

L 3 COMMUNICATIONS HOLDINGS INC  
Form 10-Q  
November 02, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended September 25, 2015**

**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)**

<b>Delaware</b> <b>(State or other jurisdiction of</b>	<b>13-3937434 and 13-3937436</b> <b>(I.R.S. Employer</b>
<b>incorporation or organization)</b>	<b>Identification Nos.)</b>
<b>600 Third Avenue, New York, NY</b> <b>(Address of principal executive offices)</b>	<b>10016</b> <b>(Zip Code)</b>
<b>(212) 697-1111</b>	

**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant, L-3 Communications Holdings, Inc., is a large accelerated filer, accelerated filer, non-accelerated filer, or a smaller reporting company. 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  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant, L-3 Communications Corporation, Inc., is a large accelerated filer, accelerated filer, non-accelerated filer, or a smaller reporting company. 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  (Do not check if a smaller reporting company) Smaller reporting company

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

There were 78,387,731 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on October 23, 2015.

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AND L-3 COMMUNICATIONS CORPORATION  
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For the quarterly period ended September 25, 2015**

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	<b>(Unaudited) September 25, 2015</b>	<b>December 31, 2014</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 323	\$ 442
Billed receivables, net of allowances of \$13 in 2015 and \$14 in 2014	796	852
Contracts in process	2,483	2,295
Inventories	374	288
Deferred income taxes	129	127
Other current assets	190	186
Assets held for sale		547
Total current assets	4,295	4,737
Property, plant and equipment, net	1,108	1,088
Goodwill	7,112	7,501
Identifiable intangible assets	256	243
Deferred debt issue costs	22	27
Other assets	243	240
Total assets	\$ 13,036	\$ 13,836
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable, trade	\$ 490	\$ 382
Accrued employment costs	562	510
Accrued expenses	369	402
Advance payments and billings in excess of costs incurred	629	573
Income taxes	18	23
Other current liabilities	396	398
Liabilities held for sale		237
Total current liabilities	2,464	2,525

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Pension and postretirement benefits	1,163	1,187
Deferred income taxes	407	443
Other liabilities	403	382
Long-term debt	3,940	3,939
<b>Total liabilities</b>	<b>8,377</b>	<b>8,476</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, 79,004,449 shares outstanding at September 25, 2015 and 82,040,525 shares outstanding at December 31, 2014 (L-3 Communications Corporation's common stock: \$.01 par value, 100 shares authorized, issued and outstanding)	5,985	5,799
L-3 Communications Holdings, Inc.'s treasury stock (at cost), 78,177,799 shares at September 25, 2015 and 73,005,891 shares at December 31, 2014	(6,716)	(6,111)
Retained earnings	5,945	6,181
Accumulated other comprehensive loss	(630)	(584)
<b>Total L-3 shareholders' equity</b>	<b>4,584</b>	<b>5,285</b>
Noncontrolling interests	75	75
<b>Total equity</b>	<b>4,659</b>	<b>5,360</b>
<b>Total liabilities and equity</b>	<b>\$ 13,036</b>	<b>\$ 13,836</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)

	Third Quarter Ended	
	September 25, 2015	September 26, 2014
Net sales:		
Products	\$ 1,612	\$ 1,644
Services	1,205	1,296
Total net sales	2,817	2,940
Cost of sales:		
Products	(1,417)	(1,480)
Services	(1,114)	(1,203)
Total cost of sales	(2,531)	(2,683)
Loss related to business divestitures	(9)	
Impairment charge	(491)	
Operating (loss) income	(214)	257
Interest expense	(47)	(47)
Interest and other income, net	3	5
(Loss) income before income taxes	(258)	215
Provision for income taxes	(38)	(58)
Net (loss) income	\$ (296)	\$ 157
Net income attributable to noncontrolling interests	(3)	(3)
Net (loss) income attributable to L-3	\$ (299)	\$ 154
(Loss) earnings per share attributable to L-3 Holdings common shareholders:		
Basic	\$ (3.74)	\$ 1.81
Diluted	\$ (3.74)	\$ 1.78
Cash dividends paid per common share	\$ 0.65	\$ 0.60
L-3 Holdings weighted average common shares outstanding:		

