

***This letter is for information and requires no action***

28 March 2013

Dear Shareholder

I wrote to you last September describing discussions between BAE Systems and EADS regarding a possible combination of their businesses. In October, the Group announced that discussions had terminated. With the publication of the Annual Report for 2012, I wanted to take this opportunity to provide you with some reflections on those discussions and progress in the Group.

The Board and I unanimously believe the proposed merger was based on sound industrial logic. It presented an exciting opportunity to create a world class combination from two successful companies. We believe that the combined business would have delivered enhanced value for shareholders, greater than the sum of the parts, and would have been a technology leader across both the commercial aerospace and defence sectors.

From the outset of discussion between the parties, both BAE Systems and EADS were clear we would proceed with a merger of our businesses only if a transaction structure could be created that aligned the interests of the stakeholders of both companies and received their support. A number of prerequisites would have had to have been met before any proposal would have been taken forward to seek shareholder approval. These prerequisites included:

- That the merger should deliver enhanced value;
- That appropriate governance structures could be implemented including the removal of the stakeholder concert party arrangements in EADS;
- That any transaction would maintain acceptable provisions to safeguard national security considerations for all government parties; and
- That, with the establishment of a conventional Board composition, the new merged group would have a dividend policy that would be attractive to BAE Systems' shareholders.

Such a merger was always expected to be a complex transaction, not least due to multiple government national security considerations, but the prospect of compelling value enhancement and good strategic fit made the opportunity worthy of exploration. Despite good progress on many aspects of the merger the discussions were terminated in October, before any proposal could be taken to shareholders. This decision was taken when it became apparent that not all government parties' preferences could be reconciled, not least against our own governance prerequisites.

Given the industrial logic and value opportunity expected from such a merger, it was not only appropriate that the Board should have considered this opportunity. I believe it was also our obligation to you, the BAE Systems' shareholders, that we did so.

BAE Systems today remains strong with a robust and clear strategy focused on our position as a premier global defence, aerospace and security company. The merger discussions were not a replacement for that well founded strategy.

The Group remains committed to that underlying strategy and prospects for the business remain good. In particular, the outlook in international markets is buoyant with opportunities to mitigate or offset likely pressures on sales growth in US and UK markets. The Group's success in export markets last year was a real achievement, resulting in a significant increase in the Group's order backlog which now stands at more than £42 billion and reflects a two-fold increase in international orders outside of the UK and US markets during 2012.

In addition to the strategic and operational progress in the Group, we have also been on a path to establish world class standards of governance.

Establishing high standards of governance has been a lengthy and challenging process, involving fundamental changes in the culture of the organisation. This is a continuous process but I believe we can be proud of the progress we have made and are now justified in being regarded as a leader in this respect.

As I near the start of my tenth year as Chairman, one of the tasks of the Board's newly appointed Senior Independent Director, Nick Rose, is to manage the succession for my own role. It is important that this process is driven by the objective of finding the right person, not just by the timetable. Difficult as 2012 was, and notwithstanding the undoubtedly challenges the future holds, I believe I will be handing over the tiller of a well-managed, strong and successful company, that is operating to a very high standard of governance.

Yours sincerely



DICK OLVER  
Chairman