Preliminary Announcement and Presentation 2008

Leveraging global capability

BAE SYSTEMS

REAL PERFORMANCE. REAL ADVANTAGE.

Cover image
The Detica NerveCentre is a dynamic, state-of-the-art facility for interactive working. Featuring high-definition touch screens, interactive and secure glass whiteboards, digital data capture and multi-terabyte data storage, the Detica NerveCentre stimulates creative exploration of "the art of the possible" in information intelligence.

Results in brief, highlights and outlook

Results in brief

Results from continuing operations	2008	2007
Sales[1]	**£18,543m**	£15,710m
Underlying EBITA[2] (restated)	**£1,897m**	£1,449m
Operating profit	**£1,718m**	£1,177m
Underlying earnings[3] per share (restated)	**37.1p**	30.1p
Basic earnings per share[4]	**49.6p**	26.0p
Order book[5]	**£46.5bn**	£38.6bn
Other results including discontinued operations		
Dividend per share	**14.5p**	12.8p
Cash inflow from operating activities	**£2,009m**	£2,162m
Net cash as defined by the Group[6]	**£39m**	£700m

Highlights

– Strong financial performance
– Further progress in delivery of strategy
– Accelerated development of security business
– Exceptional year for Land & Armaments

Outlook

A feature of our business is the good visibility provided by our strong order book.

A further year of good growth is anticipated in 2009, despite a lower level of land vehicle sales than in 2008.

In addition, the Group's trading results would be expected to benefit from a continued weakness of sterling against the US dollar.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses. See page 3.
3 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, profit/(loss) on disposal of businesses and uplift on acquired inventories (see note 4). Restated to exclude profit/(loss) on disposal of businesses. See page 3.
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 (2007 £1.4bn).
6 See page 5.

Preliminary results statement

"The Group performed well with organic growth from well-positioned businesses"

BAE Systems continued to make good progress during 2008 in addressing its strategy to deliver sustainable growth in shareholder value by being the premier global defence and aerospace company.

The Group performed well with organic growth in our US businesses benefiting from strong demand in their respective market sectors. The Group has also delivered growth from recent acquisitions. Increased profitability is being achieved across this higher volume of business from good programme execution.

The Group continues to benefit from delivery against its strategic framework. The Group's progression has been achieved through the focus on existing defence capabilities, the broadening to other domains such as the land systems sector and the substantial expansion of the business footprint across its markets. Activity is starting to increase in India as resources are committed to developing that market.

In 2008, the Group has further developed the business with targeted value adding acquisitions.

In June, the acquisition of US-based MTC Technologies was completed. The acquisition focuses on the substantial readiness and sustainment opportunities seen in the US defence market and builds on the Group's established through-life support capabilities.

Also in June, the acquisition of the Australian-based defence business Tenix Defence was completed, positioning the Group as the industry leader in the Australian defence market with air, land and naval capabilities. The acquisition is another step in progressing the Group's strategy to grow through the provision of through-life capability in partnership with the armed forces in its home markets.

The acquisition of Detica in September addressed the Group's strategy of targeting national security markets. Opportunities are being identified to leverage the Group's system integration capabilities to meet adjacent, non-military, security requirements for government customers.

The Group will continue to increase emphasis on maximising defence and security capabilities across the home markets in the US, UK, Saudi Arabia, Australia, Sweden and South Africa. In addition, the Group will look to expand where it sees opportunities to establish an industrial presence in new markets, such as India.

Export performance has remained solid with awards including RG-series vehicles to a number of countries, including Spain and Sweden, M777 guns to Canada, CV90 infantry fighting vehicles, and a number of orders for Electronics, Intelligence & Support products, including those in support of US platforms.

In July, BAE Systems completed an agreement with VT Group plc (VT) to consolidate the UK naval shipbuilding industry supported by the signing of the manufacturing contract for the Future Aircraft Carrier programme and by an agreement for the future domestic warship workload with the UK government. The merger of the warship build and support businesses of VT and BAE Systems into the BVT joint venture was achieved in 2008. The joint venture is subject to put and call options and, in January 2009, VT announced that it had decided to exercise its put option to sell its interest in BVT to BAE Systems and that VT expects to be in a position to exercise that option by 1 July 2009.

Even after the active programme of acquisitions over recent years, good cash generation has enabled BAE Systems to maintain a strong balance sheet. Diligent treasury management enabled the Group, during 2008, to avoid the effects of the extreme dislocation in capital markets. Bank counterparty risk has been and continues to be monitored closely on a systematic and ongoing basis, taking account of the size of the institution, its credit rating and its credit default swap price.

The difficult economic environment, and in particular the falls in equity markets in 2008, has affected the Group's pension schemes. Pension scheme funding is regularly reviewed with the Trustees of the schemes. The agreed funding plans have been considered over the longer term and are deemed to continue to be reasonable. An agreement with the Trustees of the Main UK Pension Scheme has recently been concluded following the actuarial valuation carried out as at April 2008. The recovery plan to clear the deficit has been accepted by the Pensions Regulator.

In May 2008, the Woolf committee, an independent body appointed by the Board under the chairmanship of Lord Woolf to review the Group's ethical standards, published its report. A steering group and associated working groups have been established to address all 23 recommendations and a plan has been developed for implementation of recommendations within three years. The aim is to establish the Group as a leader in business conduct, not just within our sector but within the global business community.

Consistent with the importance attached to Corporate Responsibility and the drive towards leadership in business ethics, the Group has taken steps to embed such issues more directly in its day-to-day operations. An important part of this drive is the establishment of a global Code of Conduct in which all employees have a clear understanding of what is expected of them. The Code of Conduct was launched in January 2009 to codify the required standards of personal and business conduct.

The Group has been reorganised and the Executive Committee restructured. The operating group heads and functional leaders are all now represented on the Executive Committee. The team will remain focused on delivering financial performance, consistent programme execution and developing business in its defined home markets. In addition, further emphasis is being placed on safety performance and the Corporate Responsibility agenda is made a key objective for the executive team in 2009.

A well implemented strategy and good programme execution are only two of the elements of high performance. BAE Systems comprises well over 100,000 talented people working in numerous locations around the globe. The challenge and the opportunity is to further develop the Group as a cohesive, inclusive organisation. The move to embrace a single, Group-wide, high performance culture is creating an environment in which all employees can make a real contribution and be recognised for their part in BAE Systems' drive for continuing success.

BAE Systems has consistently delivered progressive performance over recent years. BAE Systems is not insulated from the difficult wider economic environment. The Group recognises that defence budgets are likely at some stage in the future to come under further pressure and it will continue to apply conservatism to its planning assumptions. The Group is well positioned, having a large forward order book, a good balance of market positions around the globe, a well spread portfolio of programmes and a strategy to address anticipated priority areas of spend for its customers.

Summarised income statement from continuing operations

	2008 £m	2007 £m
Sales[1]	**18,543**	15,710
Underlying EBITA[2] (restated)	**1,897**	1,449
Profit on disposal of businesses	**238**	40
Uplift on acquired inventories	**–**	(12)
Amortisation of intangible assets	**(247)**	(149)
Impairment of intangible assets	**(177)**	(148)
Net financial income[1]	**697**	93
Taxation expense[1]	**(640)**	(373)
Profit for the year	**1,768**	900
Basic earnings per share	**49.6p**	26.0p
Underlying earnings[3] per share	**37.1p**	30.1p
Dividend per share	**14.5p**	12.8p

Exchange rates

	2008	2007
£/€ – average	**1.258**	1.461
£/$ – average	**1.853**	2.002
£/€ – year end	**1.042**	1.361
£/$ – year end	**1.451**	1.988

Segmental analysis

	Sales[1]		Underlying EBITA[2] (restated)	
	2008 £m	2007 £m	2008 £m	2007 £m
Electronics, Intelligence & Support	**4,459**	3,916	**506**	437
Land & Armaments	**6,407**	3,538	**566**	324
Programmes & Support	**4,638**	5,327	**491**	456
International	**3,333**	3,359	**435**	435
HQ & Other Businesses	**235**	243	**(101)**	(203)
Intra-group	**(529)**	(673)	**–**	–
	18,543	15,710	**1,897**	1,449

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses.
3 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, profit/(loss) on disposal of businesses and uplift on acquired inventories (see note 4). Restated to exclude profit/(loss) on disposal of businesses.

Order book[1] increased by 20% to £46.5bn (2007 £38.6bn). Exchange translation, primarily due to the weakening of sterling against the US dollar, accounted for £5.9bn of the increase. Awards for the new 15-year UK munitions capability contract, the UK Future Aircraft Carrier and US land vehicles, together with a net increase from acquisitions and disposals, delivered underlying order book growth.

Sales[1] increased by 18% to £18.5bn (2007 £15.7bn). This includes contributions from the MTC, Tenix Defence and Detica businesses acquired during the year (£0.3bn) and a full year of sales from the Armor Holdings business, acquired in July 2007, of £2.3bn (2007 £0.7bn). Like-for-like growth, after adjusting for the impact of exchange translation, and acquisitions and disposals, was 3% primarily driven by high demand for armoured wheeled vehicles in the US, partially offset by a reduction in the UK businesses as the Typhoon programme transitions from Tranche 1 to Tranche 2 deliveries. US-led businesses accounted for 59% (2007 47%) of sales[1]. Sales[1] generated from the Group's six home markets represented 88% (2007 85%) of sales.

Underlying EBITA[2] (restated) Management uses an underlying profit measure to monitor the year-on-year profitability of the Group, which is defined as earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. This definition, which is referred to as underlying EBITA, has been amended to exclude profit/(loss) on disposal of businesses, which unlike in previous years, is material this year.

