Results in brief, highlights and outlook

Results in brief

Results from continuing operations	2007	2006
Sales[1]	**£15,710m**	£13,765m
EBITA[2]	**£1,477m**	£1,207m
Operating profit	**£1,177m**	£1,054m
Underlying earnings[3] per share	**31.0p**	23.8p
Basic earnings per share[4]	**26.0p**	19.9p
Order book[5]	**£38.6bn**	£31.7bn
Other results including discontinued operations		
Dividend per share	**12.8p**	11.3p
Cash inflow from operating activities	**£2,162m**	£778m
Net cash as defined by the Group	**£700m**	£435m

Highlights

– Good financial performance
– Continued growth from US businesses
– Leadership position established in global land systems sector
– Underlying earnings[3] per share up 30% to 31.0p
– Dividend increased 13.3% to 12.8p per share for the year

Outlook

We have excellent forward visibility and a further year of good growth is anticipated in 2008, including a full year contribution from the former Armor Holdings business. In addition, part-year contributions are expected following the anticipated completion in 2008 of the proposed acquisitions of MTC Technologies and Tenix Defence.

1 including share of equity accounted investments
2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense
3 earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and uplift on acquired inventories (see note 5)
4 basic earnings per share in accordance with International Accounting Standard 33
5 including share of equity accounted investments' order books and after the elimination of intra-group orders of £1.4bn (2006 £1.0bn)

Preliminary results statement

"BAE Systems once again performed well in 2007. Each of the four business sectors delivered good profitability underpinned by good programme schedule and cost performance across the Group."

BAE Systems once again performed well in 2007, demonstrating the significant fundamental strengths and quality of the business. EBITA[2] increased by 22% to £1,477m on sales[1] of £15,710m, up 14% compared with 2006. Underlying earnings[3] per share increased 30% to 31.0p for the year. The Group had net cash of £700m at year end, having invested $4.5bn (£2.2bn) excluding fees in the acquisition of Armor Holdings, Inc. during the year.

Each of the four business sectors delivered good profitability with return on sales exceeding 8.5% in all sectors. This profitability stems from good programme cost and schedule performance across the Group.

Underlying this performance are principles of ethical conduct, good governance, our values and policies and processes that guide the Group's business and the behaviour of its people, with a clear system of delegated authority within a 'One Company' approach. BAE Systems is determined that the business policies and processes mandated across the organisation align with global best practice.

BAE Systems is a global company with a strategy currently focused around six home markets. Together these home markets were responsible for generating 85% of Group sales in 2007 (2006 84%).

The Group is benefiting from a well executed strategy with good profitable growth generated from substantial business operations in its home markets and especially the United States. A notable success is the very strong growth in the land systems business in recent years. Following the earlier acquisitions of Alvis in 2004 and United Defense in 2005, the acquisition of Armor Holdings in 2007 has established BAE Systems as having a clear leadership position in the land sector.

Our multi-home market business focus continues to generate opportunities for growth, especially in the Kingdom of Saudi Arabia where the Group has a growing home market position.

United States

BAE Systems is a valued, trusted and high-performing part of the US defence industrial base and is one of the top ten largest defence companies in the US.

In the US, the Group is a market leader in advanced information technology, intelligence analysis, geospatial exploitation software, and the development of knowledge-based systems. In addition, BAE Systems continues to see strong demand for sophisticated electronic warfare and protection systems, and in its support solutions business the ship repair facilities have remained fully utilised.

In the land systems sector, further contracts to reset Bradley combat vehicles and other US tracked vehicles to 'as new' condition were awarded, providing extended visibility of throughput at the current high level of activity. In addition to the high volume of reset activity, strong demand for vehicle upgrades with new digital systems continues, in part driven by the move in the US to modular forces requiring the fielding of a common standard of more capable vehicles.

