

Driving global growth

BAE SYSTEMS

REAL PERFORMANCE. REAL ADVANTAGE.

Message from the Chief Executive



“Our strategy and investment plans are working to good effect and we are developing a strong competitive advantage with a broad global portfolio of businesses, based on our six Home Markets.”

Mike Turner Chief Executive

Highlights of 2007

- Our financial and program performance
- Saudi Arabian Typhoon order
- Successful execution of our wheeled vehicle strategy
- Astute ‘first of class’ launch
- Continued MRAP orders in the U.S.
- Successful Type 45 sea trials
- Armor Holdings acquisition
- UK Carrier decision

2007 has been another busy year for BAE Systems. The market and our shareholders expect us to deliver yet another good year of financial results built on improving program performance and good execution of our Group Strategy. Our overall performance once again reflects good program, cost and schedule execution across the Company, coupled with a focus on further enhancing our long-term relationships with our customers in each of our six Home Markets. This performance has provided a robust baseline to which we can add stretch and the delivery of strategic opportunities. Our shareholders are pleased with their investment and our strategy is understood and widely supported.

Our multi-Home Market strategy continues to generate opportunities for growth, particularly in the Kingdom of Saudi Arabia, with work on the modernization of assets and the Typhoon program under way, and the transition to a Home Market well advanced.

Another notable success is the very strong growth in our land systems business where we are establishing a clear global leadership position, which was reinforced by the acquisition of Armor Holdings.

In the U.S., we continue to see the fruits of a well executed acquisition strategy with good profitable growth from what is now a very substantial business.

Our UK operations continue to achieve good program schedule and cost performance, building on the sensible terms of business now being secured with the UK Ministry of Defence (MOD).

2008 Executive Committee Top Ten Objectives

As a leadership population, we need to lead and engage our people at all levels in our Company to:

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| 1. Meet 2008 financial targets and set challenging and realistic longer term plans | 6. Grow our U.S. business, including execution of planned investments |
| 2. Develop our partnering approach to meet our customers' capability requirements | 7. Progress delivery of the Saudi Industrialization Plan and further develop business in the Kingdom of Saudi Arabia |
| 3. Ensure continued quality application of our mandated business policies and processes | 8. Continue to implement the UK Defence Industrial Strategy, including execution of our transformation and investment plans |
| 4. Further enhance program execution through schedule and cost performance | 9. Progress export opportunities from each of our Home Markets |
| 5. Progress development of our security capabilities in our Home Markets | 10. Continue to drive performance in Safety, Ethics, and Diversity |

Delivering on our global strategy

During 2007, our strategy has evolved to reflect the current position and plans we have in our Home Markets in Australia, Saudi Arabia, South Africa, Sweden, the UK, and the U.S.

In the U.S., it has been a tremendous year for our Land & Armaments business and we continue to benefit from vehicle reset and refurbishment activities. This is a consequence of the sustained high level of equipment use in U.S. military operations. The Armor Holdings acquisition has accelerated delivery of our strategy to address the tactical wheeled vehicle sector.

The relationship between Saudi Arabia and the UK has been very important for a number of decades. Sustaining and growing our business in support of that relationship is a key objective. Therefore, the signing in September 2007 by the two governments of the contract to buy 72 Typhoon aircraft was of great significance to BAE Systems, the UK, and Saudi Arabia. The implementation of the government-to-government agreement lies at the heart of this strategy and involves modernization of existing assets in addition to the procurement of Typhoon. To achieve both the Kingdom's and our own goals, we are transitioning our Saudi business to one in which BAE Systems has an even greater and growing in-Kingdom presence.

In the UK, we have made good progress in further establishing our through-life businesses with the implementation of the multi-year Availability Transformation: Tornado Aircraft Contract (ATTAC) – a major achievement. In our naval systems businesses, we have now launched three Type

45 ships and the first Astute submarine. The first Type 45 destroyer, HMS Daring, successfully completed her stage one sea trials, performing beyond expectations. In July, we received the commitment to the UK's Future Aircraft Carrier (CVF) program. This program secures a major element of the UK's naval workload for years to come and has enabled us to proceed toward the consolidation of the naval sector as an important element of the implementation of the UK Defence Industrial Strategy (DIS). Our UK Land Systems business is investing in Systems Integration Facilities at Leicester. This is a major transformation milestone as we respond to the challenges set out in the UK DIS, allowing faster, more cost-effective, and better integration at lower risk.

The UK Government's publication of the DIS version 2 (DIS 2) has now been delayed into 2008 to take account of the difficult decisions required in the UK MOD's current Planning Round 08 following the 2007 Comprehensive Spending Review. The fundamental objective for our Company and the rest of the UK's defense industrial base is to ensure that the original principles articulated in the UK DIS in December 2005 are maintained. To deliver value for money and meet current and future equipment needs of the armed forces, securing Through-Life Capability Management and appropriate Long-Term Partnering Agreements (LTPAs) will be even more necessary under difficult budgetary conditions.

We also continue to make good progress in developing our Australian, South African, and Swedish Home Markets.

The MRAP program reflects both our industrial capacity and our ability to collaborate across sites and businesses globally.



Our Company's reputation is of paramount importance to us all and we expect that all of our employees accept ethical behavior as an integral part of their work. We have established an independent committee chaired by Lord Woolf, the former Lord Chief Justice of England and Wales, to review and evaluate the Company's policies and processes – and their application – relating to ethics and business conduct. The committee's recommendations will be fully implemented.

During 2007, we also thoroughly reviewed our policies and processes for undertaking export business. Exports will continue to be important to the sustainment and growth of our business and we will continue to look for and promote export opportunities from our six Home Markets.

2008 Group Strategy Framework

We have reviewed and refined our Group Strategic Objectives to ensure that they remain relevant. In particular, we have clarified the intent of the objective 'Develop our capabilities in emerging growth markets' by separating it into two parts. The first part – 'Develop our capabilities in existing and new Home Markets' – now focuses on developing our multi-Home Market strategy. The second – 'Establish security businesses in our Home Markets' – highlights the importance of this adjacent market opportunity. In the future, we believe that the emphasis will be on broader 'security' encompassing the current defense sector. Therefore, we need to position ourselves to maximize our role in this sector.

The relationship between the Group Strategy Framework and the Executive Committee (EC) Top Ten Objectives is important to understand. The Group Strategy defines our long-term strategic goals. This is delivered through meeting our Group Strategic Objectives and Business Portfolio Actions, and underpinned through the Integrated Business Planning (IBP) process. The EC Top Ten Objectives focus on more specific short-term deliverables requiring action in the current year to progress delivery of the long-term Group Strategy.



We have made a strong step toward establishing a partnered through-life availability support solution for the RAF Typhoon.

Driving improved performance

Program execution is central to our business and is ultimately the key determinant of customer satisfaction. Detailed risk assessment, adherence to program schedules, and strict attention to program costs and margin are crucial to program success and ultimately our profitability. This is being demonstrated to our customers on projects such as Astute, Type 45, F-22, F-35 Lightning II, Nimrod, Typhoon, Tornado ATTAC, Bradley, and Bulldog.

Partnering is also a major theme where our ambition is to work closely with our customers to encourage transparency and promote a partnering approach for mutual benefit.

Underlying our performance are the principles of the highest levels of business ethics, good governance, values, policies, and processes that guide our business and behavior, with a clear system of delegated authority within our 'One Company' approach. We are determined that the business processes mandated across our organization should draw on global best practice.

Part of continuing to deliver high performance in all aspects of our business is our commitment to the progressive development of a corporate responsibility agenda that reflects and supports a strong and well respected global company. The safety of our employees and those working on our sites is a top priority as is the development of diversity plans, so that we can develop an environment that values and respects the contribution, based on merit, of all members of the communities, internal and external, in which we operate.

“Looking forward into 2008, our three largest Home Markets – the U.S., Saudi Arabia, and the UK – are clearly key to sustaining and growing the value of the Company.”

Delivering the strategy in 2008

Looking forward into 2008, our three largest Home Markets – the U.S., Saudi Arabia, and the UK – are clearly key to sustaining and growing the value of the Company. We must focus on delivering organic growth based on both current and planned IBP investments. We will also continue to pursue acquisitions in growth market segments.

In the U.S., organic growth continues and opportunities exist for further acquisitions.

We are moving forward in Saudi Arabia with asset modernization and the Typhoon program. Our in-Kingdom plans and investments, in line with our commitments to the Saudi Arabian and UK governments, are well advanced.

Implementation of DIS in the UK is now under way but remains challenging. We are working with the UK MOD as a partner to demonstrate that we are making a difference: more capability and lower cost for the UK Armed Forces and satisfactory profitability for our Company and shareholders.

We will further develop our position in our Home Markets of Australia, South Africa and Sweden, both organically and, where appropriate, by acquisition. We will continue to explore the possibility of establishing new Home Markets in countries such as India, Japan and South Korea, and will also evaluate opportunities in adjacent markets such as intelligence and homeland security.

As we progress our global strategy, we will continue to focus on exploring options for pan-company working in order to make the most of our collective expertise, capabilities, best practice, and experience. During the 2007 IBP process, we evaluated several such areas. As a result, selected growth options have been embedded in plans for delivery from and including 2008.

While understanding and recognizing that constraints to technology sharing remain, we continue to identify and address opportunities to work together to share technology when authorized. In June, President Bush and Prime Minister Blair signed the U.S.-UK Defence Trade Co-operation Treaty. Once the Treaty has been approved by the UK Parliament and the U.S. Senate, it will expedite and simplify the ability of companies on both sides of the Atlantic to work together more effectively. This will allow us to better meet the needs of our armed forces and leverage the technologies and skills inherent in both nations. For BAE Systems, it will be a significant step forward in harnessing the combined strength of our U.S. and UK operations.



