

Results in brief, highlights and outlook**Results in brief**

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

Highlights

- Good financial performance
- Continued growth from US businesses
- Leadership position established in global land systems sector
- Underlying earnings³ per share up 30% to 31.0p
- Dividend increased 13.3% to 12.8p per share for the year

Outlook

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

1 including share of equity accounted investments

2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense

3 earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and uplift on acquired inventories (see note 5)

4 basic earnings per share in accordance with International Accounting Standard 33

5 including share of equity accounted investments' order books and after the elimination of intra-group orders of £1.4bn (2006 £1.0bn)

Preliminary results statement

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

BAE Systems once again performed well in 2007, demonstrating the significant fundamental strengths and quality of the business. EBITA² increased by 22% to £1,477m on sales¹ of £15,710m, up 14% compared with 2006. Underlying earnings³ per share increased 30% to 31.0p for the year. The Group had net cash of £700m at year end, having invested \$4.5bn (£2.2bn) excluding fees in the acquisition of Armor Holdings, Inc. during the year.

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

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

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

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

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

United States

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

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

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

To complement BAE Systems' tracked vehicle position in the US, the Group has been executing a wheeled vehicle strategy to meet a valuable, near-term, urgent operational requirement for Mine Resistant Ambush Protected (MRAP) vehicles. This has resulted

in the establishment of a new assembly facility for the RG33 mine protected vehicle in York, Pennsylvania, alongside the Bradley reset facility. Following the substantial contract award for RG33 MRAP vehicles in 2007, manufacturing volume has increased rapidly in the last months of 2007 with the completion of 23 vehicles in October rising to 102 in December.

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

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

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

United Kingdom

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

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

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

Other home markets

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

Summarised income statement from continuing operations

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

Exchange rates

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

Segmental analysis

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

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

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

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

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

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

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

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

1 including share of equity accounted investments

2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense

3 earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and uplift on acquired inventories (see note 5)

4 restated following changes to the Group's organisational structure

Preliminary results statement (continued)

Sales¹ increased 14% from £13,765m to £15,710m. Sales in the full year from the Armor Holdings business, acquired in July 2007, were £725m. Like for like growth, after adjusting for the impact of exchange translations and acquisitions and disposals, was also 14%. US-led businesses were responsible for 47% of sales and sales generated from home markets represented 85% of the Group total.

EBITA² increased 22% to £1,477m (2006 £1,207m). The growth includes the benefit of five months trading from the Armor Holdings business, acquired in July 2007, which contributed EBITA² of £77m in the year. Translation of US\$ generated results decreased EBITA² by £47m when compared with 2006. US-led businesses delivered 50% of the Group's EBITA².

Return on sales (EBITA² adjusted for uplift on acquired inventories expressed as a percentage of sales) for the Group increased from 8.8% to 9.5%.

Amortisation and impairment

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

Order book¹ increased to £38.6bn, primarily on the award of the Saudi Typhoon contract, MRAP orders and the acquisition of Armor Holdings.

Net finance costs¹

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

Underlying interest cover based on EBITA² increased from 7.7 times to 39 times.

Taxation

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

Earnings per share

Underlying earnings³ per share from continuing operations for 2007 increased by 30% to 31.0p.

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

Dividend

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

The proposed dividend is covered 2.4 times by earnings³ from continuing operations (2006 2.1 times), which is consistent with the Group's policy of growing the dividend whilst maintaining a long-term sustainable earnings cover of approximately two times.

Cash flows

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

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

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

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

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

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

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

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

Summary and outlook

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

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

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

Reconciliation of cash inflow from operating activities to net cash

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

Operating business cash flow

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

1 including share of equity accounted investments

2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense

3 earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and uplift on acquired inventories (see note 5)

4 restated following changes to the Group's organisational structure

5 cash on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance

Electronics, Intelligence & Support

The Electronics, Intelligence & Support business group, with 30,600 employees¹ and its headquarters in the US, is a provider of defence and aerospace systems, sub-systems and services. It comprises two operating groups: Electronics & Integrated Solutions and Customer Solutions.

Financial highlights

- Like for like organic sales¹ growth of 7% over 2006
- Return on sales improved to 11%

	2007	2006	2005
Sales ¹	£3,916m	£4,007m	£3,697m
EBITA ²	£429m	£429m	£324m
Return on sales	11.0%	10.7%	8.8%
Cash inflow ³	£302m	£273m	£323m
Order intake ¹	£4,178m	£4,311m	£3,659m
Order book ¹	£3.5bn	£3.4bn	£3.5bn

Key points

- Continued leadership in the provision of electronic warfare systems
- New markets developing for the HybriDrive[®] propulsion systems
- Stable demand for ship repair services

Looking forward

2008 should see continued organic growth with an anticipated part-year contribution from the proposed acquisition of MTC Technologies.

Profitable growth is anticipated in the electronic warfare and other defence and aerospace electronics activities, based on the business' strong legacy technology and services positions, combined with its continued investments in key capabilities. Ship repair activity is expected to remain stable. Growth in the IT and services businesses is dependent on the near-term priorities of the US Department of Defense.

During 2007, Electronics, Intelligence & Support achieved EBITA² of £429m (2006 £429m) on sales¹ of £3,916m (2006 £4,007m) and generated operating cash inflow³ of £302m (2006 £273m).

In 2006, the return on sales benefited from a £61m pension-related accounting gain.

In 2007, US\$ translations decreased sales¹ and EBITA² when compared with 2006 by £296m and £35m respectively.

In August, BAE Systems completed the sale of its Inertial Products business for \$140m (£70m). In December, the Group agreed to sell its Surveillance and Attack business in Lansdale, Pennsylvania for a cash consideration of \$240m (£121m). Also in December, the Group announced the proposed \$448m (£225m) acquisition of MTC Technologies, Inc., a company providing technical and professional services, and equipment integration and modernisation for the US military and intelligence agencies.

Electronics & Integrated Solutions (E&IS)

E&IS designs, develops and produces electronic systems and sub-systems for a wide range of military and commercial applications. The operating group is focused on four primary capabilities: electronic warfare, commercial and military avionics, flight and engine controls, and tactical and national network systems.

During 2007, E&IS delivered its 100th F-22A electronic warfare (EW) system, the first F-35 Lightning II (Joint Strike Fighter) EW system and its 1,000th Common Missile Warning System to protect US Army helicopters and aircraft from heat-seeking missiles. E&IS continued its role with the US Department of Homeland Security to develop a commercial version of BAE Systems Directed Infrared Countermeasures (DIRCM) system, JETEYE[™], which seeks to defeat the threat of shoulder-fired anti-aircraft missiles.

The Thermal Weapon Sight (TWS) programme achieved a production rate of more than 1,500 units per month, surpassing 18,000 total deliveries by the year end. The microbolometer technology that underpins TWS was also used to secure important night vision goggle and remote weapon stations contracts.

E&IS received a contract for the production of 50 fire fielding units of the Terminal High Altitude Area Defense (THAAD) missile, supporting the transition to production of this ballistic missile defence system.

Building on its strong legacy in C4ISR⁴ systems, E&IS has begun initial deployment of its First InterComm[™] system, which enables emergency services first responders to communicate more effectively using their existing radios and frequencies.

The business received an order to build more than 1,000 helmet assemblies for Typhoon and introduced new helmet-mounted, heads-up display technology.

1 including share of equity accounted investments

2 earnings before amortisation and impairment of intangible assets, finance costs and taxation expense

3 net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments

4 Command, Control, Communications, Computing, Intelligence, Surveillance and Reconnaissance

BAE Systems' commercial hybrid propulsion business continues to grow and reveal new opportunities. HybriDrive® propulsion technology is in daily service on more than 1,100 transit buses in the United States and Canada, and ten prototypes are scheduled to enter the London bus fleet in 2008. Orders were received for an additional 1,500 systems in 2007 from New York City, Toronto, Ottawa and Houston.

As part of its initiative to integrate commercial and defence capabilities, E&IS demonstrated the first hybrid electric drive system for ground combat vehicles as part of the US Army's Future Combat Systems (FCS) programme and has developed and demonstrated a common modular power system to meet the increasing electric power demand onboard military vehicles.

E&IS continues to focus on through-life product and logistics support for the US military through its Readiness & Sustainment efforts. An on-site presence at Warner Robins Air Force Base and Tobyhanna Army Depot provides a first-hand perspective to forecast and develop upgrades.

Customer Solutions

Customer Solutions comprises three lines of business: BAE Systems Information Technology (IT); Technology Solutions and Services (TSS); and BAE Systems Ship Repair.

Customer Solutions integrates communications systems, builds and maintains precision tracking radars, and is one of the largest service providers to the US Navy. The business is also a leader in US air and missile defence systems.

BAE Systems IT capabilities include enterprise-wide managed IT operations, mission-critical application development and lifecycle information assurance solutions and analytical services. TSS provides services and solutions, system and sub-system integration, equipment sustainment, and operations and maintenance.

BAE Systems Ship Repair is the leading non-nuclear ship repair company in the US providing conversion and modernisation services principally in the home ports of the US Navy.