Underlying EBITA[2] increased by 31% to £1,897m (2007 £1,449m) giving a return on sales of 10.2%, up from last year's 9.2%. The contributions from the businesses acquired in the year totalled a £4m loss and a full year of trading from the ex-Armor Holdings business contributed a profit of £236m (2007 £89m). In the prior year, the Group's Regional Aircraft business recognised net charges of £76m against asset carrying values, although this was largely offset by a one-off gain of £52m on completion of the Brunei Offshore Patrol Vessel arbitration process. Exchange translation, primarily relating to US dollar-denominated businesses, generated £61m of the increase. US-led businesses delivered 57% (2007 53%) of the Group's underlying EBITA[2].

Profit on disposal of businesses was £238m (2007 £40m). This includes the accounting gain on the disposal of the Group's interests in the businesses contributed to the BVT Surface Fleet joint venture (£121m), and profit on the disposal of the Surveillance & Attack business (£61m) and the Group's interest in Flagship Training (£56m).

Amortisation of intangible assets is £98m higher at £247m reflecting a full year charge in respect of the ex-Armor Holdings business and £35m relating to the businesses acquired during the year.

Impairment of intangible assets totalled £177m (2007 £148m) largely reflecting a reduction in the market value of the Group's interest in Saab of Sweden (£120m) and lower sales volumes in the US-based Products Group business (£40m), which was acquired with Armor Holdings in 2007. The prior year charge included £145m in respect of the Insyte business.

Preliminary results statement

Net financial income[1] was £697m (2007 £93m). The underlying net interest charge was £102m (2007 £38m). A net credit of £799m (2007 £131m) arose from pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements. The underlying net interest charge has increased primarily as a result of the cash cost of business acquisitions. The net credit of £799m has increased mainly on the weakening of sterling against the US dollar during the second half of the year. Underlying interest cover was 19 times (2007 38 times).

Taxation expense reflects an effective tax rate of 26% (2007 26%), which is expected to increase to 28% in 2009.

Basic earnings per share, in accordance with IAS 33 Earnings per Share, from continuing operations, increased by 91% to 49.6p (2007 26.0p).

Underlying earnings[3] per share from continuing operations was 37.1p (2007 30.1p), an increase of 23%.

Dividends The Board is recommending a final dividend of 8.7p per share (2007 7.8p), bringing the total dividend for the year to 14.5p per share (2007 12.8p), an increase of 13.3%.

The proposed dividend is covered 2.6 times by underlying earnings[3] from continuing operations (2007 2.4 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.

There was an outflow from **net capital expenditure and financial investment** of £503m (2007 £262m), which included £183m (2007 £52m) in respect of new residential and office facilities in Saudi Arabia.

Dividends received from equity accounted investments, primarily BVT, MBDA, Saab and Eurofighter, totalled £89m (2007 £78m).

Interest and preference dividends increased to £98m (2007 £65m) largely reflecting the cash cost of business acquisitions.

Taxation payments increased by £149m to £261m (2007 £112m) mainly as a result of the higher profits generated by the Group.

During the year, the Group acquired MTC, Tenix Defence and Detica for cash consideration totalling £1.1bn. The cash outflow for **acquisitions and disposals** of £1.0bn is shown net of the proceeds from the disposal of the Group's Surveillance & Attack business and its 50% interest in Flagship Training, which amounted to £134m. Net cash outflow relating to other acquisitions and disposals was £74m. In 2007, the Group acquired Armor Holdings for $4.5bn (£2.2bn).

The Group has financed part of its investment in the US through an intercompany loan. As at 31 December 2008, $2.1bn of a total of $6.6bn was hedged using a rolling programme of short-term foreign exchange hedges. As a consequence of the strengthening of the US dollar, there has been a **cash outflow from matured derivative financial instruments** of £440m in the second half of 2008 from rolling these hedges into 2009.

Foreign exchange translation during the year, primarily in respect of the Group's US dollar-denominated borrowing, decreased reported cash by £374m (2007 increased reported cash by £36m).

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4 Cash received 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.

Reconciliation of cash inflow from operating activities to net cash

	2008 £m	2007 £m
Cash inflow from operating activities	**2,009**	2,162
Capital expenditure (net) and financial investment	**(503)**	(262)
Dividends received from equity accounted investments	**89**	78
Operating business cash flow	**1,595**	1,978
Interest and preference dividends	**(98)**	(65)
Taxation	**(261)**	(112)
Free cash flow	**1,236**	1,801
Acquisitions and disposals	**(1,001)**	(1,574)
Debt acquired on acquisition of subsidiary undertakings	**(37)**	(538)
(Purchase)/issue of equity shares	**(27)**	603
Equity dividends paid	**(478)**	(396)
Dividends paid to minority interests	**(11)**	(1)
Preference share conversion	**–**	245
Cash outflow from matured derivative financial instruments	**(440)**	(14)
Cash inflow from reduction in cash collateral	**106**	9
Other non-cash movements	**339**	62
Foreign exchange	**(374)**	36
Movement in cash received on customers' account[4]	**26**	32
Movement in net cash as defined by the Group	**(661)**	265
Opening net cash as defined by the Group	**700**	435
Closing net cash as defined by the Group	**39**	700
Analysed as:		
Debt-related derivative financial assets – non-current	**203**	–
Term deposits – current	**–**	164
Cash and cash equivalents	**2,624**	3,062
Loans – non-current	**(2,608)**	(2,197)
Loans – current	**(154)**	(283)
Overdrafts – current	**(19)**	(16)
Loans and overdrafts – current	**(173)**	(299)
Cash received on customers' account[4] (included within payables)	**(7)**	(30)
Closing net cash as defined by the Group	**39**	700

Operating business cash flow

	2008 £m	2007 £m
Electronics, Intelligence & Support	**380**	302
Land & Armaments	**467**	10
Programmes & Support	**651**	807
International	**163**	678
HQ & Other Businesses	**(66)**	181
	1,595	1,978

Electronics, Intelligence & Support

The Electronics, Intelligence & Support operating group, with 33,900 employees[1] and headquartered in the US, designs, develops, produces and services systems and subsystems for a wide range of military and commercial applications.

Financial highlights

- Like-for-like organic sales[1] growth of 6% over 2007
- Underlying EBITA[2] includes a credit of £23m from share scheme mark-to-market accounting
- Order book[1] increased

Performance

	2008	2007	2006
Sales[1]	**£4,459m**	£3,916m	£4,007m
Underlying EBITA[2] (restated)	**£506m**	£437m	£429m
Return on sales	**11.3%**	11.2%	10.7%
Cash inflow[3]	**£380m**	£302m	£273m
Order intake[1]	**£4,904m**	£4,178m	£4,311m
Order book[1]	**£5.2bn**	£3.5bn	£3.4bn

Key points

- Maintained leadership in electronic warfare systems
- Won key IT, situational awareness and aviation sustainment contracts
- Addressing market for vehicle power management systems
- Sustained leadership in US non-nuclear ship repair
- Increased research and development investment

Looking forward

BAE Systems projects further growth as it delivers on its record order book and builds on existing enterprise capabilities, and continued research and development expenditure, to meet expected customer demand in cyber-space activity, and through-life product support of defence and aerospace electronics programmes. Growth in services, mission support and sustainment markets is expected to continue.

In 2008, Electronics, Intelligence & Support (EI&S) achieved underlying EBITA[2] of £506m (2007 £437m) on sales[1] of £4,459m (2007 £3,916m) and generated operating cash inflow[3] of £380m (2007 £302m).

On a like-for-like basis, sales[1] growth was 6% over 2007.

In June, BAE Systems completed the acquisition of MTC Technologies which contributed post-acquisition sales[1] of $181m (£98m) and underlying EBITA[2] of $2m (£1m).

Electronic Solutions

The low-rate initial production contract for the US Navy's decoy system on the F/A-18 E/F Super Hornet was received. The system provides aircraft defence against radar-guided missiles.

The F-35 Lightning II low-rate initial production (LRIP) of two electronic warfare suites continues, with existing funding providing deliveries through to 2012.

BAE Systems was selected as a partner in developing and producing the Airborne Maritime Fixed Station Joint Tactical Radio Systems (JTRS), which will consist of software-defined radios that enable commanders to share information across ships, enhance decision-making, and increase mission capability. With this award, BAE Systems is now a partner on all five programmes that comprise JTRS, the family of software-programmable tactical radios that will permit combat personnel to communicate at every level of command.

Deliveries commenced under a five-year contract to provide thermal imaging modules for the US Army's Common Remotely Operated Weapon System that allows soldiers to detect and identify targets while remaining protected in their vehicles. To date, orders received under this contract total $110m (£76m). A $169m (£116m) extension from the US Army for continued production of thermal weapon sights was received. This programme has a production rate of 1,500 units per month, with more than 37,000 delivered by the end of 2008.

In support of homeland security and safety, JETEYE® , the infrared aircraft missile defence system, began its nine-month evaluation aboard civilian passenger aircraft in July and First InterComm™, an interoperable communications and data solution system for first responders, has been deployed in seven US states.

US defence research and development programmes launched in 2008 included bio-inspired, miniature, intelligence-gathering robots, tactical ultra-low visibility communications, advanced night vision technology, and all-weather advanced persistent surveillance systems. These programmes represent the strengthening of core business areas as well as advances into new market areas.

1 Including share of equity accounted investments.
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3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.

Information Solutions
Our Information Technology business continues to be ranked in the top 25 by Computer World Magazine as a Best Place to Work in IT.

Five multiple and one single-award indefinite delivery/indefinite quantity contracts were received in the year, including a position on the Defense Information Systems Agency's Encore II contract.

