

Chief Executive's review



the Group as a trusted supplier of advanced technology solutions and industrial capabilities to help customers achieve their critical national and global security missions.

2023 financial performance

Our key financial measures of order intake, sales, underlying EBIT, underlying EPS and free cash flow all increased, amidst a high inflation environment. This was only possible because of the excellent work of our employees on programme execution, our discipline on contracting and meaningful internal efficiency efforts.

On a constant currency basis, we grew order backlog by 21%, sales by 9% and underlying EPS by 14%. We delivered a record free cash flow of £2.6bn for the year and, as a result, exceeded our stated three-year free cash flow target for 2021 to 2023.

This strong set of results was enhanced by our ongoing share buyback programme. In 2023, we repurchased £561m worth of our shares, or 1.9% of our outstanding share capital.

Building an operational and financial track record

In 2021, we laid out how we would build on a period of transition and our good performance from 2018 to 2020. It centred around building a track record of good quality operational and financial performance on which customers and shareholders could consistently rely. We delivered against all the operational areas in the scorecard, which has led to strong financial performance over the three years from 2021 to 2023 with sales growth of 20%, margin expansion of 80bps, cash conversion of 100% and total shareholder returns of £4.2bn.

With strong momentum behind us from our last three years of delivery, a record order backlog and our largest ever acquisition completed, we look forward to the next three years with confidence. In many aspects, our ambitions for the coming years are a continuation of the strategy we have been

2023 saw another stand-out year of order flow on new and existing programmes, renewals on incumbent positions and a strong opportunity pipeline. These underpin our confidence and visibility for good top-line growth in the coming years, while we continue reinforcing our value-compounding model with a sharp focus on operational performance and disciplined capital allocation.

Overview

I am pleased to report that BAE Systems delivered another year of strong operational and financial performance in 2023, despite continued global supply chain disruptions and high inflation.

These pressures are starting to recede and we have entered 2024 with a compelling competitive position, thanks to our portfolio and geographic diversity, and multiple new business opportunities, including the acquisition of Ball Aerospace – all of which point to another productive year for BAE Systems and our shareholders.

2023's successes were undoubtedly driven by our people, their unwavering focus on our purpose of protecting those who protect us, and a values-led culture, committed to sustainable business practices, inclusion, a

robust governance structure and high ethical standards. The global events of recent years have reinforced the essential role of the defence industry in helping governments protect their countries and citizens.

2023 operational performance

Overall, we have made strong operational progress and advanced the strategic objectives we have been pursuing for the past several years.

Our focus on operational excellence continues to benefit our customers and shareholders, especially as we execute on complex, long-duration programmes like Dreadnought, Type 26 and Hunter Class frigates, Typhoon and F-35 jets, electronic warfare systems, combat vehicles, and many other programmes. This relentless focus on delivering for our customers has positioned



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Charles Woodburn CBE
Chief Executive

Returns to shareholders¹

£1,418m

Order backlog

£69.8bn

1. See calculation on page 32.

executing, with the foundations for delivery built on:

- strong operational performance and contracting discipline;
- investing appropriately to support growth and our customers' priorities; and
- looking to deepen partnerships and collaborations.

Delivery against these ambitions, coupled with the acquisition of Ball Aerospace which is set to be additive to our top-line growth, margin expansion and cash conversion outlook, means we are well positioned to deliver a compelling and predictable value-compounding model for our stakeholders.



Balance sheet strength

We ended 2023 with a strong balance sheet, featuring a cash position of £4.1bn, net debt (excluding lease liabilities) of £1.0bn, and a net pension position that remains in an accounting surplus. Our capital allocation remains consistent and is focused on underpinning the Group's long-term strength and expected growth. We prioritise investing in the business for the long term through research and development (R&D), as well as acquisitions in high-growth and high-return parts of the business. Our capital expenditure (capex) is targeted to ensure our systems and facilities are modern, deliver an effective working environment and provide the capacity needed to support our growth outlook.

Our ambitions 2021–2023

Strong consistent programme performance	Further investment in technology	Efficiency and simplification in working	Portfolio shaping for value creation	Secure further opportunities and wider market base	Accelerate our sustainability agenda
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Financial outcome from delivery against our ambitions

Top-line growth

Since 2021, we have grown sales by 20% on a constant currency basis.