To complement BAE Systems' tracked vehicle position in the US, the Group has been executing a wheeled vehicle strategy to meet a valuable, near-term, urgent operational requirement for Mine Resistant Ambush Protected (MRAP) vehicles. This has resulted in the establishment of a new assembly facility for the RG33 mine protected vehicle in York, Pennsylvania, alongside the Bradley reset facility. Following the substantial contract award for RG33 MRAP vehicles in 2007, manufacturing volume has increased rapidly in the last months of 2007 with the completion of 23 vehicles in October rising to 102 in December.

The acquisition of Armor Holdings, Inc. delivered further progress as regards the wheeled vehicle strategy. The business is a key player in the tactical wheeled vehicle market and in the increasingly vital areas of armour protection and survivability. With strong demand for its products, notably for the Family of Medium Tactical Vehicles (FMTV) and the Caiman mine protected vehicle derivative, the Armor Holdings acquisition is well on track to deliver our required return on investment.

BAE Systems has worked across its global businesses rapidly to design, produce and deliver vehicles to protect the armed forces. The Group's role on the MRAP programme involves collaboration across sites and businesses globally including the integration of the former Armor Holdings' capabilities. The programme brings together more than 35 years of experience in mine protected wheeled vehicle expertise and highly survivable combat platforms.

In December 2007, the Group announced the proposed acquisition of MTC Technologies, Inc. MTC complements BAE Systems' existing readiness and sustainment capabilities in the US.

United Kingdom

The Group's UK-based businesses are performing well with good programme schedule and cost performance. This performance improvement included a recovery to profitable trading for the land systems business in the UK.

BAE Systems continues to make progress in developing integrated through-life support business in partnering arrangements with the UK MoD and the UK's armed forces. Benefits are now apparent as some of the earlier programme relationships mature. For example, the National Audit Office has concluded that the partnered support arrangements for the Tornado combat aircraft have contributed to a 51% reduction in cost per flying hour and cost savings over the past five years of £1.3bn. BAE Systems is similarly involved in support for a number of other UK air platforms and is addressing through-life support for the UK's armoured fighting vehicle fleet. The Group identifies further opportunities to develop such arrangements in air, land and naval support.

The UK government's commitment to the new Carrier programme in July enabled BAE Systems to enter into a Framework Agreement with VT Group for the establishment of a joint venture which would, subject to completion, bring together BAE Systems' and VT Group's respective surface warship building and surface warship through-life support operations.

Other home markets

Saudi Arabia continues to be an important home market for BAE Systems, building on a performance track record established over many decades. The large programme of support for Tornado is being maintained and the modernisation of existing assets continues. In September 2007, under the new defence co-operation programme

Summarised income statement from continuing operations

	2007 £m	2006 £m
Sales[1]	15,710	13,765
EBITA[2]	1,477	1,207
Amortisation	(149)	(105)
Impairment	(148)	(34)
Net finance costs[1]	93	(174)
Taxation expense[1]	(373)	(248)
Profit for the year	900	646
Basic earnings per share	26.0p	19.9p
Underlying earnings[3] per share	31.0p	23.8p
Dividend per share	12.8p	11.3p

Exchange rates

	2007	2006
£/€ – average	1.461	1.467
£/$ – average	2.002	1.844
£/€ – year end	1.361	1.484
£/$ – year end	1.988	1.957

Segmental analysis

	Sales[1]		EBITA[2]	
		Restated[4]		Restated[4]
	2007 £m	2006 £m	2007 £m	2006 £m
Electronics, Intelligence & Support	3,916	4,007	429	429
Land & Armaments	3,538	2,115	312	168
Programmes & Support	5,327	4,615	456	342
International Businesses	3,359	3,428	435	415
HQ & Other Businesses	243	295	(155)	(147)
Intra-group	(673)	(695)	–	–
	15,710	13,765	1,477	1,207

known as 'Project Salam', contracts were signed between the UK government and the Kingdom of Saudi Arabia for the supply of 72 Typhoon aircraft.