BAE Systems IT operates within the large US government information technology market and continues to deliver mission-enabling support to its customers. BAE Systems ranked sixth in Computerworld's 'Best Places to Work in IT' for 2007. Contract successes include an award as a prime contractor for the General Services Administration (GSA) Alliant government-wide acquisition contract, a ten-year, \$50bn (£25bn) multiple award/indefinite-delivery indefinite-quantity (IDIQ) programme designed to provide full IT lifecycle support services in support of the US defence, intelligence and civilian government markets. The business was also awarded a competitive \$120m (£60m), five-year contract to develop applications for the US Department of Labor. A variety of

contracts were secured by winning re-competes and new business to provide key services such as network implementation and operation, and lifecycle software development engineering to the US government.

In 2007, TSS won more than 98% of its re-competes, including technical support to the US Missile Defense Agency and Federal agencies, US Air Force range radar depot and engineering support work, and US Navy communications station operations and maintenance in Hawaii. TSS expanded into adjacent markets by supporting the US Army with critical personnel for the global war on terror and by obtaining the integrator role for the new US Air Force Battle Control System.

BAE Systems Ship Repair secured a five-year, multi-ship multi-option contract from the US Navy to maintain and repair all Arleigh Burke-class destroyers homeported or visiting San Diego, with a total potential value in excess of \$150m (£75m). Ship Repair also secured a three-year contract from the US Navy for work on three newly commissioned San Antonio-class amphibious transport dock ships and a contract from the US Navy for modernisation of the Ticonderoga-class guided missile cruiser USS Bunker Hill.

Land & Armaments

The Land & Armaments business group, with 20,700 employees¹ and its headquarters in the US, is a 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 intelligent munitions.

Financial highlights

- Like for like organic sales growth of 41% over 2006
- Post-acquisition sales of \$1.5bn from Armor Holdings
- Success in wheeled vehicle market
- Order book growth on core products and urgent operational requirements

	2007	2006	2005
Sales ¹	£3,538m	£2,115m	£1,270m
EBITA ²	£312m	£168m	£42m
Return on sales	8.8%	7.9%	3.3%
Cash inflow ³	£10m	£137m	£168m
Order intake ¹	£4,535m	£2,964m	£1,541m
Order book ¹	£7.3bn	£4.9bn	£4.4bn

Key points

- High volume of vehicle reset and upgrade activity
- UK business returned to profitability
- Wheeled armoured vehicle successes
- Good progress in next-generation combat vehicle programmes

Looking forward

Further organic growth is anticipated in 2008 together with a full year's contribution from the former Armor Holdings business.

In the near term, US Land & Armaments operations are expected to continue to benefit from operational requirements in Iraq and Afghanistan and the Group's investment made in the wheeled vehicle market. In the longer term, the outlook will be dependent on the land sector continuing to be a priority area of spend for the US and the UK.

UK operations will continue their emphasis on performance improvements, seeking to secure an integrator role on the Future Rapid Effect System (FRES) programme and on reaching resolution on a mutually beneficial, sustainable munitions contract with the UK MoD.

The businesses in Sweden and South Africa aim to deliver growth through both new domestic government business and building on their track record of securing export orders.

During 2007, Land & Armaments achieved EBITA² of £312m (2006 £168m) on sales¹ of £3,538m (2006 £2,115m) and generated operating cash inflow³ of £10m (2006 £137m). The 2007 results showed strong organic growth on core products in addition to success in winning new business in the mine-protected vehicle market. The results include five months of operations from the former Armor Holdings, Inc. business.

At the end of July, BAE Systems completed the \$4.5bn acquisition of Armor Holdings, Inc. This acquisition has enhanced the Land & Armaments global land systems business, most notably in the increasingly important tactical wheeled vehicle sector, together with technology in the vital areas of armour and survivability. Sales and EBITA² from the acquired business amounted to \$1,452m (£725m) and \$155m (£77m) respectively.

United States

During the year, US Army contracts were secured for the refurbishment and upgrade of Bradley, M88 Hercules improved recovery vehicles and M113 fighting vehicles totalling \$2.3bn (£1.2bn).

As expected, during the first half of 2007, the US Army announced its intention to terminate the M113 fighting vehicle programme. Sales of M113 vehicles in 2007 totalled \$105m (£52m).

BAE Systems is one of several companies providing the US Army and Marine Corps with new Mine Resistant Ambush Protected (MRAP) wheeled vehicles. In February 2007, the US business received an initial order for 94 MRAP vehicles. Following evaluation and testing, follow-on awards have been received for 3,485 MRAP vehicles with a total value of \$2.2bn (£1.1bn). MRAP vehicles are produced as 4x4 and 6x6 wheeled vehicles including the Heavy Armed Ground Ambulance and Special Operation variants. BAE Systems has been awarded approximately 35% of all MRAP vehicle orders placed to date.

BAE Systems continued to make substantial progress on the Manned Ground Vehicles of the Future Combat Systems programme. Land & Armaments delivered the Non-Line-of-Sight Mortar (NLOS-M) prototype firing platform in early 2007. Test firing of the Non-Line-of-Sight Cannon (NLOS-C) continues at the Yuma Proving Ground with the first pre-production prototype delivery scheduled for May 2008. October saw the opening of a temporary facility as well as the commencement of construction for a 150,000 square foot NLOS-C integration facility in Elgin, Oklahoma. The new facility will be adjacent to the US Army Field Artillery School at Fort Sill and is targeted for completion in early 2009.

Development of the 155mm Advanced Gun System (AGS) and the Long Range Land Attack Projectile for the US Navy's DDG-1000 programme continues, with design, integration and production awards secured totalling \$386m (£194m). Land & Armaments conducted a successful interim baseline review in August of AGS

¹ including share of equity accounted investments

² earnings before amortisation and impairment of intangible assets, finance costs and taxation expense

³ net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments

and production is ramping-up at a new production site in Alabama. Land & Armaments is designing and testing a Vertical Launching System that will enable the US Navy's DDG-1000 to launch a wide range of missiles.

Land & Armaments is also providing a 57mm medium-calibre gun for the DDG-1000, the US Navy's Littoral Combat Ship and the Coast Guard's Deepwater programme.

United Kingdom

The British Army's operations in Afghanistan and Iraq have resulted in numerous urgent operational requirement orders to enhance FV430 and Warrior vehicles and many small and medium-calibre ammunition orders in excess of £400m.

Full rate production of the M777 lightweight howitzer is on track with delivery of an initial 151 guns to the US Army completed. An additional award for 173 guns was received in December. The M777 system has also been deployed in Afghanistan by the Canadian Army.

Engineering Tank Systems production continues with a total of 33 bridge-laying Titan vehicles and 33 Trojan obstacle-clearing vehicles being delivered to the British Army. The Panther programme completed Reliability Qualification Testing in August and is scheduled to deliver 408 vehicles by May 2009. The Terrier armoured tractor programme is experiencing delays and a revised programme baseline is under discussion with the customer.

In order to provide long-term savings to the customer and deliver a sustainable munitions business, discussions continue with the UK MoD aimed at agreeing a revised long-term contractual arrangement for the Munitions Acquisition Supply Solution.

Land & Armaments continues to compete for the vehicle integrator role on the Future Rapid Effect System (FRES) programme. BAE Systems is the UK partner and Design Authority for much of the UK Armoured Fighting Vehicle fleet.

Sweden

BAE Systems received a funding contract for £24m on the Archer self-propelled artillery programme demonstrating Sweden and Norway's joint commitment to continue the final phase of the development programme.

Deliveries of CV9035 armed vehicles to the Netherlands and Denmark commenced during the fourth quarter of the year, under a multi-year contract to provide 229 vehicles through to 2010.

In the area of intelligent munitions for artillery and mortar systems, the 155mm Excalibur supplied to the US Army performed well in theatre.

In November, Land & Armaments acquired Pitch Technologies, an innovative computer-based training and research simulation technologies company for £5m. The combination of BAE Systems and Pitch creates a world-class capability in enterprise-level simulation interoperability and solutions for training and simulation.

South Africa

The growing international requirement for mine-protected wheeled vehicles continues to generate new orders for the RG31 and RG32 vehicles built by OMC, Land & Armaments' South African subsidiary. Land & Armaments received an initial award in February 2007 from the prime contractor, General Dynamics, for the production of 24 RG31 MRAP vehicles for the US Marine Corps. This was followed by a further order in August for 600 vehicles, of which 305 are being produced by OMC in South Africa.

Programmes & Support

The Programmes & Support business group, with 29,100 employees¹, comprises the Group's UK-based air, naval and underwater systems activities and the Integrated System Technologies business.

Financial highlights

- Sales¹ growth of 15%
- Return on sales improved to 8.6%
- Order book¹ at a new high of £20.9bn

	2007	Restated ⁴ 2006	Restated ⁴ 2005
Sales ¹	£5,327m	£4,615m	£4,660m
EBITA ²	£456m	£342m	£261m
Return on sales	8.6%	7.4%	5.6%
Cash inflow ³	£807m	£449m	£441m
Order intake ¹	£9,091m	£5,178m	£4,186m
Order book ¹	£20.9bn	£17.0bn	£16.8bn

Key points

- RAF Typhoons now operational
- Full six ship Type 45 destroyer contract awarded
- Launch of first of class Astute submarine
- Orders received for second and third Astute Class submarines
- Offshore Patrol Vessel arbitration settled

Looking forward

The future of Programmes & Support is linked to MoD funding in order to meet current UK armed forces operational requirements and delivery of the Defence Industrial Strategy.