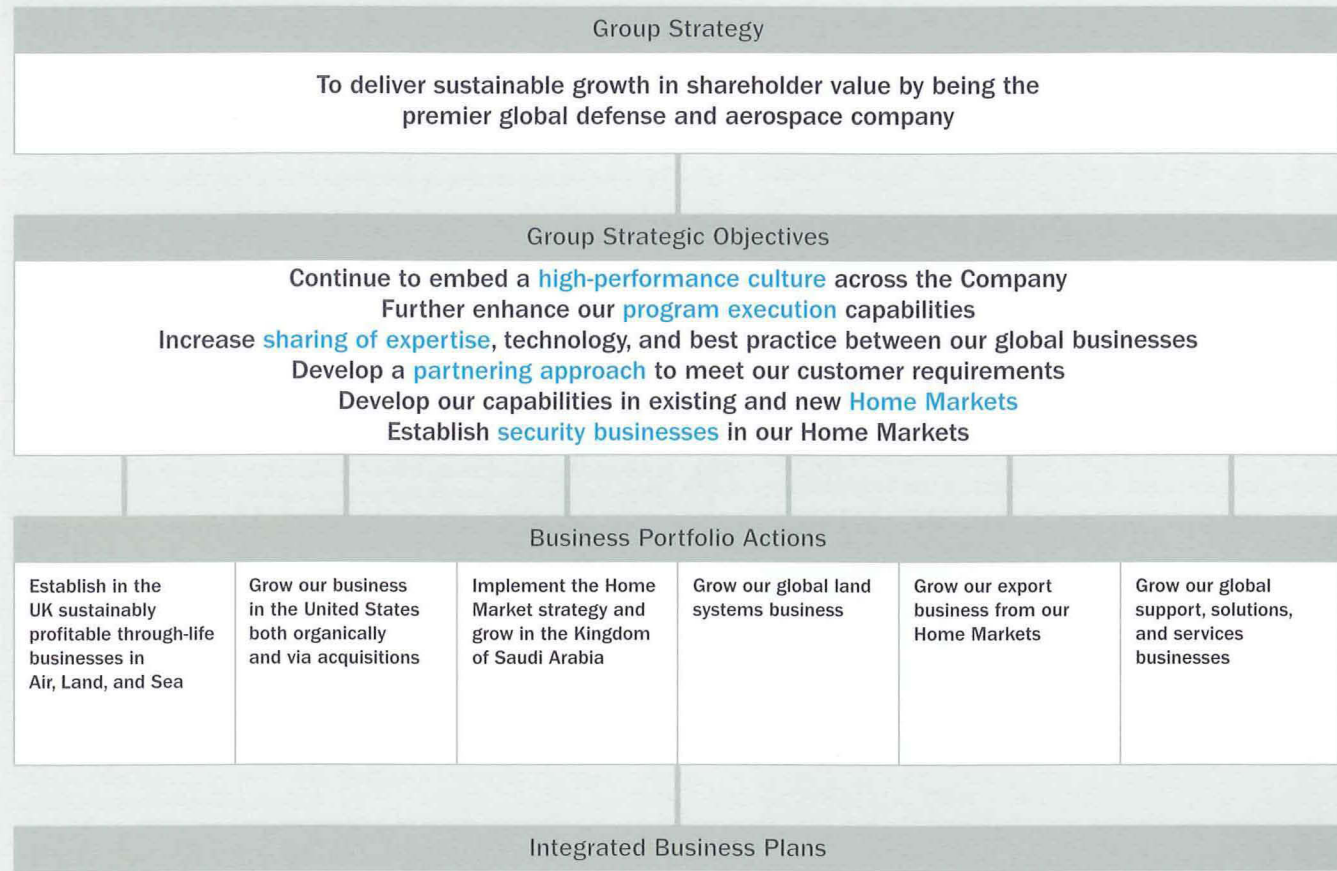
The safety of our employees and those working on our sites is of paramount importance.

In conclusion, we are continuing to deliver strong financial and program performance together with our strategy. The continued execution of our global strategy has differentiated us and will continue to give us a competitive advantage. We are delivering value for money and capability to our customers. We are well positioned for the future and we now have a 'quality business' based on a strong, well balanced portfolio and the highest standard of ethics that gives us confidence that we will continue to deliver shareholder value in line with our long-term plans. We must continue to build further on this very strong business base in 2008.

Mike Turner Chief Executive

A strategy that delivers

Our Company strategy is 'To deliver sustainable growth in shareholder value by being the premier global defense and aerospace company.' We deliver this through our Group Strategic Objectives, Business Portfolio Actions, and Integrated Business Plans. The six Group Strategic Objectives are championed by the Executive Committee and apply across all of our businesses, while the Business Portfolio Actions are championed by the relevant Executive Committee member and are delivered by the businesses either separately or jointly. Both are underpinned by our Integrated Business Plans.



Group Strategic Objectives

The six Group Strategic Objectives are championed by the Executive Committee and apply across all of our businesses:

Continue to embed a **high-performance culture** across the Company

Having a high-performance culture underpins our ability to achieve our strategy and we all share the responsibility for delivering high performance. This means setting challenging targets and reviewing our performance, so that we deliver against our commitments, as individuals and as teams. In meeting these commitments, we must, at all times, apply the highest standards of business conduct in line with our ethical principles.

Further enhance our **program execution** capabilities

Excellence in program execution remains at the core of the successful delivery of our strategy, both in terms of executing on our existing contracts and winning new business. Being recognized by our customers as their reliable partner of choice to deliver to their expectations on time and budget will ensure we continue to deliver performance and the growth of our business. We will continue to improve the effectiveness of the application of our processes and the training of our people, to deliver on our customer commitments. Enhancing our program execution capability means recognizing that our external and internal customers are our priority and that we consistently meet their expectations.

Increase **sharing of expertise**, technology, and best practice between our global businesses

As our customers' requirements increasingly demand the ability to offer through-life and capability solutions, we are committed to finding ways to increasingly collaborate across our business and project boundaries to deliver these solutions. We need to continue to build on our ability to work across the lines of business that span our six Home Markets, maximizing and leveraging our wide range of skills, capabilities, resources, and technologies in line with our 'One Company' approach. We need to collaborate globally, share our technology when authorized, to capitalize on our combined strengths to deliver the best possible value to our customers and shareholders.

Develop a **partnering approach** to meet our customer requirements

Mutually beneficial trust-based partnering relationships with our customers are increasingly important to the long-term future and stability of our business. Worldwide, many of our customers are recognizing the long-term nature and strategic importance of many defense procurements, which means that long-term partnering approaches can, in certain circumstances, provide better outcomes than practices based on competition. We are responding to this trend by building our partnering capabilities in ways such as working in integrated project teams and embedding our activities alongside customers.

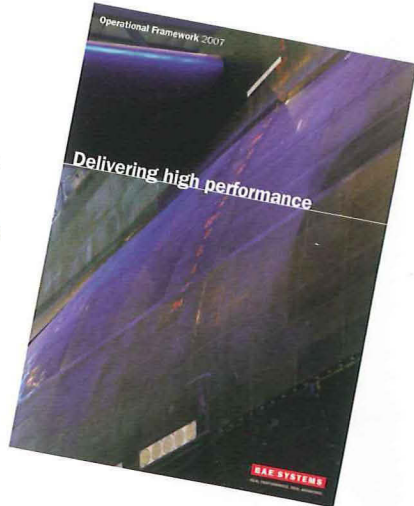
Develop our capabilities in existing and new **Home Markets**

We continue to evaluate ways in which we can develop our in-country presence, both in our six existing Home Markets and in potential new Home Markets. In the latter, we have concentrated on markets that are forecast to have significant and growing defense expenditure, and which want to develop a significant domestic defense industry. This has led us to evaluate three countries: India, Japan, and South Korea. We will continue to explore possibilities with a range of potential industrial partners throughout 2008.

Establish **security businesses** in our Home Markets

In 2007, we evaluated opportunities to grow into related new market segments, providing we could leverage our core technologies and capabilities appropriately. Through this work, we have decided that establishing security businesses in our Home Markets should be a specific area of focus.

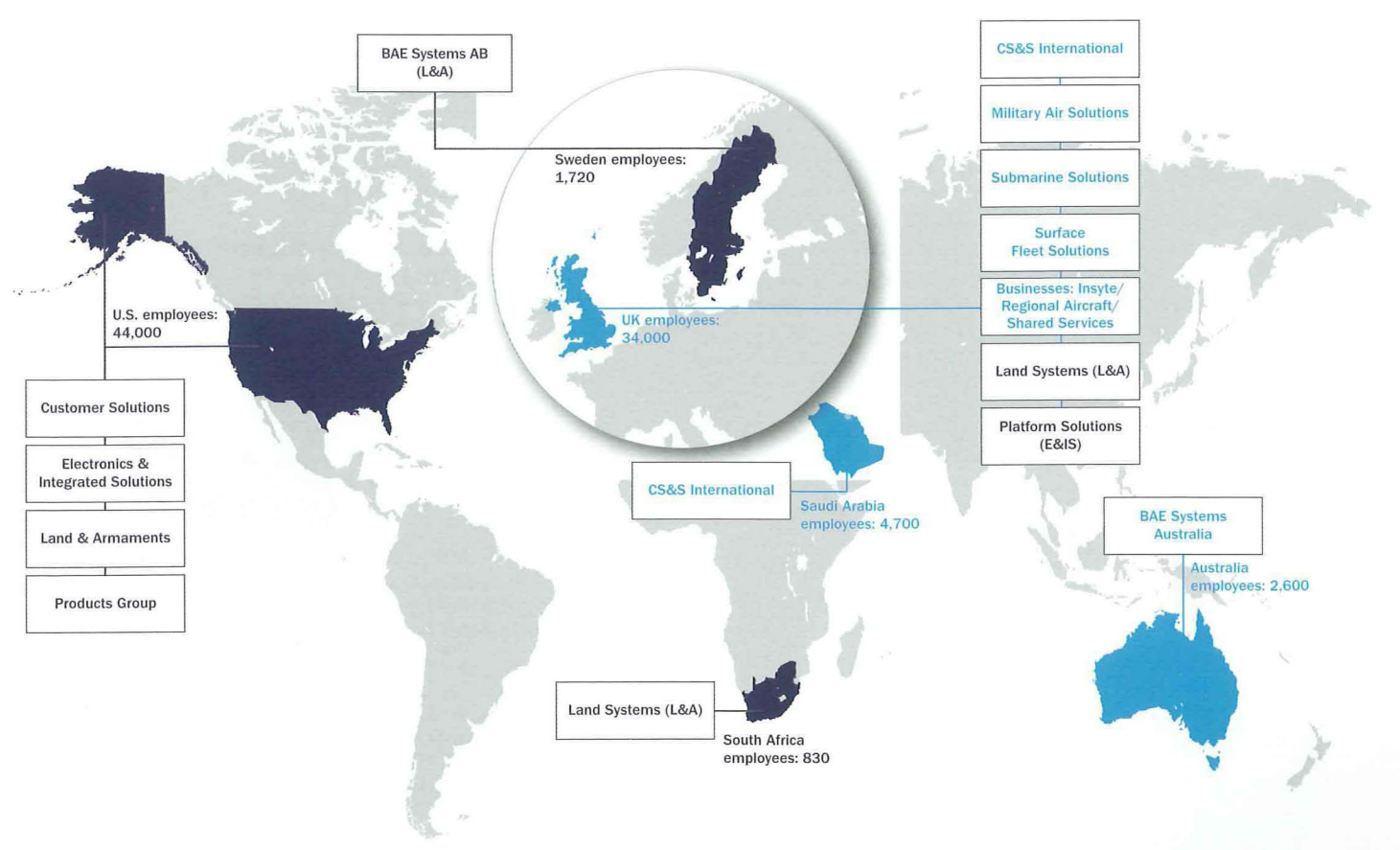
The Operational Framework sets out the way we do business and what it means to be part of our Company. It includes key policies and procedures that are to be operated across the businesses.



