

L 3 COMMUNICATIONS CORP

Form 10-Q

May 04, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended March 26, 2010**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission file numbers 001-14141 and 333-46983**

**L-3 COMMUNICATIONS HOLDINGS, INC.  
L-3 COMMUNICATIONS CORPORATION**

**(Exact names of registrants as specified in their charters)**

**Delaware**

**(State or other jurisdiction of  
incorporation or organization)**

**600 Third Avenue, New York, NY  
(Address of principal executive offices)**

**13-3937434 and 13-3937436**

**(I.R.S. Employer  
Identification Nos.)**

**10016  
(Zip Code)**

**(212) 697-1111  
(Telephone number)**

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files).  Yes  No

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Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, non-accelerated filers, or smaller reporting companies. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller Reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Act).  Yes     No

There were 115,741,171 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on April 29, 2010.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**INDEX TO QUARTERLY REPORT ON FORM 10-Q  
For the quarterly period ended March 26, 2010**

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ITEM 1. FINANCIAL STATEMENTS****L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS  
(in millions, except share data)**

	<b>(Unaudited) March 26, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,135	\$ 1,016
Billed receivables, net of allowances of \$38 in 2010 and \$32 in 2009	1,299	1,149
Contracts in process	2,436	2,358
Inventories	262	258
Deferred income taxes	199	247
Other current assets	135	123
Total current assets	5,466	5,151
Property, plant and equipment, net	834	854
Goodwill	8,183	8,190
Identifiable intangible assets	362	377
Deferred debt issue costs	44	47
Other assets	203	194
Total assets	\$ 15,092	\$ 14,813
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 681	\$
Accounts payable, trade	549	464
Accrued employment costs	641	642
Accrued expenses	465	482
Advance payments and billings in excess of costs incurred	521	521
Income taxes	83	10
Other current liabilities	358	363
Total current liabilities	3,298	2,482

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Pension and postretirement benefits	837	817
Deferred income taxes	308	272
Other liabilities	416	470
Long-term debt	3,437	4,112
<b>Total liabilities</b>	<b>8,296</b>	<b>8,153</b>
Commitments and contingencies (see Note 17)		
Equity:		
L-3 shareholders' equity:		
L-3 Communications Holdings, Inc.'s common stock: \$.01 par value; 300,000,000 shares authorized, 115,659,642 shares outstanding at March 26, 2010 and 115,353,546 shares outstanding at December 31, 2009 (L-3 Communications Corporation's common stock: \$.01 par value, 100 shares authorized, issued and outstanding)	4,544	4,449
L-3 Communications Holdings, Inc.'s treasury stock (at cost), 22,421,913 shares at March 26, 2010 and 21,040,541 shares at December 31, 2009	(1,947)	(1,824)
Retained earnings	4,281	4,108
Accumulated other comprehensive loss	(174)	(166)
<b>Total L-3 shareholders' equity</b>	<b>6,704</b>	<b>6,567</b>
Noncontrolling interests	92	93
<b>Total equity</b>	<b>6,796</b>	<b>6,660</b>
<b>Total liabilities and equity</b>	<b>\$ 15,092</b>	<b>\$ 14,813</b>

See notes to unaudited condensed consolidated financial statements.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share data)

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
Net sales:		
Products	\$ 1,714	\$ 1,762
Services	1,910	1,874
Total net sales	3,624	3,636
Cost of sales:		
Products	1,488	1,566
Services	1,726	1,694
Total cost of sales	3,214	3,260
Operating income	410	376
Interest and other income, net	4	3
Interest expense	64	66
Income before income taxes	350	313
Provision for income taxes	128	112
Net income	\$ 222	\$ 201
Less: Net income attributable to noncontrolling interests	1	2
Net income attributable to L-3	\$ 221	\$ 199
Less: Net income allocable to participating securities	2	2
Net income allocable to L-3 Holdings common shareholders	\$ 219	\$ 197
Earnings per share allocable to L-3 Holdings common shareholders:		
Basic	\$ 1.89	\$ 1.66
Diluted	\$ 1.87	\$ 1.66
L-3 Holdings weighted average common shares outstanding:		
Basic	115.9	118.4
Diluted	116.9	118.8





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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY  
(in millions, except per share data)**

	L-3 Holdings		Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Noncontrolling Interests	Total Equity
	Common Shares Issued	Par Value				Retained Earnings	Income (Loss)		
<b>For the quarter ended March 26, 2010:</b>									
Balance at December 31, 2009	115.4	\$ 1	\$ 4,448	\$ (1,824)	\$ 4,108	\$ (166)	\$ 93	\$ 6,660	
Comprehensive income:									
Net income					221		1	222	
Pension and postretirement benefit plans:									
Net gain arising during the period						2		2	
Amortization of net loss previously recognized, net of income taxes of \$4						6		6	
Foreign currency translation adjustment						(19)		(19)	
Unrealized gains on hedging instruments, net of income taxes of \$2						3		3	
Total comprehensive income								214	
Distributions to noncontrolling interests							(2)	(2)	
Cash dividends paid on common stock (\$0.40 per share)					(47)			(47)	
Shares issued:									
Employee savings plans	0.4		30					30	
Exercise of stock options	0.8		48					48	
Employee stock purchase plan	0.5								
Stock-based compensation expense			19					19	
Treasury stock purchased	(1.4)			(123)				(123)	

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Other	(2)			(1)			(3)		
Balance at March 26, 2010	115.7	\$ 1	\$ 4,543	\$ (1,947)	\$ 4,281	\$ (174)	\$ 92	\$ 6,796	
<b>For the quarter ended March 27, 2009:</b>									
Balance at December 31, 2008	118.6	\$ 1	\$ 4,135	\$ (1,319)	\$ 3,373	\$ (332)	\$ 83	\$ 5,941	
Comprehensive income:									
Net income					199		2	201	
Pension and postretirement benefit plans:									
Amortization of net loss previously recognized, net of income taxes of \$5						8		8	
Foreign currency translation adjustment						(13)		(13)	
Total comprehensive income								196	
Distributions to noncontrolling interests							(1)	(1)	
Cash dividends paid on common stock (\$0.35 per share)					(42)			(42)	
Shares issued:									
Employee savings plans	0.5		32					32	
Exercise of stock options			2					2	
Employee stock purchase plan	0.6								
Stock-based compensation expense			17					17	
Treasury stock purchased	(3.4)			(232)				(232)	
Balance at March 27, 2009	116.3	\$ 1	\$ 4,186	\$ (1,551)	\$ 3,530	\$ (337)	\$ 84	\$ 5,913	

See notes to unaudited condensed consolidated financial statements.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions)

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
<b>Operating activities:</b>		
Net income	\$ 222	\$ 201
Depreciation of property, plant and equipment	41	38
Amortization of intangibles and other assets	15	15
Deferred income tax provision	29	14
Stock-based employee compensation expense	19	17
Contributions to employee savings plans in L-3 Holdings common stock	30	32
Amortization of pension and postretirement benefit plans net loss and prior service cost	10	13
Amortization of bond discounts (included in interest expense)	6	6
Amortization of deferred debt issue costs (included in interest expense)	3	3
Subtotal	375	339
Changes in operating assets and liabilities, excluding acquired and divested amounts:		
Billed receivables	(157)	(101)
Contracts in process	(75)	(144)
Inventories	(10)	(10)
Accounts payable, trade	87	99
Accrued employment costs	(17)	(102)
Accrued expenses	(12)	25
Advance payments and billings in excess of costs incurred	1	(15)
Income taxes	80	56
Excess income tax benefits related to share-based payment arrangements	(5)	(1)
Other current liabilities	(3)	(13)
Pension and postretirement benefits	24	26
All other operating activities	(17)	(7)
Subtotal	(104)	(187)
Net cash from operating activities	271	152
<b>Investing activities:</b>		
Business acquisitions, net of cash acquired	(1)	(82)
Capital expenditures	(26)	(41)
Dispositions of property, plant and equipment		1
Investments in equity investees	(9)	
Other investing activities	1	

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Net cash used in investing activities	(35)	(122)
<b>Financing activities:</b>		
Common stock repurchased	(123)	(232)
Dividends paid on L-3 Holdings common stock	(47)	(42)
Proceeds from exercises of stock options	44	1
Proceeds from employee stock purchase plan	18	17
Excess income tax benefits related to share-based payment arrangements	5	1
Other financing activities	(1)	(1)
Net cash used in financing activities	(104)	(256)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(13)	(3)
Net increase (decrease) in cash and cash equivalents	119	(229)
Cash and cash equivalents, beginning of the period	1,016	867
Cash and cash equivalents, end of the period	\$ 1,135	\$ 638

See notes to unaudited condensed consolidated financial statements.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS**

**1. Description of Business**

L-3 Communications Holdings, Inc. derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a prime contractor in Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) systems, aircraft modernization and maintenance, and government services. L-3 is also a leading provider of a broad range of electronic systems used on military and commercial platforms. The Company's customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), U.S. Department of Justice (DoJ), allied foreign governments, domestic and foreign commercial customers and select other U.S. federal, state and local government agencies.