Platform Solutions
Following the launch of its improved HybriDrive® propulsion system, BAE Systems' partner, Alexander Dennis, delivered its first double-deck hybrid electric bus to Transport for London with the buses scheduled to enter revenue-service testing in 2009. BAE Systems also expanded the global reach of the HybriDrive® programme by entering into agreements with Japan's ISUZU and North America's New Flyer Industries.

Collaborating with Land & Armaments, the business will provide power management components on board the Warrior demonstration vehicle supporting the UK Ministry of Defence programme to create an architecture that allows vehicles to power systems such as communications and electronic warfare suites. The same architecture will allow future upgrades to add more accessories and convert hydraulic systems to electrically powered systems.

Support Solutions
The US Air Force named BAE Systems one of 12 prime contractors on the Future Flexible Acquisition and Sustainment Tool contract. This indefinite delivery/indefinite quantity contract, under which prime contractors compete for task orders, has a total potential value of $6.9bn (£4.8bn). The contract will address future US Air Force requirements for modifications, development, and maintenance of weapon systems managed by the US Air Force and Air Force Special Operations Command.

BAE Systems received a US Air Force contract to support the Tactical Air Control Party (TACP)-Modernisation Vehicular Communications System programme. With an initial value of $120m (£83m) and a maximum potential value of $233m (£161m), BAE Systems will design, produce and install state-of-the-art communications for up to 400 TACP ground vehicles.

In the ship repair business, work continues at the San Diego shipyard to maintain, repair, and modernise the guided missile cruiser USS Bunker Hill, and efforts are progressing on a five-year multi-ship, multi-option contract to maintain and repair all Arleigh Burke-class destroyers. The US Navy awarded BAE Systems a post-shakedown availability contract for destroyers and a multi-ship multi-option award for repairs to mine countermeasures ships.

In June, the acquisition of MTC Technologies provided the business with increased technical and professional service capabilities, and equipment integration and modernisation capabilities for the US military and intelligence customers.

In 2008, the Technology Solutions and Services business won all of its major recompetes.

Land & Armaments

The Land & Armaments operating group, with 21,300 employees[1] and headquartered in the US, is a global leader in the design, development, production, through-life support and upgrade of armoured combat vehicles, tactical wheeled vehicles, naval guns, missile launchers, artillery systems and munitions.

Financial highlights

- Like-for-like organic sales[1] growth of 38% over 2007
- UK business secured a 15-year munitions partnering agreement with growth potential to £3bn
- Ex-Armor Holdings business performing ahead of expectations

Performance

	2008	2007	2006
Sales[1]	**£6,407m**	£3,538m	£2,115m
Underlying EBITA[2] (restated)	**£566m**	£324m	£168m
Return on sales	**8.8%**	9.2%	7.9%
Cash inflow[3]	**£467m**	£10m	£137m
Order intake[1]	**£8,568m**	£4,535m	£2,964m
Order book[1]	**£11.5bn**	£7.3bn	£4.9bn

Key points

- High volume of vehicle reset and upgrade activity
- Successfully addressed US mine protected vehicle requirements
- 15-year UK munitions partnering agreement secured
- Wheeled armoured vehicle successes
- Joint Light Tactical Vehicle down select

Looking forward

After a period of significant growth primarily driven by deliveries on the short-term Mine Resistant Ambush Protected programme, demand in the medium term is expected to be influenced by the tempo of operations in Iraq and Afghanistan.

Land & Armaments will continue to pursue opportunities globally leveraging leadership positions in Tracked Combat Systems, Medium Tactical Vehicles, Mine Resistant Vehicles, Armour and Survivability Technologies and Artillery Systems.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses. See page 3.
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.

In 2008, Land & Armaments achieved underlying EBITA[2] of £566m (2007 £324m) on sales[1] of £6,407m (2007 £3,538m) and generated operating cash inflow[3] of £467m (2007 £10m). The 2008 results included sales[1] of $3.1bn (£1.7bn) from the largely completed Mine Resistant Ambush Protected (MRAP) programme. The results include a full year of operations from the former Armor Holdings, Inc. business acquired in July 2007.

United States

The MRAP vehicle programme was largely completed in 2008, with global production of 4,714 mine protected vehicles.

In addition to the MRAP programmes, continued growth was secured in the area of vehicle armour protection, most notably for the High Mobility Multi-purpose Wheeled Vehicles (HMMWV) and individual soldier protection. The business was also awarded a $3.7bn (£2.6bn) contract for the production of 20,000 Family of Medium Tactical Vehicles (FMTVs).

The sole sourced Medium Mine Protected Vehicle (MMPV) programme was awarded with orders in 2008 totalling $110m (£76m). The MMPV contract envisions production of up to 2,500 vehicles at a potential value of $2.2bn (£1.5bn) through to 2015.

BAE Systems continued to serve as the premier support agency for the US Army Heavy Brigade Combat Team, providing remanufacturing and reset for key brigade components, including the Bradley Fighting Vehicle, as well as unveiling mortar and ambulance variants of the Bradley.

BAE Systems secured two technology development contracts for the US multi-service Joint Light Tactical Vehicle (JLTV). These 27-month contracts are the next step in selecting a new generation of tactical vehicles.

In the year, BAE Systems unveiled the first Non-Line-of-Sight Cannon (NLOS-C) for the US Army's Future Combat Systems Manned Ground Vehicles programme. Two vehicles are undergoing firing and mobility tests at Army testing facilities, with four additional vehicles undergoing integration. Along with the NLOS-C deliveries, successful test firing continued for the NLOS-C mortar platform.

BAE Systems' 57mm Mk 110 Naval Gun System was selected for the National Security Cutter and Littoral Combat Ship programmes, the gun systems entering into service in August and November, respectively.

United Kingdom

The munitions business secured a 15-year partnering agreement with growth potential to £3bn from the UK Ministry of Defence (MoD) in August covering the supply of approximately 80% of general munitions consumed by UK Armed Forces, including small arms and medium-calibre ammunition, mortar bombs, tank ammunition and artillery shells. Under the contract, BAE Systems will invest over £120m in new, highly-automated facilities.

The Weapons & Vehicles business secured significant work supporting operations in Iraq and Afghanistan, particularly in carrying out urgent upgrades to vehicles such as Bulldog, CVR(T), Warrior and Panther to protect against rapidly-evolving threats. The commitment and support given by the business to finding innovative solutions for Urgent Operational Requirements (UORs) in very tight timescales has been recognised by the customer on several occasions and 15 employees were awarded campaign medals by the MoD for their support in theatre.

Production of the M777 155mm lightweight howitzer programme continues, with 168 guns delivered in 2008 and a total of 737 guns ordered to date, to the US and Canadian armed forces. The M777 system has been deployed in operations in both Iraq and Afghanistan.

Requirements and schedule changes on the challenging Terrier armoured tractor programme have now been agreed with the customer. The programme has been rebaselined, and includes further improvements to protection levels and the robustness of the vehicle. Pre-production and proving of the Terrier will commence in 2009.

Sweden
The Swedish business underwent two restructuring measures in the year in order to better position the business to match future strategic demands.

A contract for 20 BvS10 VIKING amphibious armoured all-terrain vehicles from the UK MoD was received, bringing the total number of vehicles ordered by the MoD to 149.

BAE Systems is partnered with Raytheon on the Excalibur artillery programme, the next generation family of guided projectiles for the US Army and Marine Corps artillery.

The 155mm Archer self-propelled Artillery System has been selected by Sweden and Norway with contracts to be awarded for up to 48 systems.

South Africa
The South African business benefited significantly in the year from support to the US MRAP programme as well as the growing international requirement for mine-protected wheeled vehicles. A total of 475 RG31s were delivered to customers worldwide in 2008 bringing the total of RG31s sold to over 2,200. The business acquired IST Dynamics in August 2008, building on its systems integration capability, particularly in the areas of Turret Systems and Fire-Control Systems.

Programmes & Support

The Programmes & Support operating group, with 30,200 employees[1], comprises the Group's UK-based air and naval activities, the activities of the acquired Detica security business and the Integrated System Technologies business.

Financial highlights

- Sales[1] reduced over 2007 on Brunei OPV completion and transition to Typhoon Tranche 2 deliveries
- Return on sales[1] improved to 10.6%
- Typhoon Tranche 2 pricing agreed

Performance

	2008	2007	2006
Sales[1]	**£4,638m**	£5,327m	£4,615m
Underlying EBITA[2] (restated)	**£491m**	£456m	£331m
Return on sales	**10.6%**	8.6%	7.2%
Cash inflow[3]	**£651m**	£807m	£449m
Order intake[1]	**£4,195m**	£9,091m	£5,178m
Order book[1]	**£19.8bn**	£20.9bn	£17.0bn

Key points

- Successful transition to start of Typhoon Tranche 2 deliveries
- BVT naval joint venture formed
- Manufacturing contract for Future Carriers secured
- Detica acquisition completed
- First Type 45 successfully delivered off contract

Looking forward

Programmes & Support is driven by its existing order book and the level of future UK MoD funding to meet current UK armed forces operational requirements and delivery of the Defence Industrial Strategy.

The BVT joint venture is underpinned by the six ship Type 45 programme, the manufacturing phase of the Future Aircraft Carrier (CVF) programme and export contracts.

Detica's position in the UK market means that it is well-positioned to benefit from increasing government focus on intelligence, security and resilience.

During 2008, Programmes & Support achieved underlying EBITA[2] of £491m (2007 £456m) on sales[1] of £4,638m (2007 £5,327m) and generated an operating cash inflow[3] of £651m (2007 £807m). The lower sales[1] in 2008 reflect the transition from Typhoon Tranche 1 deliveries to Tranche 2 and completion in 2007 of the Brunei Offshore Patrol Vessel contract. The acquisition of Detica in September contributed sales[1] and underlying EBITA[2] of £55m and £9m, respectively.