In the air sector, short-term growth is dependent both upon production execution and in-service support performance in the UK and on export deliveries.

The naval sector expects the creation of the joint venture, BVT Surface Fleet Limited. Growth prospects for the joint venture include the UK's Future Carrier (CVF) programme and the Military Afloat Reach and Sustainability programme. The six ship Type 45 programme underpins the business for the next few years.

The Submarines business is focused on the Astute programme and securing concept design work on the Future Submarine programme. Securing orders for Astute Boats 4 to 7 is key in retaining the necessary skill base in order to design and build the next generation nuclear deterrent submarine.

During 2007, Programmes & Support achieved EBITA² of £456m (2006 £342m) on sales¹ of £5,327m (2006 £4,615m) and generated an operating cash inflow³ of £807m (2006 £449m).

Return on sales benefited by 0.8% arising from one-off gains recorded in the first half of 2007, including completion of the Offshore Patrol Vessel arbitration process.

Order intake includes the appropriate work share of the award of the Saudi Typhoon contract.

Military Air Solutions

Military Air Solutions is responsible for delivering five major programmes: Typhoon, Hawk, Nimrod MRA4, F-35 Lightning II (Joint Strike Fighter), and Autonomous Systems & Future Capability. In addition, it is responsible for through-life support for these programmes as well as for the UK's Royal Air Force (RAF) fleets of Harrier, Tornado, Nimrod MR2 and VC-10 aircraft.

The business made strong progress during 2007; both on delivering its programme commitments and working in partnership with its customers to enhance their military capability. Work continues towards the creation of an air sector Long-Term Partnering Agreement (LTPA) as envisaged in the Defence Industrial Strategy, published in December 2005. A foundation contract, setting out the partnering principles and providing a framework for detailed negotiations, was agreed in March. This has enabled the Group to generate a shared view of the business and is helping to direct investment.

Delivery of Typhoon aircraft to the four partner nations continues with a total of 53 aircraft delivered to the UK and 84 across the other European partner nations as at 31 December 2007. Five of the 15 contracted aircraft for Austria were also delivered during the year.

In the UK, RAF Typhoons are operational in air defence and Quick Reaction Alert roles. Discussions to establish long-term integrated logistics support contracts are progressing well. Tranche 2 aircraft are now in final assembly with the first delivery planned for 2008. Work has also commenced on further air-to-ground capability enhancements.

Good progress is being made on development and production of the UK RAF Hawk Advanced Jet Trainer, where the first production aircraft is now structurally complete.

On the Hawk contract for India, ten aircraft have been accepted by the customer during the year. Twenty Hawk aircraft for South Africa have been delivered, with the remaining aircraft due for delivery in the first half of 2008. In March, the 200th T-45 Goshawk aircraft was delivered to the US Navy and the ongoing T-45 production programmes continue to schedule.

The Nimrod MRA4 aircraft development programme is progressing and the production programme continues to perform to the contractual milestones. A Stability Augmentation System has now been embodied into the aircraft.

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4 restated following changes to the Group's organisational structure

The support contracts for the VC-10 and Nimrod MR2 aircraft continue and VC-10 fleet maintenance has now been extended to 2013.

The Tornado availability programme, ATTAC, is fully effective and a contract expansion has been agreed. This increases the scope of ATTAC to include the remaining areas of the Tornado aircraft.

The Harrier GR9 aircraft has transitioned successfully into service. Harrier has supported UK military operations with high recognition for the capability it is providing.

Military Air Solutions is partnered with Lockheed Martin and Northrop Grumman on the F-35 Lightning II programme, with responsibility for the design and manufacture of the rear fuselage, empennage and delivery of a number of key aircraft systems. Three aircraft variants are in development; Carrier, Conventional Take-Off and Landing (CTOL) and Short Take-Off and Vertical Landing (STOVL). The Carrier variant completed its final Critical Design Review successfully in June and manufacture and assembly has now commenced. All three aircraft variants are now in various stages of manufacture and assembly.

Successful trials of a highly autonomous medium-altitude long-endurance unmanned air system, HERTI, took place in 2007.

The Taranis unmanned combat air vehicle technology demonstration programme continues on plan and to cost with the first metal cut of the demonstration vehicle in September. Taranis is a key enabler to the UK MoD's evaluation of future capability requirements.

In-country flight testing of the first South African Gripen is proceeding to plan.

Surface Fleet Solutions

In August, the Type 45 six ship contract was signed, capturing the remaining scope of work to complete all six destroyers and establishing a jointly managed risk profile against a robust schedule, that met the MoD's cost aspirations.

The second and third ships, Dauntless and Diamond, were launched in January and November 2007 respectively, whilst the first of class, HMS Daring, commenced sea trials in July.

The final vessel of the Bay Class Landing Ship Dock (Auxiliary), RFA Lyme Bay, was handed over to the customer in June – two months ahead of the contract date.

Two of the three ex-Royal Navy Type 23 frigates for the Chilean Navy completed their reactivation and were delivered to the customer. The third ship is planned to be handed over to the Chilean Navy in May 2008.

The CVF programme passed the UK MoD Main Gate Review in 2007. Contracts for the manufacturing phase are now in the final stages of negotiation.

The arbitration process in respect of the Offshore Patrol Vessels was settled and title to all three vessels transferred to the customer in April 2007.

The naval joint ventures continue to perform to plan. Upon creation of the new maritime sector Joint Venture, BVT Surface Fleet Limited, BAE Systems will sell its share of Flagship Training Limited to VT Group, and Fleet Support Limited will become wholly owned by BVT Surface Fleet Limited.

Submarine Solutions

The first of class boat, HMS Astute, was launched in June 2007 and has completed Trim & Basin Trials successfully. The boat is on schedule for delivery to the November 2008 contracted date. Construction activities on Boats 2 and 3 are also progressing well. Agreement of pricing of Boats 2 and 3 was reached and an order received to allow the start of production on Boat 4.

Integrated System Technologies (Insyte) and Underwater Systems

The Sampson Radar, the Combat Management System and Long Range Radar programmes for the Type 45 destroyers continue to meet all key milestones. The first of class radar has been successfully installed onto HMS Daring.

The Seawolf Mid-Life Update Tracker completed all of its trials at the shore-based facility, HMS Collingwood.

The Falcon programme continues to progress to schedule and will provide the UK Armed Forces with a new tactical communications network, providing a secure information infrastructure capability.

The Sting Ray lightweight torpedo main production order remains on schedule with the third batch accepted in October 2007.

The Archerfish mine disposal system has successfully passed initial qualification trials as the Common Neutraliser for sea mines with the US Navy.

Talisman, the company-funded Unmanned Underwater Vehicle, has been developed further, reducing the size, unit cost and the underwater drag while retaining the payload capacity. It has undertaken exercises with the US Navy.

International Businesses

The International Businesses business group, with 15,300 employees¹, comprises the Group's businesses in Saudi Arabia and Australia, together with a 37.5% interest in the pan-European MBDA joint venture and a 20.5% interest in Saab of Sweden.

Financial highlights

- Sales¹ increased by 1%, net of 2006 Atlas disposal
- Return on sales increased to 13.0%
- Cash flow³ generation of £678m, including Saudi Typhoon milestones

	2007	Restated ⁴ 2006	Restated ⁴ 2005
Sales ¹	£3,359m	£3,428m	£3,138m
EBITA ²	£435m	£415m	£400m
Return on sales	13.0%	12.1%	12.7%
Cash inflow ³	£678m	£171m	£711m
Order intake ¹	£3,876m	£3,854m	£3,235m
Order book ¹	£7.9bn	£7.1bn	£6.7bn

Key points

- Saudi Typhoon contract secured
- Investment in the Kingdom of Saudi Arabia continues
- Down-selection for the provision of vehicles for the Australian Defence Force
- Proposed acquisition of Tenix Defence announced in January 2008

Looking forward

The Group seeks to sustain its long-term presence in the Kingdom of Saudi Arabia through delivering on current support and investment commitments, and developing new business, and to reinforce its business in Australia as through-life capability partner to the Australian Defence Force, including land sector support.

In January 2008 the Group announced its proposed acquisition of Tenix Defence which will, on completion, be integrated with BAE Systems' Australian operations.

During 2007, International Businesses achieved EBITA² of £435m (2006 £415m) on sales¹ of £3,359m (2006 £3,428m) and generated an operating cash inflow³ of £678m (2006 £171m).

Sales¹ and EBITA² in 2006 included £99m and £2m respectively for the Atlas Elektronik business that was disposed of in August 2006.

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. Over the last two decades the programme has included the provision of aircraft, associated hardware, support, infrastructure and manpower training for the Royal Saudi Air Force (RSAF) and Royal Saudi Naval Force (RSNF). Progress is being made on modernising the Saudi armed forces in line with the Understanding Document signed on 21 December 2005 between the UK and Saudi Arabian governments. Under the terms of the signed document, Typhoon aircraft will replace Tornado Air Defence Variant aircraft and others currently in service with the RSAF. A contract for the delivery of 72 Typhoon aircraft was agreed in the year with delivery of the first aircraft scheduled for June 2009. Discussions are ongoing with the RSAF to define and agree the support and training solutions to enable their entry into service during 2009.