The Company has the following four reportable segments: (1) C<sup>3</sup>ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Electronic Systems. Financial information with respect to each of the Company's reportable segments is included in Note 21. C<sup>3</sup>ISR provides products and services for the global ISR market, C<sup>3</sup> systems, networked communications systems and secure communications products. The Company believes that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Government Services provides a full range of engineering, technical, analytical, information technology (IT), advisory, training, logistics and support services to the DoD, DoS, DoJ, and U.S. Government intelligence agencies and allied foreign governments. AM&M provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. The Company sells these services primarily to the DoD, the Canadian Department of National Defense and other allied foreign governments. Electronic Systems provides a broad range of products and services, including components, products, subsystems, systems, and related services to military and commercial customers in several niche markets across several business areas, including power & control systems, electro-optic/infrared (EO/IR), microwave, simulation & training, precision engagement, aviation products, security & detection, propulsion systems, displays, telemetry & advanced technology, undersea warfare, and marine services.

**2. Basis of Presentation**

These unaudited condensed consolidated financial statements for the quarterly period ended March 26, 2010 should be read in conjunction with the audited consolidated financial statements of L-3 Holdings and L-3 Communications included in their Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

The accompanying financial statements comprise the consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings' only asset is its investment in the common stock of L-3 Communications, its wholly-owned subsidiary, and its only obligations are: (1) the 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued by L-3 Holdings on July 29, 2005, (2) its guarantee of borrowings under the revolving credit facility of L-3 Communications and (3) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and

unconditionally guaranteed by L-3 Communications and certain of its wholly-owned domestic subsidiaries. Accordingly, such debt has been reflected as debt of L-3 Communications in its consolidated financial statements in accordance with the accounting standards for pushdown accounting. All issuances of and conversions into L-3 Holdings equity securities, including grants of stock options, restricted stock, restricted stock units and

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

performance units by L-3 Holdings to employees and directors of L-3 Communications and its subsidiaries, have been reflected in the consolidated financial statements of L-3 Communications. As a result, the consolidated financial positions, results of operations and cash flows of L-3 Holdings and L-3 Communications are substantially the same. See Note 23 for additional information regarding the unaudited financial information of L-3 Communications and its subsidiaries.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year.

Certain reclassifications have been made to conform prior year amounts to the current year presentation.

It is the Company's established practice to close its books for the quarters ending March, June and September on the Friday nearest to the end of the calendar quarter. The interim unaudited condensed consolidated financial statements included herein have been prepared and are labeled based on that convention. The Company closes its annual books on December 31 regardless of what day it falls on.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs of sales during the reporting period. The most significant of these estimates and assumptions relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, market values for inventories reported at lower of cost or market, pension and post-retirement benefit obligations, stock-based employee compensation expense, income taxes, including the valuations of deferred tax assets, litigation reserves and environmental obligations, accrued product warranty costs, and the recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Changes in estimates are reflected in the periods during which they become known. Actual amounts will differ from these estimates and could differ materially. For a more complete discussion of these estimates and assumptions, see the Annual Report of L-3 Holdings and L-3 Communications on Form 10-K for the fiscal year ended December 31, 2009.

**3. New Accounting Standards Implemented**

In June 2009, the Financial Accounting Standards Board (FASB) issued a revised standard for the accounting for variable interest entities (VIE), which replaces the quantitative-based risks and rewards approach with a qualitative approach and requires certain additional disclosures. The new qualitative approach focuses on determining which entity has the power and control to direct the activities of a VIE and requires an ongoing assessment of that conclusion. The revised accounting standard was effective for the Company beginning on January 1, 2010 and did not have a material impact on the Company's financial position, results of operations or cash flows.





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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

**4. Acquisitions**

All of the business acquisitions are included in the Company's results of operations from their respective dates of acquisition.

***2010 Business Acquisitions***

On April 14, 2010, the Company acquired all of the outstanding stock of Insight Technology Incorporated, a manufacturer of mission critical night vision and electro-optical equipment, for a preliminary purchase price of \$613 million. The purchase price was funded with cash on hand and is subject to adjustment based on the closing date actual net working capital, which has not been finalized. The final purchase price allocation is expected to be completed by the fourth quarter of 2010.

***2009 Business Acquisitions***

On January 30, 2009, the Company acquired all of the outstanding stock of Chesapeake Sciences Corporation (CSC) for a purchase price of \$91 million in cash, which included a \$7 million net working capital adjustment and \$4 million related to certain tax benefits acquired. The net working capital adjustment included \$6 million for cash acquired. The acquisition was financed using cash on hand. CSC is a developer and manufacturer of anti-submarine warfare systems for use onboard submarines and surface ship combatants. Based on the final purchase price allocation, the amount of goodwill recognized was \$56 million, which was assigned to the Electronic Systems reportable segment, and is not expected to be deductible for income tax purposes.

***Unaudited Pro Forma Statements of Operations Data***

The quarter ended March 27, 2009 unaudited pro forma Statements of Operations data presented below combines the results of the Company and its CSC business acquisition completed during the year ended December 31, 2009, assuming that the acquisition had occurred on January 1, 2009.

	<b>First Quarter Ended March 27, 2009 (in millions, except per share data)</b>	
Pro forma net sales	\$	3,642
Pro forma net income attributable to L-3	\$	199
Pro forma diluted earnings per share	\$	1.66

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2009.



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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

**5. Contracts in Process**

The components of contracts in process are presented in the table below.

	<b>March 26, 2010</b>	<b>December 31, 2009</b>
	(in millions)	
Unbilled contract receivables, gross	\$ 2,484	\$ 2,373
Less: unliquidated progress payments	(761)	(700)
Unbilled contract receivables, net	1,723	1,673
Inventoried contract costs, gross	823	800
Less: unliquidated progress payments	(110)	(115)
Inventoried contract costs, net	713	685
Total contracts in process	\$ 2,436	\$ 2,358

*Inventoried Contract Costs.* In accordance with contract accounting standards, the Company accounts for the portion of its general and administrative (G&A), independent research and development (IRAD) and bid and proposal (B&P) costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on its U.S. Government contracts (revenue arrangements) as inventoried contract costs. G&A, IRAD and B&P costs are allocated to contracts for which the U.S. Government is the end customer and are charged to costs of sales when sales on the related contracts are recognized. The Company's unallowable portion of its G&A, IRAD and B&P costs for its U.S. Government contractor businesses are expensed as incurred and are not included in inventoried contract costs.

The table below presents a summary of G&A, IRAD and B&P costs included in inventoried contract costs and the changes to them, including amounts charged to cost of sales for U.S. Government contracts for the periods presented.

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
	(in millions)	
Amounts included in inventoried contract costs at beginning of the period	\$ 77	\$ 74
Add: Contract costs incurred <sup>(1)</sup>	313	308
Less: Amounts charged to cost of sales	(306)	(303)

Amounts included in inventoried contract costs at end of the period	\$	84	\$	79
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(1) Incurred costs include IRAD and B&P costs of \$81 million for the quarter ended March 26, 2010 and \$76 million for the quarter ended March 27, 2009.

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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The table below presents a summary of selling, general and administrative expenses and research and development expenses for the Company's commercial businesses, which are expensed as incurred and not included in inventoried contract costs.

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
	<b>(in millions)</b>	
Selling, general and administrative expenses	\$ 63	\$ 66
Research and development expenses	12	15
Total	\$ 75	\$ 81

**6. Inventories**

*Inventories at Lower of Cost or Market.* The table below presents the components of inventories at cost (first-in, first-out or average cost), but not in excess of realizable value.

	<b>March 26, 2010</b>	<b>December 31, 2009</b>
	<b>(in millions)</b>	
Raw materials, components and sub-assemblies	\$ 93	\$ 92
Work in process	131	129
Finished goods	38	37
Total	\$ 262	\$ 258

**7. Goodwill and Identifiable Intangible Assets**

*Goodwill.* In accordance with the accounting standards for business combinations, the Company records the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). The table below presents the changes in goodwill allocated to the Company's reportable segments.

<b>Government</b>	<b>Electronic</b>	<b>Consolidated</b>
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	<b>C<sup>3</sup>ISR</b>	<b>Services</b>	<b>AM&amp;M (in millions)</b>	<b>Systems</b>	<b>Total</b>
<b>Balance at December 31, 2009</b>	\$ 870	\$ 2,320	\$ 1,158	\$ 3,842	\$ 8,190
Foreign currency translation adjustments <sup>(1)</sup>	(4)	(1)	7	(9)	(7)
<b>Balance at March 26, 2010</b>	\$ 866	\$ 2,319	\$ 1,165	\$ 3,833	\$ 8,183

<sup>(1)</sup> The net decrease in goodwill from foreign currency translation adjustments is due to the strengthening of the U.S. dollar during the quarter ended March 26, 2010 against the functional currencies of L-3's foreign subsidiaries in Germany and the United Kingdom, which was partially offset by the weakening of the U.S. dollar against the Canadian dollar.

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

*Identifiable Intangible Assets.* Information on the Company's identifiable intangible assets that are subject to amortization is presented in the table below.

	March 26, 2010			December 31, 2009			
	Weighted Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
				(in millions)			
Customer contractual relationships	23	\$ 512	\$ 173	\$ 339	\$ 515	\$ 163	\$ 352
Technology	9	78	60	18	78	58	20
Other, primarily favorable leasehold interests	7	14	9	5	14	9	5
Total	22	\$ 604	\$ 242	\$ 362	\$ 607	\$ 230	\$ 377

Amortization expense recorded by the Company for its identifiable intangible assets is presented in the table below.

	First Quarter Ended	
	March 26, 2010	March 27, 2009
	(in millions)	
Amortization expense	\$ 13	\$ 13

Based on gross carrying amounts at March 26, 2010, the Company's estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2010 through 2014 are presented in the table below.

	Year Ending December 31,				
	2010	2011	2012	2013	2014
	(in millions)				
Estimated amortization expense	\$ 51	\$ 46	\$ 39	\$ 30	\$ 30



At March 26, 2010 and December 31, 2009, the Company had approximately \$1 million of indefinite-lived identifiable intangible assets.

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**8. Other Current Liabilities and Other Liabilities**

The table below presents the components of other current liabilities.

	<b>March 26, 2010</b>	<b>December 31, 2009</b>
	(in millions)	
<b>Other Current Liabilities:</b>		
Accruals for pending and threatened litigation (see Note 17)	\$ 3	\$ 2
Accrued product warranty costs	91	90
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	77	74
Accrued interest	74	76
Deferred revenues	30	28
Aggregate purchase price payable for acquired businesses	3	4
Other	80	89
Total other current liabilities	\$ 358	\$ 363

The table below presents the components of other liabilities.

	<b>March 26, 2010</b>	<b>December 31, 2009</b>
	(in millions)	
<b>Other Liabilities:</b>		
Non-current income taxes payable (see Note 11)	\$ 181	\$ 232
Deferred compensation	80	83
Accrued workers compensation	50	46
Notes payable and capital lease obligations	10	10
Accrued product warranty costs	7	9
Unfavorable lease obligations	5	6
Other non-current liabilities	83	84
Total other liabilities	\$ 416	\$ 470

The table below presents the changes in the Company's accrued product warranty costs.

	<b>First Quarter Ended</b>	
	<b>March 26,</b>	<b>March 27,</b>
	<b>2010</b>	<b>2009</b>
	<b>(in millions)</b>	
<b>Accrued product warranty costs<sup>(1)</sup>:</b>		
Balance at January 1	\$ 99	\$ 102
Accruals for product warranties issued during the period	13	10
Foreign currency translation adjustments	(2)	
Settlements made during the period	(12)	(14)
Balance at end of period	\$ 98	\$ 98

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- (1) Warranty obligations incurred in connection with long-term production contracts that are accounted for under the percentage-of-completion cost-to-cost method are included within the contract estimates at completion and are excluded from the above amounts. The balances above include both long-term and short-term amounts.

**9. Debt**

The components of debt and a reconciliation to the carrying amount of current and long-term debt are presented in the table below.

	<b>March 26, 2010</b>	<b>December 31, 2009</b>
	<b>(in millions)</b>	
<b>L-3 Communications:</b>		
Borrowings under Revolving Credit Facility <sup>(1)</sup>	\$	\$
5 1/5% Senior Notes due 2019	1,000	1,000
6 1/8% Senior Subordinated Notes due 2013	400	400
6 1/8% Senior Subordinated Notes due 2014	400	400
5 7/8% Senior Subordinated Notes due 2015	650	650
6 3/8% Senior Subordinated Notes due 2015	1,000	1,000
Subtotal	3,450	3,450
<b>L-3 Holdings:</b>		
3% Convertible Contingent Debt Securities due 2035 <sup>(2)</sup>	700	700
Principal amount of long-term debt	4,150	4,150
Less: Unamortized discounts	(32)	(38)
Carrying amount of long-term debt	4,118	4,112
Less: Current portion of long-term debt <sup>(3)</sup>	(681)	
Carrying amount of long-term debt, excluding current portion	\$ 3,437	\$ 4,112

- (1) The Company's Revolving Credit Facility, which matures on October 23, 2012, allows for total aggregate borrowings of up to \$1 billion. At March 26, 2010, available borrowings under the Revolving Credit Facility were \$968 million after reductions for outstanding letters of credit of \$32 million.

(2)

Under select conditions, including if L-3 Holdings common stock price is more than 120% (currently \$120.17) of the then current conversion price (currently \$100.14) for a specified period, the conversion feature of the CODES will require L-3 Holdings, upon conversion, to pay the \$700 million principal amount in cash, and if the settlement amount exceeds the principal amount, the excess will be settled in cash or stock or a combination thereof, at the Company's option. At the current conversion price of \$100.14, the aggregate consideration to be delivered upon conversion would be determined based on 7.0 million shares of L-3 Holdings' common stock. See Note 10 to the audited consolidated financial statements for the year ended December 31, 2009, included in the Company's Annual Report on Form 10-K for additional information regarding the CODES, including conditions for conversion. L-3 Holdings' closing stock price on May 3, 2010 was \$95.34 per share. The effective interest rate on the CODES is 6.33%. Interest expense relates to both the contractual coupon interest and amortization of the discount on the liability components. Interest expense recognized was \$10 million for the first quarter periods ended March 26, 2010 and March 27, 2009. The following table provides additional information about the Company's CODES:

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	March 26, 2010	December 31, 2009
	(in millions)	
Carrying amount of the equity component (conversion feature)	\$ 64	\$ 64
Unamortized discount of liability component being amortized through February 1, 2011	\$ 19	\$ 24
Net carrying amount of liability component	\$ 681	\$ 676

- (3) Holders of the CODES may require us to repurchase them in whole or in part at a cash price equal to 100% of the principal amount (plus accrued and unpaid interest, including contingent interest and additional interest, if any) through the exercise of a put option on February 1, 2011. As a result, the CODES have been classified as a current liability at March 26, 2010.

**10. Comprehensive Income**

A reconciliation of net income to comprehensive income attributable to L-3 is presented in the table below.

	First Quarter Ended March 26, 2010	March 27, 2009
	(in millions)	
Net income	\$ 222	\$ 201
Other comprehensive income (loss):		
Foreign currency translation adjustments	(19)	(13)
Unrealized gains on hedging instruments	3 <sup>(1)</sup>	
Net gain from pension and postretirement benefit plans arising during the period	2	
Amortization of pension and postretirement benefit plans net loss and prior service cost <sup>(2)</sup>	6	8
Total comprehensive income	214	196
Less: Comprehensive income attributable to noncontrolling interests	1	2
Comprehensive income attributable to L-3	\$ 213	\$ 194

- (1) Amount is net of income taxes of \$2 million for the quarterly period ended March 26, 2010.

- (2)

Amounts are net of income taxes of \$4 million and \$5 million for the quarter ended March 26, 2010 and March 27, 2009, respectively. See Note 18.

## **11. Income Taxes**

The U.S. Federal income tax jurisdiction is the Company's major tax jurisdiction. The statutes of limitation for the Company's U.S. Federal income tax returns for the years ended December 31, 2006 through 2008 are open as of March 26, 2010. The Internal Revenue Service (IRS) began its audit of the Company's 2006 and 2007 U.S. Federal income tax returns in April 2009. In addition, the Company has numerous state and foreign income tax return audits currently in process. As a result of filing an IRS tax accounting method change regarding compensation expense during the quarter ended March 26, 2010, the Company decreased both its unrecognized tax benefits and its current deferred tax assets by \$48 million. As of March 26, 2010, the Company anticipates that unrecognized tax benefits will decrease by approximately \$7 million over the next 12 months.

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Current and non-current income taxes payable include accrued interest of \$16 million (\$10 million after income taxes) at March 26, 2010 and \$23 million (\$14 million after income taxes) at December 31, 2009, and penalties of \$10 million at March 26, 2010 and \$9 million at December 31, 2009.

**12. L-3 Holdings Earnings Per Common Share**

A reconciliation of basic and diluted earnings per share (EPS) is presented in the table below.

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
	<b>(in millions, except per share data)</b>	
<b>Reconciliation of net income:</b>		
Net income	\$ 222	\$ 201
Net income attributable to noncontrolling interests	(1)	(2)
Net income allocable to participating securities	(2)	(2)
Net income allocable to L-3 Holdings common shareholders	\$ 219	\$ 197
<b>Earnings per share allocable to L-3 Holdings common shareholders:</b>		
<b>Basic:</b>		
Weighted average common shares outstanding	115.9	118.4
<b>Basic earnings per share:</b>		
Net income	\$ 1.89	\$ 1.66
<b>Diluted:</b>		
Common and potential common shares:		
Weighted average common shares outstanding	115.9	118.4
Assumed exercise of stock options	3.6	3.5
Unvested restricted stock awards	1.1	0.1
Employee stock purchase plan contributions	0.5	0.6
Performance unit awards	0.1	
Assumed purchase of common shares for treasury	(4.3)	(3.8)
Assumed conversion of the CODES	(1)	(1)
Common and potential common shares	116.9	118.8
<b>Diluted earnings per share:</b>		
Net income	\$ 1.87	\$ 1.66



- (1) L-3 Holdings CODES had no impact on diluted EPS for the quarter period ended March 26, 2010 or the quarter period ended March 27, 2009, because the average market price of L-3 Holdings common stock during these periods was less than the price at which the CODES would have been convertible into L-3 Holdings common stock. As of March 26, 2010 the conversion price was \$100.14.

Excluded from the computations of diluted EPS are shares related to stock options, restricted stock, and restricted stock units underlying employee stock-based compensation of 2.3 million and 2.8 million for the quarter ended March 26, 2010 and the quarter ended March 27, 2009, respectively, because they were anti-dilutive.

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**13. Equity**

Repurchases of L-3 Holdings common stock under the \$1 billion share repurchase program, approved by the Board of Directors in November 2008, are made from time to time at management's discretion in accordance with applicable U.S. federal securities laws in the open market or otherwise. All share repurchases of L-3 Holdings common stock have been recorded as treasury shares. At March 26, 2010, the remaining dollar value under the share repurchase program was \$303 million.

From March 27, 2010 through May 3, 2010, L-3 Holdings repurchased 268,364 shares of its common stock at an average price of \$94.42 per share for an aggregate amount of \$25 million.

On April 27, 2010, L-3 Holdings' Board of Directors declared a quarterly cash dividend of \$0.40 per share, payable on June 15, 2010 to shareholders of record at the close of business on May 17, 2010.

**14. Fair Value Measurements**

The following table presents the fair value hierarchy level for each of the Company's assets and liabilities that are measured and recorded at fair value on a recurring basis.

Description	March 26, 2010			December 31, 2009		
	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Level 3 <sup>(3)</sup>	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Level 3 <sup>(3)</sup>
	(in millions)					
<b>Assets</b>						
Cash equivalents	\$ 791	\$	\$	\$ 891	\$	\$
Derivatives (foreign currency forward contracts)		23			16	\$
<b>Total Assets</b>	\$ 791	\$ 23	\$	\$ 891	\$ 16	\$
<b>Liabilities</b>						
Derivatives (foreign currency forward contracts)	\$	\$ 12	\$	\$	\$ 10	\$

(1) Level 1 is based on quoted market prices available in active markets for identical assets or liabilities as of the reporting date. Cash equivalents are primarily held in registered money market funds which are valued using quoted market prices.

(2) Level 2 is based on pricing inputs other than quoted prices in active markets, which are either directly or indirectly observable. The fair value is determined using a valuation model based on observable market inputs,

including quoted foreign currency forward exchange rates and consideration of non-performance risk.

- (3) Level 3 is based on pricing inputs that are not observable and not corroborated by market data. The Company has no Level 3 assets or liabilities.

## **15. Financial Instruments**

At March 26, 2010 and December 31, 2009, the Company's financial instruments consisted primarily of cash and cash equivalents, billed receivables, trade accounts payable, Senior Notes, Senior Subordinated Notes, CODES and foreign currency forward contracts. The carrying amounts of cash and cash equivalents, billed receivables and trade accounts payable are representative of their respective fair values because of the short-term maturities or expected settlement dates of these instruments. The fair value of the Senior Notes, Senior Subordinated Notes and CODES are based on quoted prices for these securities. The fair values of foreign currency forward contracts are

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based on forward exchange rates. The carrying amounts and estimated fair values of the Company's financial instruments are presented in the table below.

	March 26, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Senior Notes	\$ 997	\$ 1,003	\$ 996	\$ 995
Senior Subordinated Notes	2,440	2,498	2,440	2,461
CODES	681	738	676	736
Foreign currency forward contracts <sup>(1)</sup>	11	11	6	6

<sup>(1)</sup> See Note 16 for additional disclosures regarding the notional amounts and fair values of foreign currency forward contracts.

**16. Derivative Financial Instruments**

*Derivative Financial Instruments.* The Company's derivative financial instruments include foreign currency forward contracts, which are entered into for risk management purposes, and an embedded derivative representing the contingent interest payment provision related to the CODES.

*Foreign Currency Forward Contracts.* The Company's U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, the Company enters into foreign currency forward contracts. The Company's activities involving foreign currency forward contracts are designed to hedge the changes in the functional currency equivalent cash flows due to movements in foreign exchange rates compared to the functional currency. The foreign currencies hedged are primarily the Canadian dollar, the Euro, the British pound and the U.S. dollar. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. Foreign currency forward contracts are recorded in the Company's condensed consolidated balance sheets at fair value and are generally designated and accounted for as cash flow hedges in accordance with the accounting standards for derivative instruments and hedging activities. Gains and losses on designated foreign currency forward contracts that are highly effective in offsetting the corresponding change in the cash flows of the hedged transactions are recorded net of income taxes in accumulated other comprehensive income (loss) (accumulated OCI) and then recognized in income when the underlying hedged transaction affects income. Gains and losses on foreign currency forward contracts that do not meet hedge accounting criteria are recognized in income immediately.

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Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The table below presents the notional amounts of the Company's outstanding foreign currency forward contracts by currency as of March 26, 2010:

Currency	Notional Amount (in millions)
U.S. dollar	\$ 104
Canadian dollar	84
British pound	81
Euro	35
Other	6
Total	\$ 310

At March 26, 2010, the Company's foreign currency forward contracts had maturities through 2016.

*Embedded Derivative.* The embedded derivative related to the issuance of the CODES is recorded at fair value with changes reflected in the unaudited condensed consolidated statements of operations.

The table below presents the fair values and the location of the Company's derivative instruments in the condensed consolidated balance sheets.

Fair Values of Derivative Instruments <sup>(1)</sup>							
March 26, 2010				December 31, 2009			
Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities
(in millions)							

**Derivatives designated as  
hedging instruments:**

Foreign currency forward contracts	\$ 7	\$ 11	\$ 5	\$ 2	\$ 6	\$ 7	\$ 4	\$ 2
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**Derivatives not designated as  
hedging instruments:**

Foreign currency forward contracts	3	2	3	2	2	1	3	1
Embedded derivative related to the CODES								

Total derivative instruments      \$ 10    \$ 13    \$ 8    \$ 4    \$ 8    \$ 8    \$ 7    \$ 3

(1) See Note 14 for a description of the fair value hierarchy related to the Company's foreign currency forward contracts.

The effect of gains or losses from foreign currency forward contracts was not material to the unaudited condensed consolidated statements of operations for the quarters ended March 26, 2010 and March 27, 2009. The estimated net amount of existing gains at March 26, 2010 that is expected to be reclassified into income within the next 12 months is \$3 million.

**17. Commitments and Contingencies**

***U.S. and Foreign Government Procurement Regulations***

A substantial majority of the Company's revenues are generated from providing products and services under legally binding agreements, or contracts, with U.S. Government and foreign government customers. U.S. Government contracts are subject to extensive legal and regulatory requirements, and, from time to time, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. The Company is currently cooperating with the U.S. Government on several investigations from which civil, criminal or administrative proceedings could result and give rise to fines, penalties, compensatory and

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treble damages, restitution and/or forfeitures. The Company does not currently anticipate that any of these investigations will have a material adverse effect, individually or in the aggregate, on its consolidated financial position, results of operations or cash flows. However, under U.S. Government regulations, an indictment of the Company by a federal grand jury could result in the Company being suspended for a period of time from eligibility for awards of new government contracts or in a loss of export privileges. A conviction could result in debarment from contracting with the federal government for a specified term. In addition, all of the Company's U.S. Government contracts: (1) are subject to audit and various pricing and cost controls, (2) include standard provisions for termination for the convenience of the U.S. Government or for default, and (3) are subject to cancellation if funds for contracts become unavailable. Foreign government contracts generally include comparable provisions relating to terminations for convenience and default, as well as other procurement clauses relevant to the foreign government.

***Litigation Matters***

The Company has been subject to and is involved in litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to its businesses, including those specified below. Furthermore, in connection with certain business acquisitions, the Company has assumed some or all claims against, and liabilities of, the acquired business, including both asserted and unasserted claims and liabilities. In accordance with the accounting standard for contingencies, the Company records a liability when management believes that it is both probable that a liability has been incurred and the Company can reasonably estimate the amount of the loss. Generally, the loss is recorded at the amount the Company expects to resolve the liability. The estimated amounts of liabilities recorded for pending and threatened litigation is disclosed in Note 8. Amounts recoverable from insurance contracts or third parties are recorded as assets when deemed probable. At March 26, 2010, the Company did not record any amounts for recoveries from insurance contracts or third parties in connection with the amount of liabilities recorded for pending and threatened litigation. Legal defense costs are expensed as incurred. The Company believes it has recorded adequate provisions for its litigation matters. The Company reviews these provisions quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. While it is reasonably possible that an unfavorable outcome may occur in one or more of the following matters, unless otherwise stated below, the Company believes that it is not probable that a loss has been incurred in any of these matters. An estimate of loss or range of loss is disclosed for a particular litigation matter when such amount or amounts can be reasonably estimated and no loss has been accrued. The Company believes that any damage amounts claimed in the specific matters discussed below are not meaningful indicators of potential liability. Although the Company believes that it has valid defenses with respect to legal matters and investigations pending against it, litigation is inherently unpredictable, including those that are expected to be resolved with jury trials, for which outcomes are difficult to predict. Therefore, it is possible that the financial position, results of operations or cash flows of the Company could be materially adversely affected in any particular period by the unfavorable resolution of one or more of these or other contingencies.

*Kalitta Air.* On January 31, 1997, a predecessor of Kalitta Air filed a lawsuit in the U.S. District Court for the Northern District of California (the trial court) asserting, among other things, negligence and negligent misrepresentation against Central Texas Airborne Systems, Inc. (CTAS), a predecessor to L-3 Integrated Systems (L-3 IS), in connection with work performed by a predecessor to CTAS to convert two Boeing 747 aircraft from passenger configuration to cargo freighters. The work was performed using Supplemental Type Certificates (STCs) issued in 1988 by the Federal Aviation Administration (FAA). In 1996, following completion of the work, the FAA issued an

airworthiness directive with respect to the STCs that effectively grounded the aircraft. On August 11, 2000, the trial court granted CTAS motion for summary judgment as to negligence, dismissing that claim. In January 2001, after a ruling by the trial court that excluded certain evidence from trial, a jury rendered a unanimous defense verdict in favor of CTAS on the negligent misrepresentation claim. On December 10, 2002, the U.S. Court of Appeals for the



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Ninth Circuit (the Court of Appeals) reversed the trial court's decisions as to summary judgment and the exclusion of evidence, and remanded the case for a new trial on both the negligence and negligent misrepresentation claims. The retrial ended on March 2, 2005 with a deadlocked jury and mistrial. On July 22, 2005, the trial court granted CTAS' motion for judgment as a matter of law as to negligence, dismissing that claim, and denied CTAS' motion for judgment as a matter of law as to negligent misrepresentation. On October 8, 2008, the Court of Appeals reversed the trial court's dismissal of the negligence claim and affirmed the trial court's ruling as to the negligent misrepresentation claim. As a result, the case was remanded to the trial court to reconsider the negligence claim and for further proceedings on the negligent misrepresentation claim. The trial court held a new hearing on CTAS' motion to dismiss the negligence claim on April 30, 2009, after which it determined to take the matter under advisement. The case is currently scheduled to go to a third trial on November 1, 2010. The parties have participated in court-ordered mediations from time to time, and are expected to participate in future court-ordered mediations prior to trial, but to date such mediations have not resulted in a mutually acceptable resolution of this matter. In connection with these mediations, Kalitta Air has claimed it may seek damages at the third trial of between \$430 million and \$900 million, including between \$200 million and \$240 million of pre-judgment interest. CTAS' insurance carrier has accepted defense of this matter and has retained counsel, subject to a reservation of rights by the insurer to dispute its obligations under the applicable insurance policies in the event of a finding against L-3. The Company believes that it has meritorious defenses to the claims asserted and the damages sought and intends to defend itself vigorously.

*Korean Lot II Program.* On April 4, 2005, Lockheed Martin Corporation (Lockheed) filed a lawsuit in the U.S. District Court for the Northern District of Georgia alleging that L-3 IS is in breach of its license agreement with Lockheed and is infringing on Lockheed's intellectual property rights as a result of its performance of a subcontract awarded to L-3 IS for the Korean Lot II program. During the trial that began on May 4, 2009, Lockheed sought disgorgement of the monies paid or payable to L-3 IS under the subcontract (which Lockheed claims to be approximately \$315 million) or, under an alternative theory of damages, royalties of approximately \$20 million. On May 21, 2009, a jury found in favor of Lockheed and awarded \$30 million on the misappropriation claim, approximately \$7 million on the breach of license agreement claim, plus legal fees and expenses. On August 28, 2009, L-3 IS filed a motion with the court seeking dismissal or a retrial of the case on various grounds. On March 31, 2010, the court set aside the jury verdict and ordered a new trial based on its findings that Lockheed withheld certain documents from L-3 IS that were required to be produced as part of pre-trial discovery. The date for the new trial has not yet been scheduled.

*Aircrew Training and Rehearsal Support (ATARS) Investigation.* Following a lawsuit filed by Lockheed on April 6, 2006 in the U.S. District Court for the Middle District of Florida against the Company and certain individuals related to the ATARS II Program (which was settled in November 2007), the Company received Grand Jury subpoenas in November 2006 and December 2007 in connection with an investigation being conducted by the United States Attorney for the Middle District of Florida, Orlando Division. The subpoenas request the production of documents related to Lockheed's allegations or produced in the civil litigation. The Company is cooperating fully with the U.S. Government.

*Titan Government Investigation.* In October 2002, The Titan Corporation (Titan) received a grand jury subpoena from the Antitrust Division of the DoJ requesting the production of documents relating to information technology services performed for the U.S. Air Force at Hanscom Air Force Base in Massachusetts and Wright-Patterson Air Force Base in Ohio. Titan was informed that other companies who have performed similar services had received subpoenas as

well. The Company acquired Titan in July 2005. On September 20, 2006, counsel for the Company was informed by the New York Field Office of the DoJ's Criminal Antitrust Division that it was considering indictment. Additionally, a former Titan employee received a letter from the DoJ indicating that he was a target of the investigation. In December 2008, the DoJ contacted the Company to arrange additional employee

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interviews concerning a teaming agreement relating to the Wright-Patterson Air Force Base procurement. In January 2010, counsel for the Company was again informed by the New York Field Office that it was considering indictment. If the Field Office recommends indictment then, under normal DoJ procedures, Titan (now known as L-3 Services, Inc.) will be afforded an opportunity to make a presentation to the Criminal Antitrust Division in Washington, D.C. before the DoJ acts on the recommendation. It is not known whether an indictment of L-3 Services or any of its current or former employees will occur. If it does occur, it is possible that L-3 Services could be suspended or debarred from conducting business with the U.S. Government. The Company is cooperating fully with the U.S. Government.

*CyTerra Government Investigation.* Since November 2006, CyTerra has been served with civil and Grand Jury subpoenas by the DoD Office of the Inspector General and the DoJ and has been asked to facilitate employee interviews. The Company is cooperating fully with the U.S. Government. The Company believes that it is entitled to indemnification for any course of defense related to this matter out of, and has made a claim against, a \$15 million escrow fund established in connection with the Company's acquisition of CyTerra in March 2006.

*Bashkirian Airways.* On July 1, 2004, lawsuits were filed on behalf of the estates of 31 Russian children in the state courts of Washington, Arizona, California, Florida, New York and New Jersey against Honeywell, Honeywell TCAS, Thales USA, Thales France, the Company and Aviation Communications & Surveillance Systems (ACSS), which is a joint venture of L-3 and Thales. The suits relate to the crash over southern Germany of Bashkirian Airways Tupelov TU 154M aircraft and a DHL Boeing 757 cargo aircraft. On-board the Tupelov aircraft were 9 crew members and 60 passengers, including 45 children. The Boeing aircraft carried a crew of two. Both aircraft were equipped with Honeywell/ACSS Model 2000, Change 7 Traffic Collision and Avoidance Systems (TCAS). Sensing the other aircraft, the on-board DHL TCAS instructed the DHL pilot to descend, and the Tupelov on-board TCAS instructed the Tupelov pilot to climb. However, the Swiss air traffic controller ordered the Tupelov pilot to descend. The Tupelov pilot disregarded the on-board TCAS and put the Tupelov aircraft into a descent striking the DHL aircraft in midair at approximately 35,000 feet. All crew and passengers of both planes were lost. Investigations by the National Transportation Safety Board after the crash revealed that both TCAS units were performing as designed. The suits allege negligence and strict product liability based upon the design of the units and the training provided to resolve conflicting commands and seek approximately \$315 million in damages, including \$150 million in punitive damages. The Company's insurers have accepted defense of this matter and have retained counsel. The matters were consolidated in the U.S. District Court for the District of New Jersey, which has dismissed the actions on the basis of forum non conveniens. The plaintiffs re-filed a complaint on April 23, 2007 with the Barcelona Court's Registry in Spain. On March 9, 2010, the court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of approximately \$6.7 million, all of which represented compensatory damages. The Company believes that the verdict and the damages awarded are inconsistent with the law and evidence presented. Accordingly, on March 17, 2010, ACSS filed a notice with the court of its intent to appeal. The plaintiffs notified the court on the same date that they also intend to appeal.

*Gol Airlines.* A complaint was filed on November 7, 2006 in the U.S. District Court for the Eastern District of New York against ExcelAire, Joseph Lepore, Jan Paul Paladino, and Honeywell. On October 23, 2007, an amended complaint was filed to include Lockheed, Raytheon, Amazon Technologies and ACSS. The complaints relate to the September 29, 2006 airplane crash over Brazil of a Boeing 737-800 operated by GOL Linhas Aereas Inteligentes, S.A. and an Embraer 600 business jet operated by ExcelAire. The complaints allege that ACSS designed the Traffic

Collision and Avoidance System (TCAS) on the ExcelAire jet, and assert claims of negligence, strict products liability and breach of warranty against ACSS based on the design of the TCAS and the instructions provided for its use. The complaints seek unspecified monetary damages, including punitive damages. The Company's insurers have accepted defense of this matter and have retained counsel. On July 2, 2008, the District Court dismissed the actions on the basis of forum non conveniens on the grounds that Brazil was the location of the accident and is more

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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convenient for witnesses and document availability. On December 2, 2009, the U.S. Court of Appeals for the Second Circuit upheld this decision. Some of the plaintiffs re-filed their complaints in the Lower Civil Court in the Judicial District of Peixoto de Azevedo in Brazil on July 3, 2009.

**18. Pension and Other Postretirement Benefits**

The following table summarizes the components of net periodic benefit cost for the Company's pension and postretirement benefit plans.

	Pension Plans		Postretirement Benefit Plans	
	March 26, 2010	First Quarter Ended March 27, 2009	March 26, 2010	March 27, 2009
	(in millions)			
<b>Components of net periodic benefit cost:</b>				
Service cost	\$ 24	\$ 22	\$ 1	\$ 1
Interest cost	30	27	3	3
Expected return on plan assets	(28)	(22)		(1)
Amortization of prior service costs (credits)	1	1	(1)	(1)
Amortization of net losses	10	13		
Curtailement loss		1		
Net periodic benefit cost	\$ 37	\$ 42	\$ 3	\$ 2

*Contributions.* For the year ending December 31, 2010, the Company currently expects to contribute cash of approximately \$140 million to its pension plans, and approximately \$13 million to its postretirement benefit plans. The Company contributed cash of \$4 million to its pension plans and \$3 million to its postretirement benefit plans during the quarter ended March 26, 2010.

**19. Employee Stock-Based Compensation**

On February 23, 2010, the Company granted stock-based compensation awards under the 2008 Long Term Performance Plan (2008 LTTP) in the form of stock options, restricted stock units and performance units.

*Stock Options.* The Company granted 548,165 stock options with an exercise price equal to the fair market value of L-3 Holdings' common stock on the date of grant. The options expire after 10 years from the date of grant and vest ratably over a three year period on the annual anniversary of the date of grant. The weighted average grant date fair value for the options awarded was \$18.40 and was estimated using the Black-Scholes option-pricing model. The weighted average assumptions used in the valuation model for this grant are presented in the table below:

Expected holding period (in years)	4.7
Expected volatility	26.2%
Expected dividend yield	2.2%
Risk-free interest rate	2.3%

*Restricted Stock Units.* The Company granted 593,373 restricted stock units with a weighted average grant date fair value of \$90.18 per share. These units automatically convert into shares of L-3 Holdings common stock

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upon vesting, and are subject to forfeiture until certain restrictions have lapsed, including a three year cliff vesting period starting on the date of grant.

*Performance Units.* The Company granted 67,200 performance units, with a weighted average grant date fair value per unit of \$105.19. The payout for these units is based on the achievement of pre-determined performance goals established by the compensation committee of the Company's board of directors for the three-year period ending December 31, 2012. The payout can range from zero to 200% of the original number of units awarded, which are converted into shares of L-3 Holdings' common stock and/or an amount of cash based on the then existing closing price at the end of the performance period.

On April 27, 2010, the stockholders of L-3 Holdings approved an amendment to the 2008 LTTP. The principal purpose of the amendment is to increase the number of shares authorized for issuance under the 2008 LTTP to approximately 12.2 million shares, except that each share of L-3 Holdings common stock issued under a full value award (awards other than stock options or stock appreciation rights) will be counted as 2.6 shares for purposes of this share limit.

**20. Supplemental Cash Flow Information**

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
	<b>(in millions)</b>	
Interest paid on outstanding debt	\$ 57	\$ 59
Income tax payments	23	45
Income tax refunds	4	2

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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**21. Segment Information**

The Company has four reportable segments, which are described in Note 1. The tables below present net sales, operating income, depreciation and amortization and total assets by reportable segment.

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
	<b>(in millions)</b>	
<b>Net Sales:</b>		
C <sup>3</sup> ISR	\$ 805	\$ 715
Government Services	943	1,007
AM&M	719	672
Electronic Systems	1,266	1,286
Elimination of intercompany sales	(109)	(44)
Consolidated total	\$ 3,624	\$ 3,636
<b>Operating Income:</b>		
C <sup>3</sup> ISR	\$ 106	\$ 78
Government Services	77	91
AM&M	60	66
Electronic Systems	167	141
Consolidated total	\$ 410	\$ 376
<b>Depreciation and amortization:</b>		
C <sup>3</sup> ISR	\$ 14	\$ 10
Government Services	10	10
AM&M	5	5
Electronic Systems	27	28
Consolidated total	\$ 56	\$ 53

**March 26,      December 31,  
2010              2009  
(in millions)**

**Total Assets:**



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C <sup>3</sup> ISR	\$	1,931	\$	1,865
Government Services		3,480		3,333
AM&M		1,986		1,914
Electronic Systems		6,644		6,524
Corporate		1,051		1,177
Consolidated total	\$	15,092	\$	14,813

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**22. Accounting Standards Issued and Not Yet Implemented**

In October 2009, the FASB issued a revised accounting standard for revenue arrangements with multiple deliverables. The revision: (1) removes the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, (2) provides a hierarchy that entities must use to estimate the selling price, (3) eliminates the use of the residual method for allocation, and (4) expands the ongoing disclosure requirements. The revised accounting standard is effective for the Company beginning on January 1, 2011, with early adoption permitted. The Company is currently assessing the impact the revised accounting standard will have on its consolidated financial statements.

In October 2009, the FASB issued a revised accounting standard for certain revenue arrangements that include software elements. Under the revised standard, tangible products that contain both software and non-software components that work together to deliver a product's essential functionality will be removed from the scope of pre-existing software revenue recognition standards. In addition, hardware components of a tangible product containing software components will always be excluded from software revenue recognition standards. The revised accounting standard is effective for the Company beginning on January 1, 2011, with early adoption permitted. The Company is currently assessing the impact the revised accounting standard will have on its consolidated financial statements.

**23. Unaudited Financial Information of L-3 Communications and Its Subsidiaries**

L-3 Communications is a wholly-owned subsidiary of L-3 Holdings. The debt of L-3 Communications, including the Senior Notes, Senior Subordinated Notes and borrowings under amounts drawn against the Revolving Credit Facility, are guaranteed, on a joint and several, full and unconditional basis, by certain of its domestic subsidiaries (the Guarantor Subsidiaries). The foreign subsidiaries and certain domestic subsidiaries of L-3 Communications (the Non-Guarantor Subsidiaries) do not guarantee the debt of L-3 Communications. None of the debt of L-3 Communications has been issued by its subsidiaries. There are no restrictions on the payment of dividends from the Guarantor Subsidiaries to L-3 Communications.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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The following unaudited condensed combining financial information presents the results of operations, financial position and cash flows of: (1) L-3 Holdings, excluding L-3 Communications and its consolidated subsidiaries (the Parent ), (2) L-3 Communications, excluding its consolidated subsidiaries, (3) the Guarantor Subsidiaries, (4) the Non-Guarantor Subsidiaries, and (5) the eliminations to arrive at the information for L-3 on a consolidated basis.

	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communication</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated L-3</b>
	<b>(in millions)</b>					
<b><u>Condensed Combining Balance Sheets:</u></b>						
<b><u>At March 26, 2010:</u></b>						
Current assets:						
Cash and cash equivalents	\$	\$	733	\$	5	\$
Billed receivables, net			298		773	\$
Contracts in process			674		1,542	\$
Other current assets			296		160	\$
					140	\$
Total current assets			2,001		2,480	\$
Goodwill			1,130		5,898	\$
Other assets	3		486		774	\$
Investment in and amounts due from consolidated subsidiaries	7,382		9,260		1,836	\$
						(18,478)
Total assets	\$	7,385	\$	12,877	\$	10,988
						\$
						2,348
						\$
						(18,506)
						\$
						15,092
Current portion of long-term debt						
Other current liabilities	\$	681	\$	681	\$	(681)
Amounts due to consolidated subsidiaries			819		1,242	\$
Other long-term liabilities			1,236		237	\$
Long-term debt			3,437		88	\$
					299	\$
						(299)
Total liabilities	681		6,173		1,479	\$
						968
						(1,005)
						\$
						8,296
L-3 shareholders' equity	6,704		6,704		9,509	\$
Noncontrolling interests					1,380	\$
						(17,593)
						\$
						6,704
						92
						\$
						92

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Total equity	6,704	6,704	9,509	1,380	(17,501)	6,796
Total liabilities and equity	\$ 7,385	\$ 12,877	\$ 10,988	\$ 2,348	\$ (18,506)	\$ 15,092

**At December 31, 2009:**

Current assets:

Cash and cash equivalents	\$	\$ 797	\$ 4	\$ 364	\$ (149)	\$ 1,016
Billed receivables, net		321	629	199		1,149
Contracts in process		593	1,533	232		2,358
Other current assets		334	164	130		628

Total current assets		2,045	2,330	925	(149)	5,151
Goodwill		1,144	5,874	1,172		8,190
Other assets	3	485	810	177	(3)	1,472
Investment in and amounts due from consolidated subsidiaries	7,240	8,962	1,949		(18,151)	

Total assets	\$ 7,243	\$ 12,636	\$ 10,963	\$ 2,274	\$ (18,303)	\$ 14,813
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Current liabilities	\$	\$ 714	\$ 1,338	\$ 579	\$ (149)	\$ 2,482
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Amounts due to consolidated subsidiaries				260	(260)	
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Other long-term liabilities		1,243	226	90		1,559
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Long-term debt	676	4,112			(676)	4,112
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Total liabilities	676	6,069	1,564	929	(1,085)	8,153
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L-3 shareholders equity	6,567	6,567	9,399	1,345	(17,311)	6,567
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Noncontrolling interests					93	93
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Total equity	6,567	6,567	9,399	1,345	(17,218)	6,660
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Total liabilities and equity	\$ 7,243	\$ 12,636	\$ 10,963	\$ 2,274	\$ (18,303)	\$ 14,813
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**L-3 COMMUNICATIONS HOLDINGS, INC.  
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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communication</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated L-3</b>
	<b>(in millions)</b>					
<b><u>Condensed Combining Statements of Operations:</u></b>						
<b><u>For the quarter ended March 26, 2010:</u></b>						
Net sales	\$	\$	797	\$	2,390	\$
Cost of sales		19	669	2,165	435	(74)
Operating (loss) income		(19)	128	225	57	19
Interest and other income, net			32			(28)
Interest expense		11	64	27	1	(39)
(Loss) income before income taxes		(30)	96	198	56	30
(Benefit) provision for income taxes		(11)	35	72	21	11
Equity in net income of consolidated subsidiaries		240	160			(400)
Net income		221	221	126	35	(381)
Net income attributable to noncontrolling interests						1
Net income attributable to L-3	\$	221	\$	221	\$	126
						35
						(382)
	\$		\$		\$	221
<b><u>For the quarter ended March 27, 2009:</u></b>						
Net sales	\$	\$	794	\$	2,444	\$
Cost of sales		17	697	2,211	379	(44)
Operating (loss) income		(17)	97	233	46	17
Interest and other income, net			30		1	(28)
Interest expense		11	66	27	1	(39)
(Loss) income before income taxes		(28)	61	206	46	28
(Benefit) provision for income taxes		(10)	20	75	17	10
		217	158			(375)

