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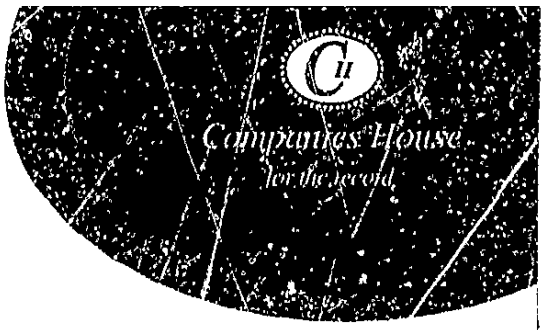
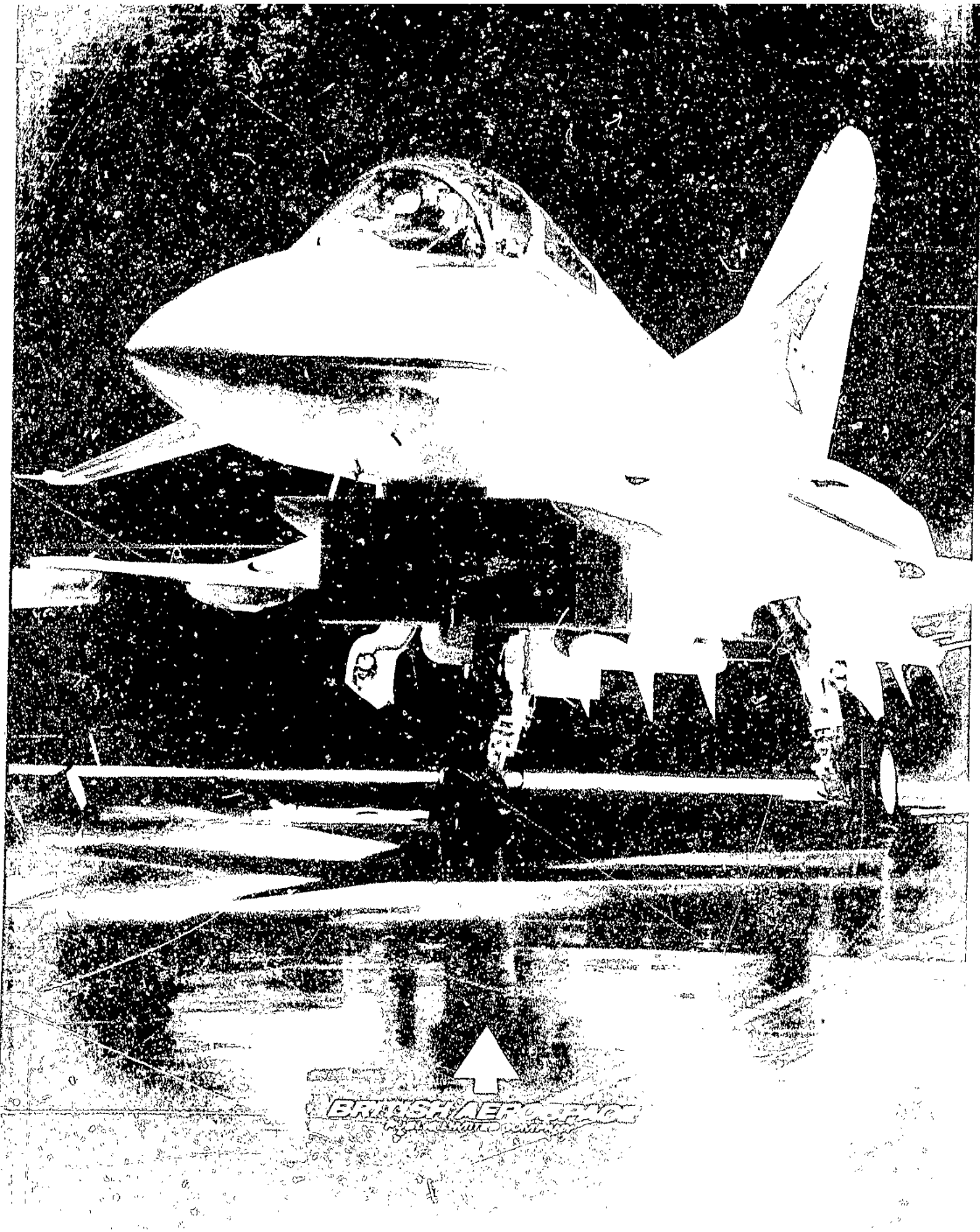


NOTICE OF ILLEGIBLE PAGES

Companies House regrets that documents in this company's record have pages which are illegible.

The poor quality has been noted, but unfortunately steps taken to improve them were unsuccessful.

Companies House would like to apologise for any inconvenience this may cause



Sir Austin Pearce

Late in 1979 I was invited by the Government to become the full-time Executive Chairman of British Aerospace with the objective of taking the Company through the first stages of privatisation.

I took office in April 1980 and, after two false starts, eventually in February 1981 British Aerospace became the first company to be privatised under the present Government's programme. Being the first there was little experience to guide either the Government or us, there was no shortage of doubters to make the process difficult, but we succeeded and learnt many lessons for those to come.

Since then British Aerospace has weathered the storms of two take-over approaches and a second stage of privatisation, and we are now a fully privatised company.

In 1980 I took the Chair of a successful company, but the aerospace world was changing rapidly and British Aerospace too had to change rapidly if it was to grow in a highly competitive market.

In the years ahead we could see that the British market would become a smaller part of our activity and we had to become truly international. Compared with the competition we were disadvantaged by poor use of capital with too many sites and too many layers of management. It was apparent that financial control and discipline had to be strengthened and changed, and we had to strengthen our marketing effort. We could see that, if our workforce were to perform the tasks needed to time and to quality, we had to provide the tools and the conditions needed to achieve this.

All these tasks and many more have been tackled by some who have spent many years in the Company as well as some who are new to it and we have made great progress. Many of those who laid the foundations for the current success have retired, but have been replaced by younger management and those behind them are being trained to be their successors.

Later this year I too plan to retire from full-time executive responsibility to make way for a younger person.

Much has, therefore, been achieved by many people, but much more has still to be achieved and I am confident it will be.

The results show that, despite increasing competition which has squeezed our operating margins, we have increased our trading profit and achieved greater sales together with a larger order book.

There is no doubt our productivity can be improved and this is one of our continuous objectives.

There has been a run down in the total number of people employed, but the numbers would have been considerably lower if we had not improved our sales and order book. There is a very simple correlation which states that orders equals jobs and without orders there are no jobs. Productivity from all our resources whether human or financial is directly linked to our ability to sell, and our sales determine our future.

The Company is in a strong position today with good products which are selling. This activity has been

> **"1986 was . . . a year of many significant events bringing with them another successful outcome"**

underpinned by strong financial management which sees British Aerospace with good financial resources which will enable it to ride the swings in political decision-making and to modify its business direction as and when required.

Much of what we have done I believe could only be achieved by a company freed from the restrictions of a government bureaucratic machine. I know many government officials and usually they are very nice people with a job to do, but they cannot be expected to be responsible or accountable for

business decisions. Many of the decisions taken by the Board have long term consequences and commitments, and the management must be free to make its decisions quickly and with full responsibility and accountability.

Privatisation gave the Company the freedom to act and as a result the future for British Aerospace is much brighter today than it was seven years ago.

1986 was, however, the first full year for British Aerospace as a 100% privately owned company and once again it was a year of many significant events bringing with them another successful outcome.

Total sales exceeded £3,000 million for the first time and increased by 18% over 1985. With continued fierce competition and the need for prudence in taking profits on contracts with extended delivery programmes, margins were under pressure and the trading profit at £217 million reflects a margin of 7% on turnover. The profit before tax and extraordinary item of £182 million is in line with expectations and shows an increase of 21% over 1985. With a higher tax charge in 1986 because capital and other allowances are no longer available, profit after tax is at a similar level to the previous year.

The sustained pressure on margins reinforces the continuing and vital need to seek ways and means of improving efficiency and reducing costs. It was against this background that, after careful study, the decision was taken to close the Weybridge manufacturing activities. As a result an extraordinary write off of £44 million has been made in 1986 to cover the costs of the closure.

Also, the Naval Weapons and Electronic Systems and Equipment Divisions have been merged with effect from 1st January, 1987. The Managing Directors of each of our six Divisions now have full responsibility for their profit performance.

In August 1986 we consolidated our management reorganisation when moving to our new Headquarters offices at 11, Strand. This provided for further rationalisation of our management structure with clearer and shorter lines of responsibility for profit performances.

The development of our civil aircraft business is now concentrated in one Division, but selling prices

The British Aerospace family of civil aircraft in formation over Farnborough, from left to right, the ATP, the BAe 125-800, the Jetstream 31 and the BAe 146-200.

continue to reflect worldwide competition and a buyers' market. The weakening of the US dollar has not been helpful in getting adequate returns on sales. The loss for the year of £8 million emphasises the need for reduced costs and increased prices The outlook for sales is very good, but the profitability is coming through too slowly and that we need to change.

The aerospace business clearly poses many exciting challenges for British Aerospace in its objectives of growing in size and profitability.

Dividend

The Board is proposing a final dividend of 11p per share making a total dividend for 1986 of 17.4p—an increase of 10% over 1985. This dividend is covered three times by net earnings.

The Board

On 1st October, 1986 we welcomed Mr. D. E. Bucknall to the Board as Personnel Director.

On 31st October, 1986 Sir Kenneth Durham, who joined the Board as a non-executive Director on 11th August, 1980, was appointed a Deputy Chairman of the Company.

On 13th January, 1987 Mr. R. H. Evans joined the Board as Marketing Director.

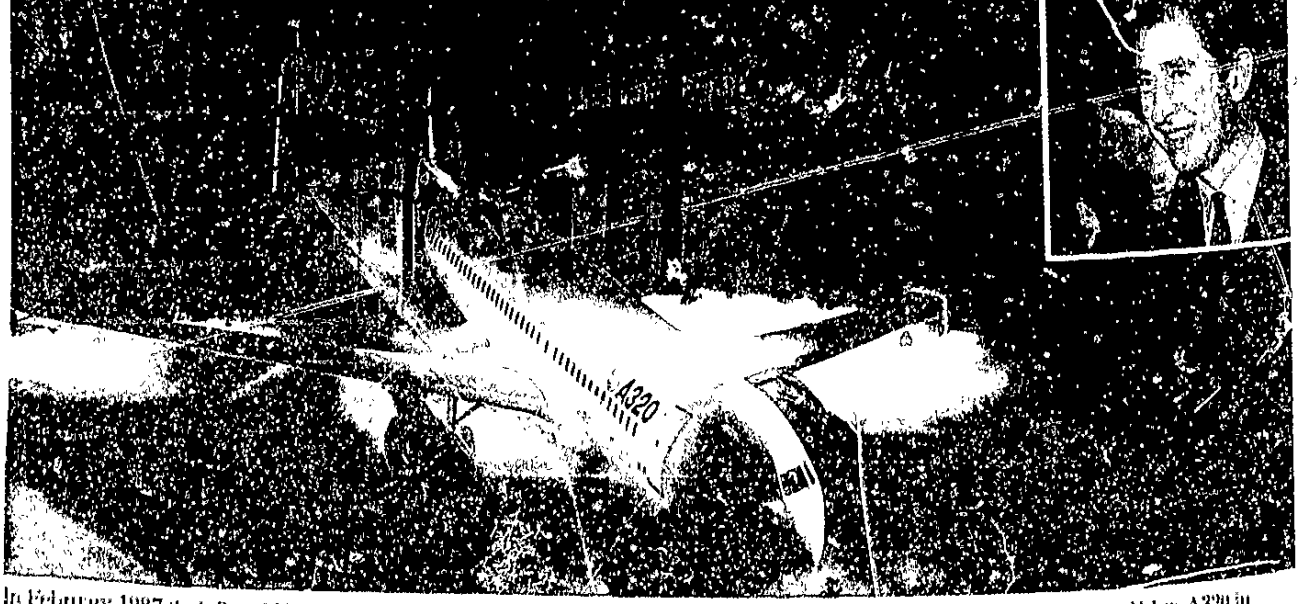
On 11th February, 1987 Professor Roland Smith joined the Board as a non-executive Director.

On 24th March, 1987 Mr. K. M. Bevins resigned from the Board in order to reduce his business commitments. Ken Bevins was the non-executive Government Director, but always looked to the interests of the Company and his knowledge of financial matters contributed greatly to the key decisions made by the Board.

At the Annual General Meeting Sir Jack Wellings, who is nearing the age of 70, will retire as a non-executive Director of the Board. Sir Jack brought to the Board experience of many industries, including aerospace, and of particular importance, wisdom gained in many business battles.

Mr. J. L. Glasscock will also be retiring as a Director at the Annual General Meeting. John Glasscock has been with the Company some 34 years and has held a variety of senior positions culminating in his appointment to the Board in 1982. He has decided to take early retirement and his experience will be greatly missed.

I take this opportunity publicly of expressing my appreciation of the counsel and commitment of all three retiring Directors and I wish them all many happy years ahead.



In February 1987 their Royal Highnesses the Prince and Princess of Wales attended the roll-out ceremony for the new Airbus A320 in Toulouse

A number of employees were honoured in 1986 as shown in the Directors' Report and I was particularly pleased that Mr. R. H. Evans, our new Marketing Director, was awarded the C.B.E.

The Future

British Aerospace entered 1987 with an order book of £8,600 million, liquid assets of £1,000 million and steady productivity increases. Over the past five years we have spent £400 million on new buildings, plant and equipment with the prime objective of getting a good return from increasing productivity. The results of this expenditure will increasingly show through in higher profitability.

We have also invested substantially in research and development. Some of the achievements noted this year are the result of this long range planning strategy. The Board remains firmly convinced that it is essential to maintain substantial and continued investment in research and development—both in products and in methods and process technology—aimed at maintaining and further improving our international competitive edge and technological expertise. Such expenditure is the seed-corn for profits in the 1990s and beyond and means British Aerospace will continue to enjoy its worldwide success and recognition as a market leader in a wide range of aerospace products, civil passenger aircraft, military combat and training aircraft, guided weapons, space systems, underwater systems and in the management of very large national and international programmes.

Our financial base is strong, as described by our Director of Finance in his Financial Review, but this is also a business in which we have to minimise the impact of currency fluctuations, and this we are doing.

We must ensure that as a company in the private sector, we have a balance of business activities so that we are not over dependent on any one sector. In civil aircraft we have moved quickly to establish a position in the market place both with our own products and through Airbus Industrie. Although the Company could fund the costs of a large new programme, such as the A330/A340, nevertheless we must pay due regard to the additional risk that this would add to the already significant level of funds employed on other existing civil projects. Without an acceptable level of risk participation outside the Company, it would not be prudent to commit ourselves to these programmes, however deserving.

We have made good progress over the last few years matching our resources to customer requirements. We shall continue to make headway along these lines so that our strength of first class skills, sound projects and financial stability are utilised in the optimum way to meet the aspirations of a dedicated workforce, to give customers the right products and to yield a good return to our shareholders.

I am very proud to have been associated with the Company and its people, and its successes in my seven years. Success is the result of the efforts of many people spread throughout the Company. Some naturally have done more than others, but to all of them I say, thank you for the help I have been given and all continued success in the future.

Sir Austin Pearce
Chairman

24th March, 1987

Important events during 1986 added considerably to the Company's financial base and its future well-being.

The progressing of the very large contracts, under the Government to Government Memorandum of Understanding for the supply of aircraft, missiles and support activities to Saudi Arabia, together with the large UK Government order for Rapier 2000, are reflected in the year end order book of £8,600 million—an increase of £3,462 million from 1985.

Advance payments have resulted in liquid assets at 31st December, 1986 of £1,001 million. These downpayments have an important influence on the level of trading margins for the supply of products. In recognition of this situation, the interest attributable to customer advances is now included within trading profit and interest on the Company's funds is shown separately as interest receivable.

In 1986 the Company also entered the US Commercial Paper market to supplement its existing multi-currency credit lines with UK and US banks. As a prerequisite the Company obtained excellent credit ratings from US agencies. Some $100 million of British Aerospace Commercial Paper is now traded with the result that the Company's name is much better known in the US financial market.

Savings will accrue over future years from the decision to close the manufacturing facilities at Weybridge. The estimated after tax costs of this closure of £44 million, including relocation and employee related costs, have been written off as an extraordinary item.

Results in brief

		1986	1985
Turnover	£m	**3,137**	2,648
Exports	£m	**2,071**	1,623
Trading profit	£m	**217**	211
Profit before taxation and extraordinary item	£m	**182**	150
Dividend per share	p	**17.4**	15.8
Assets employed	£m	**1,457**	1,451
Capital expenditure	£m	**99**	99
Order book	£m	**8,600**	5,138

Total turnover at £3,137 million showed a creditable increase of 18% and exports at 66% of turnover held up well, with all business sectors contributing to the increase. Trading margins, however, reflected the continuing competitive pressures on selling prices for virtually all product classes, including military aircraft and weapons. Since many of the Company's sales contracts have a long delivery time-span profitability will depend on many factors, such as production costs, interest and exchange rates, and their final outcome cannot be determined until contract completion. For reasons of prudence the margins on such contracts reflect the extended time-scales of deliveries. Margins on sales of 6.9% in 1986 compare with 8.0% in 1985. This reinforces the need to cut costs by continuing investment in projects which provide a good return and a reasonably quick payback and by intensive reviews of the costs associated with developing, producing and supporting our range of products. We need to improve trading margins.

B. E. Friend,
Director of Finance

In 1986 some £99 million was spent on new facilities and plant and machinery and £63 million on company funded research and development activities, which will produce the profits of the future. Manning levels continued their downward trend with a total workforce of 74,914 at the end of 1986 compared with 75,823 a year earlier.

As a result of past changes in tax legislation, including first year tax depreciation allowances on capital expenditure being severely reduced, the Company's tax charge is increasing rapidly and in 1986 was 29.5% of reported profits as compared with 15.6% in 1985.

Business sectors

Turning now to the results of separate business activities, all sectors contributed to the overall increase in turnover. Military aircraft showed an increase of 24% at £1,168 million, passing the £1 billion mark for the first time. Guided weapons and electronics also exceeded the £1 billion level in 1986 with an increase of 10% over 1985. Civil aircraft, despite fierce competition, showed sales of £762 million, an increase of 17%, but trading margins have suffered. Space and communications have had a good sales year in 1986, with an increase of 59% on 1985 to £196 million.

> **"The Company goes forward into 1987....with a strong financial base....we need to improve trading margins"**

Profits from military aircraft sales, of which 73% were exported, were again very supportive of the Company's results for the year. Although they were marginally lower than 1985 at £146 million, they reflect contributions from

some contracts which have only just commenced and which will extend over many years.

Guided weapons and electronics contributed £140 million to overall profits, an increase of £12 million over 1985. This was a very good performance, with Rapier again in the forefront.

Civil aircraft experienced another difficult year turning in a loss of £8 million at the trading level. Competition for orders resulted in keen selling prices that are too low to produce profits and the strengthening of sterling against the US dollar had an adverse effect on margins. The Company policy of hedging a significant proportion of its currency exposure mitigated the full cost of currency changes, but a strengthening of the US dollar would assist future civil aircraft profits.

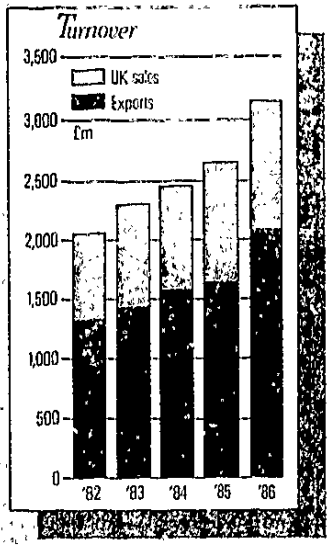
Space and communications achieved the anticipated turnround from loss to profit in 1986. Although modest, the profit of £2 million, as compared with a loss of £2 million in 1985, was an important indicator that costs are now under control.

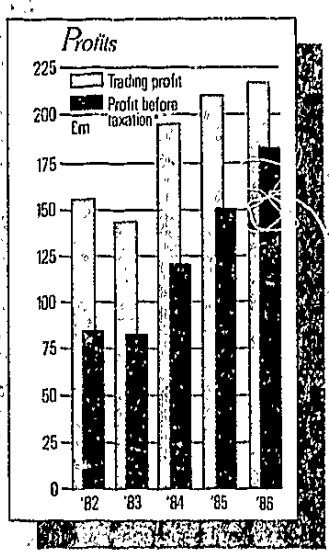
Financing and capital employed

Working capital has been satisfactorily controlled within a total assets employed figure of £1,457 million at the end of 1986—only £36 million higher than 1985 even though sales increased by 18%. Liquid assets of £1,001 million have increased from £642 million in 1985 reflecting a significant increase in customer advances up from £377 million to £800 million at the 1986 year end.