We continue to invest within Saudi Arabia in both the expansion of the Kingdom's industrial capability and new secure residential accommodation. The first of two new compounds for our employees is now being occupied in Riyadh.

In Sweden, production of the CV90 infantry fighting vehicle is underway for the Dutch Army, continuing the good export performance of this business.

In Australia, the Group continues to build on its position as a through-life capability partner to the Australian Defence Force, including a follow-on multi-year support contract for the Hawk aircraft.

The selection by Australia of the FMTV as the basis for the Land 121 vehicle programme will generate substantial industrial involvement in Australia. BAE Systems is also a major sub-contractor on the Australian Wedgetail Airborne Early Warning and Control programme, where we are jointly engaged with Boeing and the customer to re-baseline this programme.

In January 2008, the Group announced the proposed acquisition of Tenix Defence, a leading Australian defence contractor. The acquisition will more than double BAE Systems' presence in Australia, making it the largest in-country supplier to the Australian Defence Force. The organisations are an excellent fit and have largely complementary programmes and capabilities. This acquisition is a significant step in the implementation of the Group's strategy to develop as the premier global defence and aerospace company by growing the business in Australia, one of the Group's six home markets.

In South Africa, the land systems OMC business is achieving growth through exports with its RG31 and RG32 mine protected vehicles.

1 including share of equity accounted investments
2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense
3 earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and uplift on acquired inventories (see note 5)
4 restated following changes to the Group's organisational structure

Preliminary results statement (continued)

Sales[1] increased 14% from £13,765m to £15,710m. Sales in the full year from the Armor Holdings business, acquired in July 2007, were £725m. Like for like growth, after adjusting for the impact of exchange translations and acquisitions and disposals, was also 14%. US-led businesses were responsible for 47% of sales and sales generated from home markets represented 85% of the Group total.

EBITA[2] increased 22% to £1,477m (2006 £1,207m). The growth includes the benefit of five months trading from the Armor Holdings business, acquired in July 2007, which contributed EBITA[2] of £77m in the year. Translation of US$ generated results decreased EBITA[2] by £47m when compared with 2006. US-led businesses delivered 50% of the Group's EBITA[2].

Return on sales (EBITA[2] adjusted for uplift on acquired inventories expressed as a percentage of sales) for the Group increased from 8.8% to 9.5%.

Amortisation and impairment

The impairment charge of £148m includes £145m in respect of the goodwill associated with the Group's Insyte business.

Order book[1] increased to £38.6bn, primarily on the award of the Saudi Typhoon contract, MRAP orders and the acquisition of Armor Holdings.

Net finance costs[1]

Financial income, including the Group's share of the finance costs of equity accounted investments, was £93m (2006 £174m financial expense). The underlying net interest charge of £38m (2006 £157m) was offset by a net credit of £131m (2006 increased by a net charge of £17m) arising from pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements. Finance costs were reduced in 2007, primarily as a result of the benefit of the October 2006 Airbus net disposal proceeds (£1.2bn).

Underlying interest cover based on EBITA[2] increased from 7.7 times to 39 times.

Taxation

The Group's effective tax rate for continuing operations for the year was unchanged from 2006 at 26%.

Earnings per share

Underlying earnings[3] per share from continuing operations for 2007 increased by 30% to 31.0p.

Basic earnings per share, in accordance with IAS 33 Earnings per Share, from continuing operations, increased by 31% to 26.0p (2006 19.9p).

Dividend

The Board is recommending a final dividend of 7.8p per share (2006 6.9p), bringing the total dividend for the year to 12.8p per share (2006 11.3p), an increase of 13.3%.

The proposed dividend is covered 2.4 times by earnings[3] from continuing operations (2006 2.1 times), which is consistent with the Group's policy of growing the dividend whilst maintaining a long-term sustainable earnings cover of approximately two times.

Cash flows

Cash inflow from operating activities was £2,162m (2006 £778m), which is after £76m (2006 £441m) special contributions to the UK pension schemes.