Margin expansion

We have increased margins from 10.3% in 2021 to 10.6% in 2023, driven by:

- Improvement in programme performance across the portfolio.
- Inflation management and strong supply chain performance.
- Operational efficiencies and simplification.

Strong cash conversion

We have generated £6.4bn of free cash flow in the three years to December 2023.

We anticipate strong cash conversion to continue, forecasting free cash flow of in excess of £5bn for the next three years from 2024 to 2026.

Higher return on capital employed (ROCE)

We have increased profitability, with underlying EBIT increasing 30% on a constant currency basis over three years since 2021. We have boosted efficiency through our careful capital allocation, resulting in a higher ROCE for our investors.

ROCE is a key metric in driving executive remuneration.

Focused capital allocation

We have applied a clear, consistent and careful capital allocation across the business.

- We have continued to invest in our people, growing to 99,800 employees at the end of 2023 from 89,600 in January 2021, including our share of equity accounted investments.
- We have applied significant investment in upgrading and improving facilities across our sites to ensure our processes are efficient and we are able to deliver operational excellence.
- We continue to invest in future technologies. Our total R&D spend across the three years to the end of 2023 was £5.9bn.
- We continue to identify and pursue value-enhancing acquisitions in alignment with our Group strategy.

Following ratings upgrades from S&P Global and Fitch in 2022, as well as being placed on positive outlook by Moody's, we have maintained our strong investment grade credit ratings.

Rating	Outlook	Category
Moody's Investors Service		
Baa2	Positive	Investment grade
Standard & Poor's Ratings Services		
BBB+	Stable	Investment grade
Fitch Ratings		
BBB+	Stable	Investment grade

Attractive shareholder returns

Total shareholder returns since 2021

£4.2bn

- As at 31 December 2023, we have returned £4.2bn through dividends and share repurchases under announced share buyback programmes since 2021.
- We continue to target paying dividends in line with the Group's policy of long-term sustainable cover of around two times underlying earnings.

Chief Executive's review continued

We are also committed to returning value to shareholders in accordance with our capital allocation policy through a dividend, which has increased for 20 years in a row, and share buybacks. Reflecting this, in August, we announced a further three-year share buyback programme of up to £1.5bn to commence after the completion of the current programme.

Highly relevant capabilities

As one of the world's largest defence companies, our technologies, capabilities and global footprint position BAE Systems as a leader in helping customers meet the elevated threat environment of today and tomorrow. Executing on our ambitious product and technology strategy, the

Group continues to design, develop and manufacture cutting-edge products – across the domains of air, sea, land, cyber and space – that our customers count on. Our exceptional portfolio is enhanced by enabling technologies including artificial intelligence, autonomy, synthetic environments and cyber defence, ensuring we remain at the forefront of national security-related innovation. In addition to our defence portfolio, our commercial aviation product lines are recovering as more passengers return to flying. Demand for our low and zero emission propulsion systems also grew, with opportunities to take these applications into the defence arena, as well as maritime and air.