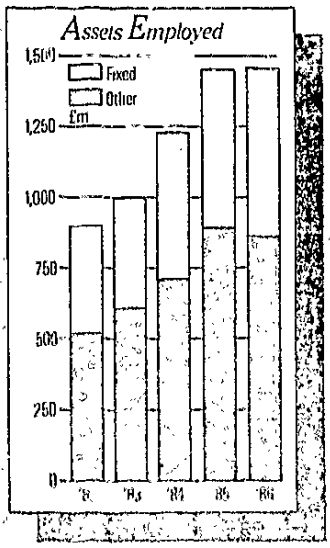
Cash flow in 1986 was very strong. After meeting capital expenditure and company funded research, design and development expenditures, totalling £209 million, there was a net inflow of £387 million.

The Company goes forward into 1987 and future years with a strong financial base. Liquid assets comprise gilt edged securities, deposits with banks, local authorities and other financial institutions, all with reasonably short maturities to reflect the large proportion of the liquid assets representing customer advances. Commitments from the banks are in place to meet all the Company's foreseeable needs, including contingent liabilities in respect of recourse or similar obligations under sales finance arrangements. The policy of hedging a proportion of the Company's currency exposure will continue and opportunities will be taken to increase the coverage should there be occasions, albeit of short duration, when the US dollar strengthens.





*1982 before exceptional item 1986 before extraordinary item



1986 was an important milestone in the relatively short history of British Aerospace plc. The Company marked its first full year of privatisation with the achievement of massive new orders and the launch of major new products.

Farnborough '86 provided a platform from which our new products could be displayed and they performed magnificently. An impressive display was provided by the EAP (Experimental Aircraft Programme), the flying test bed aimed at proving the technology for the new EFA (European Fighter Aircraft). The EAP flew for the first time shortly before appearing at the Farnborough Air Show alongside the Tornado. The Tornado is at the centre of the £5 billion contract for the supply and support of defence equipment to Saudi Arabia, which also includes the Hawk, guided weapons, the training of crews and the design and construction of facilities.

The Company's family of civil aircraft flew in formation at Farnborough in a parade that very few companies in the world could beat. It included the ATP (Advanced Turboprop), Britain's newest civil airliner, which flew for the first time on 6th August, 1986, demonstrating its exceptionally quiet performance. The aircraft achieved its first flight to the time and specification set years before.

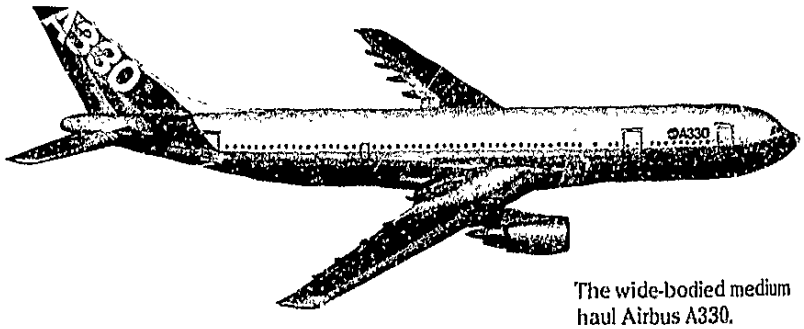
Through our successful collaboration with European aerospace companies in Airbus Industrie we continue to be involved in the development of larger airliners. The latest Airbus, the A320, made a successful maiden flight in February 1987.

During 1986 the Company submitted a launch aid proposal to HM Government towards the cost of participating in the A330 and A340 — the next generation of Airbus airliners.

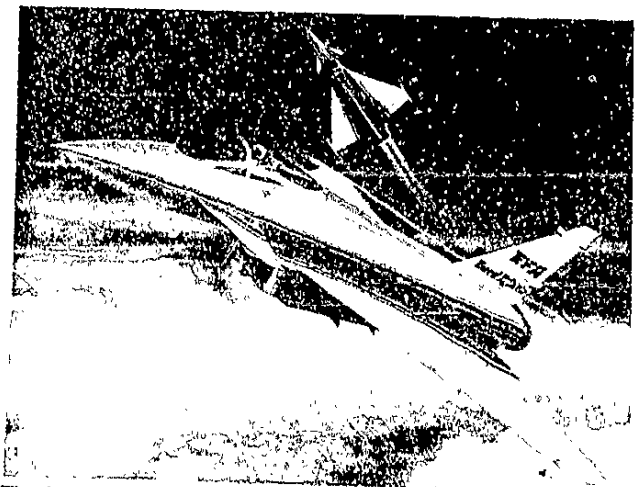
Sir Raymond Lygo, Chief Executive

In 1986 we also won our largest single contract for missile systems with an order worth some £1 billion from HM Government for Rapier 2000. The order is of immense importance to the Company's future guided weapons business. Rapier 2000 will enter service with the British Army and RAF in the early 1990s and will remain in production well into the 21st century. The system has considerable export potential and is expected to generate business worth billions of pounds.

The year also saw a turnround into profits by the Space and Communications Division. One noteworthy achievement was winning the contract to supply a new generation of NATO satellites which will provide secure military and diplomatic communications, the first time that NATO has entrusted to a non-American contractor the supply of satellites to its front line. A particularly impressive achievement in 1986 was the successful interception of Halley's Comet by the Giotto spacecraft. The Company is currently responsible for eleven communication satellites and is engaged in design work on the exciting new spaceplane, Hotol, and the Space Platform—one of four major projects in the European Columbus programme.

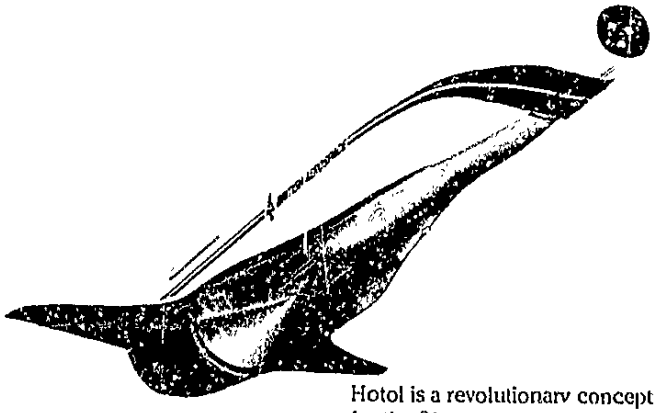


The wide-bodied medium haul Airbus A330.



The four nation EFA (European Fighter Aircraft) will be in service in 1995.

We have completed the management reorganisation foreshadowed last year with a functionally organised single headquarters reduced in size, the elimination of one complete level of management and with all the Managing Directors of the Divisions responsible and accountable to the Chief Executive and his functional colleagues for their total performance. In 1986, within the parameters established, all the objectives set for the



Hotol is a revolutionary concept for the 21st century.

Managing Directors were met. As part of the policy to reduce costs and increase competitiveness to secure a larger share of the international market the decision was taken, with great regret, to close the Military Aircraft Division's manufacturing facilities at Weybridge. The majority of the 4,000 employees are being given the opportunity to transfer to other sites and full support to find alternative employment.

The Electronic Systems and Equipment Division and the Naval Weapons Division have been merged with effect from 1st January, 1987. The two Divisions had much in common and their combined strength will create a more powerful and economic unit.

In 1986 our changes in structure have resulted in a reduction in the workforce of nearly 1,000 people. We suffered from a strike at Warton in the earlier part of the year which had an adverse effect on the total output of the Military Aircraft Division.

We continue to explore ways of widening our product base and developing the talents and expertise which we already have to offer. An example of this is our recent initiative to establish the Flying Training College to train civil and military pilots. Skills in this field have been developed over the years by training over 10,000 pilots to fly Company built aircraft. To ensure the most stimulating environment for success we have set up a wholly owned subsidiary, British Aerospace Flying College Ltd., through which the business will be operated. We intend to extend this sort of business development into other areas.

Five Major Awards for British Aerospace

In 1986, British Aerospace was awarded the following four separate Queen's Awards to Industry, a record achievement for any company in a single year.

1986 EXPORTS — Awarded to the Civil Aircraft Division for the sales success in 1985 of the Jetstream 31 light turboprop aircraft. (Awarded for the second year running).

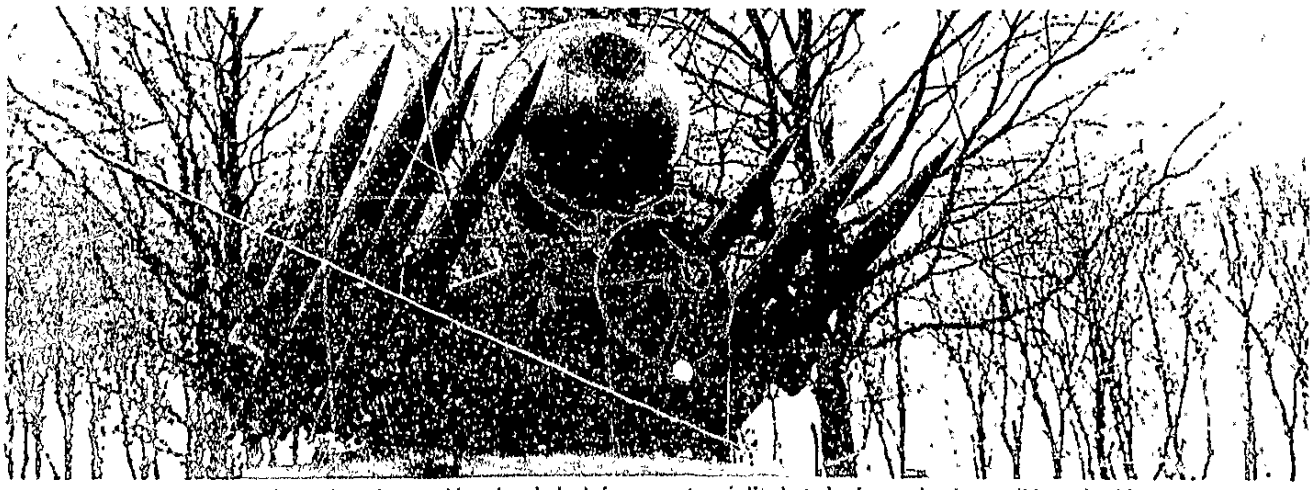
1986 EXPORTS — Awarded to the Civil Aircraft Division for the sales success in 1985 of the BAe 146 regional jetliner. (Last year an Award for Technological Achievement was given for the BAe 146).

1986 EXPORTS — Awarded to the Army Weapons Division largely for the sales success of the Rapier air-defence system in 1985.

1986 TECHNOLOGY — Awarded to the Space and Communications Division for the design, development and manufacture of the Giotto spacecraft which successfully intercepted Halley's Comet.

Also in 1986 our Australian subsidiary won the Defence Industry Quality and Achievement Award.

1986 — Awarded to British Aerospace Australia Ltd. This is a prestigious award for which 4,500 Australian defence companies are eligible to compete.



Rapier 2000: the new technologically advanced low level air-defence system is likely to be in production well into the 21st century.

Civil Aircraft

An important and successful year for Airbus

Airbus Industrie, of which British Aerospace is a member, had an outstandingly successful year. 80 orders, worth over $5 billion, were received during 1986 for the family of Airbus airliners. By the end of the year firm orders had reached 557 with over 350 aircraft in service worldwide. There are over 50 airlines operating Airbus aircraft.

The Company is responsible for the design and manufacture of wings for all types of Airbus aircraft.

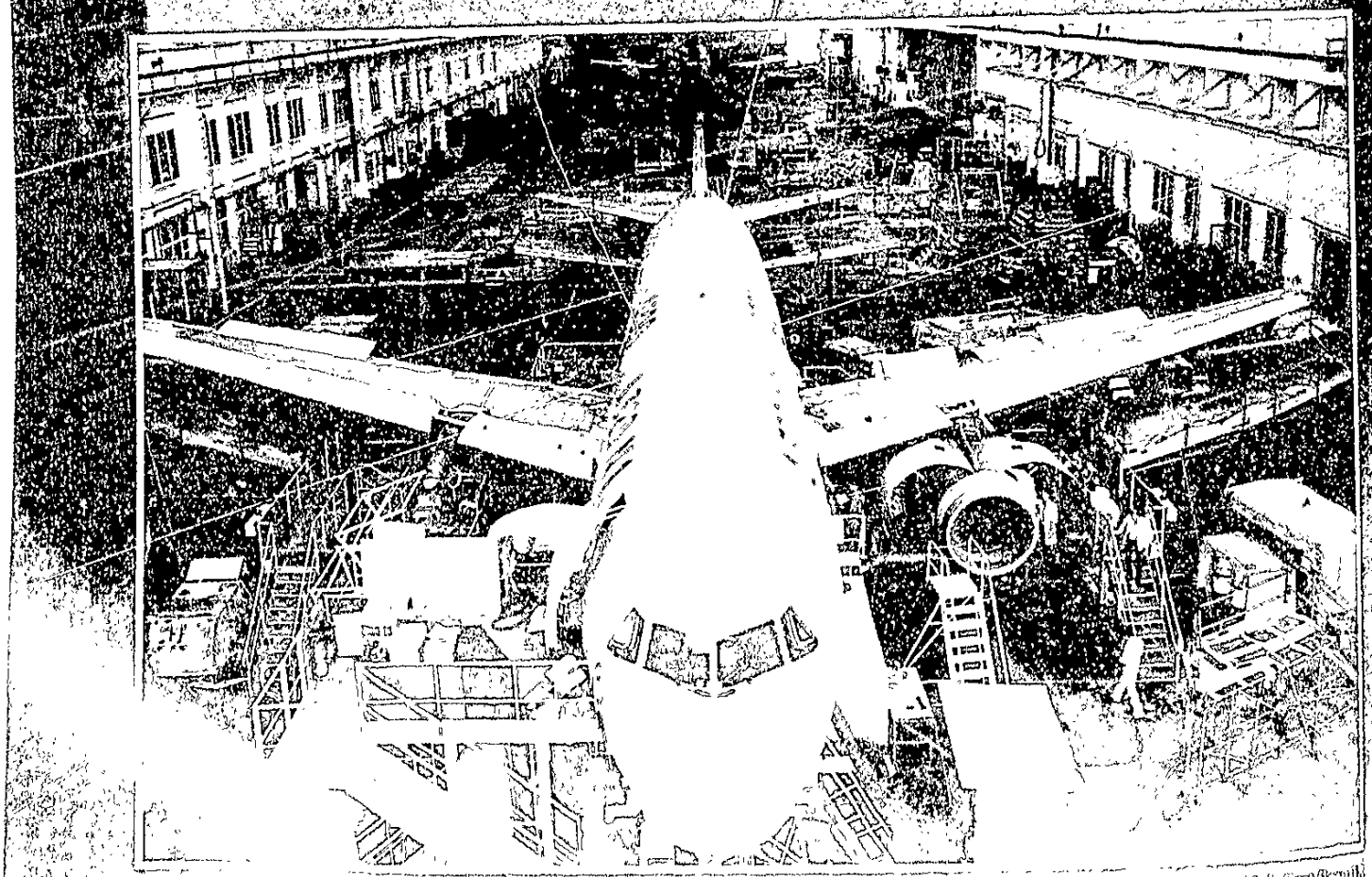
The latest airliner in the Airbus family is the A320, a single aisle, twin engined, 150 seat aircraft which had its successful first flight in February 1987. The work on the wings provides the Company with just over 25% of the work in building each A320 airframe. The advanced aerodynamic design of the wings allows high fuel volume with a low wing weight and low drag. This is a continuation of the philosophy pursued in the wing design of the existing Airbus models. By the end of 1986, 145 orders and 221 options had been received for the A320; 'off the drawing board' orders and options for the A320 are greater than those achieved by any other civil aircraft at a comparable stage in development, which should ensure the long term success of the airliner.

Our wing has made a major contribution to the A320's attractive operating costs which have led to the airliner's remarkable early sales success. It was fitting, therefore, that the Prince and Princess of Wales attended, as guests of honour, the roll-out ceremony in February 1987.

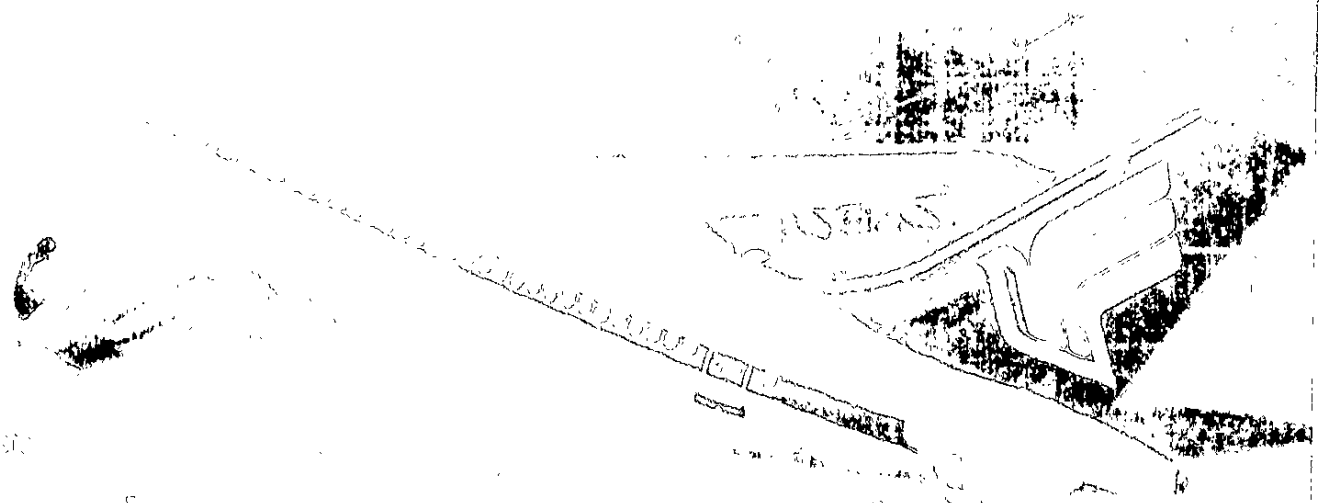
In 1986 Airbus Industrie proposed the launch of two new aircraft, the A330 and A340, to complete the family of Airbus airliners. The twin engined, medium range A330 would typically carry 328 passengers and the four engined A340 would be capable of carrying up to 295 passengers on long haul routes. A decision on the launch of these two models, variants of the same basic aircraft, is expected in early 1987. British Aerospace has submitted a launch aid proposal to HM Government, agreement to which will enable the Company to be fully involved in the design and production of the common wing for the new models.

A family of aircraft

Air transport is a major growth industry and market studies indicate a doubling of air traffic over the next 12



Assembly of the A320 at Toulouse. The aircraft is the most complex [illegible] which first flew in February 1987.



years. During this period there will also be substantial replacements of older aircraft. Nearly half of all initial civil aircraft deliveries forecast during the next 20 years, comprising no fewer than 4,700 aircraft, are in seating ranges covered by the British Aerospace civil aircraft family.

In the regional aircraft sector the Company has developed its Jetstream family of aircraft with seating capacities ranging from eight to 112 seats. We have adopted and complete commercial selective strategy of identifying suitable slots in the short/medium haul market place.

ATP Update

The ATP (Advanced Turboprop) is the latest member of the Company's family of civil aircraft and made its first flight in August. Since then it has completed over 200 hours of successful flight testing. A total of 750 hours are scheduled for the flight test programme leading to full certification in July 1987 with the aircraft entering service with British Midland Airways in September 1987.

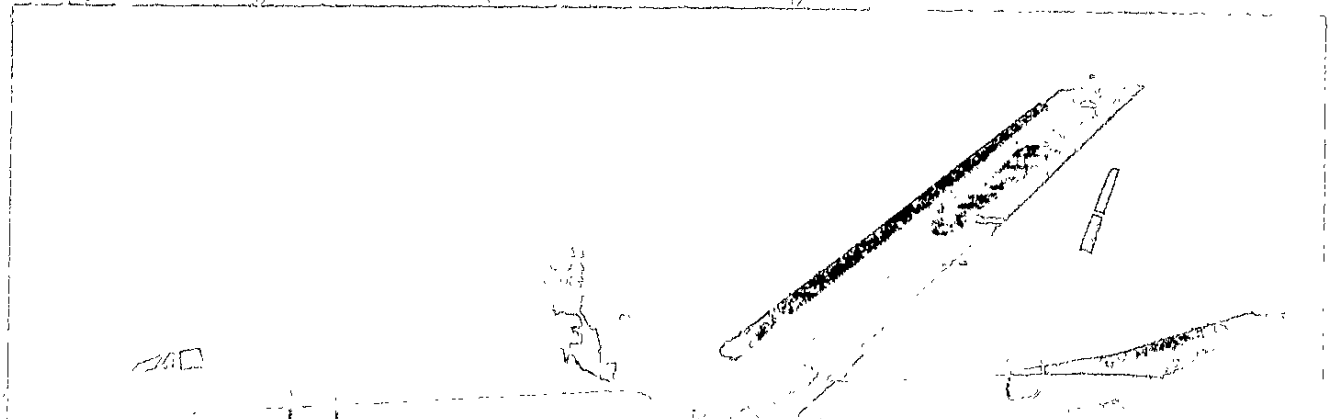
The ATP is a twin-engined turboprop airliner with a seating capacity of between 60 and 72 passengers. In operation the ATP can break-even with only 20 to 26 passengers.