Military Air Solutions

Military Air Solutions is responsible for delivering a range of military programmes including Typhoon, Hawk, Nimrod MRA4, F-35 Lightning II and autonomous air vehicles. In addition, it is responsible for through-life support to Harrier, Hawk, Tornado, Nimrod MR2, E-3D Sentry and VC-10 aircraft.

The business made good progress during 2008 in delivering on its programme commitments. Work continues with the UK MoD to explore whether a long-term partnering agreement (LTPA) in the air sector may provide mutual value to both parties.

Delivery of Typhoon aircraft to the four partner nations continues with a cumulative total of 57 aircraft delivered to the UK and 97 to the other European partner nations. All Tranche 1 aircraft have now been delivered and Tranche 2 deliveries commenced. In October, the first flight of a Typhoon aircraft for the Saudi customer took place marking the start of the flight test programme.

In the UK, Royal Air Force (RAF) Typhoons are operational in Air Defence and Quick Reaction Alert roles, and have a full multi-role capability. Discussions to establish a long-term, availability-based support contract are progressing. Work has also commenced on further air-to-ground capability enhancements. Discussions regarding the Tranche 3 requirements of each of the four partner nations are ongoing.

On the Hawk contract for India, 23 of the UK-built aircraft have been accepted by the customer and have been inducted to the Indian Air Force. Customer acceptance of the last of the 24 Hawk aircraft for South Africa took place in November.

The first five South African Gripen aircraft have been accepted by the customer to plan.

Aircraft acceptances of the Hawk Mk128 Advanced Jet Trainer for the RAF are expected to commence in early 2009, with RAF pilots then starting their Mk128 conversion flying programme. Support under the Hawk Integrated Operational Support programme, and provision of synthetic training to RAF fast jet pilots, continues at RAF Valley.

The current Nimrod MRA4 aircraft development programme is progressing with completion of the flight test programme and qualification of the aircraft systems expected during 2009. All nine production standard aircraft are in manufacture.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses. See page 3.
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.

The contracts for VC-10, Sentry and Nimrod MR2 aircraft support continue, and a contract expansion for much of the on-base engineering, logistics and technical support for the VC-10 has been secured.

The Tornado availability programme, ATTAC, is in full service and continues to perform in line with contractual milestones.

The Harrier GR9 upgrade programme is on schedule. The Harrier aircraft is currently providing close air support to UK military operations overseas. Discussions are progressing on contracting for a Harrier availability service.

All three F-35 Lightning II aircraft variants, Carrier, Conventional Take-Off and Landing, and Short Take-Off and Vertical Landing (STOVL), are now in various stages of manufacture and assembly. The STOVL variant had its maiden flight in June. Low-rate initial production continues under contract from Lockheed Martin.

BAE Systems continues to leverage its expertise in Unmanned Aircraft Systems (UAS) and position itself in this growth market. In addition to the existing Taranis programme, which is a key enabler to the UK MoD's evaluation of future requirements, BAE Systems has entered into a jointly funded UK MoD Mantis advanced technology demonstrator programme. The aim of this programme is to demonstrate the potential of a large unmanned system to support future operational needs. The UAS portfolio also includes the HERTI surveillance system. The pre-production HERTI unmanned air system has been operating at fully active overseas customer airbases integrated with manned platform operations.

The redundancy programme announced in April affecting over 600 jobs at the Brough and Woodford sites is progressing towards its 2010 completion.

BVT Surface Fleet Limited (BVT) (55% interest)
The joint venture between BAE Systems and VT Group (VT) was formed on 1 July 2008, creating the UK's leading provider of surface warship building and through-life support operations. Following formation, BVT signed the manufacturing contract for the Future Aircraft Carrier (CVF) and has assumed overall responsibility for delivery of the programme, including project management, engineering, shipbuild and integration. BVT is also responsible for the engineering and build of blocks 2 and 4. The cutting of steel for the first ship is planned for spring 2009.

The programme to build six Type 45 Destroyers has progressed well during the year with all key milestones being achieved, including the successful completion of sea trials and acceptance off contract by the customer of the first of class ship, HMS Daring.

Both contracts to build three Ocean Patrol Vessels for the Royal Navy of Oman and three Offshore Patrol Vessels for the Trinidad and Tobago Coastguard are projected to incur significant losses. Consistent with estimates provided by BVT management, loss provisions of £96m (£53m at our 55% share) have been recorded through fair value accounting. As a result of a review of these export contracts, which were contributed by VT into BVT, BAE Systems is in negotiation with VT regarding a possible injection of capital by VT into the BVT business.

In September 2008, a contract was received to support the construction of two further Fast Attack Craft for the Hellenic Navy, building on the successful contract for the previous five vessels.

The last of the three ex-Royal Navy Type 23 frigates for the Chilean Navy completed its reactivation and was handed over to the customer.

In January 2009, VT announced that it has decided to exercise its put option to sell its interest in BVT to BAE Systems and that it expects to be in a position to exercise that option by 1 July 2009.

Submarine Solutions
In a challenging year for the Astute programme, HMS Astute, the first of class, is now scheduled for delivery to the customer at the end of 2009. Orders have been received to continue the build of boat 4 and for long lead items on boat 5.

Detica
BAE Systems acquired Detica, a leading UK consultancy servicing the counter-threat agenda, in September 2008. Detica employs 1,400 staff. Detica helps its clients tackle terrorism and serious crime by helping them collect, manage and exploit information to reveal actionable intelligence. Services range from business and technology consulting, system integration and support to the sale of proprietary hardware and software.

Detica assists clients with initiatives in areas such as counter-terrorism, serious and organised crime, and immigration and border control, as well as fraud detection and identity management through its sales of Detica NetReveal® software. Its financial services business remains challenged by current market conditions.

Detica's sales for the full year increased by 20% on 2007 reflecting higher sales to the UK government and, in particular, growth in sales of Detica NetReveal® software.

Integrated System Technologies (Insyte)
Following the successful sea trials of the first of class Type 45 destroyer, HMS Daring, during 2008, the Sampson Radar, Combat Management System and Long Range Radar are all now fitted to the next three ships.

The Seawolf Mid-Life Update system has now passed successful system harbour trials and is undertaking sea trials on the Type 23 HMS Sutherland.

The establishment of the Maritime Composite Training Systems, state-of-the-art training facilities at HMS Collingwood and Royal Naval Base Devonport, will be achieved in 2009.

The Sting Ray lightweight torpedo programme remains ahead of schedule with the fourth batch of production weapons accepted by the customer in November 2008. Progress on securing an export order for this torpedo is well advanced.

International

The International operating group, with 18,200 employees[1], comprises the Group's businesses in Saudi Arabia and Australia, together with a 37.5% interest in the pan-European MBDA joint venture, a 20.5% shareholding in Saab of Sweden and a 49% shareholding in Air Astana.

Financial highlights

- Aggregate return on sales[1] maintained at 13% for the sector
- Cash inflow[3] reflects utilisation of advances received in 2007 on the Salam Typhoon programme
- Post-acquisition sales[1] of £130m from Tenix Defence

Performance

	2008	2007	2006
Sales[1]	**£3,333m**	£3,359m	£3,428m
Underlying EBITA[2] (restated)	**£435m**	£435m	£412m
Return on sales	**13.1%**	13.0%	12.0%
Cash inflow[3]	**£163m**	£678m	£171m
Order intake[1]	**£4,065m**	£3,876m	£3,854m
Order book[1]	**£11.0bn**	£7.9bn	£7.1bn

Key points

- Saudi Typhoon programme (Salam) progressing to schedule
- Tenix Defence acquisition completed; price adjustments in negotiation
- Impairment taken of £120m on Saab carrying value

Looking forward

The Group seeks to sustain its long-term presence in the Kingdom of Saudi Arabia through delivering on current programme and industrialisation commitments, and developing new business. In Australia, the acquisition of Tenix Defence and reinforcement of the business as through-life capability partner to the Australian Defence Force across all domains, are expected to provide growth in the near term.

During 2008, the International operating group achieved underlying EBITA[2] of £435m (2007 £435m) on sales[1] of £3,333m (2007 £3,359m) and generated an operating cash inflow[3] of £163m (2007 £678m) as advances received in 2007 on the Salam Typhoon programme were utilised. In June 2008, BAE Systems completed the acquisition of Tenix Defence, which contributed sales[1] of £130m and a £12m post-acquisition loss[2] after including integration costs.

CS&S International

BAE Systems has a major presence in the Kingdom of Saudi Arabia where it acts as prime contractor for the UK government-to-government defence agreement. Progress continues to be made to modernise the Saudi armed forces in line with the Understanding Document signed in December 2005 between the UK and Saudi Arabian governments.

Under the 2007 contract for the supply of 72 Typhoon aircraft, the first aircraft remains on schedule for delivery in June 2009. Discussions continue with the Royal Saudi Air Force (RSAF) to agree the support and training solutions for the aircraft to enable their entry into service during 2009.

The support provided under the Saudi British Defence Co-operation Programme continues to provide operational capability to both the RSAF and Royal Saudi Naval Forces operations. In particular, work is ongoing in partnership with the RSAF to maintain and enhance the capability of the Tornado aircraft while extending its operational life.

In addition to some 1,500 employees in the UK, around 4,500 people are employed by the Group in the Kingdom of Saudi Arabia of whom approximately half are Saudi nationals. The business continues to develop its presence in Saudi Arabia and remains committed to developing a greater indigenous capability in the Kingdom.

The security of employees is the highest priority and new residential and office facilities were completed in 2008, incorporating increased security measures and a greater range of pastoral and recreational facilities for the workforce. Further facilities will be completed in 2010.