Our global company

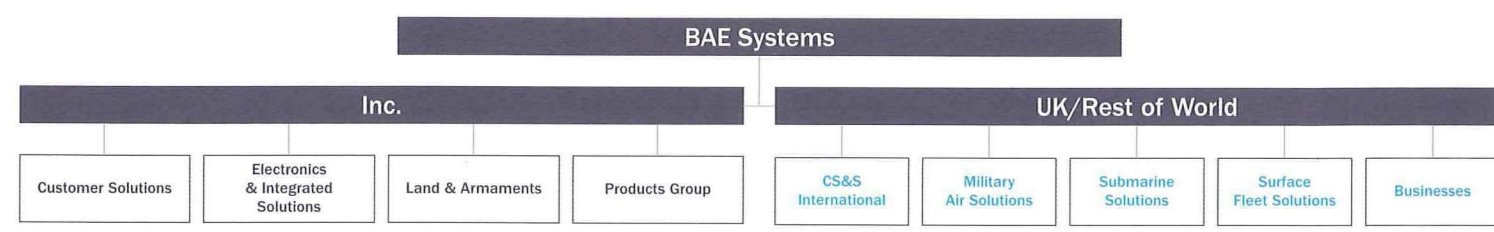
Our global business is based around our Home Markets in Australia, Saudi Arabia, South Africa, Sweden, the UK, and the U.S. These are markets identified as having a significant and sustained commitment to defense and where we already have a good position in their defense industrial base along with strong customer relationships. We intend to invest and grow in these markets.

Our existing Home Markets



All employee numbers on a pro forma basis, assuming that at the end of 2006 BAE Systems had owned Armor Holdings, Inc.

Our operating structure



Inc.

Customer Solutions (CS)
 CS comprises three businesses and employs nearly 14,000 people. BAE Systems IT is one of the largest IT providers to the U.S. Government. BAE Systems Technology Solutions & Services (TSS) provides tailored, integrated technical and professional services solutions for the U.S. Department of Defense, Federal Government, and homeland security markets. BAE Systems Ship Repair is the leading non-nuclear ship repair, modernization, and conversion company in the U.S.

Electronics & Integrated Solutions (E&IS)
 E&IS is a major defense electronics business with more than 17,000 employees. It designs, develops, and produces electronic systems and subsystems for a wide range of military and commercial applications. The business group has four primary capabilities: electronic warfare, commercial and military avionics, flight and engine controls, as well as tactical and national network systems.

Land & Armaments (L&A)
 L&A, employing 20,000 people, is a global leader in the design, development, production, and through-life support and upgrade of armored combat vehicles and tactical wheeled vehicles, naval guns, missile launchers, artillery systems, and intelligent munitions. Its objective is to provide the broadest range of systems and components together with through-life capability support to its customers.

Products Group
 Products Group has 2,000 employees across four divisions and manufactures many of the world's most recognized and established brands of security products exclusively for law enforcement, corrections, military, and licensed security professionals.

UK/Rest of World

CS&S International (CS&SI)
 CS&SI has about 6,000 employees and is responsible for the development of new market opportunities and the sustainment of business in the Middle East region, including our long-term presence in Saudi Arabia.

Military Air Solutions (MAS)
 MAS, with its 15,000 employees, provides advanced through-life military air capability by successful delivery of our design, development, manufacture, and support contracts with UK and overseas customers. Working in partnership with customers and suppliers, MAS ensures operational requirements are met in the most cost-effective manner.

Submarine Solutions
 With more than 3,500 employees, Submarine Solutions designs, builds, and supports conventional and nuclear submarines for the UK, demonstrating value for money over a wide range of contracts, system integration, design and build services. It is developing the Astute class, designed for littoral, deep sea, or ocean deployment around the globe.

Surface Fleet Solutions (SFS)
 SFS, employing about 3,800 people, is the leading provider of through-life, integrated surface warship capability to the UK MOD and selected export customers. Its key programs include Type 45 Destroyer, Landing Ship Dock Auxiliary, and the Carrier.

Businesses
 Businesses, with more than 8,000 employees, comprises BAE Systems Australia, Integrated System Technologies (Insyte), Regional Aircraft, Shared Services, and BAE Systems' shareholding in MBDA and Saab.

Priorities for growth BAE Systems, Inc.



Walt Havenstein Chief Operating Officer

In 2007, we set the following priorities:

- Meet or exceed the business plan
- Grow the business
- Strive to operate as a high-performance enterprise
- Encourage a high-performance culture and behaviors

BAE Systems, Inc. has been successful in meeting these priorities and has continued to deliver the Company's strategy.

We have undergone significant changes in leadership and organization during 2007, as well as consolidating two former lines of business within our Electronics & Integrated Solutions (E&IS) business into Network Systems. We have remained focused during these changes as we continually worked to align ourselves with our customers and to more efficiently and effectively 'punch our weight.'

The focus on customers, priorities, and program performance has enabled BAE Systems, Inc., through its operating groups, to meet its business objectives, as well as its goals for organic growth. We have to offer our customers, whether they wear military, police or fire uniforms, a competitive advantage in the field to ensure their mission success. This requires that we remain agile and willing to take on new and ever-changing roles and responsibilities. Investment in our businesses is being stepped up in 2008 and 2009 to address the need for future growth.

While the businesses and functions have reported solid performance for 2007, we still have a lot of room for more cross-business collaboration. We will continue to emphasize the following strategic Business Portfolio Actions as we move through 2008:

Grow our business in the United States both organically and via acquisitions

The U.S. market is likely to become increasingly challenging if the growth in U.S. defense budgets begins to slow. Despite this, the U.S. continues to be the most attractive of all the major defense markets. Our U.S. business now manages more than US\$14 billion of annual sales, and employs around 50,000 people in 38 states and in our Home Markets of the UK, South Africa, and Sweden. Our Company is currently one of the top ten prime contractors to the U.S. Department of Defense (DoD). Our goal is to continue to grow the business in the U.S. through a combination of sustained organic growth and acquisitions.

"We have to offer our customers, whether they wear military, police or fire uniforms, a competitive advantage in the field to ensure their mission success."

In 2007, we exceeded our organic growth targets through a combination of solid program execution and key program wins.

In 2007, we completed the acquisition of Armor Holdings, Inc., which had 2006 sales of US\$2.6 billion and 8,000 employees. The integration of Armor Holdings with BAE Systems' existing Land & Armaments business further strengthened our ability to provide our customers with innovative capabilities, products and services, and positioned the Company as the world's leading land systems business. Following the acquisition, the Products Group, with an extensive line of products and well-recognized brands that meet the needs of the law enforcement and fire protection agencies, has been established as a separate line of business reporting directly to BAE Systems, Inc.

The E&IS business has continued to grow in the U.S. by leveraging its market leadership position and introducing new capabilities that meet customer needs. In 2007, E&IS delivered its 100th F-22A Raptor aircraft electronic warfare (EW) system and its first F-35 Lightning II EW system. The business also delivered its 1,000th Common Missile Warning System (CMWS), which protects U.S. Army helicopters and aircraft from heat-seeking missiles. The Thermal Weapon Sight program achieved a production rate of more than 1,500 units per month, and has surpassed 18,500 total deliveries. E&IS continues to be a market leader in advanced information technology, intelligence analysis and production, geospatial exploitation software, and development of knowledge-based systems.