The aircraft combines a proven airframe structure with an advanced technology engine and propeller combination, as well as an advanced flight deck and systems. The slow turning six-bladed propellers and engines give the ATP a noise footprint of less than one fifth that of a current twin jet and the lowest fuel burn per passenger of any airliner. The aircraft therefore offers the world's regional airline market new standards in low operating costs, low noise levels, vibration free passenger comfort and excellent profit potential.

The value of the market for airliners in the ATP category is forecast to reach some $13 billion over the next 20 years.

New versions of the BAe 146

1986 saw the introduction into service of the BAe 146 airliner into new sectors, in particular China and the East Coast of the USA. In China, the first of ten aircraft entered service for the Civil Aviation Administration of China



(CAAC) which intends to use its BAe 146 fleet to develop air travel for business and tourism.

Five BAe 146-200 aircraft (plus further options) have been ordered by the US East Coast airline Presidential Airways which, by operating in association with Continental Airlines, will provide the 146 with the opportunity to repeat the success already shown on the West Coast. Its success in the intensely competitive Californian market, with its ultra-low noise levels and excellent fuel consumption, has been demonstrated by purchases made by competing airlines. The 146 is now operated on the West Coast by PSA and AirCal.

The Statesman has been developed with special interiors for Heads of State or Presidential use. Its launch was announced to coincide with the handover of the first BAe 146-100 to The Queen's Flight in April 1986. Since then the two 146's of The Queen's Flight have seen steady service, most notably flying the Duke and Duchess of York on their honeymoon and The Queen and the Duke of Edinburgh during their State visit to China.

(above) The BAe 146, seen here at Orange County Airport, is successfully operated on the West Coast of the USA by PSA and AirCal. (top right) The BAe 146 operated by the Civil Aviation Administration of China. (right) The BAe 146 Quiet Trader—low noise offers freight carriers greater flexibility.

The BAe 146—the world's quietest jetliner—in three series, seating from 80 to 112 passengers, is ideal for airlines operating in populated areas, and for the overnight package market—one of the fastest growing segments of the world's air transport scene. During 1986 three new variants were launched: the 146-series 300, the QT and the Statesman. The BAe 146-300 will make its first flight on 1st May, 1987. It is aimed at the high yield 100 seat business class market.

The BAe 146-QT (Quiet Trader), with a large side door and strengthened floor structure, was displayed at the Farnborough Air Show. The low noise 146 is uniquely suited to night freight use being able to operate unobtrusively into noise sensitive airports, thereby giving freight carriers greater flexibility in scheduling their flights.

The commuter and corporate market

The Jetstream 31, the 18/19 seater turboprop commuter airliner, continued to enjoy success particularly in the fiercely competitive US regional markets. It has achieved almost 50% penetration of the 19 seater pressurised commuter airline market in the USA. Many operators of the aircraft have formed feederline relationships with the major trunk carriers to provide a direct link into the main airport hubs.

Of particular note was the receipt, during 1986 of our first order from a major US airline, Piedmont Airlines who ordered 14 aircraft with a further 20 options.

Jetstream 31's market penetration within the USA has resulted in total sales of 117 aircraft to over 20 operators. A significant number of those sales have been re-orders

The Jetstream 31 now in service with Australian Airlines.

thereby underlining the confidence of its operators. The aircraft has entered service in Australia with the national domestic carrier—Australian Airlines—in Queensland. Improvements introduced during the year include a baggage pannier to help with the large amount of carry-on baggage

The BAe 125 is the world's best selling mid-sized business jet with some 650 aircraft sold. The total sales value now exceeds $2 billion (in 1986 terms) with over 80% of production exported. Success has continued throughout 1986, in particular in North America and with the opening up of new export areas, including New Zealand. A noteworthy order came from Swiss Air Ambulance for two aircraft for aero-medical use.

An interesting feature in 1986 was the trend towards fleet purchases. Arising from the rationalisation of some major companies' air transport fleets, the 125, with five to ten seats, has emerged as probably the most cost effective vehicle offering better value for money than smaller business jets and with the range and interior space to compete with the larger and more expensive corporate aircraft.

British Aerospace continues to develop the aircraft—the latest innovations being more baggage space and optional thrust reversers.

■ USA activities

Our activities in the USA continued to expand in 1986 through our subsidiary, British Aerospace (Holdings) Inc. The USA is currently our largest civil aircraft export market. Our USA subsidiary's business is managed from its headquarters facility at Washington Dulles International Airport and through more than 40 offices across the country. British Aerospace (Holdings) Inc. has responsibility for marketing the Company's range of aircraft in North America. Customer support is provided for more than 800 commercial aircraft and during 1986 a new West Coast support and marketing facility was opened in Southern California.

The BAe 125 is the world's best selling mid-sized business jet.

The European Fighter Aircraft

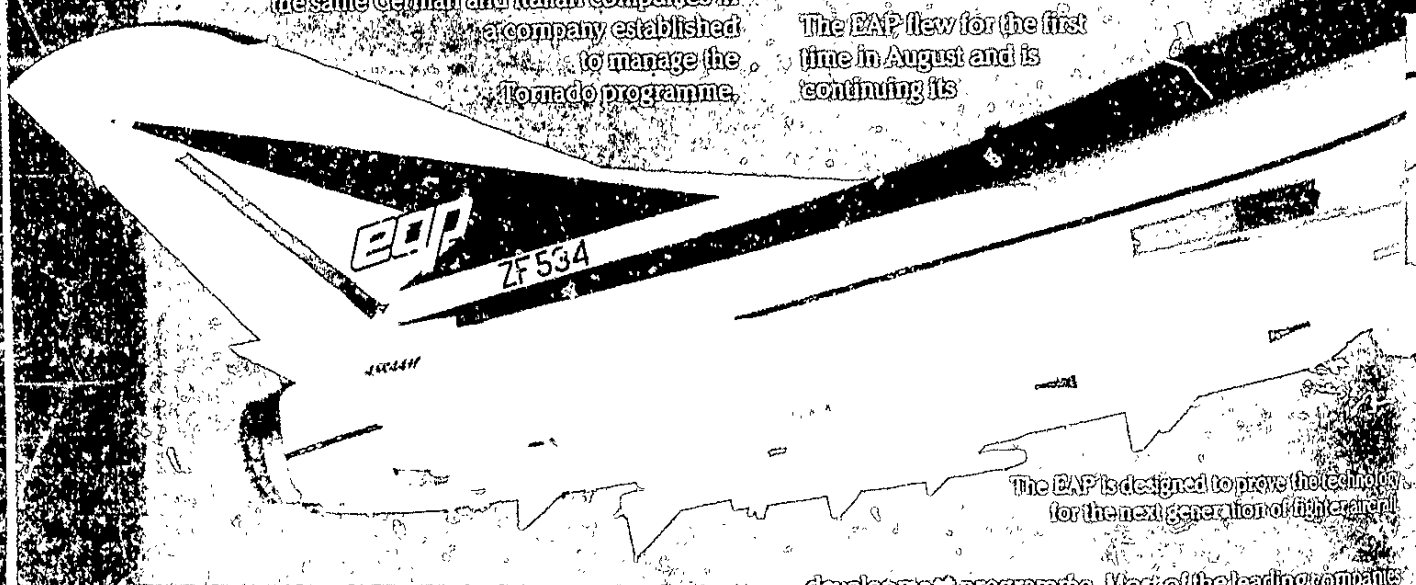
In terms of future military aircraft activities, both for British Aerospace and for Europe, the most important achievement was the launch of the project definition phase of the EFA (European Fighter Aircraft), known as the Eurofighter, for which governmental agreement was reached in 1985 between the UK, Germany, Italy and Spain. In June 1986 a new company, Eurofighter/Jagdflugzeug GmbH, was formed to manage the EFA programme. The company, based in Munich, is owned by four companies, British Aerospace, Messerschmitt-Bölkow-Blohm, Aeritalia and CASA. The largest work-shares will be taken by the British and German companies—38% each. This management structure is already working successfully we are in collaboration with the same German and Italian companies in a company established to manage the Tornado programme.

The task of defining the Eurofighter aircraft to meet the common requirements of the four countries is basically complete and should lead to a full development phase beginning in 1987 to meet an in-service date of 1995. The programme envisages 800 aircraft for the air forces of the partner nations alone.

The EAP—state of the art technology

The EAP (Experimental Aircraft Programme) is a single seat, air superiority demonstrator aircraft designed to bring together the latest aerospace technology previously partially developed in isolation and now combined in a single airframe. The objective is to prove the latest technology for the next generation of fighter aircraft—specifically, the EFA. This technology includes active controls (fly-by-wire), carbon fibre composites and a very advanced cockpit, with all data required by the pilot shown on coloured multi-function displays.

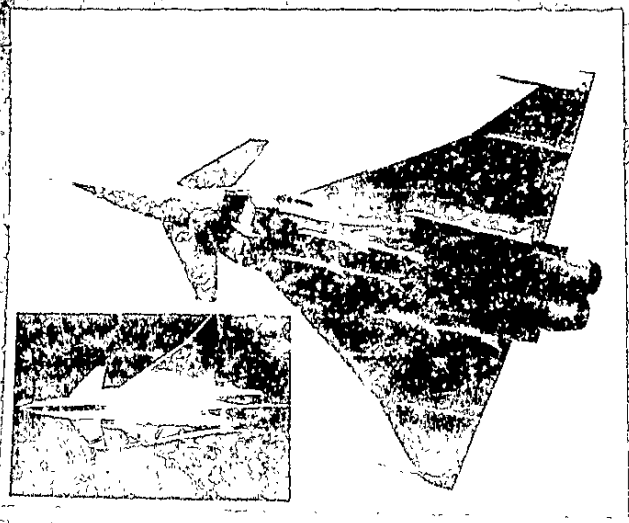
The EAP flew for the first time in August and is continuing its development programme. Most of the leading companies in the UK aerospace industry have joined British Aerospace to provide 50% of the UK funding.



The EAP is designed to prove the technology for the next generation of fighter aircraft

The timescale of less than four years from original contract to first flight was a remarkable achievement for an aircraft of such complexity.

The canard wing design helps to provide exceptional manoeuvrability throughout the speed range and advantage over current combat aircraft types.



The Tornado programme

The Tornado programme, involving the UK, Germany and Italy, is [illegible] most successful

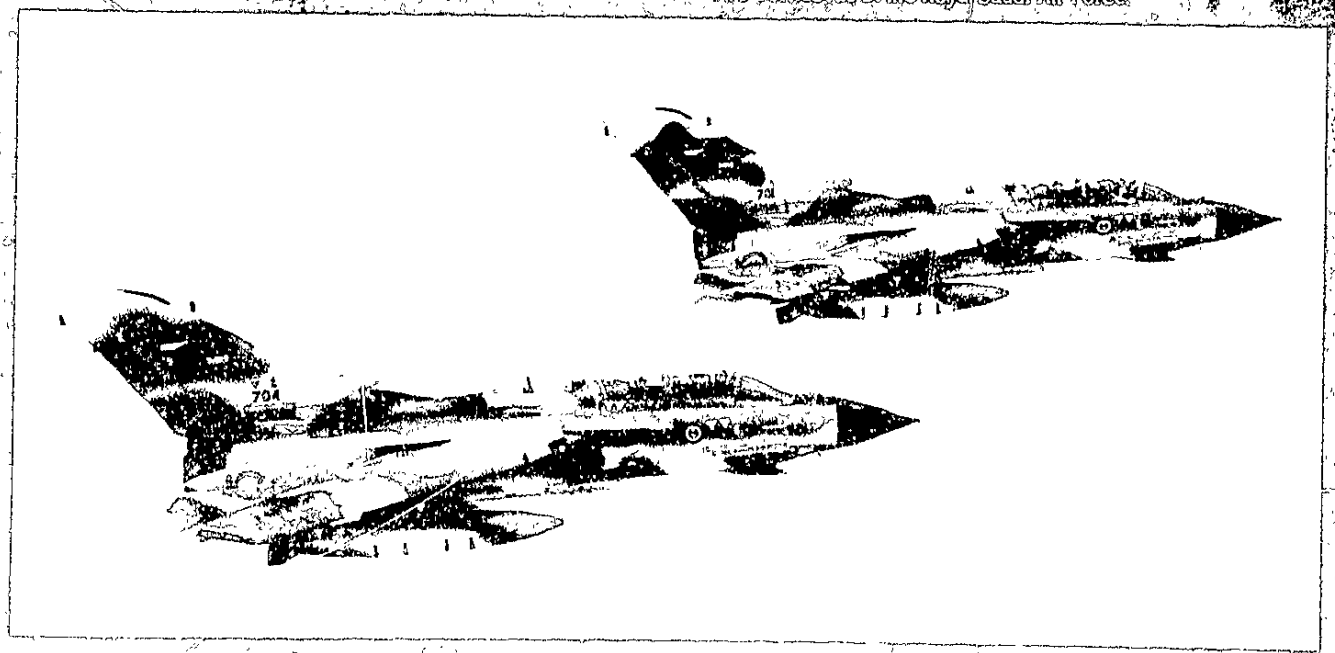
collaborative venture undertaken by the European military aerospace industry. There are two versions of the aircraft—an Interdictor Strike (IDS) version capable of carrying heavy loads of armaments and an Air Defence Variant (ADV) designed to provide long range defence. Its outstanding export success in Saudi Arabia and Oman, together with further orders from the RAF and Germany, led to production authorisation in February 1987 for a further 124 aircraft. The total number of Tornadoes now ordered stands at 988 of which nearly 600 have been delivered. The supply of Tornadoes to the Royal Saudi Air Force (RSAF) is the major element in the Memorandum of Understanding (MOU) signed between the Governments of Saudi Arabia and the UK. "Project Al Yamamah" is the largest ever British defence export order valued at £5 billion for the initial three year phase.

The Company will also supply a range of advanced flight simulators and cockpit procedure trainers. In addition a comprehensive programme of training—air and ground crews is currently taking place in the UK prior to its establishment in Saudi Arabia.

The first Tornadoes were delivered to the RSAF in April 1986, only six months after the initial Memorandum of Understanding was signed between the two Governments and six weeks after contract signature. Initial deliveries of spare parts, ground equipment and weapons were completed in parallel to provide a fully operational capability. We received excellent support from the RAF to achieve this.

The hand-over of the first PC-9 basic trainer aircraft for the RSAF took place in December, only ten months after contract signature. We are responsible for introducing engineering changes required by the RSAF, equipping the Swiss-built aircraft and developing a complete training system around the aircraft. Following basic training on the PC-9 students will graduate to the Hawk advanced trainer.

Two Tornadoes of the Royal Saudi Air Force



The project covers 72 Tornado and 30 Hawk aircraft incorporating advanced guided weapon and electronic systems for these aircraft as well as 30 Swiss Pilatus PC-9 turboprop basic trainers. The comprehensive weapon [illegible] Sky Flash air-to-air missiles and ALARM anti-radar [illegible] the first export order for ALARM.

A continuing key element in the project is the overall support for the products, including the design and construction of new facilities. Our support team in Saudi Arabia will nearly double over the next five years from its current level of around 2,000.

In addition to the order from Saudi Arabia, the Company will be supplying eight Tornado ADVs ordered by Sky

Harrier II aircraft of the US Marine Corps.

Flash missiles to Oman. These contracts have stimulated further interest in export markets.

Developing the Harrier

British Aerospace is currently involved with development and production of two versions of the Harrier—the Sea Harrier and, in collaboration with McDonnell Douglas, the advanced Harrier II.

Total requirement for Harrier II is 390 aircraft of which 328, designated the AV8B, are for the US Marine Corps and 62, designated GR5, are for the RAF. British Aerospace produces the centre and rear fuselages for both types and McDonnell Douglas manufactures the forward centre fuselage, the carbon fibre composite wings and the cockpit. Final assembly of the GR5 is in the UK and the AV8B in the USA.

The US Marine Corps has now been equipped with three operational squadrons and a training squadron covering some 70 AV8B aircraft. The first GR5 for the RAF will be delivered early in 1987 and, in addition to the existing order, authorisation has been given for ordering materials for a further 27 aircraft for the RAF.

During the year the Indian Government contracted to purchase a third batch of Sea Harriers. The Italian Navy is awaiting authorisation to operate VSTOL aircraft from its new class of aircraft carriers following which orders for the Harrier are expected.

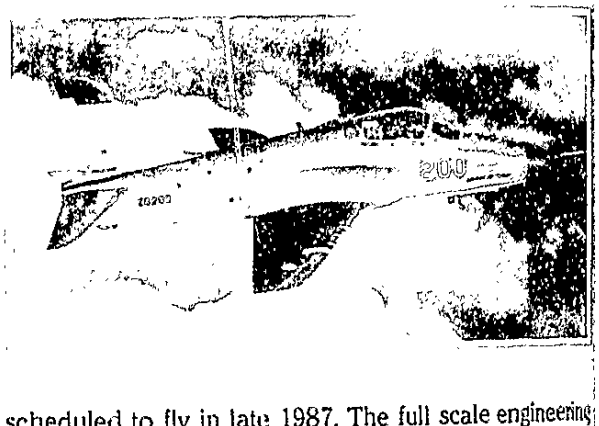
Work on the first Sea Harriers for a mid-life update has now begun involving new avionics and weapon systems.

The Hawk

The second prototype of the Hawk 200 combat aircraft is scheduled to fly in the early summer of 1987 following the tragic loss of the first aircraft in a flying accident in July 1986. There was no technical fault with the aircraft; the programme, aimed at the export market, is continuing. Hawk 200 is a single seat variant of the successful and well proven two seat Hawk and its first flight in May was a complete success. The avionics changes in the Hawk 200 take advantage of the new miniaturised, low cost avionic developments and advanced missiles now available and the weight and space saved by the removal of the second seat permit more fuel, armaments and avionics equipment to be carried.

The largest current Hawk programme is the development with McDonnell Douglas of the T45A version, known as "Goshawk", for the US Navy. The programme covers 300 aircraft of which the first of two development aircraft is

The Hawk 200 combat aircraft in flight.



scheduled to fly in late 1987. The full scale engineering development contract has now been signed.

Orders and commitments for other variants of the Hawk now total more than 330 aircraft. Overseas interest in this versatile aircraft has been stimulated by the Saudi Arabian order for 30. The Swiss Military Department has decided in favour of the Hawk as the next advanced trainer for the Swiss Air Force and is recommending, for Parliamentary approval, the acquisition of 20 Hawks for 1990. There is continued world-wide export interest.

The Nimrod AEW project

The Company was disappointed with the cancellation of the Nimrod AEW project, for which it had built the aircraft, but noted the Secretary of State's statement that "British Aerospace carried out its part in the contract excellently and completely to the stage that it had reached." Eleven airframes had been completed and the aircraft delivered to the RAF at the time of cancellation. No decision has yet been made on the future of the aircraft but the personnel engaged on the project have now been deployed on other tasks.

The development of Rapier

Rapier, the low level air-defence system, is the most successful missile system ever produced by Britain and one of the major defence systems of the West. Operational with the British Army, the RAF and 12 overseas nations, total orders received for Rapier now approach £4 billion.

The most important event for the future of Rapier took place in November when the Government awarded the Company a £1 billion contract to complete development and produce initial quantities of Rapier 2000, a new technologically advanced low level air-defence weapon system. Rapier 2000 evolved from earlier Towed Rapier systems and incorporates the latest advances in defence sciences. The new missile will enter service in the early 1990s and remain in production well into the 21st century. It promises considerable export potential.

Earlier in the year another version of Rapier— Rapier Darkfire —was introduced. The Darkfire system includes an electro-optical tracker enabling engagements to be carried out even when a target is visually obscured by night, smoke or mist. This Rapier system has been ordered by the British Army.

A modified Tracked Rapier, fitted with two guns to meet the US Army's requirements, was demonstrated in the USA and performed well. Our bid would make a highly cost effective solution to the US Army's needs.

Interior of a British Army command post showing the BAe Battery Command Post Processor.

A £250 million contract with the Swiss Army was completed in the year with the delivery of the 60th Towed Rapier.

Tow and Merlin

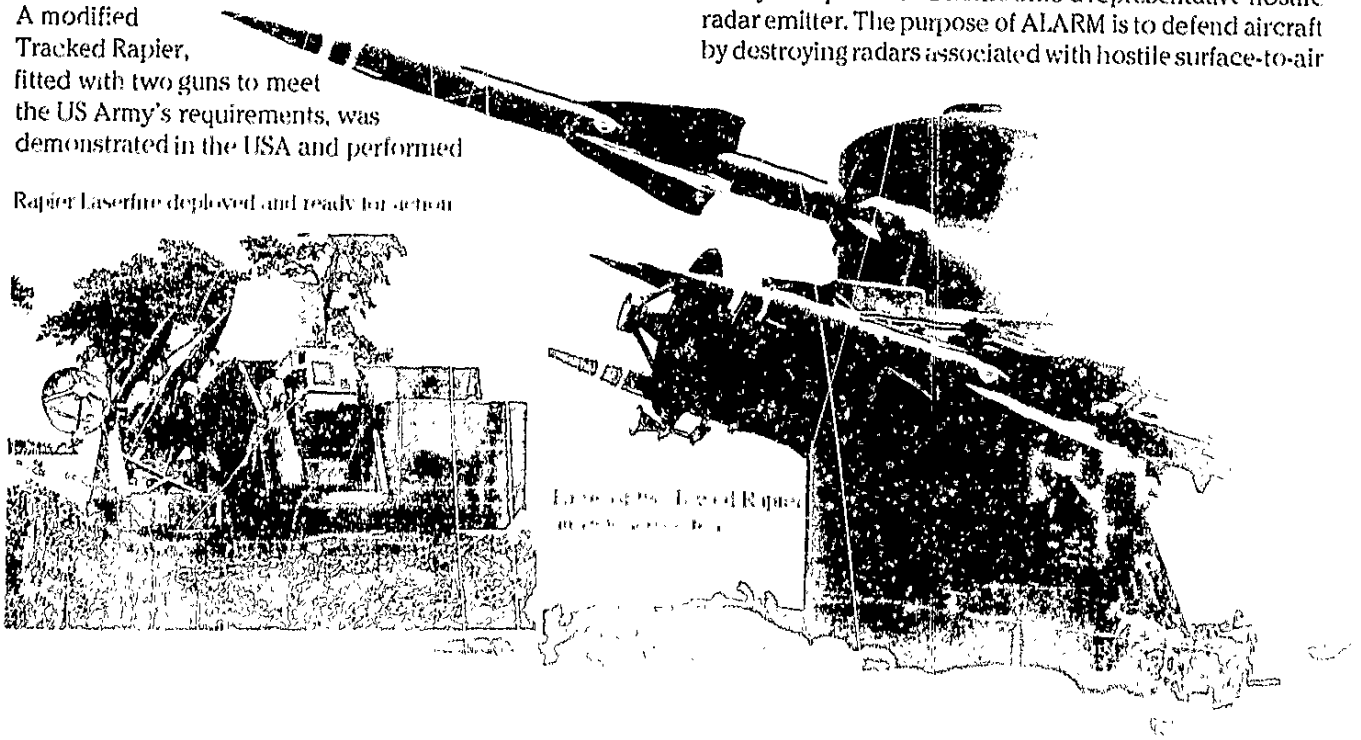
We have been awarded a contract worth over £60 million for an improvement programme to the Tow anti-tank missile sight, mounted on British Army Lynx helicopters.

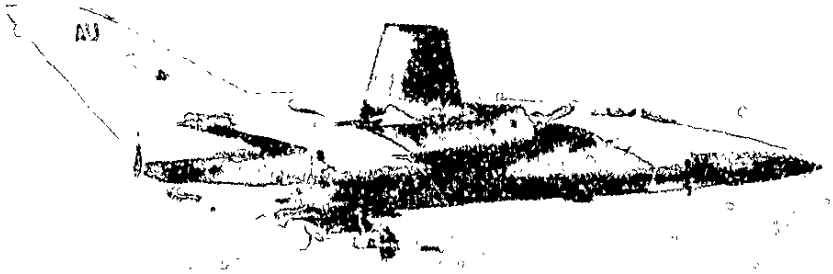
Merlin, a low cost, all-weather fire-and-forget, terminally-guided, anti-armour mortar bomb for infantry use, continues in development. The first guided firings will begin in late 1987.

ALARM

One of the most important air weapons under development is ALARM—an air-launched, anti-radar missile. The missile is being developed for the RAF and the first firings took place in December, confirming its ability to separate and home onto a representative hostile radar emitter. The purpose of ALARM is to defend aircraft by destroying radars associated with hostile surface-to-air

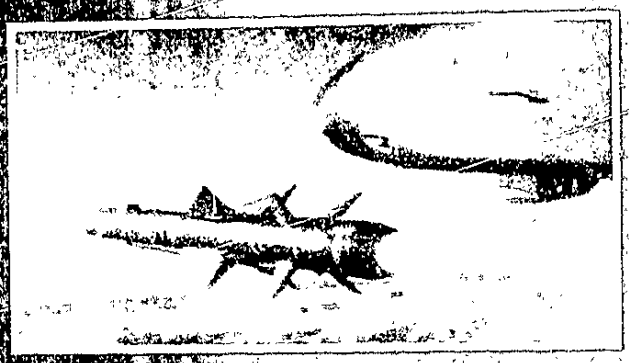
Rapier Laserfire deployed and ready for action





Sky Flash being fired from Tornado ADV

missiles and anti-aircraft artillery. The missile offers a number of attack modes, including its unique loiter capability in which the missile climbs to altitude before deploying a parachute from which it can remain suspended for several minutes while searching for targets. Unlike competitor systems ALARM is lightweight and can be fitted to a range of aircraft. It will be fitted to RAF Tornado IDS aircraft already in full squadron service.



First firing of ALARM

■ Sky Flash

The Sky Flash air-to-air weapon is in service with the RAF and Swedish Air Force. The latest Tornado, Air Defence Variant F3, equipped with Sky Flash entered service in 1986 and, in trials at Aberporth, two missiles successfully engaged targets demonstrating the operation of the entire system.

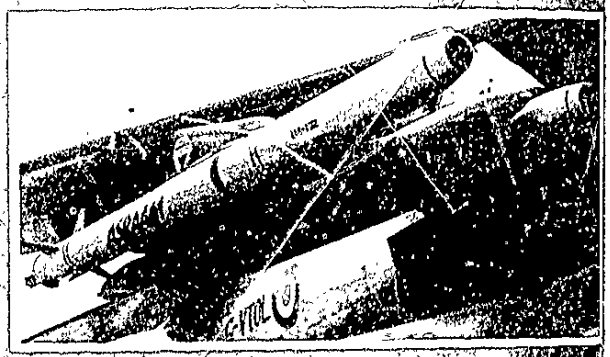
A new variant of Sky Flash—Active Sky Flash—is being developed and funded by the Company. This missile is equipped with an active radar seeker and, once launched, can acquire its target with no further help from the launch aircraft.

■ Collaborative developments

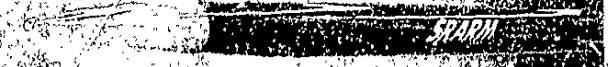
We are involved in a number of collaborative agreements for the development of weapon systems. As a member of the Euromissile Dynamics Group the Company is participating in the European Trigat programme developing two different anti-tank missile systems. The Swingfire anti-tank missile will continue in production until replaced by one of these new weapons.

There are further opportunities in the field of [illegible] with Eurodynamics.

Co-operative development continues of ASRAAM (advanced short range air-to-air missile) as a NATO weapon. We are leading a consortium of British organisations which has completed studies for ALARM (advanced air-launched anti-armour weapon) for dispensing terminally-guided munitions against tank formations. We are also prime contractor of a seven nation consortium which has been studying SRAM



ASRAAM—the advanced short range air-to-air missile



The SRAAM short range anti-radiation missile

(short range anti-radiation missile), for use by aircraft against ground based weapons. The Company is a member of a joint UK/US/West German consortium completing a design study for LRSOM (long range stand-off missile) an air-launched subsonic cruise missile required by NATO for attacking high value targets.

Another collaborative programme includes a long range anti-submarine weapon being developed with the Australian Government. Named Super Ikara, the development of the successful Ikara, the weapon comprises a ship-launched, guided air vehicle that carries and drops a homing torpedo at the predicted position of a hostile submarine.

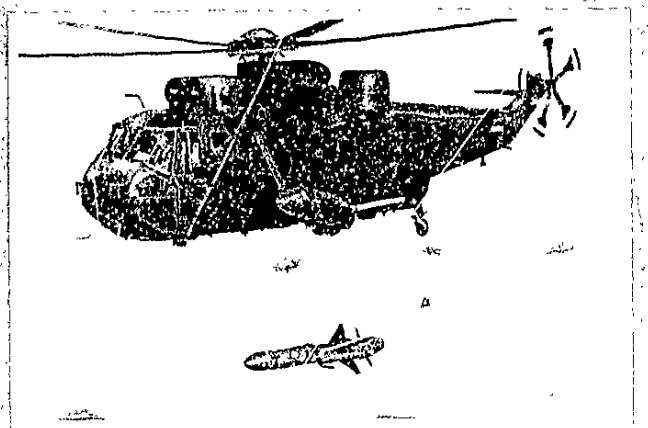
The Company is unrivalled in the range of naval equipment it produces: shipborne and airborne missiles and defence systems, gunfire control systems, ship navigation systems, underwater weapons and weapon detection systems. On these pages there is space to explore only those products and developments which have featured prominently in 1986.

Successful firings of Vertical Launch Seawolf

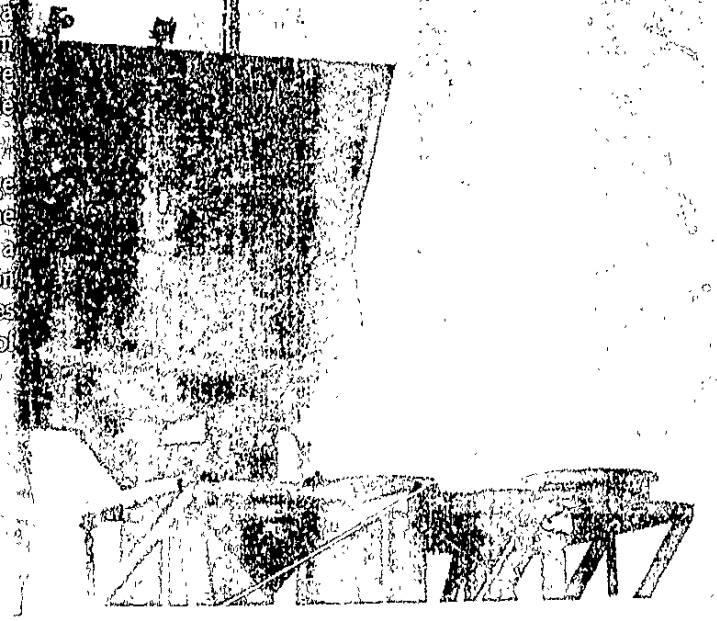
Test firings of Vertical Launch (VL) Seawolf, the new version of the combat proven, ship-defence anti-missile missile, continue from the trials barge "Longbow" on station in Cardigan Bay. VL Seawolf is being developed under a £150 million development and production contract from HM Government and will be installed on the Royal Navy's Type 23 frigates and on the recently announced Auxiliary Oiler Replenishment (AOR) vessels. Its fast all round reaction and increased range make VL Seawolf the most effective answer to the anti-ship missile threat. The original Seawolf system, from which VL Seawolf is being developed, is now in service on 12 Royal Navy ships.

Sea Eagle now in service

Sea Eagle is a sophisticated long range fire-and-forget missile originally designed to be launched from aircraft against warships up to the largest size and defended by the latest countermeasures and air defences. It is now in full production and in service with both the Royal Navy and RAF. A helicopter-launched version is being developed to arm Sea King helicopters of the Indian Navy.



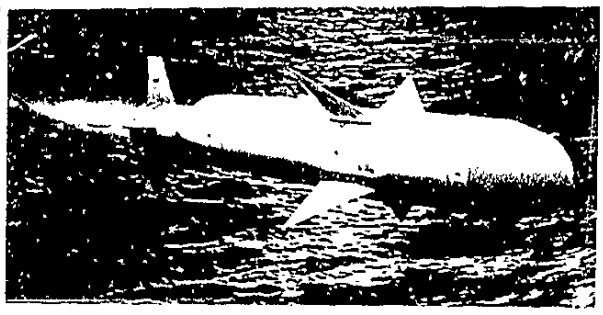
The anti-ship missile Sea Eagle launched from a Sea King helicopter.



VL Seawolf provides vessels of a hundred tonnes and upwards with an exceptional anti-missile defence capability.

Sea Skua ordered by West Germans

Sea Skua is a lightweight air-launched sea-skimming missile with an all-weather, day and night capability. The missiles can be launched to destroy ships up to destroyer size from well outside their point defence systems. During the year Sea Skua was chosen, in the face of stiff competition, for the West German Navy. It will be the first British missile to enter service with the armed forces of the Federal Republic of Germany. A ship-launched version of Sea Skua is under development.

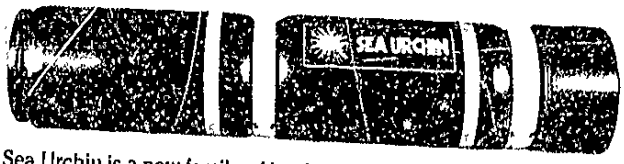


The ship-launched version of Sea Skua currently under development.

A wide range of underwater products

The Company produces a range of mines and mine countermeasure systems, sonar equipment and navigation and control systems for torpedoes.

The Versatile Exercise Mine System (VEMS), was developed by British Aerospace for the Royal Navy as a system to assess the effectiveness of mine countermeasures, equipment and tactics. During the year the system successfully completed Fleet Weapon



Sea Urchin is a new family of intelligent mines

Acceptance Trials, and is now in production for the Royal Navy. It is capable of simulating all known seabed mines, is recoverable, reusable and provides a safe and cost effective method of training crews in mine sweeping techniques.

Sea Urchin, a new family of intelligent mines, utilises [illegible] microprocessor control system to ensure [illegible] at the optimum time. Elements of Sea [illegible] packaged to enhance older names giving them significantly better performance. Developed by British Aerospace, Osborn is the latest and most advanced acoustic mine sweeping system available today. It is in service with the Royal Navy and will soon be undergoing evaluation trials with the US Navy.

Osborn acoustic mine sweeping system.

A contract worth more than £20 million was won in the face of strong competition to manufacture control surface actuation systems for the Royal Navy's Sting Ray Torpedo. The work will continue into the early 1990s.

Development of HELRAS, a long range high resolution helicopter dipping sonar, continues with Bendix Oceanics of California. Manufacture of demonstration systems has begun for evaluation trials in 1987. HELRAS is expected to be in production in 1990 and investment in the programme represents a significant long term commitment by the Company in this field.

The Italian Government, as part of its programme to select equipment for the new EH101 helicopter, will be contributing to HELRAS by purchasing the first airborne demonstration model for evaluation.

High technology electronics

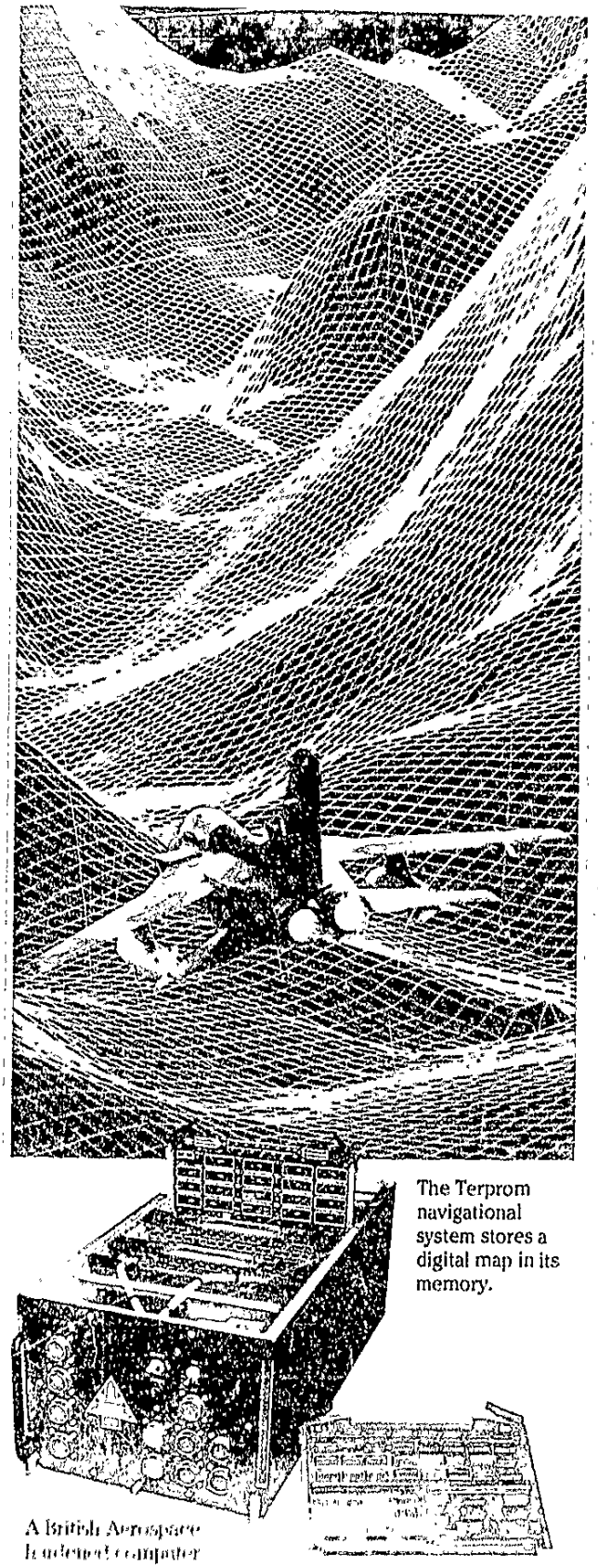
Electronic systems form an essential part of all modern aircraft and weapon systems. We are one of the UK's leading electronic design, development and manufacturing organisations. The final products are installed in the Company's own aircraft and missiles and are sold to other aerospace manufacturers. The development of expertise in this field has led to the development of "stand-alone" high technology products marketed in their own right. The following paragraphs examine just some of these activities.

We are a leader in the high technology field of aircraft navigation. LINS 300, an inertial navigation system incorporating three laser gyros has been ordered for the new Anglo-Italian EH101 helicopter and will be retro-fitted to Northrop F-5E fighters.

A complementary device to the laser gyro is the fibre optic gyro which relies on detecting changes in the characteristics of a light beam transmitted round a circular path to measure rotational motion. Research in this field continues.

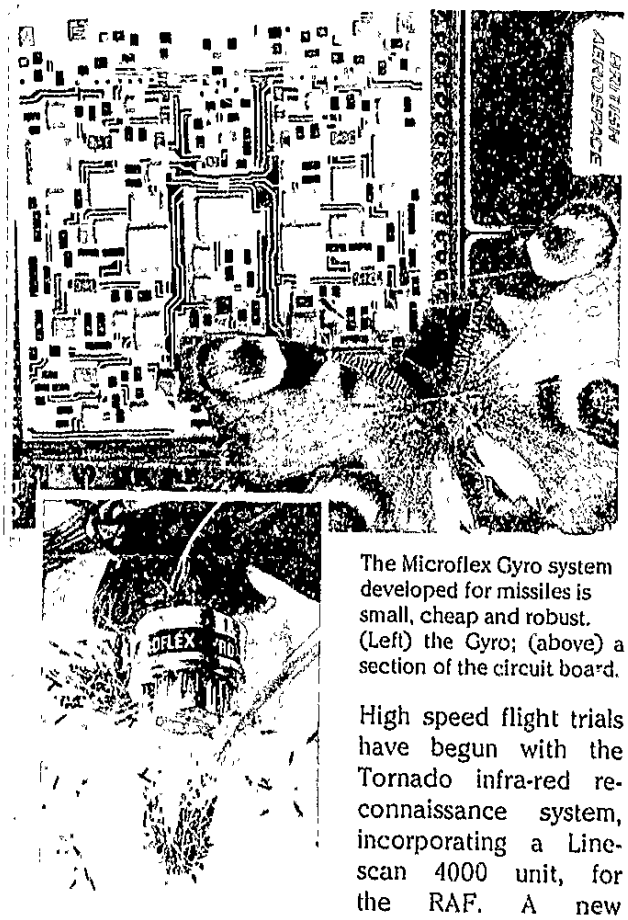
Another navigational system under development is Terprom which utilises an aircraft's radar altimeter to provide terrain data for comparison with a digital map stored in its memory. The information enables the aircraft to be flown to an accuracy of 50 to 100 yards, regardless of flight duration, without reference to external signals and without emitting forward radar signals. High speed sorties in low flying areas have been a total success.