Around 4,300 people are employed by the Group in the Kingdom of Saudi Arabia, of whom approximately half are Saudi nationals. The business is continuing to develop its presence in Saudi Arabia, including the relocation of staff from the UK, and is helping to develop a greater indigenous capability in the Kingdom.

The security of employees is the highest priority and progress is well advanced on new residential and office facilities as well as increased security measures. Employees are in occupation at the first new residential compound and office facility.

Through the core Saudi support programme, the business continues to provide significant support to both the RSAF and RSNF operations and their operational capability. In particular, steps are being taken with the RSAF to maintain the capability of the Tornado aircraft while extending its operational life.

BAE Systems investment and support for infrastructure development in the Kingdom of Saudi Arabia includes the creation of training and youth welfare programmes.

In December 2007, the first 22 RSAF Tornado Technicians to undertake a new 'multi-skilled training programme', graduated. The programme, designed in partnership with the RSAF, is aimed at producing multi-skilled, rather than single-skilled, aircraft technicians.

BAE Systems also makes valuable contributions to the communities in Saudi Arabia. Youth sports partnership activities between Saudi Arabia and the United Kingdom began in 1987 with a formal Memorandum of Understanding on sports exchange. Since that time, 1,000 Saudi coaches have successfully undertaken Sports Coach UK qualification

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courses. In addition, national team training camps in a range of sports have taken place annually in both Saudi Arabia and the UK.

Australia

BAE Systems Australia continues to reinforce its position as a through-life capability partner to the Australian Defence Force (ADF). Work has commenced on the Electronic Support Measures mid-life upgrade on the AP-3C aircraft, and continues under the second five-year support contract for the Australian Hawk Lead-In Fighter aircraft.

A five-year support contract, with two five-year options, has been agreed with the ADF for the ongoing upgrade, operation and support of the Jindalee over-the-horizon radar. The Nulka active missile decoy has received export approval in principle from both the US and Australian authorities. To date the Nulka active missile decoy has been fitted to over 100 ships across the Australian, Canadian and US navies.

BAE Systems has recently been down-selected by the Australian Government to provide medium/heavy capability vehicles to replace the Army's wheeled tactical logistic vehicle fleet.

The business is a subcontractor to Boeing on the Wedgetail airborne, early warning and control system for the Royal Australian Air Force. The programme is behind schedule and BAE Systems is engaged jointly with Boeing and the customer to re-baseline the programme.

Saab (20.5% shareholding)

Sales rose by 9.5% to SEK23bn (£1.7bn), with export sales accounting for 65%. Operating income rose to SEK2,607m (£193m), including non-recurring items of SEK453m (£34m) producing an operating margin of 11.3%. Although reduced in comparison with 2006, order intake remained strong at SEK20.8bn (£1.5bn). This included orders from FMV to upgrade 31 Gripen fighters and helmet mounted displays, from the Royal Australian Navy for combat and fire control management systems, from Tenix Marine for combat management systems on Australian Navy's landing helicopter dock class ships and from the Royal Netherlands Army for a Mobile Battalion Combat Training Centre.

Saab's order book at the end of the year was SEK47.3bn (£3.7bn) which included a reduction for the Pakistan airborne surveillance system being re-negotiated to supply fewer systems than was originally recorded in 2006.

MBDA (37.5% interest)

MBDA continued to maintain strong deliveries across a number of key programmes. Key domestic deliveries included the Brimstone air-launched anti-armour weapon, Mica air-to-air missile, Storm Shadow, SCALP and Taurus cruise missiles. While in the export market key deliveries included air weapons packages to Greece and UAE and Aster and Rapier short-range air defence missiles.

Development programmes also progressed well. The six-nation Meteor beyond visual range air-to-air missile continues to meet its development milestones with the successful completion of the four key development milestones and a continuing active firing campaign.

The Principal Anti-Air Missile System (PAAMS) programme for the Royal Navy is now entering firing trials in preparation for qualification while the tri-national MEADS area defence system is preparing for the critical design review phase.

MBDA is leading negotiations towards the Team Complex Weapons strategic partnering agreement under the UK's Defence Industrial Strategy.

During 2007 MBDA acquired the German rocket motor company Bayern Chemie GmbH, supplier of the ramjet for the Meteor missile.

HQ & Other Businesses, with 1,800 employees¹, comprises the regional aircraft asset management and support activities, head office and UK shared services activity, including research centres and property management.

Financial highlights and key points

- Agreements reached with the majority of reinsurers under the Group's Financial Risk Insurance Programme (FRIP)
- Regional Aircraft fleet valuation methodology changed

	2007	2006	2005
Sales ¹	£243m	£295m	£471m
EBITA ²	£(155)m	£(147)m	£(118)m
Cash inflow/(outflow) ³	£181m	£(225)m	£(79)m
Order intake ¹	£345m	£267m	£398m
Order book ¹	£0.4bn	£0.3bn	£0.6bn

Looking forward

The leasing market for BAE Systems aircraft continues to remain challenging, with new markets likely to be dominated by higher risk customers. Support revenues are expected to remain stable but are dependent on maintaining aircraft in service. Following the charges taken in 2007 against the carrying value of the assets, future losses are expected to be reduced.

During 2007, HQ & Other Businesses reported a loss of £155m (2006 loss £147m) on sales¹ of £243m (2006 £295m) and had an operating cash inflow³ of £181m (2006 outflow £225m). Of this, the reported loss for Regional Aircraft was £101m (2006 loss £114m) with operating cash inflow of £175m (2006 outflow £66m).

The reduction in sales when compared with 2006 was due to the disposal in March 2006 of the Aerostructures business.

During the period the Regional Aircraft leasing team made significant progress securing leases for 64 aircraft, including Avro RJ Jets to CityJet of Ireland, Blue1 of Denmark and British Airways. The market continues to be challenging. Compared with last year, revenues remained stable. A freighter conversion programme for the 146 Jet was launched after the success of a similar programme for the ATP fleet.

Much of the leasing business was underpinned by the Group's Financial Risk Insurance Programme (FRIP) which makes good shortfalls in actual lease income against originally estimated future income for a 15 year period from 1998 to 2013. Since 2006, BAE Systems and certain of the reinsurers have been in dispute over several areas of the policy. During 2007, agreement was reached with almost all reinsurers and settlements have been paid by them based on the net present value of estimated future claims. Arbitration proceedings now continue with one remaining reinsurer.

The Regional Aircraft loss for the year includes net charges of £76m (2006 £77m) against the carrying value of the assets of the business of which £61m was taken in the first half year. These charges include the effect of a change to the Group's aircraft valuation methodology and will reduce the future depreciation charged on these aircraft.

A gain of £44m was recorded in respect of the disposal of the Group's 50% interest in the Xchanging Procurement Services and Xchanging HR Services joint ventures.


A charge of £35m was taken for an onerous lease provision following the sublease of two vacated buildings at the Group's Farnborough site.

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The first of class Type 45 destroyer, HMS Daring, successfully completed her stage one sea trials on schedule in August 2007.

Consolidated income statement

for the year ended 31 December

	Notes	2007 £m	Total 2007 £m	2006 £m	Total 2006 £m
Continuing operations					
Combined sales of Group and equity accounted investments			15,710		13,765
Less: share of equity accounted investments			(1,401)		(1,432)
Revenue			14,309		12,333
Operating costs			(13,480)		(11,763)
Other income			209		371
<i>Group operating profit excluding amortisation and impairment of intangible assets</i>		1,335		1,080	
<i>Amortisation</i>		(149)		(105)	
<i>Impairment</i>		(148)		(34)	
Group operating profit			1,038		941
<i>Share of results of equity accounted investments excluding finance costs and taxation expense</i>		142		127	
<i>Financial income of equity accounted investments</i>		35		21	
<i>Taxation expense of equity accounted investments</i>		(38)		(35)	
Share of results of equity accounted investments	6		139		113
<i>Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA)</i>		1,477		1,207	
<i>Amortisation</i>		(149)		(105)	
<i>Impairment</i>		(148)		(34)	
<i>Financial income of equity accounted investments</i>		35		21	
<i>Taxation expense of equity accounted investments</i>		(38)		(35)	
Operating profit			1,177		1,054
Finance costs	2				
Financial income		1,257		1,330	
Financial expense		(1,199)		(1,525)	
			58		(195)
Profit before taxation			1,235		859
Taxation expense	3				
UK taxation		(201)		(97)	
Overseas taxation		(134)		(116)	
			(335)		(213)
Profit for the year from continuing operations			900		646
Profit for the year from discontinued operations	4		22		993
Profit for the year			922		1,639
Attributable to:					
BAE Systems shareholders			901		1,636
Minority interests			21		3
			922		1,639
Earnings per share					
	5				
Continuing operations:					
Basic earnings per share			26.0p		19.9p
Diluted earnings per share			25.8p		19.8p
Discontinued operations:					
Basic earnings per share			0.6p		30.8p
Diluted earnings per share			0.6p		29.4p
Total:					
Basic earnings per share			26.6p		50.7p
Diluted earnings per share			26.4p		49.2p