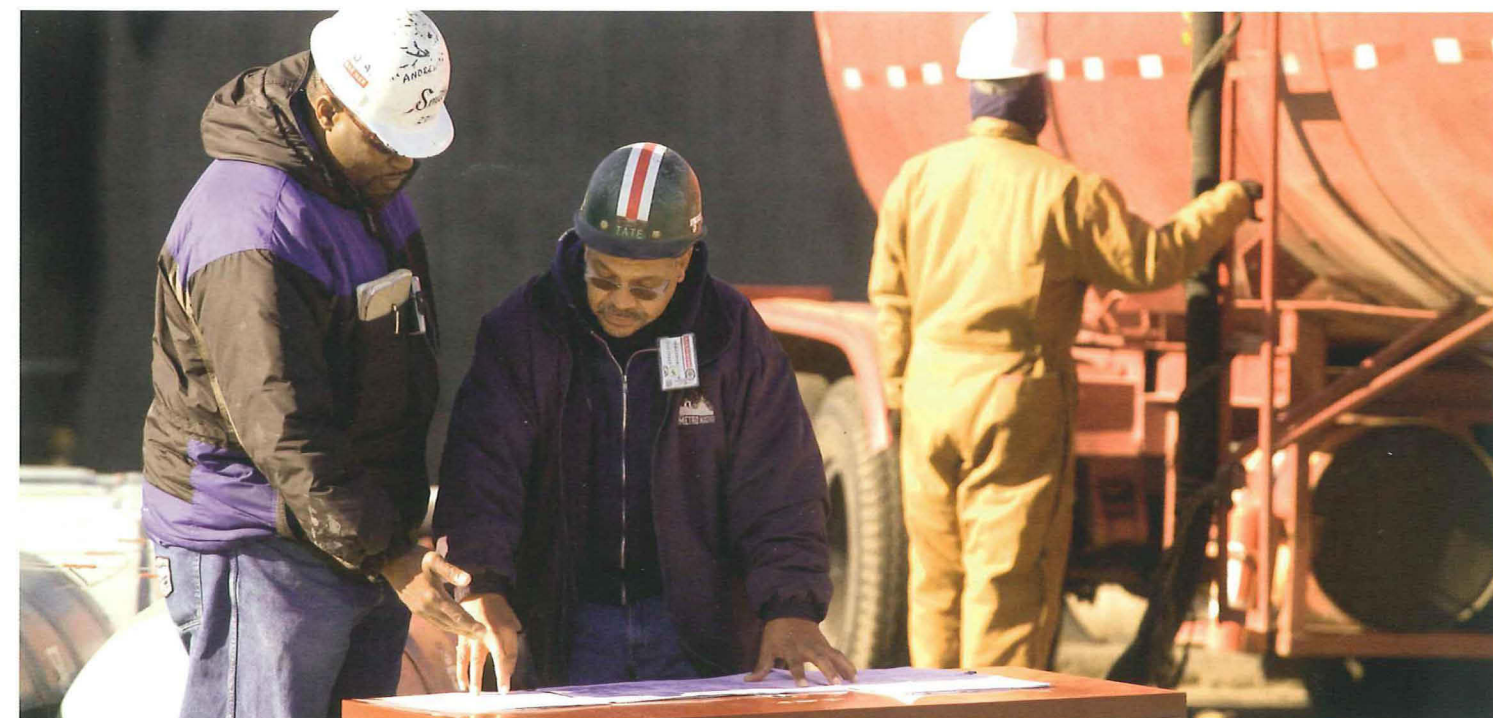
E&IS' Defense Avionics business based in the UK was awarded an order to build more than 1,000 helmet assemblies for the Typhoon and introduced new helmet-mounted, head-up display technology.

Seeking new markets, the E&IS commercial hybrid technology business demonstrated the first hybrid electric drive system for ground combat vehicles as part of the U.S. Army's Future Combat Systems (FCS) program. E&IS has also developed and demonstrated a common module power system to meet the increasing electric power demands of systems on board military vehicles.

Grow our global land systems business

During 2007, Land & Armaments, including our acquisition of Armor Holdings, has been at the forefront of our land systems business growth objective. In meeting the urgent manufacturing requirements for Mine-Resistant, Ambush-Protected (MRAP) vehicles, the U.S. DoD's top acquisition priority, we have received US\$2.2 billion of MRAP orders over the past 14 months.

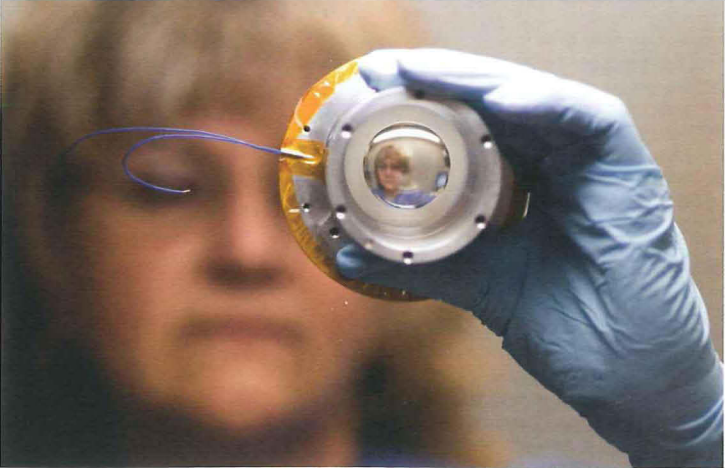
We manufacture MRAP variants across multiple sites. The three variants are the RG-31, RG-33, and Caiman. We currently have orders for 624 RG-31s from the U.S. Marine Corps, while orders for the RG-33 stand at 1,731 vehicles. The RG-33s began arriving in theater in October 2007 and will be supported on site by company field service technicians. The Caiman, a product of the former Armor Holdings, is based on the design of



Our Customer Solutions Ship Repair business will focus on delivering drydock and pierside repair and sustainment services for the U.S. Navy, other defense agencies, and commercial customers.

Chief Operating Officer Priorities (continued)

The E&IS business has continued to grow in the U.S. by leveraging its market leadership positions and introducing new capabilities that meet customer needs.



the U.S. Army's Family of Medium Tactical Vehicles (FMTV) and has been designed to provide parts commonality. Currently 1,848 Caimans are under contract.

We have worked across our global businesses with remarkable speed to design, produce, and deliver the very best we have to offer to protect the warfighter. Our role on the MRAP program reflects not only our industrial capacity but also the ability to collaborate across sites and businesses globally and the ability to integrate former Armor Holdings' capabilities into the effort. Collaborating globally, the RG-33 development leveraged capabilities at Company locations in South Africa and the U.S. It builds on proven, fielded designs and brings together more than 35 years' experience in mine-protected wheeled vehicle expertise, and decades developing highly survivable combat platforms for the U.S. military. Capacity has been ramped up to maximize production capacity at the MRAP manufacturing site in South Africa to produce 305 RG-31 vehicles.

Land & Armaments has many other ongoing programs and activities. In August 2007, we began work on a new facility at Elgin, Oklahoma to be opened in 2009, which will initially focus on production integration and assembly of the Non-Line-of-Sight (NLOS) Cannon for the U.S. Army's FCS program. Development of the Advanced Gun System (AGS) for the U.S. Navy's DDG-1000 destroyer continues. The AGS is a vital component to the lethality and effectiveness that the U.S. Navy needs for long-range fire support.

In the UK, Land Systems has been magnificent in responding to urgent vehicle modifications for the FV430 and Warrior vehicles to protect British troops. These modifications include new armor, external fire suppression systems, and night vision systems. The Land Systems business is also investing in transformation in response to the challenges set out in the UK DIS.

In Sweden, BAE Systems AB has particularly strong positions in selected weapon systems. We have started deliveries on schedule of CV9035 armored fighting vehicles to the Netherlands and Denmark as well as continued to make sales of the BvS10 armored all-terrain vehicles.

Grow our global support, solutions, and services businesses
All Inc. businesses are contributing to 'grow our global support, solutions, and services businesses, which is a common Business Portfolio Action with the UK/RoW businesses.

Our Customer Solutions Ship Repair business will focus on delivering dry-dock and pierside ship repair and sustainment services for the U.S. Navy, other defense agencies, and commercial customers. During 2007, Ship Repair was awarded multiple maintenance and overhaul contracts by Military Sealift Command. These include contracts for fitting out availability and post shakedown availability on two new U.S. Navy amphibious transport dock ships; preservation work on nuclear submarines; and maintenance of all DDG Class destroyers in San Diego, Norfolk, and Hawaii. We will continue to look to expand our support, solutions, and services business.

Our Technology Solutions & Services business has continued to build on its long-standing record of providing engineering and technical services and systems integration support to the U.S. Navy, and also of providing logistics support and services at military posts.

We will compete for larger support contracts. BAE Systems IT was awarded a major contract by the U.S. Department of Labor and was also selected as a prime contractor for the General Services Administration's Alliant Government-Wide Acquisition Contract.

Vehicle reset and upgrade is also an important part of our support solutions portfolio for the future. Our Land & Armaments Ground Systems business has received multiple contracts for the remanufacture and upgrade of Bradley Combat Systems, which total US\$3.9 billion over the period 2005 to 2007. In addition, we have won reset contracts for M88A2 recovery vehicles and M113A3 armored personnel carriers.

E&IS has continued to focus on through-life products and logistics support for the U.S. military through its readiness and sustainment effort, as represented by its on-site presence at Warner Robins Air Force Base and Tobyhanna Army Depot.

Grow our export business from our Home Markets
Operating in 54 locations, seven countries and four Home Markets, the Land & Armaments business is demonstrating our ability to 'grow our export business from our Home Markets.' Land & Armaments accounts for more than half of BAE Systems, Inc.'s export revenue, and OMC in South Africa and BAE Systems AB in Sweden receive more than half of their sales revenue from export sales. With products currently in service around the globe, Land & Armaments will benefit from an ongoing requirement for global product support, solutions, and services.

"During 2008, we will launch initiatives that will enable us to take an integrated view of markets and capabilities, 'do things differently,' and provide more potential than single lines of business operating independently."

E&IS is actively engaged in export markets and provides aircraft electronics and avionics equipment, including communications, navigation and identification friend or foe systems, defensive and weapons systems, software enterprise solutions, as well as aircraft test equipment. The operating group also provides flight control systems for fixed wing and rotary wing aircraft built by a range of leading manufacturers worldwide.

Export sales represent a growing market opportunity for hybrid electric drive buses that are currently being tested in three international markets, including Canada, the UK, and Japan.

Moving forward
During 2008, BAE Systems, Inc. will launch a series of initiatives that will enable us to take an integrated view of markets and capabilities, 'do things differently,' and provide more potential than single lines of business operating independently. Our challenges for 2008 are not altogether different from those of 2007 and many are continued.

To enhance our ability to grow, we will establish an Inc. Business Development Council with a formal structure to facilitate 'taking a bigger view' of the marketplace, with a remit to identify, qualify, and capture new business.

We will also maintain our priority on developing a high-performance culture through the development of our leaders and future leaders. For 2008 and beyond, program management expertise and capabilities will become added facets to this leadership development program. All leaders will be able to converse in a common language regarding program performance, mission success, and associated metrics. In 2007, 20 high-potential, early-career employees completed the demanding LEAD Program. We are pleased that this valuable program will be available globally in 2008. These internal development programs will continue to be one of our top priorities, so that we build critical capabilities required for our future success.



We are establishing a clear global leadership position in our land systems business, which was reinforced by the acquisition of Armor Holdings.

BAE Systems has also made a commitment to be a 2008 national sponsor for the FIRST (For Inspiration & Recognition of Science & Technology) program, which supports the vital need to develop our future workforce.