Equity in net income of consolidated subsidiaries

Net income	199		199		131		29		(357)		201
Net income attributable to noncontrolling interests									2		2
Net income attributable to L-3	\$ 199	\$	199	\$	131	\$	29	\$	(359)	\$	199

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AND L-3 COMMUNICATIONS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communication Subsidiaries</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated L-3</b>
	<b>(in millions)</b>					
<b><u>Condensed Combining Statements of Cash Flows:</u></b>						
<b><u>For the quarter ended March 26, 2010:</u></b>						
<b>Operating activities:</b>						
Net cash from operating activities	\$ 170	\$ 182	\$ 52	\$ 37	\$ (170)	\$ 271
<b>Investing activities:</b>						
Business acquisitions, net of cash acquired		(1)				(1)
Other investing activities	(58)	(10)	(22)	(2)	58	(34)
Net cash used in investing activities	(58)	(11)	(22)	(2)	58	(35)
<b>Financing activities:</b>						
Common stock repurchased	(123)					(123)
Other financing activities	11	(235)	(29)	36	236	19
Net cash (used in) from financing activities	(112)	(235)	(29)	36	236	(104)
Effect of foreign currency exchange rate changes on cash				(13)		(13)
Net (decrease) increase in cash		(64)	1	58	124	119
Cash and cash equivalents, beginning of the period		797	4	364	(149)	1,016
Cash and cash equivalents, end of the period	\$	\$ 733	\$ 5	\$ 422	\$ (25)	\$ 1,135

**For the quarter ended March 27,  
2009:****Operating activities:**

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Net cash from operating activities	\$ 274	\$ 83	\$ 61	\$ 8	\$ (274)	\$ 152
<b>Investing activities:</b>						
Business acquisitions, net of cash acquired		(82)				(82)
Other investing activities	(16)	(10)	(27)	(3)	16	(40)
Net cash used in investing activities	(16)	(92)	(27)	(3)	16	(122)
<b>Financing activities:</b>						
Common stock repurchased	(232)					(232)
Other financing activities	(26)	(262)	5	1	258	(24)
Net cash (used in) from financing activities	(258)	(262)	5	1	258	(256)
Effect of foreign currency exchange rate changes on cash				(3)		(3)
Net (decrease) increase in cash		(271)	39	3		(229)
Cash and cash equivalents, beginning of the period		720	(81)	228		867
Cash and cash equivalents, end of the period	\$	\$ 449	\$ (42)	\$ 231	\$	\$ 638



**Table of Contents****ITEM 2.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS*****Financial Section Roadmap***

Management's discussion and analysis (MD&A) can be found on pages 28 to 38, and our unaudited condensed consolidated financial statements and related notes contained in this quarterly report can be found on pages 1 to 27. The following table is designed to assist in your review of MD&A.

<b>Topic</b>	<b>Location</b>
Overview and Outlook:	
L-3's Business	Pages 28 29
Key Performance Measures	Pages 29 30
Business Acquisitions and Business and Product Line Dispositions	Page 30
Results of Operations (includes business segments)	Pages 30 34
Liquidity and Capital Resources:	
Anticipated Sources and Uses of Cash Flow	Pages 34 35
Balance Sheet	Pages 35 36
Statement of Cash Flows	Pages 36 38
Legal Proceedings and Contingencies	Page 38

**Overview and Outlook*****L-3's Business***

L-3 is a prime contractor in Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) systems, aircraft modernization and maintenance, and government services. L-3 is also a leading provider of a broad range of electronic systems used on military and commercial platforms. Our customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), U.S. Department of Justice (DoJ), allied foreign governments, domestic and foreign commercial customers, and select other U.S. federal, state and local government agencies.

For the year ended December 31, 2009, we generated sales of \$15.6 billion. Our primary customer was the DoD. The table below presents a summary of our 2009 sales by major category of end customer and the percent contributed by each end customer to our total 2009 sales. We currently do not anticipate significant changes to our end customer sales mix for the year ending December 31, 2010.

	<b>2009 Sales (in millions)</b>	<b>% of 2009 Sales</b>
DoD	\$ 11,932	76%

Other U.S. Government	1,127	7
Total U.S. Government	13,059	83%
Foreign governments	1,082	7
Commercial foreign	867	6
Commercial domestic	607	4
Total sales	\$ 15,615	100%

We have the following four reportable segments: (1) C<sup>3</sup>ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Electronic Systems. Financial information with respect to each of our reportable segments is included in Note 21 to our unaudited condensed consolidated financial statements contained

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in this quarterly report. C<sup>3</sup>ISR provides products and services for the global ISR market, C<sup>3</sup> systems, networked communications systems and secure communications products. We believe that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Government Services provides a full range of engineering, technical, analytical, information technology (IT), advisory, training, logistics and support services to the DoD, DoS, DoJ, and U.S. Government intelligence agencies and allied foreign governments. AM&M provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. We sell these services primarily to the DoD, the Canadian Department of National Defense and other allied foreign governments. Electronic Systems provides a broad range of products and services, including components, products, subsystems, systems, and related services to military and commercial customers in several niche markets across several business areas, including power & control systems, electro-optic/infrared (EO/IR), microwave, simulation & training, precision engagement, aviation products, security & detection, propulsion systems, displays, telemetry & advanced technology, undersea warfare, and marine services.

*Key Performance Measures*

The primary financial performance measures that L-3 uses to manage its businesses and monitor results of operations are sales growth and operating income growth. Management believes that these financial performance measures are the primary growth drivers for L-3's earnings per common share and net cash from operating activities. L-3's business strategy is focused on increasing sales from organic growth and select business acquisitions. We define organic sales growth as the increase or decrease in sales for the current period compared to the prior period, excluding sales in the: (1) current period from business and product line acquisitions that are included in L-3's actual results of operations for less than twelve months, and (2) prior period from business and product line divestitures that are included in L-3's actual results of operations for the twelve-month period prior to the divestiture date. We expect to supplement our organic sales growth by selectively acquiring businesses that: (1) add important new technologies, services, and products, (2) provide access to select customers, programs, and contracts and (3) provide attractive returns on investments. The two main determinants of our operating income growth are sales growth and improvements in direct and indirect contract costs. We define operating margin as operating income as a percentage of sales.

*Sales Growth.* Sales growth for the year ended December 31, 2009 was 5%, comprised of organic sales growth of 4%, and sales growth from business acquisitions, net of divestitures, of 1%. For the quarter ended March 26, 2010 (2010 First Quarter), consolidated net sales of \$3,624 million declined by 0.3%, comprised of an organic sales decline of 0.8% and sales growth from acquisitions of \$16 million or 0.5%, compared to the quarter ended March 27, 2009 (2009 First Quarter). Currently, we expect 2010 sales growth to be in the low single digits.

For the year ended December 31, 2009, our largest contract (revenue arrangement) in terms of annual sales was the Special Operations Forces Support Activity (SOFSA) contract, which generated approximately 3% of our sales. On March 3, 2009, SOFSA announced that L-3 was not selected to perform on the follow-on contract. L-3 subsequently protested and, as a consequence, SOFSA has taken corrective action, which will include the issuance of a revised solicitation. Once a new solicitation is issued, proposals will be requested from all bidders. We were notified by the customer that a new solicitation will be issued in June 2010, with an expected award date of January 2011. While we may not succeed in winning the recompetition for the next SOFSA contract, we continue to perform on the current contract, which has been extended to January 31, 2011.

As is the case with most other U.S. defense contractors, we have benefited from the upward trend in DoD budget authorization and spending outlays over recent years, including supplemental appropriations for military operations in Iraq and Afghanistan. We expect future DoD budgets, including supplemental appropriations, to grow at a

significantly slower pace than the past several years, and to possibly flatten or decline. However, we believe that our businesses should be able to continue to generate modest organic sales growth because we anticipate the defense budget and spending priorities will continue to focus on several areas that match L-3's core competencies, such as

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communications and ISR, sensors, special operations support, helicopter crew training and maintenance and simulation & training.

We expect to continue to generate modest annual increases in operating margin as we expect to increase sales, grow sales at a rate faster than the increase in our indirect costs, and improve our overall contract performance. However, we may not be able to continue to expand our operating margin on an annual basis. In addition, business acquisitions and new business, including contract renewals and new contracts, could result in decreased operating margins if their margins are lower than L-3's operating margin on existing business and contracts. Our business objectives include growing earnings per common share and net cash from operating activities. Improving operating margins is one method for achieving these goals, but it is not the only one.