Consolidated balance sheet

as at 31 December

	Notes	2007 £m	2006 £m
Non-current assets			
Intangible assets		9,559	7,595
Property, plant and equipment		1,774	1,746
Investment property		113	123
Equity accounted investments	6	781	671
Other investments		6	11
Other receivables		322	569
Other financial assets		48	51
Deferred tax assets		567	1,077
		13,170	11,843
Current assets			
Inventories		701	395
Trade and other receivables including amounts due from customers for contract work		2,933	2,253
Current tax		35	3
Other investments		164	503
Other financial assets		101	50
Cash and cash equivalents		3,062	3,100
		6,996	6,304
Non-current assets and disposal groups held for sale		94	–
		7,090	6,304
Total assets		20,260	18,147
Non-current liabilities			
Loans		(2,197)	(2,776)
Trade and other payables		(413)	(465)
Retirement benefit obligations	7	(1,629)	(2,499)
Other financial liabilities		(26)	(45)
Deferred tax liabilities		(40)	(15)
Provisions		(399)	(271)
		(4,704)	(6,071)
Current liabilities			
Loans and overdrafts		(299)	(334)
Trade and other payables		(8,245)	(6,717)
Other financial liabilities		(71)	(50)
Current tax		(499)	(417)
Provisions		(410)	(424)
		(9,524)	(7,942)
Liabilities directly associated with disposal groups held for sale		(30)	–
		(9,554)	(7,942)
Total liabilities		(14,258)	(14,013)
Net assets		6,002	4,134
Capital and reserves			
Issued share capital	9	90	81
Share premium	9	1,222	841
Equity option of convertible preference shares	9	–	76
Other reserves	9	4,631	4,330
Retained earnings	9	23	(1,211)
Total equity attributable to equity holders of the parent		5,966	4,117
Minority interests	9	36	17
Total equity		6,002	4,134

Approved by the Board on 20 February 2008 and signed on its behalf by:

M J Turner G W Rose
Chief Executive Group Finance Director

Consolidated cash flow statement

for the year ended 31 December

	Notes	2007 £m	2006 £m
Profit for the year from continuing operations		900	646
Profit for the year from discontinued operations		22	993
Profit for the year		922	1,639
Taxation expense – continuing operations		335	213
Taxation expense – discontinued operations		-	4
Share of results of equity accounted investments – continuing operations	6	(139)	(113)
Share of results of equity accounted investments – discontinued operations		-	(70)
Net finance costs – continuing operations		(58)	195
Net finance costs – discontinued operations		-	(2)
Depreciation, amortisation and impairment		610	422
Loss/(gain) on disposal of property, plant and equipment		3	(60)
Gain on disposal of investment property		(47)	(84)
Gain on disposal of non-current other investments		(8)	-
Gain on disposal of businesses – continuing operations		(40)	(13)
Gain on disposal of businesses – discontinued operations		(22)	(925)
Impairment of other investments		-	2
Cost of equity-settled employee share schemes		34	21
Movements in provisions		52	47
Decrease in liabilities for retirement benefit obligations		(233)	(834)
(Increase)/decrease in working capital:			
Inventories		(188)	28
Trade and other receivables		(271)	(187)
Trade and other payables		1,212	495
Cash inflow from operating activities		2,162	778
Interest paid		(224)	(315)
Interest element of finance lease rental payments		(6)	(11)
Taxation paid		(112)	(85)
Net cash inflow from operating activities		1,820	367
Dividends received from equity accounted investments – continuing operations		78	57
Dividends received from equity accounted investments – discontinued operations		-	88
Interest received		175	139
Purchases of property, plant and equipment		(307)	(419)
Purchases of intangible assets		(31)	(27)
Equity accounted investment funding		(4)	-
Proceeds from sale of property, plant and equipment		13	135
Proceeds from sale of investment property		53	174
Proceeds from sale of non-current other investments		15	1
Purchase of non-current other investments		(1)	(5)
Purchase of subsidiary undertakings	4,10	(1,731)	(12)
Net cash acquired with subsidiary undertakings	10	6	-
Purchase of equity accounted investments	10	(1)	(4)
Proceeds from sale of subsidiary undertakings	4,10	96	174
Cash and cash equivalents disposed of with subsidiary undertakings	10	(1)	(40)
Proceeds from sale of equity accounted investments	4,10	57	1,212
Proceeds from sale of Exchange Property		-	557
Net proceeds from sale/(purchase) of other deposits/securities		343	(468)
Net cash (outflow)/inflow from investing activities		(1,240)	1,562
Capital element of finance lease rental payments		(25)	(45)
Proceeds from issue of share capital	9	805	53
Purchase of treasury shares	9	(152)	(112)
Purchase of own shares	9	(50)	(12)
Equity dividends paid	11	(396)	(346)
Dividends paid to minority interests		(1)	-
Dividends paid on preference shares		(10)	(20)
Cash inflow from loans		-	66
Cash outflow from repayment of loans		(782)	(921)
Net cash outflow from financing activities		(611)	(1,337)
Net (decrease)/increase in cash and cash equivalents		(31)	592
Cash and cash equivalents at 1 January		3,074	2,491
Effect of foreign exchange rate changes on cash and cash equivalents		3	(9)
Cash and cash equivalents at 31 December		3,046	3,074
Comprising: Cash and cash equivalents		3,062	3,100
Overdrafts		(16)	(26)
Cash and cash equivalents at 31 December		3,046	3,074

Consolidated statement of recognised income and expense

for the year ended 31 December

	Notes	2007 £m	2006 £m
Currency translation on foreign currency net investments:			
Subsidiaries		(1)	(162)
Equity accounted investments	6	43	(26)
Amounts credited to hedging reserve		41	221
Net actuarial gains on defined benefit pension schemes:			
Subsidiaries		544	692
Equity accounted investments		24	72
Fair value movements on available-for-sale investments		5	–
Current tax on items taken directly to equity		96	21
Deferred tax on items taken directly to equity:			
Subsidiaries		(259)	(227)
Tax rate adjustment ¹		(19)	–
Equity accounted investments		(6)	(92)
Recycling of fair value movements on disposal of available-for-sale investments		(6)	–
Recycling of cumulative currency translation on disposal:			
Continuing operations		–	3
Discontinued operations		–	11
Recycling of cumulative net hedging reserve on disposal – discontinued operations		–	(448)
Net income recognised directly in equity		462	65
Profit for the year		922	1,639
Total recognised income and expense		1,384	1,704
Attributable to:			
Equity shareholders		1,363	1,701
Minority interests		21	3
		1,384	1,704

1 The UK current tax rate will be reduced from 30% to 28% with effect from 1 April 2008. In line with this change, the rate applying to UK deferred tax assets and liabilities has also been reduced from 30% to 28%, creating a rate adjustment, which is 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 2007 the Group has adopted IFRS 7, Financial Instruments: Disclosures. This introduces new disclosures for financial instruments, but does not have any impact on the consolidated income statement or balance sheet.

The following amendments and interpretations to published standards are effective for accounting periods beginning on or after 1 January 2007:

- IFRIC 7, Applying the restatement approach under IAS 29;
- IFRIC 8, Scope of IFRS 2;
- IFRIC 9, Reassessment of embedded derivatives;
- IFRIC 10, Interim financial reporting and impairment; and
- Amendment to IAS 1, Presentation of financial statements – capital disclosures.

None of these have any significant 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. Finance costs

	2007 £m	2006 £m
Interest income	169	143
Net present value adjustments	21	39
Expected return on pension scheme assets	845	739
Net gain on remeasurement of financial instruments	135	259
Net gain on remeasurement of embedded derivatives	-	3
Gain on sale of available-for-sale investments	6	-
Foreign exchange gains	81	147
Financial income	1,257	1,330
Interest expense:		
On bank loans and overdrafts	(4)	(9)
On finance leases	(6)	(11)
On bonds and other financial instruments	(218)	(277)
On preference debt	(13)	(28)
	(241)	(325)
Facility fees	(4)	(4)
Net present value adjustments	(22)	(31)
Interest charge on pension scheme liabilities	(753)	(694)
Net loss on remeasurement of investments at fair value through profit or loss	-	(42)
Net loss on remeasurement of financial instruments at fair value through profit or loss	(77)	(172)
Foreign exchange losses	(102)	(257)
Financial expense	(1,199)	(1,525)
Net finance costs	58	(195)

2. Finance costs (continued)

Additional analysis of finance costs

	2007 £m	2006 £m
Net finance costs – Group	58	(195)
Net finance costs – share of equity accounted investments	35	21
	93	(174)
Analysed as:		
Net interest:		
Interest income	169	143
Interest expense	(241)	(325)
Facility fees	(4)	(4)
Net present value adjustments	(1)	8
Gain on sale of available-for-sale investments	6	–
Share of equity accounted investments	33	21
	(38)	(157)
Other finance costs:		
Group:		
Net financing credit on pensions	92	45
Other	37	(62)
Share of equity accounted investments	2	–
	93	(174)

3. Taxation expense

	2007 £m	2006 £m
Current taxation expense		
UK corporation tax		
Current tax	(140)	(91)
Double tax relief	29	35
Adjustment in respect of prior years	(21)	(93)
	(132)	(149)
Overseas tax charges		
Current year	(160)	(91)
Adjustment in respect of prior years	–	15
	(160)	(76)
	(292)	(225)
Deferred taxation expense		
UK		
Origination and reversal of temporary differences	(103)	25
Adjustment in respect of prior years	39	27
Tax rate adjustment ¹	(5)	–
Overseas		
Origination and reversal of temporary differences	22	(49)
Adjustment in respect of prior years	4	5
Attributable to recoverable deferred tax assets	–	4
	(43)	12
Taxation expense	(335)	(213)

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

Notes to the accounts (continued)

4. Acquisitions and disposals

Acquisitions

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

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

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

During 2006, the Group acquired 100% of the shares of National Sensor Systems, LLC. for £5m in cash and paid deferred consideration of £7m in respect of its acquisition, in May 2005, of OMC Group.

Disposals – continuing operations

On 17 January 2007, the Group completed the sale of its 50% shareholding interest in HR Enterprise Limited and its subsidiary, Xchanging HR Services Limited, (together 'XHRS') to HR Holdco Limited (a company within the Xchanging group) for a cash consideration of £10m.

On 6 March 2007, the Group completed the sale of its 50% shareholding interest in Xchanging Procurement Services (Holdco) Limited (XPS), to XUK Holdco (No.2) Limited (a company within the Xchanging group) for a cash consideration of £47m.

On 20 August 2007, the Group completed the sale of its Inertial Products business to investment affiliates of J. F. Lehman & Company, the US private equity firm, for a cash consideration of \$140m (£70m), subject to potential adjustment according to the level of working capital and net debt or net cash in the business at closing.

On 13 December 2007, the Group completed the sale of its Customer Training Centre (CTC) at Woodford, Manchester, UK, to Flight Academy UK Limited for a cash consideration of £6m.

Profit on disposal of businesses of £48m comprises the disposals of XHRS (£nil), XPS (£44m) and CTC (£4m).

Loss on disposal of businesses of £8m comprises the disposals of Inertial Products (£6m) and the TEMPEST products business (£2m).

Disposals – discontinued operations

On 30 March 2007, the sale of the Group's remaining 25% interest in SELEX Sensor and Airbourne Systems SpA (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.

The results from discontinued operations, which have been included in the consolidated income statement, are shown below. The results for the year ended 31 December 2006 include the results of Airbus SAS for the period to disposal on 13 October 2006.

	2007 £m	2006 £m
Revenue	-	-
Expenses	-	-
EBITA ¹	-	-
Share of results of equity accounted investments excluding finance costs and taxation expense	-	144
Finance costs of equity accounted investments	-	(25)
Taxation expense of equity accounted investments	-	(49)
Share of results of equity accounted investments	-	70
Financial income, net	-	2
Profit before taxation	-	72
Taxation expense	-	(4)
Profit for the year	-	68
Profit on disposal of discontinued operations	22	925
Profit for the year from discontinued operations	22	993

Proceeds from the sale of subsidiary undertakings in the consolidated cash flow statement of £96m in 2007 comprise the disposals of Inertial Products (£70m), SELEX (£24m), CTC (£6m) and TEMPEST (£1m), less transaction costs (£5m).

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

5. Earnings per share

	2007				2006			
	£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	901		901		1,636		1,636	
Interest on the debt instrument of the convertible preference shares	-		13		-		28	
Profit for the year after adjusting for interest on the debt instrument of the convertible preference shares	901	26.6	914	26.4	1,636	50.7	1,664	49.2
Represented by:								
Continuing operations	879	26.0	892	25.8	643	19.9	671	19.8
Discontinued operations	22	0.6	22	0.6	993	30.8	993	29.4
Add back/(deduct):								
Net financing credit on pensions, post tax	(68)		(68)		(33)		(33)	
Uplift on acquired inventories, post tax	9		9		-		-	
Market value movements on derivatives, post tax	(29)		(29)		55		55	
Amortisation and impairment of intangible assets, post tax	110		110		79		79	
Impairment of goodwill	148		148		32		32	
Underlying earnings	1,071	31.6	1,084	31.3	1,769	54.9	1,797	53.1
Represented by:								
Continuing operations	1,049	31.0	1,062	30.7	767	23.8	795	23.5
Discontinued operations	22	0.6	22	0.6	1,002	31.1	1,002	29.6
	1,071	31.6	1,084	31.3	1,769	54.9	1,797	53.1
Underlying earnings excluding profit on disposal of Airbus SAS (2006 £925m)					844	26.2	872	25.8
Represented by:								
Continuing operations					767	23.8	795	23.5
Discontinued operations					77	2.4	77	2.3
					844	26.2	872	25.8
		Millions		Millions		Millions		Millions
Weighted average number of shares used in calculating basic earnings per share		3,386		3,386		3,225		3,225
Add:								
Incremental shares in respect of employee share schemes				24				32
Incremental shares in respect of convertible preference shares				56				125
Weighted average number of shares used in calculating diluted earnings per share				3,466				3,382

Underlying earnings per share is presented in addition to that required by IAS 33 Earnings per share as 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)**6. Equity accounted investments****Carrying value of equity accounted investments**

	Share of net assets £m	Purchased goodwill £m	Carrying value £m
At 1 January 2006	317	1,404	1,721
Share of results after tax – continuing operations	113	–	113
Share of results after tax – discontinued operations	70	–	70
Acquired through acquisition	(62)	66	4
Reclassified from intangible assets	–	28	28
Disposal	(239)	(1,063)	(1,302)
Dividends	(145)	–	(145)
Market value adjustments in respect of derivative financial instruments, net of tax	144	–	144
Actuarial gains on defined benefit pension schemes, net of tax	59	–	59
Revaluation of net assets acquired by equity accounted investments ¹	5	–	5
Foreign exchange adjustment	(24)	(2)	(26)
At 31 December 2006	238	433	671
Share of results after tax – continuing operations	139	–	139
Acquired through acquisition	1	–	1
Adjustment to provisional fair values	3	(3)	–
Disposal	(10)	–	(10)
Dividends	(78)	–	(78)
Market value adjustments in respect of derivative financial instruments, net of tax	(2)	–	(2)
Actuarial gains on defined benefit pension schemes, net of tax	17	–	17
Foreign exchange adjustment	13	30	43
At 31 December 2007	321	460	781

1 The revaluation gain in 2006 arose as a result of MBDA SAS acquiring control of LFK GmbH, which was previously accounted for as a trade investment. The £5m gain reflects a fair value uplift in respect of the carrying value of the original investment. The gain is reflected as a credit to equity (note 9).

Included within purchased goodwill is £110m (2006 £113m) relating to the goodwill arising on acquisitions made by the Group's equity accounted investments subsequent to their acquisition by the Group.

The market value of the Group's shareholding in Saab AB at 31 December 2007 was £225m (2006 £350m).

7. Retirement benefit obligations

Amounts recognised on the balance sheet

	2007				2006			
	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	(1)	(97)	(13)	(111)	–	(80)	(15)	(95)
Present value of funded obligations	(15,099)	(1,912)	(103)	(17,114)	(15,445)	(1,931)	(111)	(17,487)
Fair value of plan assets	13,192	1,918	95	15,205	12,579	1,710	91	14,380
Total IAS 19 deficit, net	(1,908)	(91)	(21)	(2,020)	(2,866)	(301)	(35)	(3,202)
Allocated to equity accounted investments and other participating employers ¹	450	–	–	450	774	–	–	774
Group's share of IAS 19 deficit, net	(1,458)	(91)	(21)	(1,570)	(2,092)	(301)	(35)	(2,428)
Group's share of IAS 19 deficit of equity accounted investments	(49)	–	–	(49)	(83)	–	–	(83)
Represented by:								
Pension prepayments (within trade and other receivables)	14	32	13	59	35	25	11	71
Retirement benefit obligations	(1,472)	(123)	(34)	(1,629)	(2,127)	(326)	(46)	(2,499)
Group's share of IAS 19 deficit, net	(1,458)	(91)	(21)	(1,570)	(2,092)	(301)	(35)	(2,428)

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.

8. Aircraft financing contingent liabilities

Included within provisions is an exposure of £70m as discussed below:

	2007 £m	2006 £m
Potential future cash flow payments in respect of aircraft financing obligations	134	191
Anticipated aircraft values	(55)	(159)
Adjustments to net present values	(9)	(5)
Net exposure provided	70	27

The Group has provided residual value guarantees (RVGs) in respect of certain commercial aircraft sold. At 31 December 2007 the Group's exposure to make future payments in respect of these arrangements was £134m (2006 £191m). The Group's net exposure to these guarantees is covered by the provisions held and the residual values of the related aircraft.

The net exposure has increased during the year as a result of the re-assessment of anticipated aircraft values and the settlement of the commitments of six RVGs.

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.

Notes to the accounts (continued)

9. 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 2006	80	782	78	4,720	(2,872)	2,788	16	2,804
Total recognised income and expense	–	–	–	(476)	2,177	1,701	3	1,704
Share-based payments ¹	–	–	–	–	46	46	–	46
Share options:								
Proceeds from shares issued	1	52	–	–	–	53	–	53
Purchase of own shares by ESOP	–	–	–	–	(12)	(12)	–	(12)
Conversion of preference shares	–	7	(2)	6	(6)	5	–	5
Purchase of treasury shares	–	–	–	–	(112)	(112)	–	(112)
Release of unrealised gain on the sale of Atlas Elektronik	–	–	–	(11)	–	(11)	–	(11)
Revaluation of net assets acquired by equity accounted investments (note 6)	–	–	–	–	5	5	–	5
Reclassification	–	–	–	91	(91)	–	–	–
Other	–	–	–	–	–	–	(2)	(2)
Ordinary share dividends	–	–	–	–	(346)	(346)	–	(346)
At 31 December 2006	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

Other reserves includes a merger reserve of £4,589m (2006 £4,589m), a statutory reserve of £202m (2006 £202m), a translation reserve of £217m debit (2006 £259m debit) and a hedging reserve of £57m (2006 £27m). 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.