In 2008, through our charitable initiatives, we will bring our employees closer to our customers and our communities, and give back to the families of men and women who serve in the armed forces. We will continue our affiliation with the United Services Organizations (USO) as a global sponsor. We have also entered a strategic partnership with America Supports You, which serves as an umbrella for a variety of military support organizations and under which we will conduct charitable activities and fundraising.

Finally, reflecting our priority on business ethics and ethical behavior, BAE Systems has agreed to be principal sponsor of the Leadership and Ethics Programs at the four U.S. military service academies.

Priorities for 2008

- Meet our business plan
- Complete transition/integration of Armor Holdings
- Enhance our ability to grow
- Improve program performance
- Advance performance centered leadership
- Drive for greater efficiency, effectiveness, and compliance
- Shift our emphasis from an internal to an external focus
- Promote cross Operating Group cooperation

Priorities for growth

UK/Rest of World



Ian King Chief Operating Officer

In 2007, we implemented the new UK/RoW organization with four key objectives:

- To better align our management structure against the strategy of delivering and growing in our Home Markets
- To integrate our support and front-end focused businesses so that we can provide the end-to-end capability that our customers are seeking
- To optimize our ability to deliver through-life capability to the front line
- To strengthen our ability to deliver on our UK Defence Industrial Strategy (DIS) commitments

This organization has been successfully embedded during 2007. The benefits created by bringing together our front-end and support businesses are now facilitating an improved focus on delivering cost-effective capability to our customers across our Home Markets in Australia, Saudi Arabia, and the UK.

Establish in the UK sustainably profitable through-life businesses in Air, Land, and Sea

Our UK air, land, and sea businesses are now delivering strong performance and capability to the front-line customers. This is based on the solid foundations of good program execution, long-term workload visibility, and a proactive partnering approach between the UK MOD and the Company. Delivering on our programs provides customer confidence and gives us the platform to grow our business further.

- Typhoon production is progressing well with the air forces of the four Eurofighter nations now having more than 132 aircraft in service around Europe, including 48 operational with the RAF. These aircraft are achieving levels of capability maturity well ahead of expectations and we are addressing opportunities to move the program onto similar partnered support arrangements to those now in place for Tornado.
- HMS Daring, the first of the new Type 45 destroyers, performed beyond expectations during her stage one sea trials and we have now also completed the program restructuring for six Type 45 ships.
- HMS Astute, the next-generation nuclear-powered attack submarine, was successfully launched in June 2007 and is now progressing well toward sea trials. In 2008, Submarine Solutions will focus on continuing the drumbeat of production to reinforce our reputation of strong program execution.
- We have made great strides in the development of our Unmanned Air Systems (UAS) capability and began construction of the Taranis unmanned combat air vehicle demonstrator in September 2007, marking

a major milestone in this four-year program. Our HERTI fully autonomous unmanned air vehicle system was deployed to Afghanistan into an operational environment last year, a deployment that was hailed a success by both the RAF and BAE Systems. This is a key milestone in supporting our global UAS strategy and will continue to be developed during 2008.

- The British Army Future Rapid Effects System (FRES) remains a significant growth prospect and key to the sustainability of land systems capability in the UK, consistent with the UK DIS. Responses are now being sought by the UK customer on the initial contractual phases.
- BAE Systems, through a partnering agreement with the UK MOD, is looking to establish the Munitions Acquisition, the Supply Solution (MASS). MASS aims to ensure long-term security of supply for general munitions at reduced whole life cost from a transformed and sustainable industrial base. As part of the partnering agreement, we are committed to transforming our business by investing over a five-year period to create modern, flexible manufacturing facilities and engineering capabilities that are aligned to future defense needs and reflect the intent of the DIS.
- Following a strategic review at the beginning of 2007, our Integrated System Technologies (Insyte) business was rebaselined to align its strategy with our air, land, and sea businesses. Going forward, Insyte needs to continue delivering against its existing programs and will take a lead role in developing our growth plans in the homeland security/security and resilience market. The Underwater Systems business will also be integrated into Insyte beginning 1 January 2008.

Emphasis on creating the environment and behaviors necessary to maximize the benefits from partnering closely with our customer is also important. In the UK, a revised Partnering Arrangement was signed on 30 May 2007 between BAE Systems and Defence Equipment and Support (DE&S), which underpins the Company's future engagement with the UK customer with the joint intent of delivering effective equipment and support to the armed



HERTI was deployed to Afghanistan into an operational environment last year, a deployment that was hailed a success by both the RAF and BAE Systems.

"Bringing together our front-end and support businesses is now facilitating an improved focus on delivering cost-effective capability to our customers."

forces. This Arrangement sets the framework for regular joint program reviews between DE&S and BAE Systems, underpinned by a set of key performance practices. It stresses the need to negotiate in good faith, with trust and openness, and take all reasonable steps to address and meet each other's objectives. This Arrangement is already demonstrating positive results in encouraging partnering behaviors and is the model we will continue to use going forward.

Implementation of the UK DIS is under way against a challenging set of milestones. The UK/RoW organization will continue to work with the customer to ensure we are transforming our business to meet changing requirements, particularly focusing on developing the Long-Term Partnering Agreements (LTPAs) across air, land, and sea. The LTPAs are about fundamentally changing the business model, moving away from short-term, transactional approaches focused on front-end procurement of equipment, and moving toward longer term, mutually incentivized partnering arrangements. These will allow for the effective delivery of value for money, through-life capability, and availability support solutions.

In Military Air Solutions (MAS), our teams have worked closely with the MOD to establish the basis of LTPAs covering all current and future fixed wing aircraft. These agreements have established new ways of working, are delivering enhanced capability and value for money to our customers, and are fundamentally looking to transform the business. This will continue to be progressed in 2008.

In the maritime sector, three programs underpin the long-term sustainability of the naval sector: Astute – the largest and most capable nuclear-powered attack submarine for the Royal Navy; the Type 45 Air Defence Destroyer; and the Royal Navy's Future Aircraft Carrier (CVF). 2008 will be a key year for continuing to deliver the important milestones around the Type 45 program, including systems integration and testing before stage two trials. CVF will be starting its manufacturing phase during 2008, with a build program involving our businesses in Barrow and Glasgow, as well as Insyte for the provision of the mission system.

In the land sector, as a consequence of the high intensity of British Army operations in Afghanistan and Iraq, the UK based Land Systems activities are seeing a high level of Urgent Operational Requirements (UORs) and ammunition throughput. To date, more than 80 UORs have been delivered or are under development. The most visible example of these is the early deployment of the Bulldog (the upgraded FV430 vehicle) up-armored capability to operations, while the business has also provided up-armoring solutions to the Warrior and Challenger Armored Repair & Recovery Vehicles.

Regional Aircraft had a positive year in 2007 in terms of aircraft delivery and lease extension. In an increasingly diverse and challenging market, it secured more than 100 aircraft placements. During 2008, Regional Aircraft will continue to target new business, refurbishing and placing aircraft, with special emphasis on the idle fleet.

Chief Operating Officer Priorities (continued)

We continue to provide significant support to both the Royal Saudi Air Force and the Royal Saudi Naval Force Operations. In particular, we are taking steps to maintain the capability of the Tornado aircraft while extending its operational life.



Implement the Home Market strategy and grow in the Kingdom of Saudi Arabia

Our strategy to build on our strong customer relationships in Saudi Arabia is embedded in the Business Portfolio Action 'Implement our Home Market strategy and grow in the Kingdom of Saudi Arabia.'

During 2007, the management board of CS&S International (CS&SI) relocated to Riyadh reflecting the shift in the center of gravity of operations from the UK to developing a Home Market in the Kingdom of Saudi Arabia. The first of two new super-compounds for our employees is now being occupied in Riyadh and quarterly business reviews with CS&SI now take place in-country.

The announcement in September 2007 of the agreement between the Kingdom of Saudi Arabia and the UK Government for the supply of 72 Typhoon aircraft was an important milestone. As well as paving the way for the entry into service of Typhoon, this contract reflects the drive by the two countries to develop the capabilities of the Kingdom's defense industrial base and the armed forces. It is consistent with the policy of the Kingdom and our strategy of developing Saudi Arabia as a Home Market, with substantial employment and investment in future in-Kingdom industrial capability. The new defense cooperation program, known as 'Project Salam,' builds on a long and successful relationship between the governments and their armed forces.

Through our core program, we continue to provide significant support to both the Royal Saudi Air Force (RSAF) and Royal Saudi Naval Force Operations and their operational capability. In particular, we are taking steps with the RSAF to maintain the capability of the Tornado aircraft while extending its operational life.

In addition, we are making good progress against our training and Saudization plans, under which we are extending the employment and involvement of Saudi nationals within our workforce. We have also made progress in securing other new business streams in the region. This includes a contract for a Command and Control system (C4I) for the Kingdom.

Our strategy is to continue to develop Saudi Arabia as a key Home Market through securing new business and continued investment in local industrial capability. This supports the customer's drive for the development of a self-sufficient and world class aerospace industry. We need to continue delivering on our program and industrialization commitments and further build on this important relationship.

Grow our export business from our Home Markets

We have a strong product portfolio and have had success in demonstrating our ability to grow our export business from our Home Markets. In addition to the sale of 72 Typhoon aircraft to the Kingdom of Saudi Arabia, BAE Systems was selected by the Australian Government for the medium and heavy truck segment of Land 121 Project Overlander. This will replace about 3,000 of the Australian Defence Force's tactical trucks over a six-year period, starting in 2009. As well as supporting the growth of Australia as a key Home Market for BAE Systems, it positions the Company well to provide the customer with cost-effective through-life support.

We need to continually improve our ability to win profitable export business and must work hard to collaborate globally across our Home Markets to deliver innovative, value for money solutions for our customer.

Grow our global support, solutions, and services businesses

We continue to make progress on the Business Portfolio Action 'Grow our global support, solutions, and services businesses' in the UK, Australia, and Saudi Arabia.



The 3D visualization dome at the Systems Integration Facility at Leicester is allowing faster, more cost-effective and better integration at lower risk.

"In 2008, delivering on our programs provides customer confidence and gives us the platform to grow our business further."