Linescan infra-red systems produce thermal images, by day or night, of areas overflown, to reveal covert activity.



The Terprom navigational system stores a digital map in its memory.

A British Aerospace
[illegible] computer



The Microflex Gyro system developed for missiles is small, cheap and robust. (Left) the Gyro; (above) a section of the circuit board.

High speed flight trials have begun with the Tornado infra-red reconnaissance system, incorporating a Linescan 4000 unit, for the RAF. A new miniaturised system, MIRLS 1000, has also been introduced.

During the year the Condor contraband detection system was announced. Condor employs sophisticated analysis techniques to detect the presence of explosives and drugs in cargos without the need to unpack vehicles. This is a derivative of the cargo surveillance system which also incorporates X-ray inspection units, the first of which were installed in the Middle East during the year

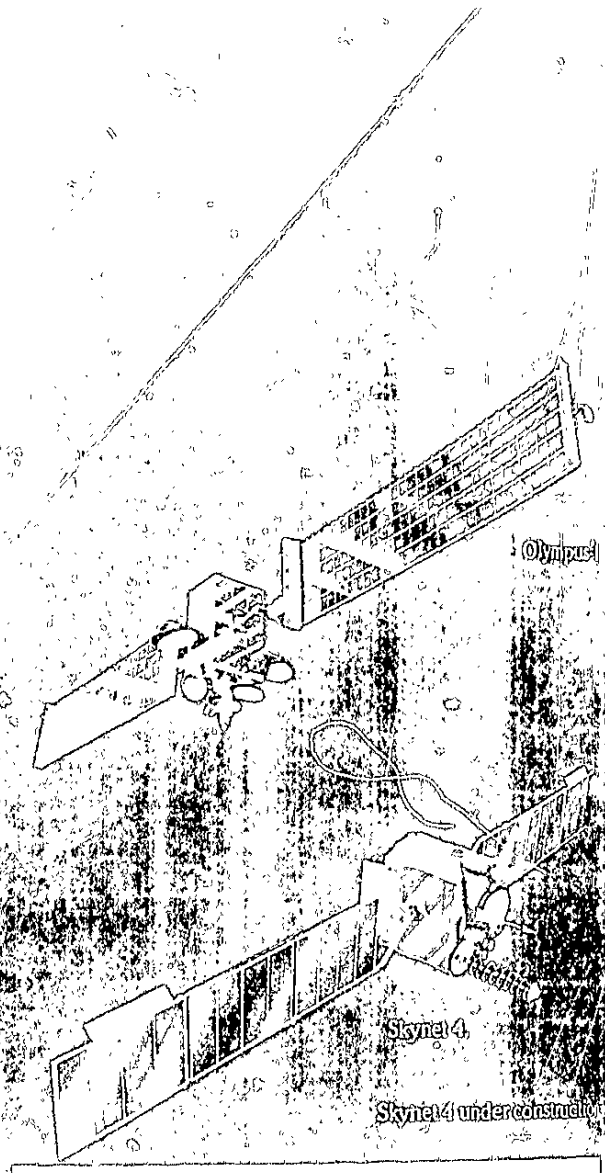
Giotto's interception of Halley's Comet on 14th March, 1986 was one of the great space science successes of the century. After a journey of 93 million miles the spacecraft passed within 35 miles of the targetted 'miss distance' of 335 miles from the comet's nucleus. The information relayed back to earth enabled scientists to make the first direct measurements of material virtually unchanged since the formation of the solar system. Amazingly, Giotto now continues in orbit and will arrive back in the vicinity of the Earth in 1990, when it may be given another scientific task to perform. British Aerospace was the prime contractor for Giotto, leading a European team of 10 nations.

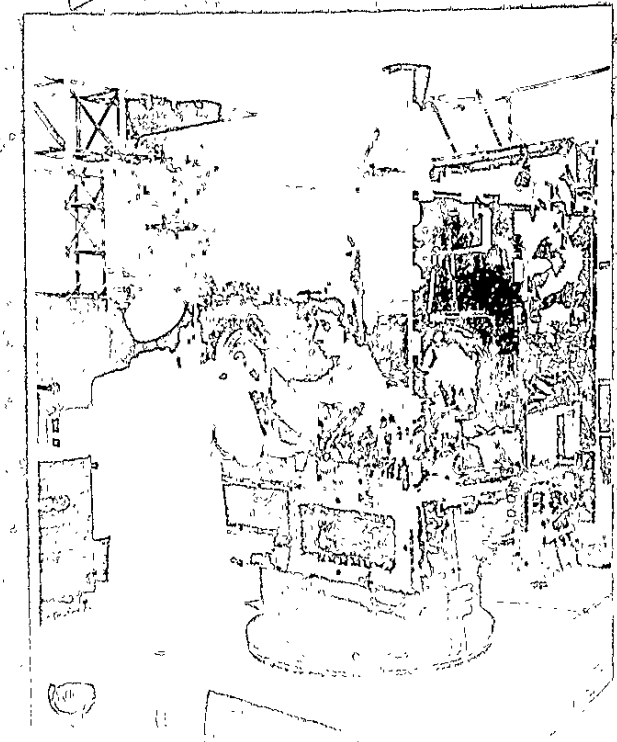
In 1986 the large roll-out solar arrays (total area 60 sq.m.) and the photon detector assembly for the Hubble Space Telescope were completed, delivered and accepted by N.A.S.A. The arrays were built by a consortium led by British Aerospace. The purpose of the arrays is to convert sunlight into electrical energy and supply power for the telescope's experiments, control and data systems.

We are currently responsible for eleven communications satellites. Work on the last two European Communications Satellites and three of five Skynet 4 military communications satellites is virtually complete. In 1987 the Company has signed the first satellite contract ever placed by NATO with a non-American company. The order for two communications satellites is worth over $100 million. Still under construction are Olympus-1 and three Inmarsat-2 maritime communications satellites. The tragic accident suffered by the US Space Shuttle and subsequent failures of Ariane have brought the spacecraft launching programme in the West to a temporary halt. When space launchings resume, satellites from this group will be placed in orbit at the rate of three a year.

Design work continues on Hotol, the revolutionary spaceplane proposed by British Aerospace and Rolls-Royce to operate from a conventional runway and place spacecraft in low Earth orbits. Hotol is being proposed as a collaborative European space project to be built under the auspices of the European Space Agency (ESA).

The next phase has begun in the design of Space Platform, a free flying orbiting equipment carrier, intended to be operated in conjunction with the permanently manned space station being developed by NASA.





Space and Communications

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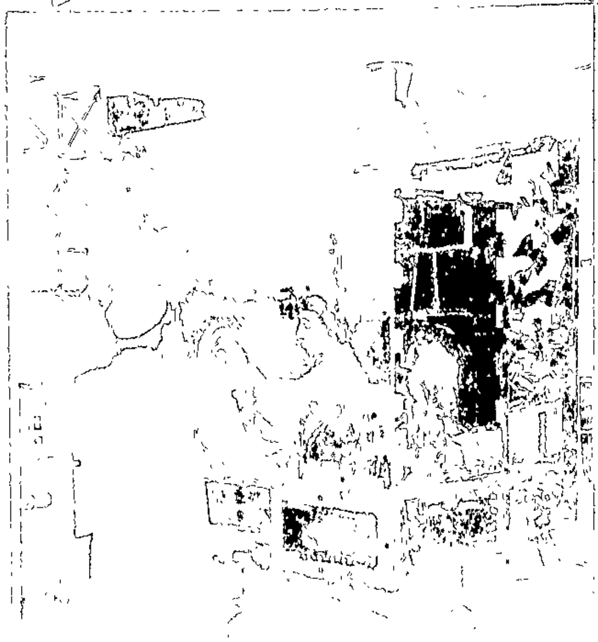
Olympus 1

Skynet 4.

Skynet 4 under constructio



Business Development

Research and development

During 1986 the results of substantial investments in earlier years have been seen in the spectacular successes of the Giotto mission, the first flights of three new aircraft – the A320, the EAP and the Hawk 200 – and HM Government's contract for Rapier 2000. Products such as the Merlin mortar bomb and the Terprom navigational system have been developed and will be available in the coming year. Additional products are being developed for service in the 1990s and beyond.

Important milestones were achieved in the phased development of flexible manufacturing systems at our sites at Preston and Brough, allied with an updating of many other advanced production systems on these and other sites. The latest computer aided engineering, advanced manufacturing and programme management systems have been introduced and the efficiency of existing systems increased. Valuable new experience has been built up over the year in the development of new materials such as metal matrix composites and aluminium-lithium alloys.

To maintain our position at the leading edge of technology some £450 million was spent during the year on research and development. This includes amounts directly funded through customer contracts. Several new manufacturing facilities have been added, including an Airbus Wing Assembly Centre at Bristol and an extension of the integrated circuit manufacturing plant at Stevenage. In Australia, the headquarters of British Aerospace Australia Ltd has moved to new premises at Technology Park, South Australia, a new development for high technology industry.

The Company has established the Sowerby Research Centre to provide an applied research service to its engineering Divisions. Its primary role is developing the technology required for new products likely to be designed in the next five to 15 years. Research on existing products under development is carried out by operating Divisions. Located at Bristol in a specially constructed building, the centre has a scientific staff of over 140.

We continue to strengthen and expand our research and development activities through co-operative agreements on national and international programmes such as those arising from the 1986 EUREKA initiative.

It is only by continued substantial investment in research, development and manufacturing technology that we can continue to enjoy worldwide success and recognition as a market leader in aerospace products and electronic systems.

New business

We are endowed with a mass of technology developed as an integral part of our mainstream activities. From time to time opportunities arise to build new stand alone businesses. How best to do this has always been a dilemma for large companies. We have decided that these new opportunities shall be developed in the most conducive environment. Generally speaking this will mean as separate trading entities. Hence the formation of British Aerospace Flying College Ltd as a wholly owned subsidiary. Where similar opportunities are identified we shall continue along this route.

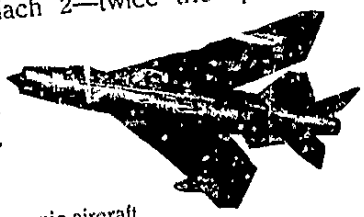
We will also consider investments and/or acquisitions, where appropriate, to increase our product base and technical skills. We have recently made an investment [illegible] 25% of the share capital of Systems [illegible]

The nucleus of Hawk's Cockpit photographed from the Giotto spacecraft

The products of British Aerospace often take many years to move from the drawing board to production. In order to recoup the large development costs it is essential that we produce products which compete over many years.

Concorde

Eleven years of Concorde service were celebrated in 1987 and still the technical achievement is unmatched. Since entering service in 1976 the Concorde fleets, operated by British Airways and Air France, have covered more than 100 million miles and carried over one and a half million passengers. Of 80,000 hours flown at supersonic speeds, over 55,000 were at Mach 2—twice the speed of sound—**more hours than achieved by all the military aircraft in the world put together.**



The Lightning supersonic aircraft.

Bloodhound

Bloodhound, an air-defence weapon, has been in fro line service for well over 20 years. Britain, Switzerlan and Singapore still deploy Bloodhound as their primar land based, long range anti-aircraft weapon. A study ha recently been completed for HM Government assessin the changes needed to ensure that Bloodhound remain an effective weapon until the turn of the century.

Lightning

The Lightning fighter was the first and only supersonic aircraft fully developed by the UK on her ow The first prototype flew in 1954, entered service with th RAF in 1959, and later versions are still in service as pa of the air defence of the UK. In 1966 the aircraft provid our introduction to the important Saudi Arabian mark now one of our major customers.

These are just four examples that show the long ter nature of the Company's business. There are many othe such as the Canberra—the first jet bomber, the Hunt Victor and Vulcan military aircraft. There are

The Concorde civil airliner.
(left) Bloodhound air-defence weapon
(right) Firing of Sea Dart

airliners like the Comet, BAC One Eleven and VC10 which are world renowned aircraft. The Swingfire mis continues in service after eighteen years. Today's m missiles have evolved from a system first in servic 1972. We are confident that our current ran products together with those in development will h commercial service with similar longevity.

Sea Dart in service until the year 2000

All Type 42 destroyers and three aircraft carriers are armed with Sea Dart – a medium range, all-weather missile in service with the Royal Navy since 1973 for use against aircraft, missiles and ships. A further contract awarded by HM Government for the supply of missiles will ensure that production continues at least until 1989.

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Our achievements in 1986 have been made possible by the effectiveness and continued support of our employees—with some 72,000 in the UK and 2,900 overseas in 31 countries.

Success in any business, and British Aerospace is no exception is dependent on the contribution from a highly skilled, competent and committed workforce. To achieve this the Company aims to provide a positive and stimulating environment in which to work. Our policies are directed towards this end.

During 1986 we continued our high investment in training to ensure that we have the right skills for the future. Those in training included apprentices and many other young people, as well as over 400 graduates recruited from British Universities and Polytechnics.

Our links with higher education establishments and with statutory bodies such as the Manpower Services Commission and the Engineering Industry Training Board ensures our training programmes take into account and

Derek Bucknall, Personnel Director, presenting awards to graduating apprentices at the Space and Communications Division.

influence the broader national training policies which are relevant to our activities.

Particular emphasis has been placed on further technical and strategic training for the Company's most senior managers during 1986. In collaboration with the international business school, INSEAD, the first groups have now attended a specially designed course which will be continued and further developed.

British Aerospace recognises its responsibilities to the local communities in which its sites are located. During 1986 there has been special emphasis on activities within

the 'Industry Year' initiative, to which employees made a significant contribution. Special emphasis was placed on the understanding within schools and colleges of the career opportunities within the engineering industry on which the Company is so dependent. We shall continue to maintain our educational links in this way and the Company is particularly grateful for the time spent by employees in this area of activity.

British Aerospace is committed to keeping employees as fully informed as possible with regard to the Company's performance and prospects and seeks to involve them, wherever practicable, in the Company and particularly in matters which concern them as employees.

The Company uses a wide variety of employee communication systems both locally and at Company level. These have been maintained and developed during the year but with the emphasis placed on those operating at the local level. They include briefing groups, factory councils, video presentations, newspapers, joint working parties, suggestion schemes and quality circles to ensure a continuing understanding of business performance.

As in previous years, the Chairman has given a series of annual communications meetings about the Company as a whole, at a number of locations. At these he addresses a wide cross-section of employees, which provides an opportunity for discussion and enables views expressed at the meetings to be reflected in the video recording made available to all employees later.

The process of communicating our business performance to employees continues to be reinforced by the publication of the Annual 'Report to Employees'. In 1986 this Report won the Mobile Training Cup for being the best amongst larger companies. This follows similar recognition in 1984 and 1985.

The Company continued with the residential discussions for a cross-section of employees at St George's House, Windsor. These events, now in their sixth year, provide an opportunity for those present to understand the strategy of the Company as a whole and to consider this with executive Directors of the Company

Board of Directors

Sir Austin Pearce, C.B.E.†
Chairman

Sir Kenneth Durham†
Deputy Chairman (non-executive)

Sir Raymond Lygo, K.C.B.
Chief Executive

D. E. Bucknall
Personnel Director

R. H. Evans, C.B.E.
Marketing Director

B. E. Friend, C.B.E.*
Director of Finance

D. O. Gladwin, C.B.E.†
Non-executive Director

J. L. Glasscock
Commercial Director

H. A. Hitchcock, D.F.C.*
Non-executive Director

H. Metcalfe, O.B.E.
Deputy Chief Executive (Operations)

Professor R. Smith
Non-executive Director

Sir Jack Wellings, C.B.E.†*
Non-executive Director

I. R. Yates, C.B.E.
Deputy Chief Executive (Engineering)

Secretary and Legal Adviser
B. Cookson*

Treasurer
J. D. Hanson

Company Comptroller
A. Smith

*Member of the Audit Committee
†Member of the Compensation Committee

(Left to right) standing: Mr D. E. Bucknall, Mr B. E. Friend, Mr J. L. Glasscock, Sir Jack Wellings, Mr H. A. Hitchcock, Mr D. O. Gladwin, Mr R. H. Evans, Mr B. Cookson. Seated: Mr I. R. Yates, Sir Kenneth Durham, Sir Austin Pearce, Sir Raymond Lygo, Mr H. Metcalfe, Mr [illegible] Reeves, C.B.E. (Retired as a non-executive Director of the Company during the period)

Directors for re-election

It may be helpful for shareholders to have the following information about those members of the Board who retire at the Annual General Meeting and, being eligible, offer themselves for re-election.

Sir Austin Pearce, C.B.E.
Sir Austin joined Esso as a chemical engineer in 1945 and became Chairman and Chief Executive of Esso Petroleum Company in 1972. He was appointed a part-time Board member of British Aerospace in April 1977. He retired from Esso in March 1980 when he was appointed full-time Chairman of British Aerospace. He is also Vice Chairman of The Royal Bank of Scotland and a Director of Pearl Assurance and of Jaguar Cars. Sir Austin is Pro-Chancellor of the University of Surrey and Chairman of the Trustees of the Science Museum. He is aged 65.

Mr. D. E. Bucknall
Mr. Bucknall joined Imperial Chemical Industries in 1961, and following a number of marketing, commercial and business management responsibilities became Personnel Manager of ICI Fibres Division and later Personnel Director of ICI Plastics Division. He was General Manager, Polyolefines and Engineering Plastics Business of ICI Petrochemicals and Plastics Division before joining British Aerospace as Director of Personnel on 1st May, 1986. He was appointed a Director of the Company, with the executive appointment of Personnel Director, on 1st October, 1986. He is aged 50.

Mr. R. H. Evans, C.B.E.
Mr. Evans joined British Aircraft Corporation in 1969. After a number of commercial responsibilities, he became Commercial Director of the Warton Division of British Aerospace in 1978. His widening responsibilities for overseas and collaborative programmes led to appointments as Assistant and then Deputy Managing Director of the Warton Division, subsequently becoming Deputy Managing Director and Managing Director Designate of the new Military Aircraft Division in January 1986. Mr. Evans was appointed a Director of the Company, with the executive appointment of Marketing Director, on 13th January, 1987. He is aged 44.

Professor R. Smith
Professor Smith is a non-executive Director of a number of industrial and City investment companies, including the Chairmanship of Hepworth Ceramic Holdings and of Equitable Life Assurance Company. He is also part-time Professor of Marketing at the University of Manchester Institute of Science and Technology. He was appointed a non-executive Director of the Company on 11th February, 1987. He is aged 58.

Auditors
Peat, Marwick, Mitchell & Co.

Brokers
Hoare Govett Limited

Registrar
Lloyds Bank Plc, Registrar's Department,
Goring-by-Sea, Worthing,
West Sussex BN2 6DA

Registered Office
11 Strand, London WC2N 5JT

The Directors present their report, together with the accounts, for the year ended 31st December, 1986.

Capital structure

The authorised share capital of the Company at 31st December, 1986 was £150,000,001, divided into 300,000,000 ordinary shares of 50p each and one special share of £1, of which 250,092,541 ordinary shares and the £1 special share were issued and fully paid; since 31st December, 1986 the exercise of options under the British Aerospace SAYE Share Option Scheme has increased the issued ordinary shares to 250,137,475 shares.

The number of ordinary shares shown in the register of members at 31st December, 1986 as Foreign-held Shares pursuant to Article 40 of the Company's Articles of Association was 30,684,867 (12.27% of the issued ordinary share capital of the Company) and at 24th March, 1987 was 32,735,143 (13.09%). At 24th March, 1987 no person had notified the Company of an interest of 5% or more in the issued share capital of the Company.

The Directors are seeking the approval of shareholders at the Annual General Meeting to amend the Company's Articles of Association so as to simplify the procedure for extending their authority, previously conferred in 1986, to allot relevant securities (as defined in Section 80 of the Companies Act 1985) and, pursuant to that authority, to allot equity securities (as defined in Section 94 of the Act) as if the pre-emption rights contained in Section 89 of the Act did not apply. An explanatory note appears in the Appendix to this report and the appropriate resolution will be proposed as special business at the Annual General Meeting.

Principal activities and business review

The principal activities of the Company and its subsidiaries are the design, development, production and sale of military and civil aircraft, guided weapon and space systems, electronics and related technologies and the provision of support services.

The Chairman's Statement and the Financial and Operating Reviews accompanying this report give a more detailed description of the Company's products and business activities during the year, important events affecting the Company since the end of the year and likely future developments. They also give an indication of the Company's activities in the field of research and development.