**Business Acquisitions and Business and Product Line Dispositions**

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 summarizes the business acquisitions and business and product line dispositions that we completed during the three years ended December 31, 2009. All of our business acquisitions are included in our consolidated results of operations from their dates of acquisition. We regularly evaluate potential business acquisitions. On April 14, 2010, we acquired all of the outstanding stock of Insight Technology Incorporated, a manufacturer of mission critical night vision and electro-optical equipment, for a preliminary purchase price of \$613 million. The purchase price was funded with cash on hand and is subject to adjustment based on the closing date actual net working capital, which has not been finalized. The final purchase price allocation is expected to be completed by the fourth quarter of 2010.

**Results of Operations**

The following information should be read in conjunction with our unaudited condensed consolidated financial statements contained in this quarterly report. Our results of operations for the periods presented are affected by our business acquisitions. See Note 4 to our audited consolidated financial statements for the year ended December 31, 2009, included in our Annual Report on Form 10-K, for a discussion of our 2009 business acquisitions.

**Consolidated Results of Operations**

The table below provides selected financial data for L-3 for the 2010 First Quarter compared with the 2009 First Quarter.

	<b>First Quarter Ended</b>		
	<b>March 26, 2010</b>	<b>March 27, 2009</b>	<b>Increase/ (decrease)</b>
	<b>(in millions, except per share data)</b>		
Net sales	\$ 3,624	\$ 3,636	\$ (12)
Operating income	\$ 410	\$ 376	\$ 34
Operating margin	11.3%	10.3%	100 bpts
Net interest expense and other income	\$ 60	\$ 63	\$ (3)
Effective income tax rate	36.6%	35.8%	80 bpts
Net income attributable to L-3	\$ 221	\$ 199	\$ 22
Diluted earnings per share	\$ 1.87	\$ 1.66	\$ 0.21
Diluted weighted average common shares outstanding	116.9	118.8	(1.9)

*Net Sales:* For the 2010 First Quarter, consolidated net sales declined slightly compared to the 2009 First Quarter. Sales growth from the Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) reportable segment was offset by lower sales from the Government Services, Aircraft Modernization and Maintenance (AM&M) and Electronic Systems reportable segments. Consolidated net sales from acquired businesses were \$16 million.

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Sales from services, which include services performed by businesses primarily in our Government Services, AM&M and C<sup>3</sup>ISR reportable segments, as well as marine services, simulation & training, and maintenance for security and detection systems within our Electronic Systems reportable segment, increased by \$36 million to \$1,910 million, representing approximately 53% of consolidated net sales for the 2010 First Quarter, compared to \$1,874 million, or approximately 52% of consolidated net sales, for the 2009 First Quarter. The increase in service sales was primarily due to organic sales growth in ISR systems, training and law enforcement support services for the U.S. Army and information technology (IT) support services for the U.S. Special Operations Forces (SOF). These increases were partially offset by reduced subcontractor pass-through sales for systems and software engineering and sustainment services, a decrease for Iraq support, including linguist services, and lower volume for contract field services and SOF support activities.

Sales from products, which primarily includes products from our C<sup>3</sup>ISR and Electronic Systems reportable segments, decreased by \$48 million to \$1,714 million, representing approximately 47% of consolidated net sales for the 2010 First Quarter, compared to \$1,762 million, or approximately 48% of consolidated net sales for the 2009 First Quarter. The decrease in product sales was primarily due to decreases for combat propulsion systems, precision engagement, and naval power and control systems. These decreases were partially offset by organic sales growth in EO/IR and microwave products. See the reportable segment results below for additional discussion of our sales results.

*Operating income and operating margin:* The 2010 First Quarter operating income increased by 9% compared to the 2009 First Quarter. Operating margin increased to 11.3% for the 2010 First Quarter from 10.3% for the 2009 First Quarter. The operating margin increase was driven by improved contract performance and favorable sales mix for businesses in the C<sup>3</sup>ISR and Electronic Systems reportable segments. In addition, lower pension expense of \$5 million (\$3 million after income taxes, or \$0.03 per diluted share), increased operating margin by 10 basis points. See the reportable segment results below for additional discussion of our segment operating margin.

*Net interest expense and other income:* Net interest expense and other income for the 2010 First Quarter decreased by 5% compared to the same period last year primarily due to lower outstanding debt and income from investments accounted for using the equity method.

*Effective income tax rate:* The effective tax rate for the 2010 First Quarter increased by 80 basis points compared to the same quarter last year due to the expiration of the U.S. Federal research and experimentation tax credit as of December 31, 2009. In addition, the 2010 First Quarter includes a tax provision of \$5 million, or \$0.04 per diluted share, related to the U.S. Federal Patient Protection and Affordable Care Act, which changed the tax treatment for certain retiree prescription drug benefits.

*Diluted earnings per share and net income attributable to L-3:* L-3 Holdings' diluted earnings per share (diluted EPS) increased by \$0.21, or 13%, to \$1.87 for the 2010 First Quarter from \$1.66 for the 2009 First Quarter, and net income attributable to L-3 increased by \$22 million, or 11%, to \$221 million from \$199 million for the same periods.

*Diluted weighted average common shares outstanding:* Diluted weighted average common shares outstanding for the 2010 First Quarter decreased by 1.9 million shares, or 2%, compared to the 2009 First Quarter. The decrease was primarily due to repurchases of our common stock in connection with our share repurchase program authorized by our Board of Directors, partially offset by additional shares issued in connection with various employee stock-based compensation programs and contributions to employee savings plans made in common stock.

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The table below presents selected data by reportable segment reconciled to consolidated totals. See Note 21 to our unaudited condensed consolidated financial statements contained in this quarterly report for additional reportable segment data.

	<b>First Quarter Ended</b>	
	<b>March 26, 2010</b>	<b>March 27, 2009</b>
	<b>(dollars in millions)</b>	
Net Sales: <sup>(1)</sup>		
C <sup>3</sup> ISR	\$ 788.0	710.1
Government Services	941.1	1,004.9
AM&M	652.1	663.5
Electronic Systems	1,242.5	1,257.2
Consolidated net sales	\$ 3,623.7	\$ 3,635.7
Operating income:		
C <sup>3</sup> ISR	\$ 105.8	\$ 78.2
Government Services	77.3	90.6
AM&M	59.5	65.8
Electronic Systems	167.1	141.3
Consolidated operating income	\$ 409.7	\$ 375.9
Operating margin:		
C <sup>3</sup> ISR	13.4%	11.0%
Government Services	8.2%	9.0%
AM&M	9.1%	9.9%
Electronic Systems	13.4%	11.2%
Consolidated operating margin	11.3%	10.3%

(1) Net sales are after intercompany eliminations.

**C<sup>3</sup>ISR**

	<b>First Quarter Ended</b>		
	<b>March 26, 2010</b>	<b>March 27, 2009</b>	<b>Increase</b>
	<b>(dollars in millions)</b>		
Net sales	\$ 788.0	\$ 710.1	\$ 77.9
Operating income	105.8	78.2	27.6
Operating margin	13.4%	11.0%	240 bpts



C<sup>3</sup>ISR net sales for the 2010 First Quarter increased by 11% compared to the 2009 First Quarter primarily due to increased demand and new business from the U.S. Department of Defense (DoD) for airborne ISR and networked communication systems for manned and unmanned platforms and higher sales volumes for force protection products to foreign ministries of defense.

C<sup>3</sup>ISR operating income for the 2010 First Quarter increased by 35% compared to the 2009 First Quarter. Operating margin increased by 240 basis points. Higher sales volume, favorable sales mix and improved contract performance increased operating margin by 220 basis points. Lower pension expense of \$2 million increased operating margin by 20 basis points.

**Table of Contents****Government Services**

	<b>First Quarter Ended</b>		
	<b>March 26,</b>	<b>March 27,</b>	
	<b>2010</b>	<b>2009</b>	<b>Decrease</b>
	<b>(dollars in millions)</b>		
Net sales	\$ 941.1	\$ 1,004.9	\$ (63.8)
Operating income	77.3	90.6	(13.3)
Operating margin	8.2%	9.0%	(80) bpts

Government Services net sales for the 2010 First Quarter decreased by 6% compared to the 2009 First Quarter. The decrease in sales was primarily due to: (1) reduced subcontractor pass-through sales volume of \$45 million related to task order renewals for U.S. Army systems and software engineering and sustainment services that migrated to a contract where L-3 is not a prime contractor and (2) \$40 million of lower sales related to Iraq support, including linguist and intelligence support services. These decreases were partially offset by \$9 million of higher sales primarily for increased training and law enforcement support services for the U.S. Army due to higher volume on new and existing contracts and information technology support services for the U.S. Special Operations Forces (SOF). Net sales from acquired businesses were \$12 million, or 1%.

Government Services operating income for the 2010 First Quarter decreased by 15% compared to the 2009 First Quarter. Operating margin decreased by 80 basis points. Lower margins on select contract renewals and higher costs for a security systems contract for the U.S. Department of Homeland Security reduced operating margin by 120 basis points and timing of the receipt of an award fee for linguist services reduced operating margin by 20 basis points. Acquired businesses reduced operating margin by 10 basis points. These decreases were partially offset by a decline in lower margin subcontractor pass-through sales, which increased operating margin by 70 basis points.

**Aircraft Modernization and Maintenance (AM&M)**

	<b>First Quarter Ended</b>		
	<b>March 26,</b>	<b>March 27,</b>	
	<b>2010</b>	<b>2009</b>	<b>Decrease</b>
	<b>(dollars in millions)</b>		
Net sales	\$ 652.1	\$ 663.5	\$ (11.4)
Operating income	59.5	65.8	(6.3)
Operating margin	9.1%	9.9%	(80) bpts