Our aim is to extend the UK availability support contracting model, as evidenced by the Tornado ATTAC and Harrier JUMP programs, by securing partnering support arrangements across the domains of air, land, and sea to cover the support and upgrade of our in-service equipment. In the air sector, we have recently taken a strong step toward establishing a partnered through-life availability support solution for Typhoon with the signing of a £10 million maintenance and upgrade contract. It will deliver a 50 percent increase in on-aircraft maintenance and upgrade capability at RAF Coningsby. This operation will be jointly managed and manned by BAE Systems employees and the RAF. Through it, we will start to see the benefit of bringing RAF and BAE Systems maintenance expertise together to offer an effective through-life support solution for Typhoon. Other examples include the award of the Hawk Integrated Operational Support (HIOS) contract for maintenance and technical support of the UK's Hawk T.1 aircraft through to 2011 and the JAVELIN (Joint Approach to VC-10 Engineering & Logistics Integration) contract extension, covering support of the VC-10 tanker fleet to the aircraft's out-of-service date.

More recently, we were awarded a contract amendment for ATTAC, known as ATTAC Phase 2, which incorporates the final phases of general systems, avionics, and engineering support services into the availability service already on contract. ATTAC Phase 2 is worth £324 million and brings the total value of the ATTAC service to £1.3 billion. The overall ATTAC service provides improved availability of Tornado aircraft for the RAF, while saving the MOD £510 million over the initial 10 years of the program.

We are currently at different levels of maturity of support solutions across our domain businesses. We will need to put more emphasis on this in 2008 in order to bring the benefits of this model into the UK land and naval sectors. Looking forward, we anticipate seeing more joint activities located at our customers' bases.

In our Home Market of Australia, we continue to build on our position as a through-life capability partner to the Australian Defence Force. In the first quarter of 2007, we received a contract to provide continuing in-service support to the Hawk Lead-In Fighter (LIF) fleet for an additional five years, thus providing a solid basis for the continued through-life support of these aircraft.

In addition, the BAE Systems Support Council has broadened its remit into a global council. Its focus in 2008 is to champion and develop our support contracting models in order to advance our through-life support approach consistently across our Home Markets. By sharing best practice and providing effective tools, the Council plans to equip our businesses for successful growth in the support, services, and solutions markets globally.

Moving forward

Moving into 2008, we need to build upon the strong progress achieved in 2007 by continuing to deliver against our program commitments and executing against our well defined strategic plans. This will allow us to invest in our future capabilities, develop growth in the business, and deliver excellence with our customer. Our customers are demanding the ability to offer through-life and capability solutions. The emphasis going forward will be on industry and the governments in our Home Markets to work together to maintain a robust and successful defense capability in the long term.

Priorities for 2008

- Continue to develop and respond to the UK DIS, including execution of our transformation and investment plans and maturation of the LTPAs across our air, land, and sea businesses
- Deliver the milestones on Project Salam and the core Saudi programs
- Progress delivery of the Saudi industrialization plan
- Progress the four-nation contract for the third tranche of Typhoon
- Extend the support model across air, land, and sea
- Develop security capabilities in our Home Markets
- Progress export opportunities from our Home Markets

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Cover image: The first of class Type 45 destroyer, HMS Daring, successfully completed her stage one sea trials on schedule in August 2007. Conducted off the coast of Scotland by BAE Systems engineers and Royal Navy personnel, the trials rigorously tested the habitability and key functional attributes of the warship's platform. The performance of the ship exceeded all expectations.

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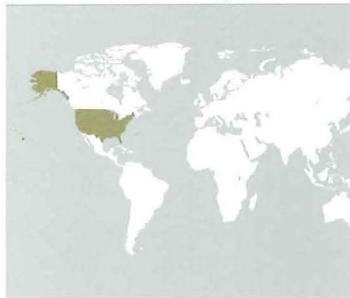
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Customer Solutions



We are growing the business in the U.S. and contributing to company-wide growth in providing mission-enabling services and solutions to our customers

Customer Solutions is comprised of three lines of business in the U.S. – BAE Systems Information Technology (BAE-IT), Technology Solutions & Services (TSS), and BAE Systems Ship Repair – that bring a wide range of mission-enabling solutions and services to U.S. military and federal government customers.

BAE-IT capabilities include enterprise-wide managed IT operations, mission-critical application development and life-cycle support, and information analysis and assured delivery. TSS provides services and solutions including system and subsystem integration, operations and maintenance, sustainment, large scale program management, and systems engineering over the entire program life-cycle. Ship Repair is the leading non-nuclear ship repair company in the U.S. and provides conversion, modernization and life-cycle sustainment services, principally in the home ports of the U.S. Navy.

Customer Solutions works closely with customers to understand emerging needs and is focused on delighting its customers by providing unique, transformational solutions and services as a valued partner, enabling those customers to effectively achieve their missions.

Performance in 2007

During 2007, Customer Solutions secured a variety of programs that underpin the future growth in the operating group and support the global strategies of BAE Systems in growing its business in the U.S. and its services and support businesses globally. Customer Solutions continues to implement operating group-wide initiatives such as its Enterprise Resource Planning system and the roll-out of a new enterprise web portal, eLink, which will increase collaborative capability and competitiveness.

BAE-IT, which operates within the large U.S. government information technology market, was selected as a prime contractor for the General Services Administration's (GSA) Alliant contract to provide full IT life-cycle services in support of the U.S. National Security Systems. BAE-IT won a competitive five-year contract to develop applications for the U.S. Department of Labor.



BAE Systems Ship Repair provides overhaul and maintenance services to U.S. Coast Guard cutters that defend U.S. maritime borders.

Business description

The Customer Solutions Operating Group continues to grow as a leading provider of integrated technical and professional service solutions for U.S. national security and federal civilian markets. Customer Solutions employs nearly 14,000 people at more than 60 locations in the U.S., providing a wide range of tailored support and service solutions to meet the needs of the U.S. government for current and future defense, intelligence, and civilian systems.

2007 Highlights

- Selected as prime contractor for the GSA Alliant Contract.
- Won a five-year contract to develop applications for U.S. Department of Labor.
- BAE-IT achieved CMMI[®] Maturity Level 3.
- Provided critical personnel to support the global war on terror.
- Obtained integrator role for the new U.S. Air Force Battle Control System.
- Secured a five-year Multiple Ship Multiple Order contract from the U.S. Navy to maintain and repair Arleigh Burke-class destroyers.
- Executed contracts to work on three San Antonio-class Amphibious Transport Dock Ships.
- Extended our lease in San Francisco to include drydock enhancements to allow service to the largest cruise ships on the U.S. West Coast.
- BAE-IT was ranked #6 in Computerworld's top 100 "Best Places to Work in IT."

Number of employees 2007

14,000

Number of locations

60+

Customer Solutions (continued)

Customer Solutions provides service and maintenance to the Cobra Dane, a national technical intelligence sensor located at Eareckson Air Force Station on the island of Shemya, Alaska.



Additional contracts were secured by winning 100% of its recompetes and by capturing new business to provide key services, such as network implementation and operation, life-cycle software development engineering and other support to the federal government. During 2007, BAE-IT achieved CMMI® Maturity Level 3, demonstrating results against its commitment to continual improvement. BAE-IT was ranked #6 in Computerworld's top 100 "Best Places to Work in IT" for 2007.

TSS continued to build on its long-standing record of providing life-cycle engineering and technical services and systems integration support to the U.S. Navy, other military, and government agencies. During 2007, TSS won more than 98% of its recompetes, including technical support to the U.S. Missile Defense Agency and other federal agencies, engineering support work, and U.S. Navy communications station operations and maintenance in Hawaii. TSS expanded into adjacent markets by supporting the U.S. military with critical personnel to support the global war on terror and by obtaining the role as the integrator for the new Air Force Battle Control System.

Ship Repair is focused on drydock and pierside ship repair and sustainment services for the U.S. Navy, other national security agencies, and commercial customers. In 2007, Ship Repair secured a five-year, multi-ship multi-option contract from the U.S. Navy to maintain and repair all Arleigh Burke-class destroyers home ported or visiting San Diego. Also during the year, Ship Repair: executed on Navy contracts to work on three of the newly commissioned San Antonio-class amphibious transport dock ships; signed a new lease in San Francisco that will allow BAE Systems to service the largest cruise ships on the U.S. West Coast; and won a Navy contract for key work on the guided missile cruiser USS Bunker Hill.

For 2007, Customer Solutions exceeded its financial and growth commitment to the company and its stakeholders, while providing high-quality services and solutions for end users in the U.S. military and federal civilian agencies.

Key Priorities for 2008

The U.S. services market is large, but is generally flat, resulting in a highly competitive environment. Future growth plans for Customer Solutions remain centered in the higher growth IT market, but all three businesses expect to contribute to the overall growth of the organization. The further

advancement or completion of a number of internal initiatives during the year will continue to assist the business with increasing operational efficiencies and reducing costs to improve competitiveness in winning new business that drives top line growth.

Customer Solutions will continue to support the growth initiatives outlined in the BAE Systems strategy by performing on its current contracts, by growing organically through a combination of internal initiatives and pursuits, and by delivering on collaborative efforts between Customer Solutions and other BAE Systems business units. The operating group will continue to focus on people and processes, integrity and culture and on employee safety.

BAE-IT will focus on growth as a provider of IT Solutions and Services for the most demanding customers. Pursuit of prime positions on select indefinite delivery/indefinite quantity (IDIQ) contracts such as Alliant, Enterprise Acquisition Gateway for Leading Edge (EAGLE), and Information Technology Enterprise Solutions 2 Services (ITES-2S) will continue to be a focus, as will executing and leveraging the company's existing IDIQ contracts and associate task orders. BAE-IT will complete the transition to in-source enterprise IT services in the company's U.S.-based businesses in 2008 and will continue to focus on the growth of its Global Analysis business.

TSS will continue on its path to grow organically as a provider of life-cycle services and solutions while collaborating with BAE Systems business units globally. Leveraging existing capabilities, TSS will focus on the growing security and sustainment markets. In late December, BAE Systems announced its intent to acquire MTC Technologies and pre-planning for its integration at closing into Customer Solutions' TSS line of business is under way.