Work is ongoing at a senior level to refine the strategy for securing a greater proportion of business in the land sector. The Royal Saudi Land Forces are anticipated to require upgrades and capability enhancements in future years.

Australia

Following the acquisition of Tenix Defence during 2008, including 100% of the former joint venture company Tenix Toll Defence Logistics, BAE Systems is now the largest defence contractor in Australia. This acquisition has ensured that BAE Systems Australia can offer capability across the aerospace, land, maritime and joint domains.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses. See page 3.
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.

BAE Systems Australia is a subcontractor to Boeing to deliver the ground and air subsystems of the Wedgetail Airborne Early Warning and Control programme. Wedgetail has experienced significant schedule delays and cost overruns. An agreement was reached with Boeing that defines and concludes the Group's role in delivering the ground subsystem by June 2009.

The Australian government has re-evaluated its requirements under the Land 121 contract for the supply of medium and heavy tactical trucks and is issuing a revised Request for Tender. BAE Systems Australia remains in the competition with responsibility for tendering (and carrying out the project) transferred from BAE Systems Inc. to BAE Systems Australia.

Major programmes now in BAE Systems Australia's portfolio following the Tenix Defence acquisition include the prime contract for the supply of two Landing Helicopter Dock (LHD) ships to the Royal Australian Navy, and the supply of one multi-role, two offshore and four inshore patrol vessels to the New Zealand Ministry of Defence. The LHD programme is in the early stages of a fixed price development programme that will need continued focus to deliver the contracted outcomes. The multi-role vessel under the New Zealand contract has been accepted by the customer, but a number of warranty claims have subsequently been made. The remaining vessels will be progressively presented for acceptance in 2009. The completion accounting process for the Tenix Defence acquisition is ongoing.

Saab (20.5% shareholding)

Saab's sales were SEK23.8bn (£2.0bn), with export sales accounting for 68%. Operating income was SEK166m (£14m), producing an operating margin of 0.7%.

The Group has taken an impairment of £120m against the carrying value of its shareholding in Saab, reflecting a significant reduction in Saab's share price during the year.

MBDA (37.5% interest)

MBDA's performance in 2008 delivered an increasing return on sales on broadly unchanged sales volume.

Key domestic production deliveries included Mica air-to-air missiles, Aster surface-to-air missiles, Seawolf naval air defence missiles and Taurus cruise missiles. 2008 saw the completion of deliveries on the UK MoD's Brimstone air-to-ground missile programme and export deliveries of an air weapons package to Greece. MBDA delivered over 2,500 missiles in 2008.

Development programmes continue to progress well. 2008 saw a number of successful development firings on key programmes, including the Meteor and Aster weapon systems.

As the UK MoD's designated lead contractor in managing its complex weapons sector under the Defence Industrial Strategy, MBDA secured a series of important Assessment Phase contracts for new programmes, including the Fire Shadow loitering munition which was successfully fired early in 2008, completing a rapid development demonstrator programme lasting just 15 months. An important contract amendment has also been received on the Meteor (air-to-air missiles) development contract to re-align the programme to a revised customer timetable. A 15-year availability contract to support the Seawolf missile system was secured.

A key export contract win was for the £398m Spada air-to-surface weapon system to Pakistan.

HQ & Other Businesses

HQ & Other Businesses, with 1,800 employees[1], comprises the regional aircraft asset management and support activities, head office and UK shared services activity, including research centres and property management.

Financial highlights

– FRIP dispute settled with all major reinsurers

Performance

	2008	2007	2006
Sales[1]	**£235m**	£243m	£295m
Underlying EBITA[2] (restated)	**£(101)m**	£(203)m	£(146)m
Cash (outflow)/inflow[3]	**£(66)m**	£181m	£(225)m
Order intake[1]	**£212m**	£345m	£267m
Order book[1]	**£0.4bn**	£0.4bn	£0.3bn

Looking forward

Market conditions in the aircraft asset management business are increasingly challenging given the economic downturn and restrictions on available credit to higher risk customers which is an increasing feature of new markets. Losses are expected to continue at levels comparable to 2008.

During 2008, HQ & Other Businesses reported a loss[2] of £101m (2007 loss[2] £203m) on sales[1] of £235m (2007 £243m) and had an operating cash outflow[3] of £66m (2007 inflow[3] £181m). Of this, the reported loss[2] for Regional Aircraft was £17m (2007 £105m) with operating cash outflow[3] of £3m (2007 inflow[3] £175m).

The commercial aircraft market has become increasingly challenging with the tightened availability of funding to aircraft operators due to the global credit issues and economic slowdown. Oil prices have been high over the year impacting operator profitability and their operational cash flows. Discussions are ongoing with operators as to their future fleet requirements and marketing activity is focused on both uncontracted idle and returning aircraft. During 2008, the Regional Aircraft business placed 75 aircraft through new leases, extensions with existing customers and sales. Support revenues have fallen on lower demand for aircraft components and services. Power-by-the-hour contracts worth £43m in 2008 were secured.

Historically, much of the leasing business has been underpinned by the Group's Financial Risk Insurance Programme (FRIP) which made good shortfalls in actual lease income against originally estimated future income for a 15-year period from 1998 to 2013. Since 2006, the Group and certain reinsurers have been in dispute over several areas of the policy. During 2007 and 2008, agreements were reached with all major reinsurers and settlements paid by them.

The balance sheet carrying value of aircraft (£240m) is based on the net present value of forecast future net leasing or disposal income and reflects the current adverse economic climate.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses. See page 3.
3 Net cash (outflow)/inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.

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Consolidated income statement

for the year ended 31 December

	Notes	2008 £m	Total 2008 £m	2007 £m	Total 2007 £m
Continuing operations					
Combined sales of Group and equity accounted investments	2		**18,543**		15,710
Less: share of sales of equity accounted investments	2		**(1,872)**		(1,401)
Revenue	2		**16,671**		14,309
Operating costs			**(15,386)**		(13,480)
Other income			**415**		209
Group operating profit excluding amortisation and impairment of intangible assets		**2,003**		1,335	
Amortisation		**(247)**		(149)	
Impairment		**(56)**		(148)	
Group operating profit			**1,700**		1,038
Share of results of equity accounted investments excluding finance costs and taxation expense		**132**		142	
Financial income of equity accounted investments		**44**		35	
Taxation expense of equity accounted investments		**(37)**		(38)	
Share of results of equity accounted investments		**139**		139	
Impairment in respect of equity accounted investments		**(121)**		–	
Contribution from equity accounted investments			**18**		139
EBITA[1] excluding profit on disposal of businesses and uplift on acquired inventories		**1,897**		1,449	
Profit on disposal of businesses[2]		**238**		40	
Uplift on acquired inventories (included in operating costs)		**–**		(12)	
EBITA[1]		**2,135**		1,477	
Amortisation		**(247)**		(149)	
Impairments		**(177)**		(148)	
Financial income of equity accounted investments		**44**		35	
Taxation expense of equity accounted investments		**(37)**		(38)	
Operating profit			**1,718**		1,177
Finance costs	3				
Financial income		**3,380**		1,257	
Financial expense		**(2,727)**		(1,199)	
			653		58
Profit before taxation			**2,371**		1,235
Taxation expense					
UK taxation		**(351)**		(201)	
Overseas taxation		**(252)**		(134)	
			(603)		(335)
Profit for the year from continuing operations			**1,768**		900
Profit for the year from discontinued operations			**–**		22
Profit for the year			**1,768**		922
Attributable to:					
BAE Systems shareholders			**1,745**		901
Minority interests			**23**		21
			1,768		922
Earnings per share	4				
Continuing operations:					
Basic earnings per share			**49.6p**		26.0p
Diluted earnings per share			**49.5p**		25.8p
Discontinued operations:					
Basic earnings per share			**–**		0.6p
Diluted earnings per share			**–**		0.6p
Total:					
Basic earnings per share			**49.6p**		26.6p
Diluted earnings per share			**49.5p**		26.4p

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.
2 Comprises a loss of £nil in operating costs (2007 £8m) and a profit of £238m in other income (2007 £48m).

Consolidated balance sheet

as at 31 December

	Notes	2008 £m	2007 £m
Non-current assets			
Intangible assets		**12,306**	9,559
Property, plant and equipment		**2,446**	1,774
Investment property		**112**	113
Equity accounted investments		**1,034**	781
Other investments		**6**	6
Other receivables		**162**	322
Other financial assets		**514**	48
Deferred tax assets		**1,026**	567
		17,606	13,170
Current assets			
Inventories		**926**	701
Trade and other receivables including amounts due from customers for contract work		**3,831**	2,933
Current tax		**14**	35
Other investments		**–**	164
Other financial assets		**674**	101
Cash and cash equivalents		**2,624**	3,062
		8,069	6,996
Non-current assets and disposal groups held for sale		**–**	94
		8,069	7,090
Total assets		**25,675**	20,260
Non-current liabilities			
Loans		**(2,608)**	(2,197)
Trade and other payables		**(701)**	(413)
Retirement benefit obligations	5	**(3,365)**	(1,629)
Other financial liabilities		**(383)**	(26)
Deferred tax liabilities		**(80)**	(40)
Provisions		**(459)**	(399)
		(7,596)	(4,704)
Current liabilities			
Loans and overdrafts		**(173)**	(299)
Trade and other payables		**(9,165)**	(8,245)
Other financial liabilities		**(362)**	(71)
Current tax		**(704)**	(499)
Provisions		**(386)**	(410)
		(10,790)	(9,524)
Liabilities directly associated with disposal groups held for sale		**–**	(30)
		(10,790)	(9,554)
Total liabilities		**(18,386)**	(14,258)
Net assets		**7,289**	6,002
Capital and reserves			
Issued share capital	7	**90**	90
Share premium	7	**1,238**	1,222
Other reserves	7	**5,974**	4,631
Retained earnings	7	**(68)**	23
Total equity attributable to equity holders of the parent		**7,234**	5,966
Minority interests	7	**55**	36
Total equity		**7,289**	6,002

