMS ordinary shares on 30 November 1999 - 369p
Opening price of Marconi plc shares on 30 November 1999 - 751.25p

Apportionment of new issued stock to one GEC share:

Marconi plc	82.7690871%
BAE SYSTEMS	15.8827107%
CALS	1.3482022%

Dividend reinvestment plan

The company offers holders of its ordinary shares the option to elect to have their dividend reinvested in shares purchased in the market instead of cash. If you would like to make this election, please request a dividend reinvestment plan mandate from our registrars:

Lloyds TSB Registrars, The Causeway, Worthing, West Sussex, BN99 6DA Telephone: 0870 241 3018 (+44 1903 502541 from outside the UK).

American Depositary Receipts

The BAE SYSTEMS plc American Depositary Receipts (ADRs) are traded on the Over The Counter market (OTC) under the symbol BAESY. One ADR represents four BAE SYSTEMS plc ordinary shares.

Morgan Guaranty Trust Company of New York is the depositary. If you should have any queries, please contact:

Morgan Guaranty Trust Company of New York, PO Box 842006, Boston, MA, 02284-2006, USA
Telephone: +1 781 575 4328

Financial calendar

Financial year end	31 December
Preference shares conversion date	31 May 2001
2000 final ordinary dividend payable	1 June 2001
2001 half yearly preference dividend payable	2 July 2001
2001 interim results announcement	September 2001
2001 interim ordinary dividend payable	November 2001
2001 half yearly preference dividend payable	2 January 2002
2001 full year results – preliminary announcement	February 2002
– report and accounts	April 2002
2001 final ordinary dividend payable	June 2002

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Produced and printed in England by Burrups Ltd, St Ives plc

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