Results and dividend

The profit after taxation and extraordinary item attributable to shareholders is £84.3 million and, subject to approval of the proposed final dividend, is dealt with as shown in the consolidated profit and loss account on page 32 of the accounts. The Directors

propose a final dividend of 11p per ordinary share which, with the interim dividend of 6.4p per ordinary share paid on 3rd November, 1986, makes a total dividend of 17.4p per ordinary share for the year. The final dividend, if approved, will be paid on 2nd June, 1987 to shareholders registered as at 17th April, 1987.

Fixed assets

Changes in fixed assets arising in the normal course of business are detailed in note 15 on the accounts on page 44. The Company's freehold and leasehold land and buildings were revalued at 31st December, 1984; the Directors do not consider there is any significant difference between the book value and market value of land and buildings at 31st December, 1986.

Charitable donations

During 1986 the Company made donations in the UK for charitable purposes amounting to £132,000 (1985 £139,000). No contributions were made for political purposes.

Directors

The names of the present Directors of the Company are listed on page 26.

On 31st October, 1986 Sir Kenneth Durham, a non-executive Director, was appointed a Deputy Chairman.

On 1st October, 1986 Mr. D. E. Bucknall was appointed a Director of the Company with the executive appointment of Personnel Director and on 13th January, 1987 Mr. R. H. Evans was appointed a Director with the executive appointment of Marketing Director. On 11th February, 1987 Professor R. Smith was appointed a non-executive Director of the Company. In accordance with Article 88 of the Company's Articles of Association, Mr. Bucknall, Mr. Evans and Professor Smith retire at the Annual General Meeting and, being eligible, will offer themselves for re-election.

On 24th March, 1987 Mr. K. M. Bevins, Government Director, resigned from the Board.

The Directors retiring by rotation at the seventh Annual General Meeting in accordance with Article 82 are Sir Austin Pearce, Mr. J. L. Glasscock and Sir Jack Wellings. Sir Austin Pearce, being eligible, will offer himself for re-election; Mr Glasscock and Sir Jack Wellings have not offered themselves for re-election and will relinquish office at the conclusion of the Annual General Meeting.

The unexpired periods, from the date of this report, of service contracts with the retiring executive Directors are:

Sir Austin Pearce	7 months
Mr. D. E. Bucknall	30 months
Mr. R. H. Evans	33 months

In accordance with their terms, the contracts of Mr. Bucknall and Mr Evans will continue beyond the stated periods unless and until they are determined by either party giving to the other not less than twelve months notice in writing but not so as to extend the contract beyond the Director's normal retirement date.

The beneficial, including family, interests in the share capital of the Company of the persons who were Directors during the year were as follows:

	At 31st December, 1986		At 1st January, 1986*	
	Ordinary shares of 50p each	Share options	Ordinary shares of 50p each	Share options
Sir Austin Pearce	2,341	112,384	2,341	112,384
Sir Kenneth Durham	200	—	200	—
Sir Raymond Lygo	4,916	98,665	4,916	85,787
D. E. Bucknall	1,000	—	1,000	—
K. M. Bevins	875	—	875	—
B. E. Friend	3,500	70,895	3,500	63,782
D. O. Gladwin	—	—	—	—
J. L. Glasscock	591	49,761	591	45,468
H. A. Hitchcock	5,000	—	5,000	—
H. Metcalfe	572	72,888	572	66,479
Sir Jack Wellings	1,250	—	1,250	—
I. R. Yates	473	63,790	473	54,937

*or (where applicable) later date of appointment.

On appointment to the Board, Mr. R. H. Evans had a beneficial interest in 333 ordinary shares and 27,303 share options and Professor R. Smith had no interest in shares or share options.

Share options were granted to certain executive Directors (a) on 30th April, 1986 under the British Aerospace SAYE Share Option Scheme for employees, exercisable at a subscription price of £5.25 per share on completion of the related five year SAYE contract, and (b) on 24th April, 1986 under the British Aerospace Executive Share Option Scheme, exercisable at a subscription price of £5.87 per share normally between 1989 and 1996.

There have been no changes in the interests of persons presently Directors of the Company between 31st December, 1986 (or, where applicable, the later date of appointment) and 24th March, 1987. None of the Directors had any non-beneficial interest in the share capital of the Company during the year nor in the period from the year end to 24th March, 1987. The Board is not aware of any contract of significance (other than service contracts or as disclosed in note 7 on the accounts) in relation to the Company or its subsidiaries in which any Director has, or has had, a material interest. The Directors are proposing to terminate the arrangement described in note 7 on the accounts relating to the leasehold house occupied by Sir Raymond Lygo; an explanatory note appears in the Appendix to this report and the appropriate resolution will be proposed as special business at the Annual General Meeting.

Employment

Disabled persons—It is the policy of the Company to employ disabled persons whenever practicable in jobs suited to their individual circumstances and, as appropriate, to consider them for recruitment opportunities, career development, promotion and training. Special consideration is given to re-training those who become disabled whilst in the Company's employment.

Health and safety at work—The Company pays close attention to the health and safety of its employees, contractors and other persons on its premises with particular regard to the requirements of the Health and Safety at Work etc. Act 1974 and related legislation. Site safety committees meet on a regular basis and cover a wide range of health and safety topics including new plant, processes and systems of work. During the year nine of the Company's sites received "Golden Hand" Awards for meeting the high standards of safety performance set by the Engineering Employers' Federation.

Equal opportunity—The Company is an equal opportunity employer. Its policy is accordingly to ensure that, subject only to considerations of national security, no job applicant or employee receives less favourable treatment on the grounds of sex, marital status, race, colour, nationality or ethnic or national origin. Selection criteria and procedures are reviewed periodically to ensure that individuals are selected, promoted and treated on the basis of merit and ability.

Employee involvement—The Company is committed to good communications with its employees and seeks to involve them, whenever practicable, in the Company's affairs and particularly in matters which concern them as employees. Measures to achieve these objectives are described more fully in the Operating Review, which accompanies this report, on page 25.

Honours

The following employees were honoured in HM The Queen's 1986 Birthday Honours and 1987 New Year Honours Lists: **C.B.E.** *R. H. Evans;* **O.B.E.** *P. J. S. Allington, M. S. Goodfellow, J. B. Scott-Wilson, R. Thomson;* **M.B.E.** *R. J. Balmer, D. C. R. Link, R. Walton;* **B.E.M.** *B. Armit, R. A. Fisher;* **Queen's Commendation for Valuable Services in the Air** *G. M. McAuley.*

Community affairs

The Company's operating units have always maintained close relationships with their local communities. In 1986 the Company introduced a community affairs policy designed to support and encourage these activities, with special emphasis on local business and young people.

The Company is a member of Business in the Community (BIC) and a growing number of operating units directly support the work of BIC and its affiliated organisations. The Company sponsors education, sports and arts events for young people, and is involved in a wide range of projects to promote better understanding between industry and education at both a national and local level.

Employee share ownership schemes

Since the introduction of the British Aerospace SAYE Share Option Scheme in June 1983, offers of participation have been made annually to employees. A further offer of participation on 9th April, 1986 resulted in 2,756 employees being granted options over a further 1,111,684 shares at an option price of £5.25 per share, normally exercisable in 1991. As a result, at 31st December, 1986 options were held by 7,854 participants over 7,664,084 shares and at 24th March, 1987 by 7,760 participants over 7,552,086 shares. Further offers of participation can be expected in 1987 and future years.

The Directors are proposing that the Rules of the British Aerospace SAYE Share Option Scheme be amended to reflect changes made in the Finance Act 1986 to the statutory provisions regulating employee savings-related share option schemes. An explanatory note appears in the Appendix to this report and the appropriate resolution will be proposed as special business at the Annual General Meeting.

Since approval of the British Aerospace Executive Share Option Scheme by shareholders in May 1985, offers of participation in the Scheme have been made in 1985 and 1986 to selected executives (including executive Directors). The second offer of participation in April 1986 resulted in 48 executives being granted options over 271,337 shares at an option price of £5.87 per share, normally exercisable between 1989 and 1996. As a result at 31st December, 1986 and at 24th March, 1987 options were held by 56 executives over 1,297,157 shares.

Close company status

The close company provisions of the Income and Corporation Taxes Act 1970 do not apply to the Company.

Auditors

At the Company's last Annual General Meeting, Messrs. Peat, Marwick, Mitchell & Co. were re-appointed as Auditors of the Company and from 1st April, 1987 they will practise under the name of Peat Marwick McLintock. A resolution proposing their re-appointment will be put to the Annual General Meeting of the Company.

By order of the Board
B. Cookson
Secretary

24th March, 1987

Appendix to the Directors' Report

Authority to issue shares—amendment of Articles of Association

The Directors are required to obtain renewal each year of their authority, given by the shareholders in General Meeting in accordance with Section 80 of the Companies Act 1985, to allot unissued shares in the capital of the Company. Associated with such authority is the disapplication (under the provisions of Section 95 of the Act) of the pre-emption rights in respect of the allotment of equity securities for cash contained in Section 89 of the Act. The Stock Exchange no longer requires shareholder approval for each specific issue of equity securities for cash.

In seeking this annual renewal of their authority, the Directors do not necessarily have any present intention of issuing such shares (other than shares reserved for issue under employee share schemes previously approved by the shareholders in General Meeting), but it is considered desirable that the specified amount of authorised but unissued share capital be available so that they can more readily take advantage of future opportunities. However, shareholders can be assured that no issue would be made which would effectively change the control of the Company without the prior approval of the shareholders in General Meeting and any issues outside the annual authority will require specific shareholder approval.

Effecting the annual authorisation presently requires a complex resolution, as has been presented to shareholders and passed in 1986 and earlier years. The Directors propose to simplify the procedure by incorporating into the Articles of Association (as is now common practice) the detailed wording required to provide for renewal of the Directors' authority, including the disapplication of pre-emption rights, with the result that the annual authority to be presented at subsequent Annual General Meetings can be in a simple form specifying the amount of shares and the duration of the period over which the Directors are seeking such authority. There is no difference in the terms and effect of the resolutions passed under the previous practice and that which is now proposed, with shareholders' approval still being sought annually.

The present Article 11 of the Company's Articles of Association gives power to the Directors to allot unissued shares in the capital of the Company as authorised by the shareholders. This provision, as retained in paragraph (A) of the proposed new Article 11 (set out in the Notice of Meeting on page 56), is qualified by paragraph (B) of the new Article to disapply, as explained above, the provisions of Section 89 regarding pre-emption rights (other than in the case of rights issues) in respect of those shares which the Directors are annually authorised to allot. On this occasion in adopting the new Article, the duration of the authority and amounts involved in respect of the first annual period are included in paragraphs (B)(iv)(b) and (c) of the new Article. Thereafter separate resolutions passed at each Annual General Meeting will establish these limits for the annual period concerned.

For the 15 month period commencing with the Annual General Meeting in May 1987, the Directors are seeking authority to issue, if required, share capital up to an aggregate nominal amount of £24,931,262 provided that no more than 5% (i.e. £7,500,000) of the nominal amount of the authorised ordinary share capital may be allotted wholly for cash, other than as a rights issue.

The Directors recommend to shareholders the adoption of this simplified procedure and a Special Resolution so to amend the Articles of Association of the Company is proposed as special business in the Notice of Meeting on page 56.

The British Aerospace SAYE Share Option Scheme

The Finance Act 1986 made changes to the statutory provisions regulating employee savings-related share option schemes. The Directors therefore propose that, with the approval of the Inland Revenue, the Rules of the British Aerospace SAYE Share Option Scheme ("the Scheme") be amended:

(a) to remove the restriction in the Scheme which prevents an employee from participating in the Scheme in the same tax year in which he has obtained rights under any similar scheme operated by another group company; although at present there are no other schemes operating within the British Aerospace group, the Directors nevertheless consider it appropriate to remove this restriction; and

(b) to enable a participant who ceases employment within the British Aerospace group because his employing company or the business of that company is transferred outside the group to exercise his option within six months of so ceasing employment; the Directors consider that, where participants cease to be employed within the group in these circumstances, it is right that they should have an opportunity to exercise their Scheme options which would otherwise lapse.

The Directors recommend approval of these amendments for the benefit of present and future participants of the Scheme and an Ordinary Resolution so to amend the Rules of the Scheme pursuant to Rule 13 is proposed as special business in the Notice of Meeting on page 56.

Transaction with a Director

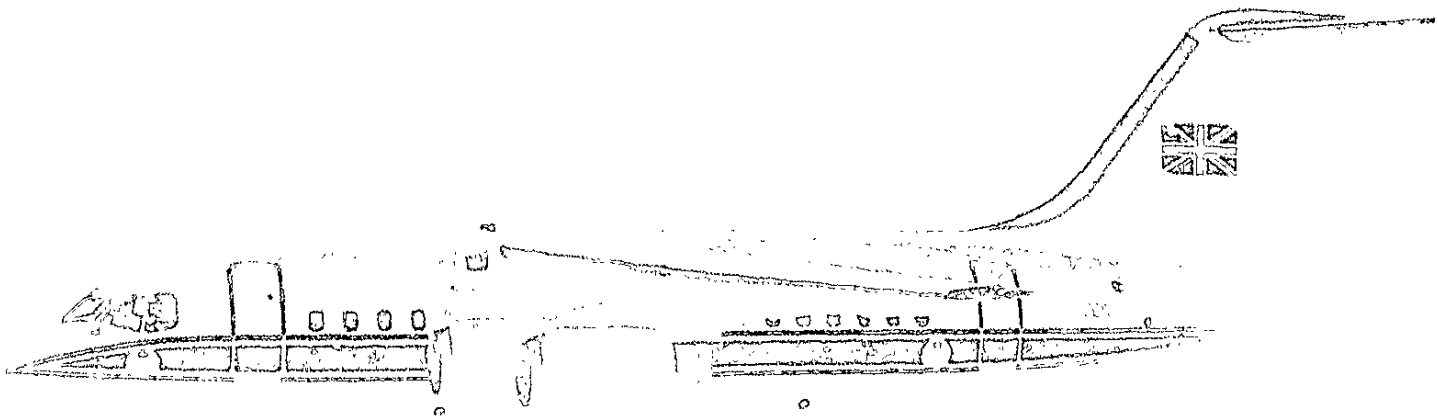
As has been previously reported to shareholders, in 1983 the Company and Sir Raymond Lygo jointly acquired the leasehold interest in a house in London to assist him to fulfil his duties as Chief Executive. The price and the cost of certain repairs and improvements were paid as to nine-tenths by the Company and as to one-tenth by Sir Raymond. By a trust deed dated 3rd March 1983 Sir Raymond is entitled to occupy the house until three months after he ceases to be Chief Executive of the Company and then either the Company or Sir Raymond can require the house to be sold and the proceeds of sale to be shared between them in the same proportions.

It is now proposed that the Company sell its share in the house to Sir Raymond who would then own the entire leasehold interest. The Company has obtained a professional valuation of the leasehold interest from Messrs. Fuller Peiser, Chartered Surveyors, and it is proposed that Sir Raymond will pay the Company for its 50 per cent. share £207,000, which is 90 per cent of that valuation. The Directors (other than Sir Raymond who has not participated in the consideration of this proposal on behalf of the Company) recommend approval of the transaction and an Ordinary Resolution to approve the sale in accordance with section 320 of the Companies Act 1985 is proposed as special business in the Notice of Meeting on page 56.

The Directors unanimously recommend shareholders to vote in favour of the above Resolutions as they intend to do in respect of their own shares. Sir Raymond Lygo will not be voting on Resolution 8.

British Aerospace p.l.c.

Accounts and Notes



Consolidated Profit and Loss Account

for the year ended 31st December, 1986

	1986 £m	1985 £m	Note
Turnover	**3,137.0**	2,647.7	2
Cost of sales	**(2,919.8)**	(2,436.6)	3
Trading profit	**217.2**	211.1	2
Launching costs	**(47.6)**	(51.6)	4
Share of profits of related companies	**3.6**	3.4	
Net interest receivable/(payable)	**9.0**	(12.4)	5
Profit before taxation and extraordinary item	**182.2**	150.5	
Taxation	**(53.8)**	(23.5)	8
Profit after taxation and before extraordinary item	**128.4**	127.0	
Extraordinary item	**(44.1)**	—	9
Profit after taxation and extraordinary item	**84.3**	127.0	10
Dividends	**(43.5)**	(39.5)	11
Retained profit	**40.8**	87.5	29
Earnings per share	**51.4p**	56.4p	12

The notes on pages 35 to 53 form part of these accounts

Balance Sheets

at 31st December, 1986

	Company and subsidiaries		Company		
	1986 £m	1985 £m	1986 £m	1985 £m	Note
Fixed assets					
Tangible assets	**571.9**	538.7	**550.5**	524.9	*15*
Investments	**23.3**	20.0	**78.6**	71.8	*16*
	595.2	558.7	**629.1**	596.7	
Current assets					
Stocks	**1,175.5**	1,090.3	**1,122.2**	1,050.4	*18*
Debtors	**505.8**	450.3	**502.1**	426.0	*19*
Investments	**922.8**	526.0	**917.1**	521.1	*20*
Cash at bank and in hand	**77.8**	116.3	**64.6**	115.1	
	2,681.9	2,182.9	**2,606.0**	2,112.6	
Current liabilities					
Loans and overdrafts	**6.1**	6.2	**3.1**	4.8	*21*
Creditors	**1,506.8**	1,043.4	**1,549.1**	1,018.4	*22*
Net current assets	**1,169.0**	1,133.3	**1,053.8**	1,089.4	
Total assets less current liabilities	**1,764.2**	1,692.0	**1,682.9**	1,686.1	
Liabilities falling due after one year					
Loans	**236.9**	265.1	**144.2**	241.8	*21*
Creditors	**76.9**	43.0	**67.7**	38.2	*22*
Provisions for liabilities and charges	**229.9**	197.7	**229.3**	196.7	*25*
	1,220.5	1,186.2	**1,241.7**	1,209.4	
Capital and reserves					
Called up share capital	**125.0**	125.0	**125.0**	125.0	*27*
Share premium account	**220.0**	220.0	**220.0**	220.0	
Statutory reserve	**202.1**	202.1	**202.1**	202.1	*28*
Revaluation reserve	**98.3**	101.8	**98.3**	101.8	*29*
Capital reserve	**101.4**	108.3	**112.4**	119.3	*29*
Profit and loss account	**473.7**	429.0	**483.9**	441.2	*29*
	1,220.5	1,186.2	**1,241.7**	1,209.4	

Approved by the Board on 24th March, 1987

Sir Austin Pearce *Chairman*

B. E. Friend *Director of Finance*

The notes on pages 35 to 53 form part of these accounts

Consolidated Statement of Source and Application of Funds

for the year ended 31st December, 1986

	1986 £m	1985 £m
Source of funds		
Profit before taxation and extraordinary item	182.9	150.5
Adjustments for items not involving the movement of funds:		
Depreciation	63.8	56.2
Provisions	(24.9)	(3.9)
Other	(3.2)	(3.2)
Funds from operations	217.9	199.6
Proceeds from share issue	—	179.4
	217.9	379.0
(Increases)/decreases in working capital:		
Stocks	(85.2)	(13.6)
Debtors	(55.5)	8.9
Creditors	54.2	(16.5)
Advances	423.1	78.6
	336.6	57.4
Total source of funds	554.5	436.4
Application of funds		
Net additions to fixed assets	98.8	98.8
Taxation paid	28.1	16.9
Dividends paid	41.0	31.3
Total application of funds	167.9	147.0
Movement in net liquid assets and loans	386.6	289.4

The notes on pages 35 to 53 form part of these accounts

Notes on the Accounts

1 ACCOUNTING POLICIES

Basis of preparation

The accounts are drawn up under the historical cost convention as modified by the revaluation of land and buildings.

Basis of consolidation

The consolidated accounts of the Company incorporate the accounts of the Company and its subsidiary and related companies, all of which were made up to 31st December.

Trading profit

Trading 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. Full provision is made for any losses in the year in which they are first foreseen.

In arriving at the estimated overall profitability of contracts with extended delivery programmes, account is taken of interest attributed to customer advances as these form an integral part of the contract.

Depreciation

Depreciation is provided on a straight line basis on the cost or valuation of all tangible fixed assets, except freehold land and assets in the course of construction.

Buildings are written off over 25 years or, if leasehold and the term of the lease is shorter than 25 years, such shorter term. Buildings erected specifically and exclusively for a research or production programme are written off over the expected life of the programme. Plant, machinery, fixtures, fittings and equipment are generally written off over eight years.

Research and development

Expenditure on research and development, other than that on buildings or specifically recoverable under contract, is written off as incurred and charged in arriving at trading profit.

Launching costs

The costs of launching a new civil aircraft project fall into three principal categories: design and development, jigs and tools, and education.