There was an outflow from net capital expenditure and financial investment of £262m (2006 £141m).

Dividends from equity accounted investments, primarily MBDA, Gripen International, Eurofighter and Saab, amounted to £78m.

The resulting operating business cash inflow of £1,978m (2006 £782m) gave rise to free cash inflow, after interest, preference dividends and taxation, of £1,801m (2006 £490m).

On 31 July 2007, the Group acquired Armor Holdings, Inc. for $4.5bn (£2.2bn) excluding fees. Net cash outflow from all acquisitions and disposals was £2,112m.

In the period, 33 million shares were purchased under the buyback programme announced in October 2006, generating a cash outflow of £152m. In May, £750m, before costs, was raised following the placing of new ordinary shares to part finance the proposed acquisition of Armor Holdings, Inc.

Conversion of the outstanding 260 million 7.75p (net) cumulative redeemable preference shares into ordinary shares removed the debt element of these preference shares, giving rise to an increase in reported cash of £245m.

The Group's net cash at 31 December 2007 was £700m, a net inflow of £265m from the net cash position of £435m at the start of the year.

Summary and outlook

BAE Systems has a successful track record of identifying and addressing market opportunities through organic investments and acquisitions. Following the acquisition of Armor Holdings the Group has maintained a strong balance sheet and is performing well. The Group continues to look for further value enhancing opportunities across its home markets and remains focused on delivering good business performance and generating value, to the benefit of customers and shareholders.

The Group is continuing to deliver its strategy with strong financial and programme performance. It is delivering value for money and capability to its customers and is well positioned for the future with an established footprint in six home markets. BAE Systems is a quality business based on a strong, well balanced portfolio and is well-positioned to continue to deliver shareholder value in line with our long-term plans.

We have excellent forward visibility and a further year of good growth is anticipated in 2008, including a full year contribution from the former Armor Holdings business. In addition, part-year contributions are expected following the anticipated completion in 2008 of the proposed acquisitions of MTC Technologies and Tenix Defence.

Reconciliation of cash inflow from operating activities to net cash

	2007 £m	2006 £m
Cash inflow from operating activities	**2,162**	778
Capital expenditure (net) and financial investment	**(262)**	(141)
Dividends received from equity accounted investments	**78**	145
Operating business cash flow	**1,978**	782
Interest and preference dividends	**(65)**	(207)
Taxation	**(112)**	(85)
Free cash flow	**1,801**	490
Acquisitions and disposals	**(1,574)**	1,330
Debt acquired on acquisition of subsidiary	**(538)**	–
Issue/(purchase) of equity shares	**603**	(71)
Equity dividends paid	**(396)**	(346)
Dividends paid to minority interests	**(1)**	–
Preference share conversion	**245**	6
Other non-cash movements	**57**	(11)
Foreign exchange	**36**	323
Movement in cash on customers' account[5]	**32**	(9)
	265	1,712
Opening net cash/(debt) as defined by the Group	**435**	(1,277)
Closing net cash as defined by the Group	**700**	435
Analysed as:		
Term deposits – non-current	**–**	4
Term deposits – current	**164**	503
Cash and cash equivalents	**3,062**	3,100
Loans – non-current	**(2,197)**	(2,776)
Loans – current	**(283)**	(308)
Overdrafts – current	**(16)**	(26)
Loans and overdrafts – current	**(299)**	(334)
Cash on customers' account[5] (included within payables)	**(30)**	(62)
Closing net cash as defined by the Group	**700**	435

Operating business cash flow

	2007 £m	Restated[4] 2006 £m
Electronics, Intelligence & Support	**302**	273
Land & Armaments	**10**	137
Programmes & Support	**807**	449
International Businesses	**678**	171
HQ & Other Businesses	**181**	(225)
Discontinued businesses	**–**	(23)
	1,978	782

1 including share of equity accounted investments
2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense
3 earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and uplift on acquired inventories (see note 5)
4 restated following changes to the Group's organisational structure
5 cash on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance