

31. Acquisition of subsidiaries

The Group acquired MTC Technologies, Inc. (MTC) in the US on 9 June 2008, Tenix Defence in Australia on 27 June 2008 and Detica Group plc (Detica) on 25 September 2008. If the acquisitions had occurred on 1 January 2008, combined sales of Group and equity accounted investments would have been £19.0bn, revenue £17.2bn and profit for the year from continuing operations £1.8bn.

MTC

On 9 June 2008, the Group acquired 100% of the issued share capital of MTC in the US for a cash consideration including transaction costs of \$375m (£188m). Goodwill arising on consolidation is £131m.

Based in Dayton, Ohio, MTC provides technical and professional services, and equipment integration and modernisation for the US military and intelligence agencies.

In the period from acquisition to 31 December, MTC contributed revenue and loss after tax of £98m and £1m, respectively, to the Group's consolidated results.

The acquisition of MTC complements the existing US business in the Electronics, Intelligence & Support operating group. It allows for synergies in professional services, aircraft integration centres, and modification and sustainment. The opportunities presented by these circumstances do not translate to separately identifiable intangible assets, but represent much of the assessed value within the Electronics, Intelligence & Support operating group supporting the goodwill.

The MTC acquisition had the following effect on the Group's assets and liabilities:

	Book value £m	Accounting policy alignments £m	Fair value adjustments £m	Fair value £m
Intangible assets	12	–	13	25
Property, plant and equipment	14	(1)	5	18
Inventories	4	–	1	5
Receivables	48	–	–	48
Deferred tax assets	1	–	15	16
Payables	(23)	–	(1)	(24)
Deferred tax liabilities	(4)	–	4	–
Provisions	–	–	(1)	(1)
Cash and cash equivalents	2	–	–	2
Loans	(32)	–	–	(32)
Net assets/(liabilities) acquired	22	(1)	36	57
Goodwill				131
Consideration				188
Consideration satisfied by:				
Cash				184
Directly attributable costs:				
Paid				4
				188

The intangible assets acquired as part of the acquisition of MTC can be analysed as follows:

	£m
Customer relationships	21
Technology	4
	25

31. Acquisition of subsidiaries *continued***Tenix Defence**

Tenix Defence Holdings Pty Limited (Tenix Defence), a leading Australian defence contractor, comprises four businesses in the Land, Aerospace, Electronic Systems and Marine sector.

On 27 June 2008, the Group acquired 100% of the issued share capital of Tenix Defence for a cash consideration including transaction costs paid of A\$697m (£328m), subject to adjustment according to the level of working capital in the business at the acquisition date.

In the period from acquisition to 31 December 2008, Tenix Defence contributed revenue, EBITA¹ and loss after tax of £130m, £12m loss and £39m, respectively, to the Group's consolidated results. Included within the loss after tax of £39m is an amortisation expense on intangible assets of £29m.

The acquisition of Tenix Defence complements the existing Australian business enabling BAE Systems to establish a greater presence in the Australian defence market and in particular to expand into the Australian land and marine sectors. These opportunities do not translate into separately identifiable intangible assets, but represent much of the assessed value within Tenix Defence supporting the recognised goodwill.

Certain of the accounting policy alignments have not yet been finalised pending further review. In addition, certain of the fair values assigned to the net assets acquired are provisional. These will be amended as necessary in light of subsequent knowledge or events to the extent that these reflect conditions as at the date of acquisition.

¹ Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.

The acquisition of Tenix Defence had the following effect on the Group's assets and liabilities:

	Book value £m	Accounting policy alignments £m	Fair value adjustments £m	Fair value £m
Intangible assets	5	(2)	91	94
Property, plant and equipment	36	(2)	43	77
Receivables	68	–	–	68
Deferred tax assets	–	–	9	9
Payables	(99)	(21)	(118)	(238)
Provisions	(1)	(3)	1	(3)
Net assets/(liabilities) acquired	9	(28)	26	7
Provisional goodwill				323
Consideration				330
Consideration satisfied by:				
Cash				323
Directly attributable costs:				
Paid				5
Accrued				2
				330

The fair value adjustment to payables of £118m is in respect of provisions for contract losses.

The intangible assets acquired as part of the acquisition of Tenix Defence can be analysed as follows:

	£m
Programmes	75
Order backlog	4
Patents	15
	94

31. Acquisition of subsidiaries *continued*

Detica

On 25 September 2008, the Group's offer for the acquisition of Detica for £543m including assumption of net debt became wholly unconditional. Detica is a specialist business and technology consultancy with expertise in information exploitation, security and resilience, threat intelligence and customer insight.

In the period from acquisition to 31 December 2008, Detica contributed revenue and profit after tax of £60m (UK £55m) and £1m, respectively, to the Group's consolidated results.

The acquisition of Detica provides access to UK and US government contracting opportunities in the intelligence, security and resilience market and significant cross-selling opportunities, particularly in our home markets. The combination of capabilities within Detica and BAE Systems will provide innovative solutions in this growing sector. The opportunities presented by these circumstances do not translate to separately identifiable intangible assets, but represent much of the assessed value within BAE Systems supporting the recognised goodwill.

Certain of the fair values assigned to the net assets acquired are provisional. These will be amended as necessary in light of subsequent knowledge or events to the extent that these reflect conditions as at the date of acquisition.

The acquisition of Detica had the following effect on the Group's assets and liabilities:

	Book value £m	Accounting policy alignments £m	Fair value adjustments £m	Fair value £m
Intangible assets	3	–	91	94
Property, plant and equipment	15	–	–	15
Inventories	2	–	–	2
Receivables	69	–	–	69
Deferred tax assets	2	–	–	2
Payables	(46)	–	–	(46)
Current tax liabilities	–	–	(1)	(1)
Deferred tax liabilities	(1)	–	(24)	(25)
Overdrafts	(4)	–	–	(4)
Loans	(5)	–	–	(5)
Net assets acquired	35	–	66	101
Provisional goodwill				442
Consideration				543
Consideration satisfied by:				
Cash				531
Directly attributable costs:				
Paid				12
				543

The intangible assets acquired as part of the acquisition of Detica can be analysed as follows:

	£m
Order backlog	22
Customer relationships	22
Trademarks	30
Software	20
	94

Other acquisitions

Other acquisitions include the acquisitions of 100% of the issued share capital of Tenix Toll Defence Logistics Pty Limited, formerly a joint venture between Tenix and Toll Holdings Pty Limited, for A\$24m (£12m) and 100% of the issued share capital of IST Dynamics for £7m. As a result of these acquisitions, £7m of goodwill was generated in the year.

Notes to the Group accounts *continued***31. Acquisition of subsidiaries** *continued***Acquisition of subsidiaries for the year ended 31 December 2007**

The Group made a number of acquisitions during the year ended 31 December 2007, the most significant of which was of Armor Holdings, Inc. in the US. The acquisitions took place throughout the year ended 31 December 2007, but if they had occurred on 1 January 2007, combined sales of Group and equity accounted investments would have been £16.7bn, revenue £15.3bn and profit for the year ended 31 December 2007 from continuing operations £928m.

Armor Holdings, Inc.

On 31 July 2007, the Group acquired 100% of the issued share capital of Armor Holdings, Inc. (Armor), in the US, for a consideration of £1,696m, excluding transaction costs incurred by the acquiree (£26m). Goodwill arising on consolidation amounted to £1,554m. Armor is a major manufacturer of tactical wheeled vehicles and a leading provider of vehicle and individual armour systems and survivability technologies for the military and for the law enforcement and commercial security markets.

In the period from acquisition to 31 December 2007, Armor contributed EBITA¹ of £77m and profit after tax of £18m to the Group's consolidated results.

