

BAE SYSTEMS (Funding Two) Limited

**Annual Report and Financial Statements
2002**

Registered Number : 4333003



Directors' Report

The Directors present their annual report, together with the audited financial statements, for the period from incorporation to 31 December 2002.

Principal Activities and Business Review

The principal activity of the Company was that of a group investment company. The Company was incorporated on 3 December 2001 accordingly these accounts have been prepared for a 12 month and 28 day period.

Results and Dividends

The profit for the period after taxation amounted to \$19,000. The Directors do not recommend the payment of a dividend.

Directors

The Directors who served during the period and at the date of this report were:

Mr D S Parkes (Appointed 3 Dec 2001)
Mr M Lester (Appointed 3 Dec 2001)
Mr C J Glasson (Appointed 20 May 2002)

None of the Directors had any beneficial or non-beneficial interest in the share capital of the Company during the period, nor in the period from 31st December, 2002 to the date of this report. The Board is not aware of any contract of significance in relation to the Company in which any Director has, or has had, a material interest. The beneficial, including family, interest in the share capital of BAE SYSTEMS plc, the ultimate holding company, of the persons who are Directors at the end of the period are shown below.

Ordinary Shares of 2.5p each of BAE SYSTEMS plc

	Shares		Share Options			
	At 1st January 2002	At 31st December 2002	At 1st January 2002	Exercised during 2002	Granted during 2002	At 31st December 2002
D S Parkes	241	1,385	27,237	1,144	8,163	34,256
M Lester	475,438	492,482	643,387	-	307,790	951,177
C J Glasson	40	40	37,400	-	20,000	57,400

M Lester holds 144,692 capital amortising loan stock (2001 : 144,692). In addition he holds a non beneficial interest in 200,000 (2001: 200,000) ordinary shares and 5,190,100 (2001 : 5,190,100) capital amortising stock. Further details of M Lester's interests are set out in the Remuneration Report contained within the 2002 BAE SYSTEMS plc Annual Report and Accounts.

Auditors

During the year KPMG Audit Plc were appointed as the Company's first auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board


D S Parkes
Director

Registered Office:
Warwick House
PO Box 87
Farnborough Aerospace Centre
Farnborough
Hants GU14 6YU

Directors' Report

Statement of Directors' Responsibilities

Company law requires the Directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent Auditor's Report on the financial statements

Independent Auditor's report to the members of BAE SYSTEMS Funding Two Limited

We have audited the financial statements on pages 4 to 6.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the Directors' report and, as described on page 2, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you, if in our opinion, the Directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Company is not disclosed.

Basis of Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31st December, 2002 and of its profit for the period since corporation then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

2nd October 2003

KPMG Audit Plc

Chartered Accountants
Registered Auditor
London

Profit and Loss Account

for the period to 31st December

	2002 \$'000
Note 3	
Interest receivable and similar income	19
Profit on ordinary activities before taxation	19
Tax on profit on ordinary activities	-
Profit on ordinary activities after taxation	19
Retained profit for the period	19

The Company had no recognised gains or losses for the period ended 31 December 2002 other than those shown above.
All results derive from continuing operations.

Balance Sheet

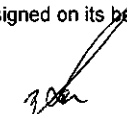
as at 31st December

	2002 \$'000
Current Assets	
Note 4	
Debtors : amounts due within one year	55,014
Note 4	
Debtors : amounts due after one year	947,410
Cash at Bank	25,805
Net Assets	1,028,229
Capital and reserves	
Note 5	
Called up share capital	1,001,000
Note 6	
Non-distributable reserve	27,210
Note 6	
Profit and loss account	19
Shareholders funds : Equity	1,028,229

These financial statements were approved by the Board on
signed on its behalf by:

2nd October 2003

and were


D.S. Parkes

Director

Notes to the Accounts

1 Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention, and on a going concern basis. The Company's earning stream is wholly in US Dollars and the Company's functional currency is the US Dollar. The Company has therefore also adopted the US Dollar as its reporting currency.

Cash flow statement

The Company is exempt from the requirement of Financial Reporting Standard No. 1 (revised) to prepare a cash flow statement as it is a wholly owned subsidiary undertaking of BAE SYSTEMS plc, and the cash flows are included within the consolidated cash flow statement of that company.

Related party transactions

The company is exempt from the requirement of Financial Reporting Standard No. 8 to disclose transactions with entities that are part of the group or investees of the group qualifying as related parties, as it is a wholly owned subsidiary undertaking of BAE SYSTEMS plc, whose consolidated financial statements are publicly available.

Taxation

The Company has not provided for corporation tax for the year, as any profits will be covered by the surrender of losses from other group companies, in respect of which no payment will be made. Provision for deferred tax is not required.

2 Directors

Emoluments

None of the Directors received any emoluments from the Company during the period.

3 Interest receivable and similar income

	2002 \$'000
External interest receivable	19

4 Debtors:

	2002 \$'000
Amounts due within one year	
Amounts owed by group undertakings	55,000
Other Debtors	14
	55,014

	2002 \$'000
Amounts due after one year	
Amounts owed by group undertakings	947,410

Notes to the Accounts

5 Share Capital

	Ordinary shares of \$1 each
Authorised	
At 31 December 2002	<u>1,600,000,000</u>
Issued	
On incorporation	100
On 24 June 2003	<u>1,001,000,000</u>
At 31 December 2002	<u>1,001,000,100</u>

On 21 June 2002 the Company made an invitation to BAE SYSTEMS Holdings Inc to make an offer to subscribe for 1,001,000,000 ordinary shares of US \$1 each in the capital of the Company. The total subscription price for the shares was US \$1,275,269,169 payable in eight instalments over a period of five years in accordance with the terms and conditions applying to the offer.

The majority of the subscription price will be paid on 30 June 2007, at the end of the five year period.

In order to make an offer to subscribe BAE SYSTEMS Holdings Inc was obliged to make the payment of the first instalment. BAE SYSTEMS Holdings Inc made the first instalment payment of \$1,000,000 in accordance with the terms of the offer to subscribe and on 24 June 2002 was issued 1,001,000,000 shares in the Company.

6 Reserves

	Non-distributable reserve
	\$'000
Movement during the period	27,210
At 31 December 2002	<u>27,210</u>

This reserve reflects the accretion of the difference between the nominal value of the shares subscribed for by BAE SYSTEMS Holdings Inc on 24 June 2002 and the total subscription price payable in instalments. This subscription is further described at Note 5.

	Profit and loss account
	\$'000
Retained profit for the period	19
At 31 December 2002	<u>19</u>

7 Ultimate Parent Company

The Company is a wholly owned subsidiary undertaking of its ultimate parent company, BAE SYSTEMS plc, a company incorporated in Great Britain and registered in England and Wales. On 25 June 2002 BAE SYSTEMS plc acquired the entire share capital of the company from BAE SYSTEMS Holdings Inc

The consolidated accounts of BAE SYSTEMS plc are available to the public and may be obtained from:
6 Carlton Gardens
Stirling Square
London SW1Y 5AD