Approved by the Board on 18 February 2009 and signed on its behalf by:

I G King
Chief Executive

G W Rose
Group Finance Director

Consolidated cash flow statement

for the year ended 31 December

	Notes	2008 £m	2007 £m
Profit for the year from continuing operations		**1,768**	900
Profit for the year from discontinued operations		**–**	22
Profit for the year		**1,768**	922
Taxation expense		**603**	335
Share of results of equity accounted investments		**(139)**	(139)
Net finance costs		**(653)**	(58)
Depreciation, amortisation and impairment		**755**	610
(Gain)/loss on disposal of property, plant and equipment		**(33)**	3
Gain on disposal of investment property		**(5)**	(47)
Gain on disposal of non-current other investments		**–**	(8)
Gain on disposal of businesses – continuing operations		**(238)**	(40)
Gain on disposal of businesses – discontinued operations		**–**	(22)
Cost of equity-settled employee share schemes		**51**	34
Movements in provisions		**(115)**	52
Decrease in liabilities for retirement benefit obligations		**(272)**	(233)
(Increase)/decrease in working capital:			
Inventories		**46**	(188)
Trade and other receivables		**(5)**	(271)
Trade and other payables		**246**	1,212
Cash inflow from operating activities		**2,009**	2,162
Interest paid		**(249)**	(224)
Interest element of finance lease rental payments		**(5)**	(6)
Taxation paid		**(261)**	(112)
Net cash inflow from operating activities		**1,494**	1,820
Dividends received from equity accounted investments		**89**	78
Interest received		**156**	175
Purchases of property, plant and equipment		**(520)**	(307)
Purchases of intangible assets		**(32)**	(31)
Equity accounted investment funding		**–**	(4)
Proceeds from sale of property, plant and equipment		**44**	13
Proceeds from sale of investment property		**5**	53
Proceeds from sale of non-current other investments		**–**	15
Purchase of non-current other investments		**–**	(1)
Purchase of subsidiary undertakings	9	**(1,078)**	(1,731)
Cash and cash equivalents acquired with subsidiary undertakings	9	**2**	6
Purchase of equity accounted investments	9	**(12)**	(1)
Proceeds from sale of subsidiary undertakings	9	**131**	96
Cash and cash equivalents disposed of with subsidiary undertakings	9	**(60)**	(1)
Proceeds from sale of equity accounted investments	9	**16**	57
Proceeds from sale of other deposits		**164**	343
Net cash outflow from investing activities		**(1,095)**	(1,240)
Capital element of finance lease rental payments		**(18)**	(25)
Proceeds from issue of share capital		**16**	805
Purchase of treasury shares		**–**	(152)
Purchase of own shares		**(43)**	(50)
Equity dividends paid		**(478)**	(396)
Dividends paid to minority interests		**(11)**	(1)
Dividends paid on preference shares		**–**	(10)
Cash outflow from matured derivative financial instruments		**(440)**	(14)
Cash inflow from reduction in cash collateral		**106**	9
Cash outflow from repayment of loans		**(306)**	(777)
Net cash outflow from financing activities		**(1,174)**	(611)
Net decrease in cash and cash equivalents		**(775)**	(31)
Cash and cash equivalents at 1 January		**3,046**	3,074
Effect of foreign exchange rate changes on cash and cash equivalents		**334**	3
Cash and cash equivalents at 31 December		**2,605**	3,046
Comprising:			
Cash and cash equivalents		**2,624**	3,062
Overdrafts		**(19)**	(16)
Cash and cash equivalents at 31 December		**2,605**	3,046

Consolidated statement of recognised income and expense

for the year ended 31 December

	Notes	2008 £m	2007 £m
Currency translation on foreign currency net investments:			
Subsidiaries		**807**	(1)
Equity accounted investments		**197**	43
Amounts credited to hedging reserve		**469**	41
Net actuarial (losses)/gains on defined benefit pension schemes:			
Subsidiaries		**(1,937)**	544
Equity accounted investments		**(60)**	24
Fair value movements on available-for-sale investments		**–**	5
Current tax on items taken directly to equity		**58**	96
Deferred tax on items taken directly to equity:			
Subsidiaries		**425**	(259)
Tax rate adjustment[1]		**–**	(19)
Equity accounted investments		**17**	(6)
Recycling of fair value movements on disposal of available-for-sale investments		**–**	(6)
Recycling of cumulative currency translation on disposal:			
Continuing operations		**1**	–
Net (expense)/income recognised directly in equity		**(23)**	462
Profit for the year		**1,768**	922
Total recognised income and expense	7	**1,745**	1,384
Attributable to:			
Equity shareholders	7	**1,722**	1,363
Minority interests	7	**23**	21
	7	**1,745**	1,384

1 The UK current tax rate was reduced from 30% to 28% with effect from 1 April 2008. In 2007, in line with this change, the rate applying to UK deferred tax assets and liabilities was also reduced from 30% to 28%, creating a rate adjustment, which was partly reflected in the Consolidated income statement and partly in the Consolidated statement of recognised income and expense.

Notes to the accounts

1. Accounting policies

Statement of compliance

The consolidated financial statements of BAE Systems plc have been prepared in accordance with EU endorsed International Financial Reporting Standards (IFRS), International Financial Reporting Interpretations Committee interpretations (IFRICs) and the Companies Act 1985 applicable to companies reporting under IFRS.

With effect from 1 January 2008 the Group has early adopted IFRS 8, Operating Segments. This requires that entities adopt the 'management approach' to the financial reporting of their operating segments, under which segment information is presented on the same basis as that used for internal reporting purposes. The standard is concerned with disclosure only and has no impact on the consolidated income statement or balance sheet.

The following interpretations to published standards are effective for accounting periods beginning on or after 1 January 2008:

– IFRIC 11, IFRS 2, Group and Treasury Share Transactions; and

– IFRIC 14, IAS 19, The Limit on Defined Benefit Asset, Minimum Funding Requirements and their Interaction.

None of these have any impact on the Group's accounts.

Basis of preparation

The consolidated financial statements are presented in pounds sterling and, unless stated otherwise, rounded to the nearest million. They have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and other relevant financial assets and financial liabilities (including derivative instruments).

2. Segmental analysis

	Combined sales of Group and equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Electronics, Intelligence & Support	**4,459**	3,916	**–**	(7)	**–**	–	**4,459**	3,909
Land & Armaments	**6,407**	3,538	**(1)**	(1)	**1**	–	**6,407**	3,537
Programmes & Support	**4,638**	5,327	**(1,531)**	(1,367)	**983**	1,111	**4,090**	5,071
International	**3,333**	3,359	**(1,446)**	(1,307)	**–**	–	**1,887**	2,052
HQ & Other Businesses	**235**	243	**–**	–	**–**	–	**235**	243
	19,072	16,383	**(2,978)**	(2,682)	**984**	1,111	**17,078**	14,812
Intra-operating group sales/revenue	**(529)**	(673)	**25**	–	**97**	170	**(407)**	(503)
	18,543	15,710	**(2,953)**	(2,682)	**1,081**	1,281	**16,671**	14,309

	Underlying EBITA[1] (restated)		Profit/(loss) on disposal of businesses		Uplift on acquired inventories		Amortisation of intangible assets		Impairment of intangible assets		Operating group result	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Electronics, Intelligence & Support	**506**	437	**61**	(8)	**–**	–	**(24)**	(15)	**–**	–	**543**	414
Land & Armaments	**566**	324	**–**	–	**–**	(12)	**(168)**	(110)	**(40)**	–	**358**	202
Programmes & Support	**491**	456	**177**	–	**–**	–	**(24)**	(19)	**(5)**	(145)	**639**	292
International	**435**	435	**–**	–	**–**	–	**(30)**	(4)	**(120)**	–	**285**	431
HQ & Other Businesses	**(101)**	(203)	**–**	48	**–**	–	**(1)**	(1)	**(12)**	(3)	**(114)**	(159)
	1,897	1,449	**238**	40	**–**	(12)	**(247)**	(149)	**(177)**	(148)	**1,711**	1,180
Financial income of equity accounted investments											**44**	35
Taxation expense of equity accounted investments											**(37)**	(38)
Operating profit											**1,718**	1,177
Finance costs											**653**	58
Profit before taxation											**2,371**	1,235
Taxation expense											**(603)**	(335)
Profit for the year from continuing operations											**1,768**	900

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding profit/(loss) on disposal of businesses and uplift on acquired inventories. Restated to exclude profit/(loss) on disposal of businesses. See page 3.