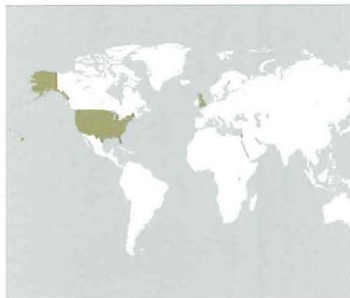
Finally, Ship Repair remains on a path to grow its market-leading position on legacy ship modernization and repair. The business will continue to focus on delivering on time and on budget, while enhancing its ability to deliver life-cycle sustainment services to its key customers.

Overall, Ship Repair activity is anticipated to remain stable while growth in the BAE-IT and TSS businesses will be driven by near-term priorities of the U.S. Department of Defense.



BAE Systems IT monitors our network operations across the U.S. from its Network Operations Center in Herndon, Virginia.

Electronics & Integrated Solutions



Agility, speed, and responsiveness make us both competitive in a changing environment and allow us to meet the ever-changing needs of the customer.

Business description

Electronics & Integrated Solutions (E&IS) designs, develops, and manufactures a wide range of electronic systems and subsystems for military and commercial applications. It operates under the banner of "We Protect Those Who Protect Us," which today reflects more than its trademark countermeasures programs, expanding to the arenas of intelligence and data gathering, and military and commercial platform products.

2007 Highlights

- Electronic Warfare continued to contribute to organizational success by delivering products such as Common Missile Warning Systems that saved aircrew lives in Iraq and Afghanistan. In addition, the 100th F-22 Raptor EW suite was delivered to Lockheed Martin and many other programs responded to customer platform protection needs.
- Platform Solutions continued to innovate with vehicle power management and the ongoing success of hybrid drive technology. Innovative fly-by-wire technology and head-up, helmet-mounted displays for aircraft pilots were among the year's other highlights.
- Network Systems continued as a market leader in advanced information technology, intelligence analysis and production, geospatial exploitation software, and development of knowledge-based systems. Key strategic wins on intelligence programs positioned BAE Systems as a premier provider of innovative solutions.
- Sensor Systems' Thermal Weapon Sight II program delivered more than 18,000 sights to its U.S. Army customer and is currently exceeding a rate of 1,500 per month. E&IS thermal imaging technology used in the sights enables the warfighter to see deep into the battlefield in all-weather conditions, both day and night, increasing the warfighter's surveillance and target acquisition range.
- Operation Noble Cause - an employee volunteer initiative to assist servicemen and women and their families through alliances with Military Support Organizations - gives back to "those who protect us."

Number of employees 2007

17,000

Number of locations

40+

Performance in 2007

E&IS grew by more than six percent in 2007 as a result of its ability to understand and deliver solutions to customer needs. Among other performance milestones:

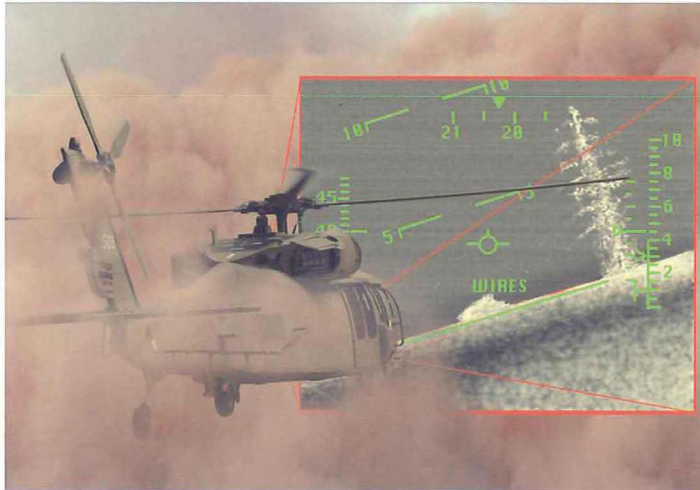
- Delivered the first F-35 Lightning II flight representative EW system.
- Delivered the 1,000th Common Missile Warning System that protects U.S. Army helicopters and aircraft from heat-seeking missiles.
- Continued its role in the U.S. Department of Homeland Security's program to develop JETEYE™, a commercial infrared countermeasure system which seeks to defeat the threat of shoulder-fired anti-aircraft missiles.
- Selected to produce 50 fire fielding units of the Terminal High Altitude Area Defense missile, supporting the transition to production of this ballistic missile defense system.
- Received an order to build more than 1,000 helmet assemblies for the Eurofighter Typhoon and debuted new helmet-mounted, head-up display technology.
- Demonstrated the first hybrid electric drive system for ground combat vehicles as part of the U.S. Army's Future Combat Systems program. E&IS also developed and demonstrated a common module power system to meet the increasing electric power demands onboard military vehicles.
- Collaborated with diverse stakeholders to secure Congressional funding to continue the Advanced Precision Kill Weapon System. APKWS fills a U.S. Marine Corps need for a low cost, precision guided weapon that gives aviators increased stand-off range and reduces collateral damage.



BAE Systems unveiled its newest head-up display technology at the Association of the U.S. Army's (AUSA) Annual Symposium in Washington, D.C., in October.

Electronics & Integrated Solutions (continued)

E&IS' Network Systems' all-weather cable and obstruction detection system uses radar to detect potentially deadly obstacles like power lines.



Key Priorities in 2008

The key to future E&IS success lies in the intimate understanding of the end-user and their missions, and then shaping and applying all company resources – knowledge, skills, capabilities, and the latest technology – toward meeting the needs of the end-user.

Customer Intimacy

Customer intimacy offers a forum to better understand current and future needs. Our on-site presence gives us first-hand perspective to forecast and develop upgrades. The end-user will be involved in realizing the solution because having resources side-by-side with the end-user builds trust and confidence, and solidifies long-term relationships.

Today, more than 500 field engineers and service representatives serve alongside our end-user at every level of maintenance and service at more than 50 military locations worldwide.

Our focus and commitment to Readiness and Sustainment supports a growing number of performance-based support needs by driving down the cost of customer equipment maintenance and ownership. Because we understand the core equipment system, we can positively contribute to capability upgrades as well as cost and obsolescence management. Because we design and build the systems, we are experts in integrating, networking, and upgrading technologies and solutions.

Culture of Innovation

Meeting the future needs of customers requires the continuous transformation of the organization and its capabilities through the strategic investment in new technologies and applications.

Part of shaping for the future is investing in resources today – people and capital – to make a difference for tomorrow. Aggressive

initiatives in LEAN operations, continuous quality improvement and organizational integration are allowing us to build capabilities that identify, anticipate, and meet future customer needs. An employer of choice environment is created by challenging employees to commit to innovation and continuously strengthening core business areas while smartly stepping-out into new market areas.

We're honing a culture that matures our relationships with the other BAE Systems entities, strategic business partners, suppliers, and the end-user to create ongoing customer value and capability. In avionics, for example, we're shaping the organization to integrate our U.S. commercial avionics with our UK defense avionics capabilities so that we can leverage best practices across both portfolios.

In engine and flight controls, we're strengthening our strategic partnership with General Electric and Boeing through performance, manufacturing excellence, and joint technology planning.

Leveraging Technology

To be successful means leveraging technology. We took our F-22 EW suite and best practices and leveraged both into the F-35. We are now taking those capabilities and will leverage them into spiral upgrades for an EW suite for legacy fighter aircraft.

Our uncooled infrared core technology, so successful in thermal weapons sights for night targeting and firing, is being looked at for applications in goggles and other night vision solutions for both warfighters and First Responders.

Our lithium ion battery module on commercial buses has been harnessed for energy storage for combat vehicles and, similarly, our military modular power management has applications for commercial bus power control.

The way of the future is to first understand the needs of the customer – both current and future – then innovate to quickly solve their problems. This means delivering solutions on cost and schedule while confidently and boldly stepping into areas of new need, such as the emerging area of Homeland Security, and sustaining legacy markets through leveraging technology. By this process we continue to strategically shape the business to maximize future customer value.



The Common Modular Power System meets the increasing electric power demands onboard military vehicles.

Land & Armaments



We have a mandate to grow our global land systems business, our export business from our home markets, and our support business.

Performance in 2007

Land & Armaments grew 43% over 2006, excluding financial performance from the former Armor Holdings, Inc. Aerospace and Defense business, now renamed Mobility & Protection Systems.

Land & Armaments received contracts for MRAP vehicles valued in excess of \$2.2B. The contracts consisted of: 1,731 RG33 vehicles valued at \$1,243M; 1,848 Caiman vehicles valued at \$976M; and 624 RG31 vehicles valued at \$153M.

Land Systems in South Africa teamed with Ground Systems in the U.S. to develop the RG33 vehicle for the MRAP program, which was designed and developed in record time. These contracts solidified the operating group's position in the emerging mine-protected vehicle market. More vehicle awards are expected in this market next year, with a competitive opportunity for the Joint Light Tactical Vehicle (JLTV) program early in 2008.

Ground Systems was awarded the Medium Mine Protected Vehicle (MMPV) program. The first delivery order is for six standard vehicles and three Explosive Ordnance Disposal variants for first article test, spares, and test support. The RG33 vehicle is the Army's selected mine-protected vehicle platform for MRAP SOCOM Vehicles and MRAP Heavy Armored Ground Ambulances.

Bradley Combat Systems achievements:

- Ground Systems reached a favorable negotiation settlement with the Government for the FY08 Reset program totaling \$1,001M.
- FY08 Remanufacturing and FY09 Reset Long Lead Item (LLI) proposal negotiations are in process.
- Successfully demonstrated the Bradley Technical Demonstrator in November during the Air Assault Expeditionary Force (AAEF) exercise at Ft. Benning, Georgia.

Armament Systems held an inaugural ceremony in Elgin, Oklahoma to initiate work on BAE Systems - Elgin Operations, scheduled to open in early 2009. This facility will be built by the city of Elgin in the Ft. Sill Industrial Park where work will initially focus on production integration and assembly of the NLOS-C for the U.S. Army's FCS program.



The Black Knight Unmanned Combat Vehicle (left) is wirelessly tele-operated from within the Bradley Technical Demonstrator (TD) and acts as a scout or wingman to the Bradley TD.