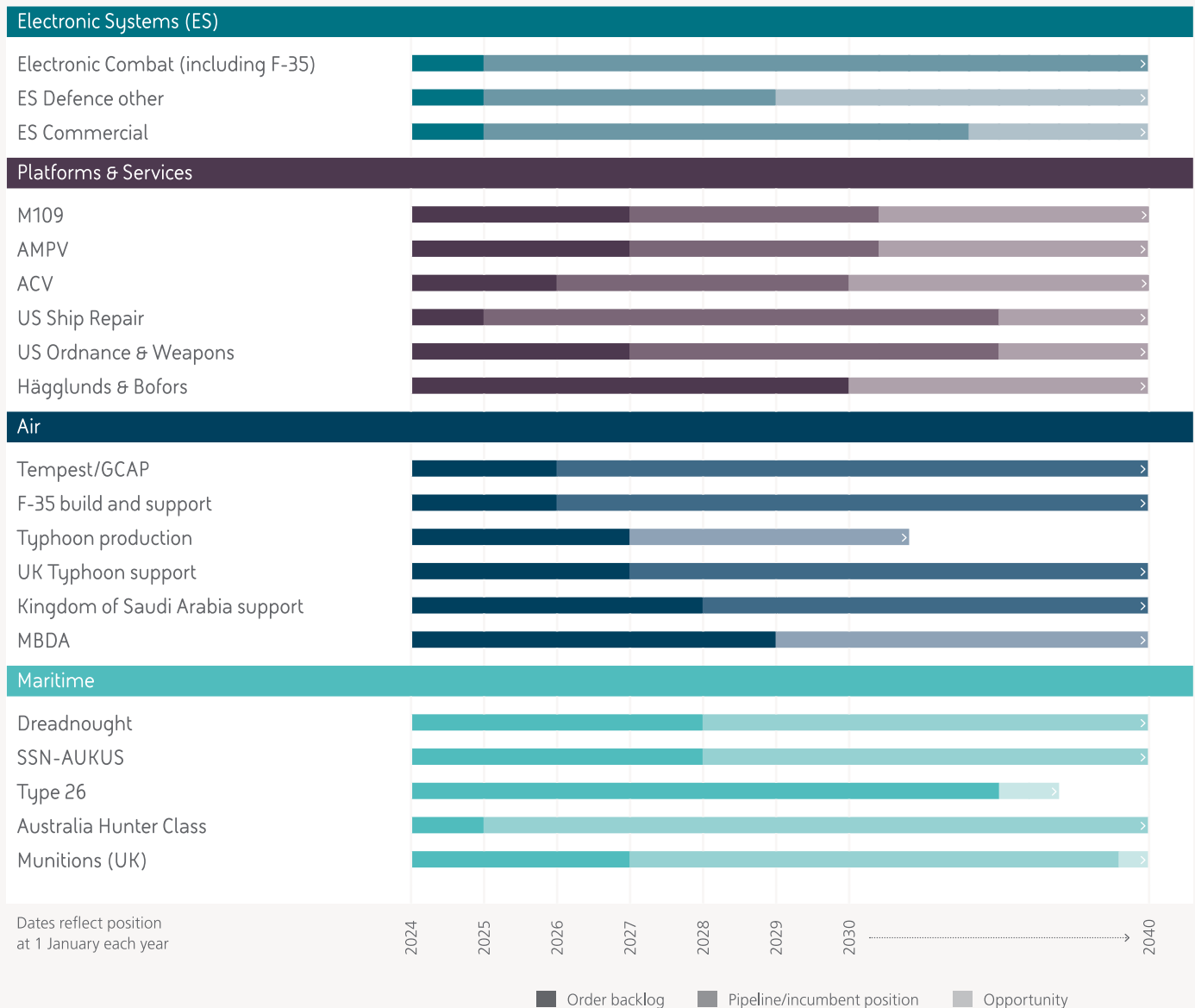
Our market differentiation

Our diverse product and services portfolio, combined with our global footprint and engagement in many of the world's largest national defence markets, are key and differentiating strengths. We see good long-term growth and significant opportunities in our US, UK, European, Middle Eastern, Australian and Asia-Pacific businesses.

Most of the countries where we operate have either announced budget increases or are planning increased spending to address the elevated threat environment. While governments continue to face global economic and fiscal pressures, commitment to defence spending in our major markets remains robust.

Please read more about our markets on page 18.

Our multi-decade programmes and growing global opportunity pipeline¹



1. Backlog for Cyber & Intelligence is generally for one year with an incumbency position following.

Our long-term visibility

With our record order backlog and programme positions, as illustrated in the chart on page 10, we have a high level of visibility of our revenues for many years to come. The order backlog is, in many cases, just a subset of the true programme length and value, with many of our key programmes running well into the next decade. The current visibility has the potential to be even further enhanced as we have a growing global opportunity pipeline, driven by our capabilities and market differentiation.

Portfolio evolution to support the long term

During the year, three significant events have positively enhanced the business portfolio relevance for the long term.