	Assets excluding intangible assets and equity accounted investments		Intangible assets		Equity accounted investments		Total assets		Total liabilities	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Electronics, Intelligence & Support	**1,954**	1,406	**5,272**	4,491	**4**	3	**7,230**	5,900	**(1,470)**	(1,164)
Land & Armaments	**2,019**	1,510	**5,712**	4,435	**–**	–	**7,731**	5,945	**(1,505)**	(1,191)
Programmes & Support	**866**	1,035	**875**	575	**217**	45	**1,958**	1,655	**(3,506)**	(3,696)
International	**1,899**	1,106	**429**	27	**813**	733	**3,141**	1,866	**(1,933)**	(1,778)
HQ & Other Businesses	**1,690**	882	**18**	31	**–**	–	**1,708**	913	**(3,035)**	(1,705)
	8,428	5,939	**12,306**	9,559	**1,034**	781	**21,768**	16,279	**(11,449)**	(9,534)
Disposal groups held for sale							**–**	94	**–**	(30)
Tax							**1,040**	602	**(784)**	(539)
Retirement benefit obligations							**40**	59	**(3,365)**	(1,629)
Cash/(debt) as defined by the Group							**2,827**	3,226	**(2,788)**	(2,526)
Consolidated total assets/(liabilities)							**25,675**	20,260	**(18,386)**	(14,258)

3. Finance costs

	2008 £m	2007 £m
Interest income	**147**	169
Net present value adjustments	**3**	21
Expected return on pension scheme assets	**846**	845
Net gain on remeasurement of financial instruments[1]	**681**	135
Gain on sale of available-for-sale investments	**–**	6
Foreign exchange gains[2]	**1,703**	81
Financial income	**3,380**	1,257
Interest expense:		
On bank loans and overdrafts	**(2)**	(4)
On finance leases	**(5)**	(6)
On bonds and other financial instruments	**(253)**	(218)
On preference debt	**–**	(13)
	(260)	(241)
Facility fees	**(4)**	(4)
Net present value adjustments	**(30)**	(22)
Interest charge on pension scheme liabilities	**(795)**	(753)
Net loss on remeasurement of financial instruments at fair value through profit or loss[3]	**(917)**	(77)
Foreign exchange losses[4]	**(721)**	(102)
Financial expense	**(2,727)**	(1,199)
Net finance costs	**653**	58

Additional analysis of finance costs

	2008 £m	2007 £m
Net finance costs – Group	**653**	58
Net finance costs – share of equity accounted investments	**44**	35
	697	93
Analysed as:		
Net interest:		
Interest income	**147**	169
Interest expense	**(260)**	(241)
Facility fees	**(4)**	(4)
Net present value adjustments	**(27)**	(1)
Gain on sale of available-for-sale investments	**–**	6
Share of equity accounted investments	**42**	33
	(102)	(38)
Other finance costs:		
Group:		
Net financing credit on pensions	**51**	92
Market value and foreign exchange movements on financial instruments and investments	**746**	37
Share of equity accounted investments	**2**	2
	697	93

1 The increase in the net gain on remeasurement of financial instruments has mainly been driven by exchange movements on the US dollar relating to debt-related derivative financial instruments, and on the Euro, relating to hedging loans from equity accounted investments.
2 The increase in foreign exchange gains mainly reflects the exchange gain on an intercompany loan from the UK to the US businesses.
3 The net loss on remeasurement of financial instruments at fair value through profit or loss is principally due to the movement in the US dollar exchange rate on hedges relating to a portion of the intercompany loan from the UK to the US businesses.
4 The increase in foreign exchange losses is mainly due to movements in the Euro exchange rate relating to loans from equity accounted investments, and the revaluation of a loan from the US business to the UK.

4. Earnings per share

	2008				2007 (restated)[1]			
	£m	**Basic pence per share**	**£m**	**Diluted pence per share**	£m	Basic pence per share	£m	Diluted pence per share
Profit for the year attributable to equity shareholders	**1,745**		**1,745**		901		901	
Interest on the debt instrument of the convertible preference shares	**–**		**–**		–		13	
Profit for the year after adjusting for interest on the debt instrument of the convertible preference shares	**1,745**	**49.6**	**1,745**	**49.5**	901	26.6	914	26.4
Represented by:								
Continuing operations	**1,745**	**49.6**	**1,745**	**49.5**	879	26.0	892	25.8
Discontinued operations	**–**	**–**	**–**	**–**	22	0.6	22	0.6
Add back/(deduct):								
Profit on disposal of businesses, post tax	**(208)**		**(208)**		(30)		(30)	
Uplift on acquired inventories, post tax	**–**		**–**		9		9	
Net financing credit on pensions, post tax	**(39)**		**(39)**		(68)		(68)	
Market value movements on derivatives, post tax	**(552)**		**(552)**		(29)		(29)	
Amortisation and impairment of intangible assets, post tax	**184**		**184**		110		110	
Impairment of goodwill – subsidiaries	**54**		**54**		148		148	
Impairment of goodwill – equity accounted investments	**121**		**121**		–		–	
Underlying earnings post tax	**1,305**	**37.1**	**1,305**	**37.0**	1,041	30.7	1,054	30.4
Represented by:								
Continuing operations	**1,305**	**37.1**	**1,305**	**37.0**	1,019	30.1	1,032	29.8
Discontinued operations	**–**	**–**	**–**	**–**	22	0.6	22	0.6
	1,305	**37.1**	**1,305**	**37.0**	1,041	30.7	1,054	30.4

	2008 Basic Millions	**2008 Diluted Millions**	2007 Basic Millions	2007 Diluted Millions
Weighted average number of shares used in calculating basic earnings per share	**3,519**	**3,519**	3,386	3,386
Add:				
Incremental shares in respect of employee share schemes		**9**		24
Incremental shares in respect of convertible preference shares		**–**		56
Weighted average number of shares used in calculating diluted earnings per share		**3,528**		3,466

1 Restated following a change in the definition of underlying earnings to exclude profit/(loss) on disposal of businesses. See page 3.

Underlying earnings per share is presented in addition to that required by IAS 33 Earnings per Share to align the adjusted earnings measure with the performance measure reviewed by the directors. The directors consider that this gives a more appropriate indication of underlying performance.

In accordance with IAS 33, the diluted earnings per share are without reference to adjustments in respect of outstanding share options and convertible preference shares where the impact would be anti-dilutive.

Notes to the accounts (continued)

5. Retirement benefit obligations

Amounts recognised on the balance sheet

	2008				2007			
	UK defined benefit pension plans £m	**US and other pension plans £m**	**US healthcare plans £m**	**Total £m**	UK defined benefit pension plans £m	US and other pension plans £m	US healthcare plans £m	Total £m
Present value of unfunded obligations	**(10)**	**(132)**	**(11)**	**(153)**	(1)	(97)	(13)	(111)
Present value of funded obligations	**(14,221)**	**(2,770)**	**(142)**	**(17,133)**	(15,099)	(1,912)	(103)	(17,114)
Fair value of plan assets	**11,159**	**1,819**	**92**	**13,070**	13,192	1,918	95	15,205
Total IAS 19 deficit, net	**(3,072)**	**(1,083)**	**(61)**	**(4,216)**	(1,908)	(91)	(21)	(2,020)
Allocated to equity accounted investments and other participating employers[1]	**891**	**–**	**–**	**891**	450	–	–	450
Group's share of IAS 19 deficit, net	**(2,181)**	**(1,083)**	**(61)**	**(3,325)**	(1,458)	(91)	(21)	(1,570)
Represented by:								
Pension prepayments (within trade and other receivables)	**–**	**25**	**15**	**40**	14	32	13	59
Retirement benefit obligations	**(2,181)**	**(1,108)**	**(76)**	**(3,365)**	(1,472)	(123)	(34)	(1,629)
	(2,181)	**(1,083)**	**(61)**	**(3,325)**	(1,458)	(91)	(21)	(1,570)
Group's share of IAS 19 deficit of equity accounted investments	**(168)**	**–**	**–**	**(168)**	(49)	–	–	(49)

1 Certain of the Group's equity accounted investments participate in the Group's defined benefit plans as well as Airbus SAS, the Group's share of which was disposed of during the year ended 31 December 2006. As these plans are multi-employer plans the Group has allocated an appropriate share of the IAS 19 pension deficit to the equity accounted investments and to Airbus SAS based upon a reasonable and consistent allocation method intended to reflect a reasonable approximation of their share of the deficit. The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments.

For its UK pension arrangements the Group has, for the purpose of calculating its liabilities as at 31 December 2008, continued to use PA 00 medium cohort tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of plan members. In addition, this mortality has been subject to a minimum assumed rate of future annual mortality improvements of 1%. For its US pension arrangements, the mortality tables used for pensioners and non-pensioners are RP 2000 projected to 2010. The current life expectancies underlying the value of the accrued liabilities for the main UK and US plans range from 19 to 23 years for current male pensioners at age 65 and 22 to 25 years for current female pensioners at age 65.

The Group's share of the IAS 19 deficit excluding the Group's share of amounts allocated to equity accounted investments and other participating employers is £2,210m (31 December 2007 £1,048m) after tax.

Contributions

The Group contributions made to the defined benefit plans in the year ended 31 December 2008 were £399m (2007 £403m) excluding those amounts allocated to equity accounted investments and participating employers (£87m). In 2009, the Group expects to make regular contributions at a similar level to those made in 2008. In addition, the Group expects to make incremental contributions of £200m in respect of the UK pension schemes and $250m (£172m) to the US pension schemes in 2009.

The Group incurred a charge in respect of the cash contributions of £84m (2007 £62m) paid to defined contribution plans for employees. Following the acquisitions the Group has made in 2008 (note 9), it expects to make a contribution of £132m to these plans in 2009.

6. Contingent liabilities

Aircraft financing contingent liabilities

Included within provisions is an exposure of £58m as discussed below:

	2008 £m	2007 £m
Potential future cash flow payments in respect of aircraft financing obligations	**97**	134
Anticipated aircraft values	**(37)**	(55)
Adjustments to net present values	**(2)**	(9)
Net exposure provided	**58**	70

The Group has provided residual value guarantees (RVGs) in respect of certain commercial aircraft sold. At 31 December 2008, the Group's gross exposure to make future payments in respect of these arrangements was £97m (2007 £134m). The Group's net exposure to these guarantees is covered by the provisions held and the residual values of the related aircraft.

The Group is also exposed to actual and contingent liabilities arising from commercial aircraft financing and RVGs given by Saab AB. Provision is made against the expected net exposures on a net present value basis within the accounts of Saab. The Group's share of such exposure is limited to its percentage shareholding in Saab.