Design and development expenditure arises mainly in the early years of a project and, with the exception of the A320 programme, is written off as incurred under the heading of launching costs in the profit and loss account. Initial launching costs on the A320 programme are covered by HM Government launch aid and, as a result, the design and development expenditure is carried forward and will be amortised, based on an appropriate assessment of sales, when deliveries commence.

Expenditure on jigs and tools is normally incurred only after the decision to manufacture has been taken.

Education costs arise early in the production cycle of a new aircraft when production skills and expertise are being acquired and unit costs are therefore relatively high. They comprise the excess of such unit production costs over the level of unit costs anticipated at a more advanced stage of the production programme.

Expenditure on jigs, tools and education is carried forward in stocks for amortisation in respect of each project by reference to an appropriate assessment of sales, subject to the status of the project and the overriding concept of financial prudence. The amortisation of jigs, tools and education is charged in arriving at trading profit.

1 ACCOUNTING POLICIES (continued)

Taxation

Provision for deferred taxation is made where a liability is likely to arise in the foreseeable future.

Stocks

Stocks are valued at the lower of cost (including all relevant overhead expenditure) and net realisable value, less progress payments and HM Government launch aid.

Stocks include launching costs carried forward and the Company's interest in Airbus Industrie.

Exchange rates

Transactions in overseas currencies are converted into sterling at the rates then ruling and assets and liabilities at the balance sheet date are translated into sterling at the rates ruling at that date. The resulting gains and losses are dealt with in the profit and loss account except where they relate to borrowings made to hedge future overseas currency revenues, in which case they are credited or charged to the relevant contract or project, and carried forward until realised.

Differences on translation of the opening net assets of overseas subsidiaries, arising from the use of exchange rates ruling at the balance sheet date, are taken direct to reserves. The sales and profits of overseas subsidiaries are translated at the rates ruling at the balance sheet date.

Airbus Industrie

As a member of Airbus Industrie, British Aerospace participates in the Airbus civil aircraft programmes. The Company is responsible for the overall design of the wings, production of wing boxes and the purchase of certain components from other UK manufacturers.

The Company also shares in the overall results of Airbus Industrie. Profits and losses are shared in proportion to members' interests except that, until the accumulated losses incurred since the first production phase of the A300 programme have been fully recovered by profits, each member's participation in profits is calculated in proportion to the accumulated losses that it has borne.

Since the Company's participation in Airbus Industrie relates to particular Airbus production programmes which are effectively carried out on a joint venture basis, profits or losses on the British Aerospace work are consolidated with the Company's share in the overall results of Airbus Industrie in assessing both the trading profits and the realisable value of work undertaken by the Company for Airbus Industrie. Outstanding amounts relating to the participation are carried forward in stocks.

2 TURNOVER AND TRADING PROFIT

Turnover represents the net value of deliveries made, work completed or services rendered during the year and includes adjustments arising from the use of estimated prices in previous years.

Exports include sales to overseas related companies under collaborative contracts, some of which relate to work on products delivered to the United Kingdom.

Turnover comprised:

	1986			1985		
	UK	**Export**	**Total**	UK	Export	Total
	£m	**£m**	**£m**	£m	£m	£m
Civil aircraft	**75.9**	**685.8**	**761.7**	47.9	602.3	650.2
Military aircraft and support services	**317.8**	**850.3**	**1,168.1**	329.6	615.6	945.2
Guided weapon and electronic systems	**618.7**	**392.4**	**1,011.1**	603.7	319.2	922.9
Space and communications	**53.2**	**142.9**	**196.1**	43.2	86.2	129.4
	1,065.6	**2,071.4**	**3,137.0**	1,024.4	1,623.3	2,647.7

The geographical distribution of exports comprised:

	1986	1985
	£m	£m
Europe	**664.9**	730.4
Africa	**26.8**	112.2
Middle East	**637.2**	187.6
Far East	**151.2**	49.5
Australasia and Pacific	**28.3**	40.5
USA and Canada	**543.4**	478.9
Central and South America	**19.6**	24.2
	2,071.4	1,623.3

Trading profit comprised:

	1986	1985
	£m	£m
Civil aircraft	**(7.7)**	(2.5)
Military aircraft and support services	**146.0**	148.3
Guided weapon and electronic systems	**139.7**	127.8
Space and communications	**1.9**	(2.0)
Company funded research and development	**(62.7)**	(54.9)
Reorganisation costs	**—**	(5.6)
Trading profit	**217.2**	211.1

Interest attributed to customer advances which has been allocated to trading profit amounted to £46.3 million (1985: £31.0 million). In previous years such amounts were included under the heading of net interest in the profit and loss account. The comparative figures have been restated to reflect this reallocation.

3 COST OF SALES

Cost of sales comprised:	1986 £m	1985 £m
Expenses		
Raw materials and consumables	186.6	168.9
Purchases of bought out equipment, components and other external charges	2,220.5	1,563.0
Staff costs (note 6)	958.4	908.5
Depreciation	63.8	56.2
Other operating charges	57.1	70.7
	3,486.4	2,767.3
Less:		
Increase in stocks of finished goods and work in progress, after amortisation of jigs, tools and education	432.7	180.7
Own work capitalised	0.1	0.4
Other operating income	39.9	67.0
Interest on customer advances (note 2)	46.3	31.0
	2,967.4	2,488.2
Less:		
Design and development expenditure included above, charged to launching costs (note 4)	47.6	51.6
Cost of sales	2,919.8	2,436.6

Included within cost of sales were:

Expenses		
Operating lease charges:		
Plant and machinery	0.8	1.9
Other, including aircraft	31.9	24.1
Hire of plant and machinery, other than under operating leases	1.7	8.3
Company funded research and development	62.7	54.9
Auditors' remuneration	0.6	0.6
Income		
Rental income from:		
Operating leases	27.9	20.0
Finance leases	1.9	2.5

4 LAUNCHING COSTS

	1986 £m	1985 £m
BAe 146	17.1	27.3
Airbus	19.4	6.9
BAe 125-800	0.3	1.5
ATP	10.8	15.9
	47.6	51.6

The amortisation of jigs, tools and education has been charged in arriving at cost of sales (note 3).

5 NET INTEREST RECEIVABLE/(PAYABLE)

	1986 £m	1985 £m
Interest receivable, other than on customer advances (note 2)	**10.0**	2.7
Income from government securities	**23.0**	15.5
	33.0	18.2
Interest payable:		
On bank overdrafts and loans repayable within 5 years	**(2.9)**	(2.9)
On other loans	**(21.1)**	(27.7)
	9.0	(12.4)

6 EMPLOYEES

The average weekly number of employees, including executive Directors, during the year was as follows:

	Number of employees 1986	1985
Civil aircraft, military aircraft and support services	**51,785**	51,800
Guided weapon, electronic systems, space and communications	**22,508**	22,588
Subsidiaries	**837**	820
Headquarters	**350**	437
	75,480	75,645

The aggregate payroll costs of these employees and Directors were:

	1986 £m	1985 £m
Wages and salaries	**843.3**	784.5
Social security costs	**59.4**	53.7
Other pension costs	**55.7**	70.3
	958.4	908.5

The emoluments, excluding pension contributions, of higher paid employees (other than Directors—see note 7) fell within the following ranges:

£ £	Number of employees 1986	1985
30,001 to 35,000	**114**	50
35,001 to 40,000	**46**	17
40,001 to 45,000	**19**	10
45,001 to 50,000	**9**	6
50,001 to 55,000	**8**	2
55,001 to 60,000	**5**	2
60,001 to 65,000	**4**	—
65,001 to 70,000	**—**	1
75,001 to 80,000	**1**	—
85,001 to 90,000	**1**	—

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3

7 DIRECTORS

(a) Emoluments

The aggregate emoluments, including pension contributions, of the Directors amounted to £784,000 (1985 £879,000), of which £48,500 (1985 £35,000) was in respect of their service as Directors of the Company.

The emoluments, excluding pension contributions, of the Chairman, who was the highest paid Director, were £152,700 (1985 £121,660).

The emoluments, excluding pension contributions, of the Chairman and Directors of the Company fell within the following ranges:

£	£	Number of Directors 1986	1985
5,001 to	10,000	4	5
10,001 to	15,000	1	—
15,001 to	20,000	1	—
20,001 to	25,000	—	1
40,001 to	45,000	—	1
55,001 to	60,000	—	1
60,001 to	65,000	—	1
65,001 to	70,000	1	1
70,001 to	75,000	—	2
75,001 to	80,000	1	—
80,001 to	85,000	2	—
105,001 to	110,000	—	1
120,001 to	125,000	—	1
130,001 to	135,000	1	—
150,001 to	155,000	1	—

(b) Transactions

(1) During 1986, Sir Raymond Lygo continued to occupy a leasehold house in London purchased by the Company and him in 1983 to assist him to fulfil his duties as Chief Executive. As noted in previous accounts, the house is held by the Company and Sir Raymond on the terms of a trust deed dated 3rd March, 1983 whereunder Sir Raymond is entitled to occupy the house without payment of any rent to the Company (but subject to the payment of the rent due to the freeholder and other normal outgoings) until three months after he ceases to be Chief Executive of the Company. On the termination of Sir Raymond's right of occupation, either the Company or Sir Raymond can require the house to be sold and the proceeds of sale to be shared between them in the proportions in which they contributed to the purchase price (the Company nine-tenths and Sir Raymond one-tenth).

The Companies Act requires accounts to state the 'value' of any such arrangement and provides that, if such value cannot be expressed as a specific sum of money, it is deemed to exceed £50,000. The Directors consider that Sir Raymond Lygo's right to occupy the property in accordance with the provisions of the Trust Deed cannot be expressed as a specific sum of money; however, they believe that the real value of this right is much smaller than £50,000.

7 DIRECTORS (continued)

(2) As was noted in previous accounts, under a Housing Loan Scheme operated by the Company, Mr. H. Metcalfe and Mr. I. R. Yates had bank loans, bearing interest at 5% per annum, incurred in buying their respective houses. Mr. Yates's loan is secured on his house and certain insurance policies and is repayable not later than 18th May, 1997. Mr. Metcalfe's loan, secured by a second mortgage on his house was repaid in December, 1986. For the duration of each loan the Company maintains with the bank a deposit equal to the amount outstanding under the loan: such deposit bears interest at 3⅜% per annum and is available as additional security for the loan. Mr. Metcalfe and Mr.Yates each agreed to indemnify the Company against any liability to the bank by reason of their respective loans.

The amounts of principal and accrued interest outstanding under these loans were as follows:

	At 31st December, 1986		At 1st January, 1986	
	Principal	**Interest**	Principal	Interest
	£	**£**	£	£
Mr. Metcalfe	**—**	**—**	10,571	24
Mr. Yates	**45,000**	**99**	45,000	99

The maximum amount of principal and accrued interest outstanding at any time during 1986 under each loan was as follows:

	£
Mr. Metcalfe	10,595
Mr. Yates	45,604

All interest which has become payable under the loans has been paid.

(3) At 31st December, 1986 there was an aggregate balance of £226,700 outstanding on house purchase loans made to or arranged for nine officers to assist with their relocation at the Company's request.

8 TAXATION

	1986	1985
	£m	£m
UK corporation tax at 36.25% (1985—41.25%)	**60.8**	40.0
Prior years' advance corporation tax utilised	**(13.8)**	(22.9)
Deferred taxation	**4.6**	5.0
Related companies	**1.8**	1.7
Overseas taxation	**0.4**	(0.3)
	53.8	23.5

3 40 42

9 EXTRAORDINARY ITEM

Following the announcement of the closure of the manufacturing facilities at Weybridge, full provision of £57.1 million has been made for the anticipated total costs of closure, less attributable taxation relief of £13.0 million.

10 PROFIT AFTER TAXATION AND EXTRAORDINARY ITEM

A separate profit and loss account dealing with the results of the Company only has not been presented. Of the consolidated profit after taxation and extraordinary item of £84.3 million (1985 £127.0 million), £83.2 million (1985 £125.3 million) has been dealt with in the accounts of the Company.

11 DIVIDENDS

	1986 £m	1985 £m
Interim paid 6.4p per ordinary share (1985—5.8p)	16.0	14.5
Final proposed 11p per ordinary share (1985—10p)	27.5	25.0
	43.5	39.5

12 EARNINGS PER SHARE

The earnings per share is calculated by reference to the profit after taxation and before extraordinary item and the average number of 250,056,144 (1985 225,181,473) ordinary shares in issue during the year.

13 LEASE COMMITMENTS

	Company and subsidiaries		Company	
	1986 £m	1985 £m	1986 £m	1985 £m
Commitments under finance leases falling due:				
In one year or less	21.5	22.7	21.2	18.6
Between one and five years	41.8	44.5	41.2	41.6
In five years or more	9.9	13.6	9.9	13.6
Finance charges	(9.9)	(13.6)	(9.8)	(12.0)
	63.3	67.8	62.5	61.8

13 LEASE COMMITMENTS (continued)

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
Commitments under operating leases falling due:				
In one year or less	**36.9**	28.2	**3.0**	5.0
Between one and two years	**35.0**	25.8	**1.4**	2.7
Between two and three years	**34.5**	25.0	**0.9**	2.1
Between three and four years	**34.5**	24.4	**0.9**	1.4
Between four and five years	**33.8**	23.5	**0.6**	0.8
Later years	**261.4**	186.3	**3.5**	4.0
	436.1	313.2	**10.3**	16.0

The majority of the operating lease commitments shown above, together with certain finance lease commitments, relate to civil aircraft sold to lessors and leased back to the Company or its subsidiaries. These commitments are broadly matched by income due under sub-leases of the aircraft to customers for periods which range from 5 to 12 years. The future sub-lease rentals receivable after 31st December, 1986 in respect of the minimum lease periods were as follows:

	Company and subsidiaries	
	1986 £m	1985 £m
In one year or less	**36.3**	26.3
Between one and two years	**37.7**	26.4
Between two and three years	**37.7**	26.4
Between three and four years	**37.7**	25.3
Between four and five years	**36.3**	24.3
Later years	**272.6**	197.1
	458.3	325.8

14 CAPITAL COMMITMENTS

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
Capital expenditure not provided for in the accounts:				
Firm orders	**35.4**	28.5	**34.4**	27.1
Approved but not ordered	**40.6**	14.1	**40.5**	13.2
	76.0	42.6	**74.9**	40.3

15

FIXED ASSETS –TANGIBLE ASSETS

	Land and buildings			Plant and machinery £m	Fixtures, fittings and equipment £m	Assets in the course of construction £m	Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m				
Company and subsidiaries							
Cost or valuation							
At 1st January, 1986	318.7	8.8	2.8	282.2	80.4	30.1	723.0
Exchange adjustment	(0.1)	—	—	(0.1)	(0.4)	—	(0.6)
Reclassifications	11.5	—	0.8	10.1	0.2	(22.6)	—
Additions	16.1	—	3.0	37.8	29.9	17.3	104.1
Disposals	—	—	—	(1.1)	(17.7)	—	(18.8)
At 31st December, 1986	346.2	8.8	6.6	328.9	92.4	24.8	807.7
Depreciation							
At 1st January, 1986	9.4	0.3	0.4	135.0	39.2	—	184.3
Exchange adjustment	—	—	—	—	(0.2)	—	(0.2)
Charge for the year	10.8	0.3	0.5	41.0	11.2	—	63.8
Disposals	—	—	—	(1.0)	(11.1)	—	(12.1)
At 31st December, 1986	20.2	0.6	0.9	175.0	39.1	—	235.8
Net book value							
At 31st December, 1986	326.0	8.2	5.7	153.9	53.3	24.8	571.9
At 31st December, 1985	309.3	8.5	2.4	147.2	41.2	30.1	538.7
Company							
Cost or valuation							
At 1st January, 1986	314.4	8.8	2.4	280.8	63.4	29.5	699.3
Reclassifications	11.1	—	0.8	10.1	—	(22.0)	—
Additions	14.6	—	2.4	37.7	16.2	17.3	88.2
Disposals	—	—	—	(1.1)	(2.8)	—	(3.9)
At 31st December, 1986	340.1	8.8	5.6	327.5	76.8	24.8	783.6
Depreciation							
At 1st January, 1986	9.4	0.3	0.1	134.4	30.2	—	174.4
Charge for the year	10.7	0.3	0.3	40.8	10.2	—	62.3
Disposals	—	—	—	(1.0)	(2.6)	—	(3.6)
At 31st December, 1986	20.1	0.6	0.4	174.2	37.8	—	233.1
Net book value							
At 31st December, 1986	320.0	8.2	5.2	153.3	39.0	24.8	550.5
At 31st December, 1985	305.0	8.5	2.3	146.4	33.2	29.5	524.9

15 FIXED ASSETS –TANGIBLE ASSETS (continued)

The UK land and buildings of the Company were valued at 31st December, 1984 on an open market existing use basis; other tangible fixed assets, including subsequent additions to UK land and buildings, are included at cost.

The historic cost of land and buildings was as follows:

	Company and subsidiaries			Company		
	Freehold £m	Long leasehold £m	Short leasehold £m	Freehold £m	Long leasehold £m	Short leasehold £m
Cost	**275.7**	**6.5**	**7.2**	**269.6**	**6.5**	**6.2**
Depreciation	**45.6**	**1.3**	**2.7**	**45.5**	**1.3**	**2.4**
Net book value						
At 31st December, 1986	**230.1**	**5.2**	**4.5**	**224.1**	**5.2**	**3.8**
At 31st December, 1985	214.3	5.5	2.2	209.8	5.5	2.1

16 FIXED ASSETS –INVESTMENTS

The operating subsidiaries, all of which were owned directly by the Company, and the principal related companies were as follows:

	Issued share capital	Proportion held
Subsidiary companies		
British Aerospace (Insurance) Limited *Country of incorporation and operation: England.* Self insurance for certain risks of the Company.	£200,000	100%
British Aerospace (Insurance Brokers) Limited *Country of incorporation and operation: England.* Insurance broking service for the Company and employees.	£100	100%
British Aerospace Australia Limited *Country of incorporation and operation: Australia.* Manufacturer of electronic systems.	A$7,000,000	100%
British Scandinavian Aviation AB *Country of incorporation and operation: Sweden.* Agency.	SKr 50,000	100%
British Aerospace (Holdings) Incorporated *Country of incorporation and operation: United States of America.* Marketing, product support and financing activities.	US$5,800,000	100%
Related companies		
Société Européene de Production de l'Avion ECAT SA *Country of incorporation and operation: France.* Co-ordinating the Jaguar programme.	FF250,000	50%
Panavia Aircraft GmbH *Country of incorporation and operation: Federal Republic of Germany.* Managing the Tornado programme.	DM20,000,000	42½%

16 FIXED ASSETS -INVESTMENTS (continued)

	Company and subsidiaries			Company			
	Investments	Related companies	Total	Subsidiary companies	Investments	Related companies	Total
	£m	£m	£m	£m	£m	£m	£m
Cost							
At 1st January, 1986	**16.0**	**1.1**	**17.1**	**228.5**	**16.0**	**1.1**	**245.6**
Exchange adjustment	**(0.4)**	**—**	**(0.4)**	**(0.7)**	**(0.4)**	**—**	**(1.1)**
Net additions	**1.1**	**0.3**	**1.4**	**8.9**	**1.1**	**0.3**	**10.3**
At 31st December, 1986	**16.7**	**1.4**	**18.1**	**236.7**	**16.7**	**1.4**	**254.8**
Retained profits							
Share of post acquisition reserves at 1st January, 1986		**2.9**	**2.9**				
Exchange adjustment		**0.8**	**0.8**				
Share of retained profits for the year		**1.5**	**1.5**				
		5.2	**5.2**				
Loans to subsidiaries							
At 1st January, 1986				13.1			13.1
At 31st December, 1986				**10.7**			**10.7**
Loans from subsidiaries							
At 1st January, 1986 and 31st December, 1986				**(186.9)**			**(186.9)**
Net book value							
At 31st December, 1986	**16.7**	**6.6**	**23.3**	**60.5**	**16.7**	**1.4**	**78.6**
At 31st December, 1985	16.0	4.0	20.0	54.7	16.0	1.1	71.8

Included in fixed assets – investments is the Company's interest in non-trading subsidiaries whose assets comprise loans to the Company totalling £186.9 million which have been offset against the cost of the Company's investment.

17 GROUPEMENTS D'INTERET ECONOMIQUE

At 31st December, 1986 the Company had interests in three Groupements d'Intérêt Economique ('GIEs') as follows:

Airbus Industrie	20%
Euromissile Dynamics Group	33⅓%
Satcom International	50%

A GIE is an organisation incorporated under French law with separate legal personality. It has certain similarities with a partnership formed under English law (see also note 23 on page 50). The accounting policy relating to Airbus Industrie is set out in note 1 on page 36.