Mobile International, a subsidiary of Armor, was acquired with a view to immediate resale. Accordingly, it was classified as held for sale in the acquisition balance sheet and as at 31 December 2007 (note 19).

The acquisition of Armor complements the existing US business in the Land & Armaments business group creating synergy potential. It allows for continued development of the Mine Resistant Ambush Protected (MRAP) vehicles and Family of Medium Tactical Vehicles (FMTV) programmes, as well as advanced ceramics for body armour. The opportunities presented by these circumstances do not translate to separately identifiable intangible assets, but represent much of the assessed value within the Land & Armaments business group supporting the recognised goodwill.

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.

The acquisition had the following effect on the Group's assets and liabilities:

	Book value £m	Accounting policy alignments £m	Fair value adjustments £m	Fair value £m
Intangible assets	172	–	581	753
Property, plant and equipment	85	(1)	8	92
Inventories	163	(5)	(4)	154
Receivables	158	(1)	(1)	156
Current tax receivable	33	–	2	35
Deferred tax assets	23	3	–	26
Payables	(204)	(1)	(20)	(225)
Deferred tax liabilities	(87)	–	(145)	(232)
Retirement benefit obligations	(24)	4	(2)	(22)
Provisions	(13)	–	(57)	(70)
Cash and cash equivalents	6	–	–	6
Loans	(386)	(5)	(147)	(538)
Held for sale	14	–	(7)	7
Net (liabilities)/assets acquired	(60)	(6)	208	142
Goodwill				1,554
Consideration				1,696

Consideration satisfied by:

Cash	1,682
Directly attributable costs:	
Paid	14
	1,696

The intangible assets acquired as part of the acquisition of Armor can be analysed as follows:

	£m
Programmes	551
Customer relationships	129
Trademarks	69
Patents	4
	753

31. Acquisition of subsidiaries *continued*

Certain of the fair values assigned to the net assets at the date of acquisition were provisional, and in accordance with IFRS 3 *Business Combinations*, the Group has adjusted the fair values attributable to legal provisions and associated deferred taxation in the year ended 31 December 2008, resulting in a net increase in goodwill on acquisition of £6m. This has not had a material impact on the consolidated accounts and, as such, the Group has not restated the balance sheet at 31 December 2007.

Other acquisitions in 2007

Other acquisitions included the acquisition of Pitch Technologies AB and iSC for a consideration of £5m and £4m, respectively. In each case, 100% of the shares were acquired. As a result of these acquisitions, an additional £9m of goodwill was generated in the year.

32. Financial risk management

A discussion of the Group's treasury objectives and policies and the use of financial instruments can be found in the Directors' report. Financial instruments comprise net cash/(debt) (note 29) together with other financial assets and other financial liabilities (note 17) and other instruments deemed to be financial instruments under IAS 32 *Financial Instruments: Disclosure and Presentation*, including non-current receivables, non-current payables and non-current provisions.

Hedging instruments

The notional, or contracted, amounts of derivative financial instruments are shown below, analysed between foreign exchange contracts and interest rate contracts, classified by year of maturity.

	31 December 2008				31 December 2007			
	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m
Foreign exchange contracts								
Net forward (sales)/purchase contracts								
US dollar	(1,199)	248	8	(943)	(2,366)	141	(12)	(2,237)
Euro	2,286	620	4	2,910	1,277	425	(1)	1,701
Other	132	2	–	134	131	3	–	134
	1,219	870	12	2,101	(958)	569	(13)	(402)
Interest rate contracts								
Interest rate swap contracts								
US dollar	–	896	–	896	–	654	–	654
Sterling	33	146	–	179	30	120	31	181
	33	1,042	–	1,075	30	774	31	835
Cross-currency swap contracts								
Net forward (sales)/purchase contracts								
US dollar	58	303	345	706	38	176	339	553
Swedish krona	–	–	–	–	(143)	–	–	(143)
	58	303	345	706	(105)	176	339	410