1 The credit in respect of share-based payments for the year ended 31 December 2006 comprises £21m in respect of equity-settled share-based payment schemes, £21m relating to a change in the terms of certain share-based payment schemes from cash-settled to equity-settled and £4m relating to discontinued operations.

10. Cash flows in relation to acquisitions and disposals

	Subsidiaries							Equity accounted investments		
	Armor Holdings £m	Other acquisitions ¹ £m	Total acquisitions £m	Inertial Products £m	SELEX £m	Other disposals ¹ £m	Total disposals £m	XPS/XHRS £m	Other £m	Total £m
Cash (consideration)/proceeds	(1,696)	(9)	(1,705)	65	24	7	96	57	(1)	(1,553)
Transaction costs incurred by acquiree	(26)	–	(26)	–	–	–	–	–	–	(26)
	(1,722)	(9)	(1,731)	65	24	7	96	57	(1)	(1,579)
Cash and cash equivalents net of overdrafts acquired/(disposed)	6	–	6	(1)	–	–	(1)	–	–	5
Acquisitions and disposals	(1,716)	(9)	(1,725)	64	24	7	95	57	(1)	(1,574)
Debt acquired on acquisition of subsidiary	(538)	–	(538)	–	–	–	–	–	–	(538)
	(2,254)	(9)	(2,263)	64	24	7	95	57	(1)	(2,112)

1 other acquisitions and disposals are described in note 4

11. Dividends

	2007 £m	2006 £m
Equity dividends		
Prior year final 6.9p dividend per ordinary share paid in the year (2006 6.3p)	221	203
Interim 5.0p dividend per ordinary share paid in the year (2006 4.4p)	175	143
	396	346

After the balance sheet date, the directors proposed a final dividend of 7.8p (2006 6.9p). The dividend, which is subject to shareholder approval, will be paid on 2 June 2008 to shareholders registered on 18 April 2008. The ex-dividend date is 16 April 2008.

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 9 May 2008.

12. Events after the balance sheet date

In January 2008, BAE Systems entered into an agreement to acquire Tenix Defence, a leading Australian defence contractor, for up to A\$775m (£342m) in cash. The acquisition of Tenix Defence will more than double BAE Systems' presence in Australia making it the largest in-country defence supplier to the Australian Defence Force.

13. Annual General Meeting

This year's Annual General Meeting will be held on 7 May 2008. 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 2008.

14. Other information

The financial information for the years ended 31 December 2007 and 31 December 2006 contained in this preliminary announcement was approved by the Board on 20 February 2008. 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 2006 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2007 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.

BAE Systems

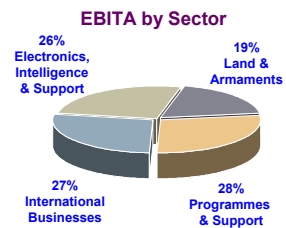
2007 Preliminary Results

21 February 2008



Overview - 2007

- **Company performing well**
- **Consistently applied strategy**
- **Successful transition**
 - recovery to sustainable growth
- **Excellent future visibility**
 - large order book
 - appropriate terms of trade
 - good programme execution
- **Strategy successfully differentiating us**
 - from other industries
 - from defence peers



Unrivalled breadth and balance of market position

UK businesses

- **Successfully establishing UK through-life business**
 - military air support successes
- **Air**
 - Tornado ATTAC
 - Typhoon Tranche 3 pricing underway
- **Land**
 - excellent UoR performance supporting UK forces
 - FRES uncertainty continues
- **Naval**
 - **Type 45**
 - second and third ships launched
 - successful sea trials
 - six ship pricing and contract secured
 - **Astute**
 - First of Class launched
 - 3 + boat pricing and contracts secured
 - **Naval sector consolidation opportunity**
 - CVF
 - joint venture with VT Group



Business planning assumptions anticipate continued difficult UK defence procurement environment

US businesses - Electronics Intelligence & Support

- **Electronics & Integrated Solutions**
 - Strong demand for Electronic Warfare systems continues
 - over 100 F-22 production EW system deliveries
 - first F-35 JSF production EW system deliveries
 - over 1,000 CMWS delivered
 - Thermal Weapon Sight production over 1,500 / month
 - New hybrid drive and power systems demonstrated
- **Customer Solutions**
 - Ship Repair contracts including DDG class Destroyers and San Antonio class amphibious dock ships
 - MTC Technologies acquisition announced
 - address substantial US readiness and sustainability market



BAE Systems - the 6th largest US defence supplier

US businesses - Land & Armaments

- **Strong underlying business performance**
 - Organic growth driven by tracked vehicle reset and upgrade
 - Higher activity from UK business
 - Acquisition of Armor Holdings in second half

- **Mine Protected Vehicle programmes**
 - Substantial MRAP order intake
 - Successful RG31, RG33 and Caiman production ramp
 - RG33 selected as basis for MMPV

- **Future programmes**
 - FCS tracked ground vehicle programmes - NLOS-C
 - FMTV medium utility vehicle programme
 - JLTV light utility vehicle bidding



BAE Systems - the leading global land systems business



Kingdom of Saudi Arabia

- **Investments in-Kingdom**
 - industrialisation plan
 - new compound build
 - management relocation

- **Modernisation programme underway**
 - Tornado support
 - Typhoon contract signed

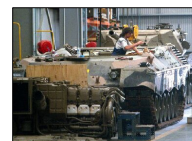


Other Home Markets

- **Sweden**
 - Danish and Dutch CV90 deliveries underway
- **South Africa**
 - RG31 vehicle exports
- **Australia**
 - Defence electronics
 - Through-life capability provision



- **A\$775m proposed acquisition of Tenix Defence**
- **Consistent with BAE Systems home market strategy**
- **Adds Naval and enhances Land systems capabilities in Australia**
- **Well positioned for provision of through-life support to ADF**
- **Expected to generate return in excess of cost of capital in first full year**



BAE Systems will become Australia's largest defence company

Top Ten Objectives - 2007

1. Meet 2007 financial targets and set realistic/challenging longer term plans
2. Ensure continued quality application of our mandated business processes
3. Further enhance programme execution - schedule and cost performance
4. Continue to grow our US business
5. Continue to implement the UK Defence Industrial Strategy
6. Progress business and investment in the Kingdom of Saudi Arabia
7. Develop export opportunities from each of our home markets
8. Demonstrate commitment to working together across our global businesses
9. Maximise development and growth of existing and potential new home markets
10. Demonstrate leadership at all levels in our company

George Rose



Financial Highlights

• Sales - continuing	£15,710m
• Underlying EBITA - continuing *	£1,489m
• Underlying earnings per share - continuing **	31.0p
• Cash inflow from operating activities	£2,162m
• Net cash	£700m
• Order book	£38.6bn
• Dividend per share	12.8p



* earnings before amortisation and impairment of intangible assets, finance costs and taxation, and uplift in acquired inventories
 ** excluding amortisation and impairment of intangible assets, non-cash finance movements, and uplift in acquired inventories

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Income Statement

- Continuing Operations

	2007 Underlying	2006 Underlying	2007 Reported	2006 Reported
Sales	15,710	13,765	15,710	13,765
EBITA *	1,477	1,207	1,477	1,207
Profit in acquired inventories	12	-		
Underlying EBITA	1,489	1,207		
Finance Costs	93	(174)	93	(174)
(deduct) / add back: Pension Interest	(92)	(45)		
Mark to Market	(39)	62		
Underlying Finance Costs	(38)	(157)		
Amortisation/Impairment			(297)	(139)
Tax	(381)	(280)	(373)	(248)
Minority Interests	(21)	(3)		
Profit after Tax	1,049	767	900	646

* earnings before amortisation and impairment of intangible assets, finance costs and taxation

£ millions

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Balance Sheet

	31/12/07	31/12/06
Intangible fixed assets	9,559	7,595
Tangible fixed assets	1,887	1,869
Investments	787	678
Working capital	(5,481)	(4,598)
Retirement benefit obligations	(1,629)	(2,499)
Tax assets & liabilities	63	648
Financial assets & liabilities	52	6
Assets held for resale	64	-
Net cash	700	435
Net assets	6,002	4,134

£ millions

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Operating Business Cash Flow

	2007
Cash inflow from operating activities	2,162
Capital expenditure (net) & financial investment	(262)
Dividends from equity accounted investments	78
Operating business cash flow	1,978
Electronics, Intelligence & Support	302
Land & Armaments	10
Programmes & Support	807
International Businesses	678
HQ & Other Businesses	181
Operating business cash flow	1,978