18 STOCKS

	Company and subsidiaries		Company	
	1986	1985	**1986**	1985
	£m	£m	**£m**	£m
Raw materials and consumables	**73.2**	67.1	**73.2**	67.1
Work in progress	**677.4**	573.3	**676.7**	572.0
Airbus work in progress and participation	**171.5**	195.6	**171.5**	195.6
Finished goods and goods for resale	**75.3**	71.6	**22.7**	33.0
	997.4	907.6	**944.1**	867.7
Unamortised launching costs:				
Design and development	**115.7**	69.8	**115.7**	69.8
Jigs and tools	**116.3**	105.6	**116.3**	105.6
Education	**142.2**	116.4	**142.2**	116.4
Less: launch aid receivable	**(196.1)**	(109.1)	**(196.1)**	(109.1)
	178.1	182.7	**178.1**	182.7
	1,175.5	1,090.3	**1,122.2**	1,050.4

Stocks are shown net of progress payments received amounting to £1,140.1 million (1985 £961.1 million) for the Company and its subsidiaries, and £1,135.7 million (1985 £954.6 million) for the Company only.

The balance on the Airbus Industrie account is included above in accordance with the accounting policy set out in note 1 on page 36.

Unamortised launching costs, which relate to civil aircraft programmes with long production cycles, are expected to be realised over a number of years. In accordance with normal practice in the aerospace industry, jigs and tools are included within stocks.

HM Government has agreed to provide up to £250 million launch aid for British Aerospace's contribution to the A320 project. As part of these arrangements, British Aerospace has agreed to make to HM Government payments aggregating £50 million over the three years 1990 to 1992 and to pay levies on A320 sales, which are designed to recover HM Government's launch aid together with a return thereon. In accordance with the accounting policy set out in note 1 on pages 35 and 36, launching costs are being carried forward and will be amortised when deliveries commence. Stocks have been reduced by the launch aid carried forward. The payments to HM Government of £50 million referred to above, will be deducted from the launch aid carried forward; the levies will be deducted both from the launch aid carried forward and from profits, as appropriate, when the relevant deliveries are made.

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19 DEBTORS

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
Amounts falling due within one year				
Trade debtors	**316.3**	308.9	**301.1**	293.5
Amounts owed by subsidiaries	**—**	**—**	**51.7**	16.8
Amounts owed by related companies	**3.4**	0.2	**3.4**	0.2
Other debtors	**54.5**	40.3	**46.8**	37.8
Prepayments and accrued income	**61.2**	41.3	**59.7**	39.8
	435.4	390.7	**462.7**	388.1
Amounts falling due after more than one year				
Trade debtors	**24.1**	28.8	**24.1**	28.8
Other debtors	**40.6**	25.1	**9.6**	3.4
Advance corporation tax recoverable (note 26)	**5.7**	5.7	**5.7**	5.7
	70.4	59.6	**39.4**	37.9
	505.8	450.3	**502.1**	426.0

20 CURRENT ASSETS – INVESTMENTS

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
Government securities:				
Fixed interest	**172.4**	120.1	**172.4**	120.1
Index linked	**59.6**	23.2	**59.6**	23.2
Floating rate notes and Eurobonds	**56.9**	2.0	**56.9**	2.0
Local authority bonds and mortgages	**1.3**	8.2	**1.3**	8.2
Term deposits with banks	**495.0**	339.6	**495.0**	339.6
Other deposits	**137.6**	32.9	**131.9**	28.0
	922.8	526.0	**917.1**	521.1

Fixed interest Government securities (which are intended to be held until maturity) are stated at cost — market value £171.5 million (1985 £121.3 million). Index linked Government securities are stated at market value — cost £53.2 million (1985 £21.0 million).

21 LOANS AND OVERDRAFTS

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
Loans falling due within one year				
Bank loans and overdrafts	**3.0**	2.2	**—**	0.8
National Loans Fund	**3.1**	4.0	**3.1**	4.0
	6.1	6.2	**3.1**	4.8

The bank loans and overdrafts include £1.4 million (1985 £1.3 million) secured by charges on assets.

Loans falling due after one year				
National Loans Fund:				
9⅞% loan, final instalment 1987	**—**	0.9	**—**	0.9
15⅜% loan, final instalment 1990	**5.5**	7.7	**5.5**	7.7
14⅜% sterling bank loan, final instalment 1992	**50.0**	50.0	**50.0**	50.0
US Commercial Paper	**66.3**	—	**—**	—
US dollar revolving bank loans	**88.7**	183.2	**88.7**	183.2
Other bank loans (secured by a fixed charge)	**26.4**	23.3	**—**	—
	236.9	265.1	**144.2**	241.8

US Commercial Paper with a maximum period to maturity of 270 days is included in loans falling due after one year as it is the intention to issue further paper on maturity or to re-finance the borrowing through existing undrawn committed long term bank facilities.

US dollar revolving bank loans and US Commercial Paper are at variable market rates of interest and at 31st December, 1986 were between 6% and 8%. Other bank loans are at variable rates of interest, between 9% and 13%.

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
The above loans and overdrafts are repayable as follows:				
In one year or less	**6.1**	6.2	**3.1**	4.8
Between one and two years	**3.8**	4.6	**2.2**	3.1
Between two and five years	**29.4**	31.1	**23.3**	25.5
Later years	**203.7**	229.4	**118.7**	213.2
	243.0	271.3	**147.3**	246.6

In the case of US Commercial Paper and loans drawn under revolving credit facilities, the date of repayment shown above is the date of the expiry of the facility.

22 CREDITORS

	Company and subsidiaries		Company	
	1986 £m	1985 £m	**1986 £m**	1985 £m
Creditors falling due within one year				
Advances	**756.0**	376.4	**755.7**	375.2
Trade creditors	**441.3**	412.2	**434.3**	397.7
Amounts owed to subsidiaries	**—**	—	**71.5**	5.4
Amounts owed to related companies	**1.8**	0.3	**1.8**	0.3
Corporation tax	**46.4**	28.9	**45.7**	28.7
Other taxes and social security costs	**28.0**	33.1	**27.9**	32.9
Dividend	**27.5**	25.0	**27.5**	25.0
Other creditors	**58.4**	65.2	**55.6**	64.3
Accruals and deferred income	**147.4**	102.3	**129.1**	88.9
	1,506.8	1,043.4	**1,549.1**	1,018.4
Creditors falling due after one year				
Advances	**44.4**	0.9	**44.4**	0.9
Trade creditors	**20.3**	35.0	**20.3**	35.0
Other creditors	**1.4**	0.5	**1.4**	0.5
Accruals and deferred income	**10.8**	6.6	**1.6**	1.8
	76.9	43.0	**67.7**	38.2

Advances represent deposits received and receivable in advance of work carried out and are deducted from work in progress as costs are incurred.

23 CONTINGENT LIABILITIES

Contingent liabilities of £41 million (1985 £10 million), relating to sales of civil aircraft, exist in respect of both guarantees and residual credit risk on supplier credit agreements entered into under Export Credits Guarantee Department arrangements.

The Company has, with other companies, given joint and several indemnities, with liability limited in the aggregate to some £27 million (1985 £22 million), in connection with certain overseas collaborative contracts; each party will indemnify the other where a liability arises due to its default.

As a member of Groupements d'Intérêt Economique ('GIEs') the Company is jointly and severally liable with the other members to third parties for the debts and obligations of those GIEs, subject to recourse amongst the members in accordance with the terms of the membership agreements.

In addition, contingent liabilities exist in respect of claims related to products, although in the opinion of the Directors no material loss is likely to be incurred as a result of any of these claims.

24 CIVIL AIRCRAFT FINANCING

With the exception of progress payments received in advance of delivery, the payment for civil aircraft is normally on delivery of the aircraft to the customer. However, orders for civil aircraft are frequently subject to the arrangement of finance (including lease finance) on extended terms, provided either by the manufacturer or by third parties (where the terms may involve recourse to the manufacturer in certain circumstances). In addition to its own civil aircraft projects, British Aerospace has obligations in relation to transactions entered into by Airbus Industrie.

At 31st December, 1986 the total amount of customer debt, lease commitments and third party recourse in respect of civil aircraft sales, including British Aerospace's share of Airbus Industrie transactions, after deducting provisions made and the estimated realisable value of the underlying security (generally the related aircraft), was £222 million (1985 £167 million). This figure includes the lease commitments shown in note 13 and the contingent liabilities shown in note 23. Of the total amount of £222 million, six airline customers accounted for approximately 63% and the largest customer accounted for 22%.

25 PROVISIONS FOR LIABILITIES AND CHARGES

	Pensions and similar obligations	Other provisions	Total
Company and subsidiaries	£m	£m	£m
At 1st January, 1986	10.7	187.0	197.7
Expenditure charged against provisions	(1.8)	(19.6)	(21.4)
Provisions created	—	53.6	53.6
At 31st December, 1986	8.9	221.0	229.9
Company			
At 1st January, 1986	10.7	186.0	196.7
Expenditure charged against provisions	(1.8)	(19.5)	(21.3)
Provisions created	—	53.9	53.9
At 31st December, 1986	8.9	220.4	229.3

Other provisions comprised:

	Company and subsidiaries		Company	
	1986	1985	**1986**	1985
	£m	£m	**£m**	£m
Product and contract provisions	**160.1**	176.8	**159.5**	176.3
Closure costs	**53.0**	—	**53.0**	—
Other	**7.9**	10.2	**7.9**	9.7
	221.0	187.0	**220.4**	186.0

26 DEFERRED TAXATION

The components of deferred taxation calculated at 35% (1985 35%) were as follows:

	Company and Group			
	Full potential liability		Amount provided	
	1986 £m	1985 £m	1986 £m	1985 £m
Accelerated capital allowances and other timing differences	51.7	51.1	9.6	5.0
Closure costs	(11.5)	—	(11.5)	—
Unrealised gains on fixed assets	53.3	56.2	6.4	—
Advance corporation tax recoverable	(10.2)	(24.5)	(10.2)	(10.7)
	83.3	82.8	(5.7)	(5.7)

The excess of advance corporation tax recoverable over the provision for deferred taxation, £5.7 million (1985 £5.7 million), is included within debtors (note 19).

27 SHARE CAPITAL

	Special share of £1	Ordinary shares of 50p	Nominal value £m
Authorised			
At 1st January, 1986 and 31st December, 1986	1	300,000,000	150.0
Issued and fully paid			
At 1st January, 1986	1	250,019,747	125.0
Exercise of options under the SAYE Scheme	—	72,794	—
At 31st December, 1986	1	250,092,541	125.0

Under the British Aerospace SAYE Share Option Scheme for employees, options to purchase ordinary shares of 50p each are exercisable normally on completion of the related five year savings contracts. The number of options exercised (in accordance with the Rules of the Scheme) and outstanding at 31st December, 1986, together with their exercise prices, were as follows:

Granted	Exercise price	Exercised	Outstanding
1983	£2.00	89,657	4,970,745
1984	£2.08	2,110	609,993
1985	£3.80	774	1,001,285
1986	£5.25	—	1,082,061
		92,541	7,664,084

Under the British Aerospace Executive Share Option Scheme, options to purchase ordinary shares of 50p 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 outstanding at 31st December, 1986, together with their exercise prices, were as follows:

Granted	Exercise price	Exercised	Outstanding
1985	£3.85	—	1,025,820
1986	£5.87	—	271,337
		—	1,297,157

28 STATUTORY RESERVE

The balance of the former Government investment, following the issue on 2nd January, 1981 of fully paid ordinary shares in the Company to HM Government under Section 3 of the British Aerospace Act 1980, was designated as 'the statutory reserve' in accordance with Section 4 of the Act. 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.

29 OTHER RESERVES

	Revaluation reserve	Capital reserve	Profit and loss account
	£m	£m	£m
Company and subsidiaries			
At 1st January, 1986	101.8	108.3	429.0
Profit for year	—	—	40.8
Exchange adjustment	—	—	0.4
Depreciation on valuation surplus	(3.5)	—	3.5
Transfer to deferred taxation	—	(6.4)	—
Other	—	(0.5)	—
At 31st December, 1986	98.3	101.4	473.7
Company			
At 1st January, 1986	101.8	119.3	441.2
Profit for year	—	—	39.7
Exchange adjustment	—	—	(0.5)
Depreciation on valuation surplus	(3.5)	—	3.5
Transfer to deferred taxation	—	(6.4)	—
Other	—	(0.5)	—
At 31st December, 1986	98.3	112.4	483.9

30 PENSION SCHEME

The British Aerospace Pension Scheme ('the Scheme') was introduced on 6th April, 1979. An actuarial valuation of the Scheme as at 6th April, 1985 showed that accrued liabilities were fully funded on a discontinuance basis and also on the basis of the security target then adopted by the Company and the trustee of the Scheme. The actuary also confirmed that the accrued liabilities would still be fully funded on a discontinuance basis notwithstanding the introduction in 1986 of a number of improvements in benefits provided by the Scheme and the adoption of a higher security target by the Company and the trustee of the Scheme. A further valuation of the Scheme will be carried out as at 6th April, 1988.

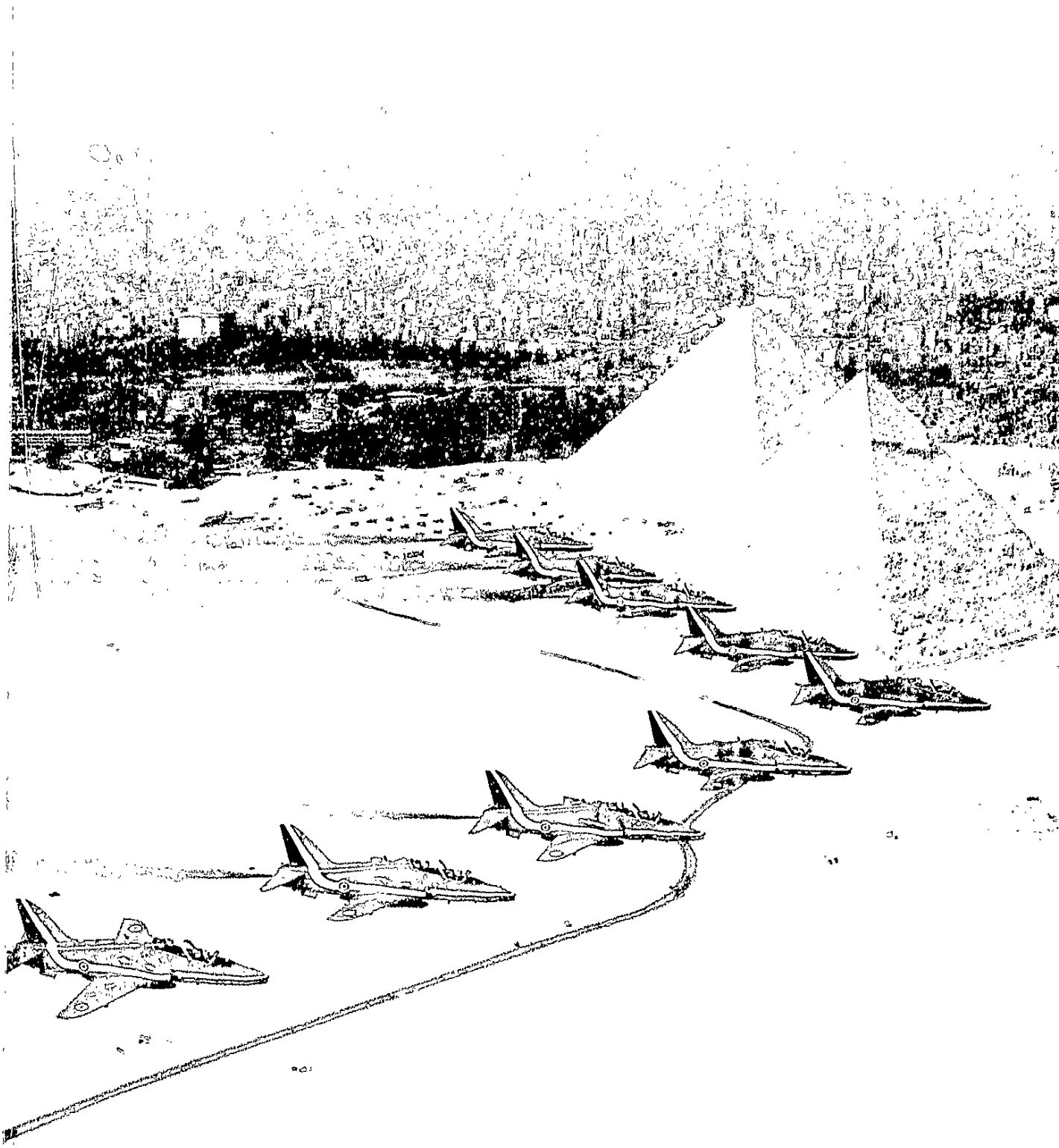
	1986 £m	1985 £m	1984 £m	1983 £m	1982 £m
Profit & Loss					
Turnover	**3,137.0**	2,647.7	2,467.9	2,300.3	2,053.0
Trading profit	**217.2**	211.1	196.2	144.0	156.0
Launching costs	**(47.6)**	(51.6)	(51.1)	(42.6)	(49.2)
Profits of related companies and interest	**12.6**	(9.0)	(24.9)	(19.1)	(22.1)
Profit before taxation, exceptional and extraordinary items	**182.2**	150.5	120.2	82.3	84.7
Exceptional provision in respect of civil aircraft programmes	**—**	—	—	—	(100.0)
Extraordinary item in respect of closure costs	**(44.1)**	—	—	—	—
Taxation	**(53.8)**	(23.5)	(12.2)	—	(7.8)
Profit/(Loss) after taxation, exceptional and extraordinary items	**84.3**	127.0	108.0	82.3	(23.1)
Capital Employed					
Fixed assets	**595.2**	558.7	513.9	392.5	379.4
Net current assets					
Stocks	**1,175.5**	1,090.3	1,076.7	968.1	791.9
Creditors less debtors	**(1,001.0)**	(593.1)	(488.5)	(372.0)	(355.6)
Liquid assets less overdrafts	**994.5**	636.1	389.9	275.2	245.1
	1,169.0	1,133.3	978.1	871.3	681.4
Provisions and long term creditors	**(306.8)**	(240.7)	(265.1)	(265.3)	(164.6)
Assets employed	**1,457.4**	1,451.3	1,226.9	998.5	896.2
Loans	**(236.9)**	(265.1)	(308.3)	(259.4)	(222.0)
Shareholders' funds	**1,220.5**	1,186.2	918.6	739.1	674.2
Other Financial Information					
Capital expenditure	**98.8**	98.8	76.3	61.8	59.9
Depreciation	**63.8**	56.2	54.2	46.5	36.9
Orders received	**6,599.1**	2,979.9	2,381.4	2,980.9	2,388.9

Financial calendar

Financial year end	31st December
Seventh Annual General Meeting	12th May, 1987
1986 final dividend payable	2nd June, 1987
1987 interim results announcement	September, 1987
1987 interim dividend payable	November, 1987
1987 full year results: preliminary announcement	March, 1988
report and accounts	April, 1988
1987 final dividend payable	June, 1988

Analysis of ordinary share register at 31st December, 1986

	Accounts		Ordinary shares of 50p each	
	Number	% of total	Number	% of total
By category of shareholder				
Individual holders				
Male	78,575	65.35	14,577,476	5.83
Female	26,816	22.30	5,734,911	2.29
Joint Accounts	9,361	7.80	2,729,191	1.10
	114,752	95.45	23,041,578	9.22
Banks (including clients' accounts)	1,713	1.43	43,757,822	17.50
Nominee companies	1,670	1.39	28,797,114	11.50
Insurance companies	377	0.31	45,660,426	18.26
Pension funds	409	0.34	88,106,902	35.23
Limited companies	1,080	0.89	12,045,662	4.82
Other corporate bodies (colleges, schools, councils, etc.)	236	0.19	8,683,037	3.47
	120,237	100.00	250,092,541	100.00
By size of holding				
1–99	25,299	21.05	1,064,676	0.43
100–499	82,761	68.83	13,460,641	5.38
500–999	6,538	5.44	4,378,595	1.75
1,000–4,999	4,136	3.44	6,701,711	2.68
5,000–9,999	329	0.27	2,140,963	0.86
10,000–49,999	591	0.49	13,589,841	5.43
50,000–99,999	207	0.17	13,683,481	5.47
100,000–999,999	329	0.27	85,820,087	34.32
1,000,000 and over	47	0.04	109,252,546	43.68
	120,237	100.00	250,092,541	100.00



British Aerospace Hawks flown by the Red Arrows team during a six week tour in Summer, 1986.

The photographs of the family of civil aircraft on page 3, the ATP on page 11, the Chinese BAe 146 on page 12 and the artists' impression of EFA on page 8 by Davis Gibson Advertising Limited. Photographs on pages 4, 10 and 11 by courtesy of Airbus Industrie.

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