Other contingent liabilities

The Group is subject to an ongoing investigation by the UK Serious Fraud Office (the SFO) in connection with marketing of the Group's products. The Group is co-operating fully with the SFO.

At this stage management cannot determine whether or not it might lead to any proceedings being brought against the Group. Accordingly, the potential for fines or other penalties cannot currently be assessed, although the directors continue to consider that the Group has not acted unlawfully in relation to any of the matters under investigation. As the investigation is ongoing it is not possible to identify the timescale in which these issues might be resolved.

In addition, in June 2007, the US Department of Justice notified the Group that it had commenced a formal investigation relating to the Group's compliance with anti-corruption laws, including its business concerning the Kingdom of Saudi Arabia. Again, given the status of this matter it is not possible to provide any details of any possible future financial effects that might result from the investigation and any subsequent actions or events that might occur as a result of the investigation. Equally it is not possible to provide any timescale in which these issues might be resolved. The directors continue to consider that the Group has not acted unlawfully in relation to its dealings with the Kingdom of Saudi Arabia or in relation to anti-corruption laws.

Should any financial effects arise as a result of these investigations the directors consider it unlikely that there is any likelihood of reimbursement for such costs from any sources other than certain rights to recover reimbursement of the legal costs under the Group's insurance policies.

7. Reconciliation of movement in capital and reserves

	Attributable to equity holders of the parent							
	Issued share capital £m	Share premium £m	Equity option of preference shares £m	Other reserves £m	Retained earnings £m	Total £m	Minority interests £m	Total equity £m
Balance at 1 January 2007	81	841	76	4,330	(1,211)	4,117	17	4,134
Total recognised income and expense	–	–	–	72	1,291	1,363	21	1,384
Placing of shares (net of costs)	5	–	–	–	736	741	–	741
Share-based payments	–	–	–	–	34	34	–	34
Share options:								
Proceeds from shares issued	1	63	–	–	–	64	–	64
Purchase of own shares	–	–	–	–	(50)	(50)	–	(50)
Conversion of preference shares	3	318	(76)	229	(229)	245	–	245
Purchase of treasury shares	–	–	–	–	(152)	(152)	–	(152)
Other	–	–	–	–	–	–	(1)	(1)
Ordinary share dividends	–	–	–	–	(396)	(396)	(1)	(397)
At 31 December 2007	90	1,222	–	4,631	23	5,966	36	6,002
Total recognised income and expense	–	–	–	1,343	379	1,722	23	1,745
Share-based payments	–	–	–	–	51	51	–	51
Share options:								
Proceeds from shares issued	–	16	–	–	–	16	–	16
Purchase of own shares	–	–	–	–	(43)	(43)	–	(43)
Other	–	–	–	–	–	–	7	7
Ordinary share dividends	–	–	–	–	(478)	(478)	(11)	(489)
At 31 December 2008	**90**	**1,238**	**–**	**5,974**	**(68)**	**7,234**	**55**	**7,289**

Other reserves include a merger reserve of £4,589m (2007 £4,589m), a statutory reserve of £202m (2007 £202m), a translation reserve of £787m (2007 £217m debit) and a hedging reserve of £396m (2007 £57m). The £1,343m credit to other reserves includes £1,004m to the translation reserve and £339m to the hedging reserve. Under Section 4 of the British Aerospace Act 1980 the statutory reserve may only be applied in paying up unissued shares of the Group to be allotted to members of the Group as fully paid bonus shares.

8. Dividends

	2008 £m	2007 £m
Equity dividends		
Prior year final 7.8p dividend per ordinary share paid in the year (2007 6.9p)	**274**	221
Interim 5.8p dividend per ordinary share paid in the year (2007 5.0p)	**204**	175
	478	396

After the balance sheet date, the directors proposed a final dividend of 8.7p (2007 7.8p). The dividend, which is subject to shareholder approval, will be paid on 1 June 2009 to shareholders registered on 24 April 2009. The ex-dividend date is 22 April 2009.

Shareholders who do not at present participate in the Company's dividend reinvestment plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 8 May 2009.

9. Acquisitions and disposals

Acquisitions

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

9. Acquisitions and disposals (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, EBITA[1] 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

9. Acquisitions and disposals (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 accounts (continued)

9. Acquisitions and disposals (continued)

Disposals

Continuing and discontinued operations for the year ended 31 December 2008

Name	Country of incorporation	Date of sale	Percentage share	Profit on disposal of businesses £m	Proceeds from sale of subsidiary undertakings £m	Proceeds from sale of equity accounted investments £m	Deferred consideration[4] £m
Surveillance and Attack division	USA	22.02.08	100%	61	118	–	–
BAE Systems Surface Fleet Solutions Limited[2]	UK	01.07.08	45%	121	–	–	–
Flagship Training Limited[1]	UK	01.07.08	50%	56	–	16	53
Gregory backpack business	USA	14.03.08	100%	–	7	–	–
Continuing operations				238	125	16	53
Discontinued operations[3] – Mobile International business	USA	14.02.08	100%	–	6	–	–
				238	131	16	53

Continuing and discontinued operations for the year ended 31 December 2007

Name	Country of incorporation	Date of sale	Percentage share	Profit/(loss) on disposal of businesses £m	Proceeds from sale of subsidiary undertakings £m	Proceeds from sale of equity accounted investments £m
HR Enterprise Limited and its subsidiary Xchanging HR Services Limited (XHRS)	UK	17.01.07	50%	–	–	10
Xchanging Procurement Services (Holdco) Limited (XPS)	UK	06.03.07	50%	44	–	47
Customer Training Centre	UK	13.12.07	100%	4	6	–
Inertial Products business	USA	20.08.07	100%	(6)	70	–
TEMPEST products business	USA	11.12.07	100%	(2)	1	–
Transaction costs				–	(5)	–
Continuing operations				40	72	57
Discontinued operations[5] – SELEX	UK	30.03.07	25%	22	24	–
				62	96	57

1 Consideration of £67m has been deferred over three years, the discounted value of which is £53m.
2 On 1 July 2008, the Group exchanged a 45% shareholding in BAE Systems Surface Fleet Solutions Limited (SFSL) as consideration for the contribution to SFSL of 100% of VT Group plc's shipbuilding and naval support businesses to form the joint venture BVT Surface Fleet Limited.
3 The Group's Mobile International business was acquired with Armor Holdings Inc. on 31 July 2007 with a view to immediate resale. Accordingly, it was classified as held for sale as at 31 December 2007. The sale was completed on 14 February 2008 for a cash consideration less transaction costs of £6m.
4 Included within other receivables.
5 On 30 March 2007, the sale of the Group's remaining 25% interest in SELEX was completed following the exercise by Finmeccanica SpA of its call option granted as part of the original disposal transaction in 2005. Net proceeds of £24m comprise the consideration of £277m, less £253m which was assigned to the BAE Systems 2000 Pension Plan in 2006. A profit of £22m was recognised during the year upon settlement of warranties and similar obligations on this transaction.

Cash flows in relation to acquisitions and disposals

	Subsidiaries								Equity accounted investments		
	MTC £m	Tenix Defence £m	Detica £m	Other acquisitions £m	**Total acquisitions £m**	Surveillance and Attack £m	Other disposals £m	**Total disposals £m**	Flagship £m	Other £m	**Total £m**
Cash (consideration)/proceeds	(188)	(328)	(543)	(19)	**(1,078)**	118	13	**131**	16	(12)	**(943)**
Cash and cash equivalents net of overdrafts acquired/disposed	2	–	(4)	4	**2**	–	(60)	**(60)**	–	–	**(58)**
Acquisitions and disposals	(186)	(328)	(547)	(15)	**(1,076)**	118	(47)	**71**	16	(12)	**(1,001)**
Debt acquired on acquisition of subsidiary	(32)	–	(5)	–	**(37)**	–	–	**–**	–	–	**(37)**
	(218)	(328)	(552)	(15)	**(1,113)**	118	(47)	**71**	16	(12)	**(1,038)**

10. Related party transactions

The Group has a related party relationship with its directors and key management, its equity accounted investments and the pension plans.

Transactions occur with the equity accounted investments in the normal course of business and are priced on an arm's-length basis and settled on normal trade terms. The more significant transactions are disclosed below:

	31 December 2008 £m	31 December 2007 £m
Sales to related parties	**1,081**	1,281
Purchases from related parties	**147**	148
Amounts owed by related parties	**200**	239
Amounts owed to related parties	**1,476**	854

11. Events after the balance sheet date

In connection with the joint venture company BVT Surface Fleet Limited (BVT), which was established on 1 July 2008, VT Group plc (VT) holds a put option exercisable from 1 July 2009 to sell its 45% interest in BVT to the Group for a minimum of £380m (subject to adjustments). In addition, on completion of that put option, deferred consideration of £65m (plus interest) in respect of the sale to VT of the Group's 50% shareholding in Flagship Training Limited becomes payable (subject to adjustment).

In January 2009, VT announced that it had decided to exercise this put option and that it expects to be in a position to exercise that option by 1 July 2009.

12. Annual General Meeting

This year's Annual General Meeting will be held on 6 May 2009. Details of the resolutions to be proposed at that meeting will be included in the notice of Annual General Meeting that will be sent to shareholders at the end of March 2009.

13. Other information

The financial information for the years ended 31 December 2008 and 31 December 2007 contained in this preliminary announcement was approved by the Board on 18 February 2009. This announcement does not constitute statutory accounts of the Company within the meaning of section 240 of the Companies Act 1985.

Statutory accounts for the year ended 31 December 2007 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2008 will be delivered to the Registrar of Companies following the Company's Annual General Meeting.

The auditors have reported on both these sets of accounts. Their reports were not qualified and did not contain a statement under section 237(2) or (3) of the Companies Act 1985.

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