- Firstly, further detail on the AUKUS trilateral agreement between Australia, the UK and the US was announced in March 2023 and has significant future potential for BAE Systems. We have already secured £3.95bn of funding in the year for the next phase of the UK's next-generation attack submarine programme.
- Secondly, GCAP, formed in 2022, saw ministers from Japan, the UK and Italy sign an important treaty in December 2023 in the shared design and development of next-generation fighter aircraft, reinforcing momentum and the strong trilateral co-operation between the partners.
- Thirdly, in August 2023, we announced the acquisition of Ball Aerospace, a leading space, defence technology and tactical missiles company, which we believe has highly relevant mission-critical capabilities for our customers' future needs. The acquisition completed in February 2024.

Investing for growth

To meet the business's growth outlook, we are increasing our investments in people, technologies and facilities. We boosted our global workforce by 6,700 employees compared to 2022. Given the long duration of many of our programmes, we put a special emphasis on early careers and community outreach to ensure we hire, develop and retain the best talent. In 2023, we increased recruitment of UK apprentices and graduates by 37% compared to 2022.

We also continue to develop and modernise our facilities, making progress in building capacity for the future in munitions, shipbuilding, submarines, combat vehicles and electronics.

Technology and innovation are central to our strategy and we increased Group R&D expenditure by 14% compared to 2022.

Our investments in core franchises and our next-generation priorities, such as: space; autonomy; sustainability; advanced manufacturing; and multi-domain and digital integration, are driven by the evolving threat landscape. At a tactical level, the conflict in Ukraine is highlighting the importance of a number of these key technologies, especially autonomy, synthetic training, digital and multi-domain capabilities, while also reinforcing the critical need for munitions and maintaining legacy capabilities.

We are driving innovation through the research labs embedded in our business sectors, including FASTLabs™ in the US, Red Ochre Labs in Australia, and now via the FalconWorks® organisation in our Air sector. These hubs are agile innovation engines aimed at delivering bold breakthrough technologies to keep our customers ahead of the challenges they face. They also foster collaborative partnerships with academia and other organisations to bring even greater levels of creative and diverse thinking into BAE Systems. Read more about our investment in technology on page 20.

Our sustainability agenda

Recent global events continue to demonstrate the need for strong defence and security in the face of aggression by nation states. At BAE Systems, we provide critical capabilities and support to our government customers and their allies to fulfil their primary obligations to keep citizens safe, as well as enabling important economic and social contributions through the provision of sustainable high-quality jobs.

In line with our Group strategic business priorities, we put a significant focus on recruitment, skills and education to ensure the future talent pipeline. A key enabler to this is a positive and inclusive workplace and we continued employee engagement through our employee resource groups and introduced new wellbeing programmes. Please read more on pages 46 to 66.

Sustainability is one of our focus areas for technology innovation in the Group. Our ambition is to improve the sustainability of our products without compromising performance, even enhancing it where possible.

Executive Committee changes

After long and successful careers with the Company, two Executive Committee members retired at the end of the year. Our Air Sector Managing Director, Cliff Robson, has been succeeded by Simon Barnes, who previously led our business in the Kingdom of Saudi Arabia. In our Digital Intelligence business, Managing Director David Armstrong has been succeeded by Andrea Thompson, who previously led our Air Sector's Europe and International business.

Summary

As you'll see throughout the pages of this report, 2023 has been a year of real progress for the Group. We delivered a strong operational and financial performance, moved forward on highly significant long-term strategic programmes with GCAP and AUKUS, increased R&D spend and capex, grew our workforce by a net 6,700 employees and announced the \$5.5bn acquisition of Ball Aerospace to enhance our space portfolio, which completed in February 2024.

On behalf of all of my BAE Systems colleagues, I'm proud to report that the fundamentals of the business are strong, the outlook is positive and our team is focused on our values and purpose – "to serve, supply and protect those who serve and protect us". We are well positioned to help our national government customers keep their citizens safe and secure in an uncertain world. For shareholders, our record order backlog, position on major programmes and our continued focus on operational excellence and financial discipline, provide a high level of visibility for sales growth, margin expansion, cash generation and capital returns in the years to come.

Thank you for your support of the Group and our strategy for value creation. We look forward to another productive and rewarding year in 2024 for all our stakeholders.

Charles Woodburn CBE
Chief Executive