Business description

BAE Systems Land & Armaments Operating Group is a global leader in the design, development, production, and service support of armored combat vehicles, major and minor caliber naval guns and missile launchers, canisters, artillery systems, and intelligent munitions, tactical wheeled vehicles, individual protection and vehicle protection systems. The group has 18,000 employees in more than 50 locations worldwide.

2007 Highlights

- Strong organic growth on core products, new business in the mine-protected vehicle market, and five months of operations from Mobility & Protection Systems.
- BAE Systems completed its acquisition of Armor Holdings, Inc.
- Selected as a 2007 Top 5 Department of Defense Program Award winner for systems engineering for the company's work on the surface ship MK57 Vertical Launching System.
- Received the "Large Contractor of the Year 2007 Award" from PM - Mortars - Picatinny Arsenal.
- Demonstrated the first hybrid electric drive system for ground combat vehicles as part of the U.S. Army's Future Combat Systems (FCS) program. The FCS Manned Ground Vehicles (MGV) family of eight vehicles is the first ever planned operational Army suite of ground combat vehicles to use hybrid electric technology.
- Land & Armaments won two of the six BAE Systems Chairman's Gold Awards and seven Silver Awards.

Number of employees 2007

18,000

Number of locations

50+

Land & Armaments (continued)

As part of the Future Combat System team, BAE Systems is leading the development of the Non-Line-of-Sight Cannon, the U.S. Army's next generation 155-mm self-propelled howitzer, and the 120-mm self-propelled Non-Line-of-Sight Mortar.



The Non-Line-of-Sight Mortar was delivered to the U.S. Army in early 2007 and has since fired more than 600 rounds at Camp Ripley in Minnesota. The NLOS Mortar Firing Platform features an automated, single-tube, breech-loaded 120-mm smoothbore turreted mortar mounted on a test stand.

Armament Systems received a contract modification from the U.S. Navy for the procurement of Mk 13 Mod 0 Canisters and Mk 25 Mod 0 Canisters. The canisters provide safe storage, transport, and launch capabilities for the Mk 41 Vertical Launching System (VLS). Armament Systems has been supplying the U.S. Navy with missile launching canisters for battle-proven systems for more than two decades. The Mk 13 and Mk 25 contribute to systems that provide critical defensive weapon support to sailors, giving them an advantage at sea and keeping them safe. BAE Systems is the U.S. Navy's exclusive design agent and worldwide supplier of Mk 41 VLS canisters.

Land Systems performed well across all of its business units with improved profitability across all parts of the business. It has increased its order intake by over 50% and has recorded a sales turnover in the year of £922M against a budget of £760M. The U.S. Land Systems Weapons & Vehicles business rolled out 151 M777 guns from its Hattiesburg, Mississippi facility, meeting important customer milestones on the program.

BAE Systems AB Bofors was awarded a contract from the Swedish Armed Forces in the development of the next generation of the artillery system, Archer, a 155 mm self-propelled wheeled howitzer. The business delivered two prototypes of the Archer in 2006 and the new contract, worth nearly \$50M, is for the last development preparations before the serial production contract, expected in 2008.

Mobility & Protection Systems was selected by the Australian Government as the preferred bidder for one of the largest Australian Army projects for decades, the next generation of medium and heavy tactical trucks and modular payloads. The Land 121 Project will replace over 3,000 of the Australian Defence Force's tactical trucks over a six-year period, beginning in 2009.

BAE Systems AB began delivery of one of the most modern Infantry Fighting Vehicles, the CV9035, to both the Netherlands and the Danish armies.

BAE Systems AB continued the serial development of the Splitterskyddad Enhets Plattform (SEP) system, a modular medium weight armored tactical vehicle system. The system includes tracked and wheeled platforms with a hybrid electric drive system and mission modules for an Armored Personnel Carrier and logistics vehicle.

Key Priorities in 2008

- Continue to grow the global land systems business in existing Home Markets
- Improve program performance in all lines of business
- Complete the integration of Armor Holdings into Land & Armaments
- Achieve greater efficiency, effectiveness, and compliance through quality application of mandated business policies and practices
- Improve overall health and sustainability of the global organization

The acquisition of Armor Holdings in 2007 brought products, technologies, markets and capabilities to Land & Armaments that have yet to be fully exploited. In 2008, the operating group will complete the integration and fully access the synergies that will enable it to realize the potential that the acquisition heralded.

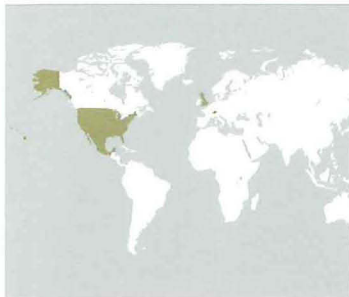
Growing existing markets and establishing a land presence in new Home Markets require that Land & Armaments brings advanced technologies and capabilities to its customers at an affordable ownership price, including support and sustainment.

The key to Land & Armaments' continuing contribution to BAE Systems' success in 2008 rests with its performance on the programs under current contract and harnessing and integrating the global technical and managerial capabilities across the operating group to capture opportunities throughout the world in its product market segments.



With the acquisition of Armor Holdings, BAE Systems greatly increases its program and product offerings, including the MRAP Caiman. In 2008, the company will continue to grow, leverage capabilities, and transform in order to maintain its competitive edge.

Products Group



In addition to growing our law enforcement business organically and via acquisitions, we anticipate growth in the homeland security and first responder markets.

Business description

BAE Systems Products Group is a leading global provider of security products. We manufacture many of the world's most recognized brands across the law enforcement, corrections, military and security markets. Our products include bullet-resistant vests (also referred as body armor), holsters, police duty gear, pepper sprays, less-lethal munitions, emergency lighting products, riot gear, forensic kits, and many other security-related items.

2007 Highlights

- Collaborative pre-close Integration team efforts culminated with successful Day One celebration. Our joint integration team continued their focus by completing the 100 day plan on schedule. Products Group adopted an "Engage, Embrace and Drive" theme throughout the integration process, supported with facility posters and individual themed cards for all employees.
- Completed organizational restructure to achieve our business objectives using three guiding principles: get closer to our customers; align management and processes to work closer with the rest of BAE Systems and to operate effectively under the Operational Framework; and prepare our organization for significant expansion in 2008-09.
- Overhauled our International sales channel and conducted extensive vetting for our new Foreign Advisors.
- Held our 2007 Products Group EXPO in Atlanta, Georgia in November. 140 attendees representing 75 of our key distributors were present to meet on various topics designed to expand our business opportunities for 2008. This event was supported by a Trade Fair featuring Products Group brands, suppliers as well as commercial products offered by BAE Systems E&IS Operating Group.

Number of employees 2007

1,700

Number of locations

12

BAE Systems Products Group began as the law enforcement segment of recently acquired Armor Holdings. Through internal product development and the acquisition of complementary businesses, the Products Group generates over \$300 million in annual revenue. We anticipate our future growth to be in the expanded homeland security and first responder markets, driven through a combination of organic market penetration, new acquisitions, and channel synergy with other BAE Systems businesses and products.

The Products Group reaches around the world, offering our products and services to law enforcement, military, security and corrections professionals, as well as sports and outdoor enthusiasts. Each of our brands sets the pace in quality and leading-edge technologies for their respective markets. The Products Group has approximately 1,700 employees in 12 manufacturing facilities throughout the United States, the United Kingdom, Switzerland and Mexico.

The primary users of our security products are U.S. federal, state, local and foreign law enforcement and homeland security agencies; public and private corrections facilities; and U.S. and allied militaries and their supporting contractors. We market and deliver our products through an extensive network of domestic and international distributors and agents, as well as through our inside sales force of over 80 representatives and specialists. We also provide training services in connection with the use of our products.

2008 Objectives

Our core objectives in 2008 are designed to expand the Products Group's focus beyond traditional law enforcement products in order to better address significant growth opportunities throughout the global markets where we do business. They include the following:

- Develop and execute on a comprehensive domestic Homeland Security strategy focused on federal DHS agencies and state & local first responders;



Officers use the Law Enforcement Vehicle Armor (L.E.V.A) system from PROTECH® and Safariland® duty gear to protect against today's more dangerous street confrontations.

Products Group (continued)



SWAT team collaborates with local law enforcement in a high risk rescue. Equipment, armor and accessories from Products Group support a successful mission.

- Safariland® may be the most recognized name in the global law enforcement industry. Safariland holsters and associated duty gear is a leading brand of choice in law enforcement. We also carry the Bianchi International® duty gear brand. Bianchi's reputation has been achieved on their success with concealable holsters and leather product offerings within the commercial channel. In 2008, we seek to explore ways of combining these two leading brands through joint R&D, manufacturing and marketing efforts to create a stronger, more complementary full line offering.
- Our focus on retail products combines Hiatt® restraints, Hatch® gloves and protective gear, and Break Free®, Speedfeed®, and KleenBore™ cleaning and lubrication products for weapons and outdoor gear. Consumer promotions are planned throughout the year using most of these brands to create in-store demand and product pull through.

BAE Systems Products Group is proud to be part of the BAE Systems family. We see many opportunities for substantial growth through collaborative efforts with the broader enterprise. Through these efforts, we are confident in our ability to achieve our strategic and financial objectives in 2008.

- Leverage transferable products and technologies from other BAE Systems businesses that are suitable for marketing and sales through Products Group's distribution channels;
- Pursue an international growth strategy using a concentrated distributor base within core markets; and
- Achieve our financial plan.

Additionally, we look to drive demand within existing customer segments by combining product categories to be marketed using a lead brand, as well as the BAE Systems brand where appropriate. For example:

- Our body armor brands include American Body Armor™, Safariland® Armorwear®, PROTECH® Tactical, SAVVY™ Armor for Women™, PROTECH® Corrections, Bianchi Body Armor™ and Second Chance®. Together, we market our body armor as the Total Armor Solution. Based on specific design elements for each brand, we market these unique characteristics of each product line so that our customers have various choices in order to meet their specific needs. For 2008, the Total Armor Solution will be marketed under the BAE Systems brand.



Tactical Officer attempts to resolve a conflict utilizing the Penn Arms Multi-Launcher, a less lethal solution from Defense Technology.