£ millions

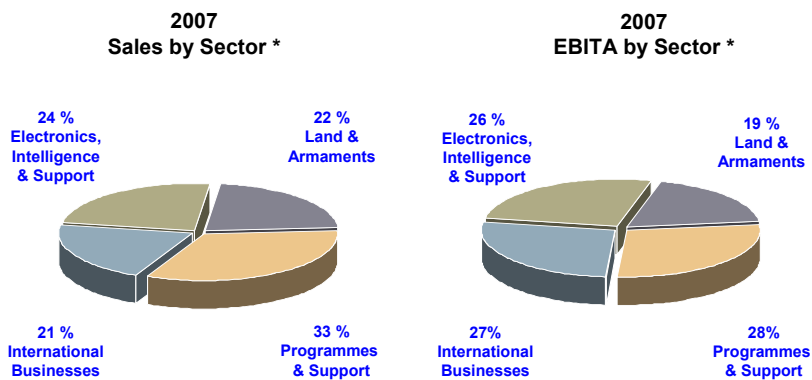
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Movement in Net Cash

	2007
Net Cash 31.12.06	435
Operating business cash flow	1,978
Interest, preference dividends and taxation	(177)
Equity dividends paid	(396)
Acquisitions & disposals	(2,112)
Net issue of equity shares	603
Preference share conversion	245
Foreign exchange	36
Movement in cash on customers' account	32
Other movements	56
Net Cash 31.12.07	700

£ millions
15

Business Groups



Strong performance – well balanced business

* excludes HQ & Other Businesses

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Electronics, Intelligence & Support

	2007	2006
Sales	\$7,838m	\$7,387m
EBITA	\$859m	\$790m *
Margin	11.0%	10.7% *
Order book	\$6.9bn	\$6.7bn
Cash flow	\$604m	\$503m



* includes \$113m pension accounting gain

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Land & Armaments

	2007	2006
Sales	\$7,082m	\$3,899m
EBITA	\$625m	\$310m
Underlying EBITA *	\$649m	\$310m
Underlying Margin	9.2%	7.9%
Order book	\$14.5bn	\$9.6bn
Cash flow	\$20m	\$253m



* earnings before amortisation and impairment of intangible assets, finance costs and taxation, and uplift in acquired inventories

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Programmes & Support

	2007	2006
Sales	£5,327m	£4,615m
EBITA	£456m	£342m
Margin	8.6%	7.4%
Order book	£20.9bn	£17.0bn
Cash flow	£807m	£449m



International Businesses

	2007	2006
Sales	£3,359m	£3,428m
EBITA	£435m	£415m
Margin	13.0%	12.1%
Order book	£7.9bn	£7.1bn
Cash flow	£678m	£171m



HQ & Other Businesses

	2007	2006
Sales	£243m	£295m
EBITA	£(155)m	£(147)m
Cash flow	£181m	£(225)m



Financial Summary

• Sales - continuing	£15,710m
• Underlying EBITA - continuing *	£1,489m
• Underlying earnings per share - continuing **	31.0p
• Cash inflow from operating activities	£2,162m
• Net cash	£700m
• Order book	£38.6bn
• Dividend per share	12.8p



* earnings before amortisation and impairment of intangible assets, finance costs and taxation, and uplift in acquired inventories

** excluding amortisation and impairment of intangible assets, non-cash finance movements, and uplift in acquired inventories

Mike Turner



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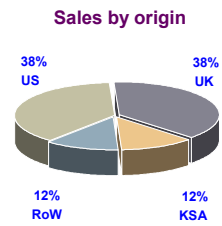
Top Ten Objectives - 2008

1. Meet 2008 financial targets and set challenging/realistic longer term plans
2. Develop partnering approach to meet customers' capability requirements
3. Ensure continued quality application of our mandated business processes
4. Further enhance programme execution - schedule and cost performance
5. Progress development of security capabilities in our home markets
6. Grow our US business including execution of planned investments
7. Progress industrialisation plan and further business in Kingdom of Saudi Arabia
8. Continue to implement the UK Defence Industrial Strategy
9. Progress export opportunities from each of our home markets
10. Continue to drive performance in Safety, Ethics and Diversity

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Summary

- The company is performing well
- Broad base of programmes and markets
- Benefiting from consistently applied strategy
 - Delivering performance now
 - Providing visibility to a strong outlook
- Further growth opportunities to exploit
 - Organic stretch
 - Acquisitions



Handouts

Electronics, Intelligence & Support

	2007	2006
Sales	£3,916m	£4,007m
EBITA	£429m	£429m *
Margin	11.0%	10.7% *
Order book	£3.5bn	£3.4bn
Cash flow	£302m	£273m



* includes £61m pension accounting gain

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Land & Armaments

	2007	2006
Sales	£3,538m	£2,115m
EBITA	£312m	£168m
Underlying EBITA *	£324m	£168m
Underlying Margin	9.2%	7.9%
Order book	£7.3bn	£4.9bn
Cash flow	£10m	£137m



* earnings before amortisation and impairment of intangible assets, finance costs and taxation, and uplift in acquired inventories

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Underlying Earnings per Share Continuing Operations

BAE SYSTEMS

	2007	2006
EBITA	1,477	1,207
- add back fair value on acquired inventories	12	-
	<u>1,489</u>	<u>1,207</u>
Interest	93	(174)
- exclude pension financing credit	(92)	(45)
- exclude market value movements on derivatives	(39)	62
	<u>(38)</u>	<u>(157)</u>
Tax	(373)	(248)
- impact of fair value on acquired inventories	(3)	-
- impact of pension financing credit	24	12
- impact of market value movements on derivatives	10	(16)
- exclude tax on intangibles	(39)	(28)
	<u>(381)</u>	<u>(280)</u>
Minority interests	(21)	(3)
Underlying earnings	<u>1,049</u>	<u>767</u>
Weighted average number of shares in issue	3,386	3,225
Underlying earnings per share	<u>31.0p</u>	<u>23.8p</u>

£ millions

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Retirement Benefit Obligations

BAE SYSTEMS

	2007
Deficit in defined benefit pension plans at 31.12.06	(3,167)
Decrease in liabilities due to changes in assumptions	952
Actual return on assets below expected returns	(156)
Contributions over service cost	290
Transfers arising on acquisitions	(22)
Other movements	104
Deficit in defined benefit pension plans at 31.12.07	<u>(1,999)</u>
US Healthcare plans	(21)
Total IAS 19 deficit	<u>(2,020)</u>
Allocated to EAls and other participating employers	450
Group's share of IAS 19 deficit * (pre-tax)	<u>(1,570)</u>
Group's share of IAS 19 deficit (post-tax)	<u>(1,048)</u>

* Balance Sheet classification : £59m within Receivables, £(1,629)m Retirement Benefit Obligations

£ millions

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Operating Cash Flow

BAE SYSTEMS

	2007
EBITA	1,477
Less share of equity accounted investments	(142)
Add depreciation & impairment	313
Gain on disposal of fixed assets & investments	(52)
Gain on disposal of businesses	(40)
Cost of equity-settled employee share schemes	34
Movements in retirement benefit obligations	(233)
Movements in provisions	52
Movements in inventories	(188)
Movements in trade and other receivables	(271)
Movements in trade and other payables	1,212
Cash inflow from operating activities	<u>2,162</u>

£ millions

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Working Capital Movements

Reconciliation to Cash Flow

BAE SYSTEMS

	31/12/07	31/12/06	Mvt	Acq/Dis *	F/X	Other	Cash Flow
Inventories (A)	701	395	(306)	119	3	(4)	(188)
Receivables - current	2,933	2,253					
Receivables - non-current	322	569					
Total receivables (B)	<u>3,255</u>	<u>2,822</u>	(433)	126	15	21	(271)
Payables - current	(8,245)	(6,717)					
Payables - non-current	(413)	(465)					
Total payables ** (C)	<u>(8,658)</u>	<u>(7,182)</u>	1,476	(209)	(47)	(8)	1,212
Liability provisions - current	(410)	(424)					
Liability provisions - non-current	(399)	(271)					
Total liability provisions (D)	<u>(809)</u>	<u>(695)</u>	114	(52)	-	(10)	52
Working capital per cash flow	<u>(5,511)</u>	<u>(4,660)</u>	851				
Cash on customers' account (E)	30	62	32				
Working capital per balance sheet ***	<u>(5,481)</u>	<u>(4,598)</u>	883				

* includes assets held for resale

** includes cash on customers' account

*** equals A+B+C+D+E

£ millions

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2007 Performance by Business Group

	Sales	Underlying EBITA
Electronics, Intelligence & Support	3,916	429
Land & Armaments	3,538	324
Programmes & Support	5,327	456
International Businesses	3,359	435
HQ & Other Businesses	243	(155)
Intra-group	(673)	-
Total	15,710	1,489

£ millions

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2007 growth

	Sales			EBITA		
	2007	2006	Growth	2007	2006	Growth
Continuing Businesses	15,710	13,765	+14.1%	1,489	1,207	+23.4%
Foreign Exchange:						
USD		(404)			(47)	
Other		10			1	
Adjusted for foreign exchange	15,710	13,371	+17.5%	1,489	1,161	+28.3%
Transactions:						
Armor Holdings	(725)	-		(89)	-	
Other	(55)	(267)		(46)	(26)	
Adjusted for f/x and transactions	14,930	13,104	+13.9%	1,354	1,135	+19.3%
Pension accounting gain					(61)	
				1,354	1,074	+26.1%

£ millions

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