Basic	80.0	85.1
Diluted	80.0	86.6

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>Year-To-Date Ended</b>	
	<b>September 25, 2015</b>	<b>September 26, 2014</b>
Net sales:		
Products	\$ 4,761	\$ 4,991
Services	3,562	3,925
Total net sales	8,323	8,916
Cost of sales:		
Products	(4,335)	(4,498)
Services	(3,316)	(3,636)
Total cost of sales	(7,651)	(8,134)
Loss related to business divestitures	(29)	
Impairment charge	(491)	
Operating income	152	782
Interest expense	(139)	(129)
Interest and other income, net	11	14
Income before income taxes	24	667
Provision for income taxes	(87)	(197)
Net (loss) income	\$ (63)	\$ 470
Net income attributable to noncontrolling interests	(11)	(9)
Net (loss) income attributable to L-3	\$ (74)	\$ 461
(Loss) earnings per share attributable to L-3 Holdings common shareholders:		
Basic	\$ (0.91)	\$ 5.38
Diluted	\$ (0.91)	\$ 5.21
Cash dividends paid per common share	\$ 1.95	\$ 1.80



L-3 Holdings	weighted average common shares outstanding:		
Basic		81.5	85.7
Diluted		81.5	88.4

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 COMPREHENSIVE INCOME**

(in millions)

	Third Quarter Ended		Year-to-Date Ended	
	September 25,	September 26,	September 25,	September 26,
	2015	2014	2015	2014
Net (loss) income	\$ (296)	\$ 157	\$ (63)	\$ 470
Other comprehensive income (loss):				
Foreign currency translation adjustments	(55)	(63)	(84)	(57)
Unrealized losses on hedging instruments <sup>(1)</sup>	(7)	(3)	(3)	
Pension and postretirement benefit plans:				
Amortization of net loss and prior service cost previously recognized <sup>(2)</sup>	10	2	32	7
Net gain arising during the period <sup>(3)</sup>			9	
Total other comprehensive loss	(52)	(64)	(46)	(50)
Comprehensive (loss) income	(348)	93	(109)	420
Comprehensive income attributable to noncontrolling interests	(3)	(3)	(11)	(9)
Comprehensive (loss) income attributable to L-3	\$ (351)	\$ 90	\$ (120)	\$ 411

(1) Amounts are net of income tax benefits of \$3 million and \$1 million for the quarterly periods ended September 25, 2015 and September 26, 2014, respectively, and income tax benefits of \$2 million for the year-to-date period ended September 25, 2015.

(2) Amounts are net of income taxes of \$7 million and \$1 million for the quarterly periods ended September 25, 2015 and September 26, 2014, respectively, and income taxes of \$18 million and \$4 million for the year-to-date periods ended September 25, 2015 and September 26, 2014, respectively.

(3) Represents the reclassification of actuarial losses into net income related to the Marine Systems International business divestiture in accordance with Accounting Standards Codification 715 *Defined Benefit Plans - Pension*. Amounts are net of income taxes of \$5 million for the year-to-date period ended September 25, 2015.

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 EQUITY**

(in millions, except per share data)

	<b>L-3 Holdings Common Stock</b>		<b>Additional Paid-in Capital</b>		<b>Treasury Stock</b>	<b>Accumulated Other Comprehensive Income</b>		<b>Noncontrolling Interests</b>	<b>Total Equity</b>
	<b>Shares Outstanding</b>	<b>Par Value</b>				<b>Retained Earnings</b>	<b>Loss</b>		
<b>For the Year-to-Date Period Ended September 25, 2015:</b>									
Balance at December 31, 2014	82.0	\$ 1	\$ 5,798		\$ (6,111)	\$ 6,181	\$ (584)	\$ 75	\$ 5,360
Net (loss) income						(74)		11	(63)
Other comprehensive loss							(46)		(46)
Distributions to noncontrolling interests								(11)	(11)
Cash dividends declared on common stock (\$1.95 per share)						(162)			(162)
<b>Shares issued:</b>									
Employee savings plans	0.8		95						95
Exercise of stock options	0.6		65						65
Employee stock purchase plan	0.3		17						17
Vesting of restricted stock units	0.7								
Employee restricted stock units surrendered in lieu of income tax withholding	(0.2)		(33)						(33)
Stock-based compensation expense			36						36
Treasury stock purchased	(5.2)				(605)				(605)
Other			6						6
Balance at September 25, 2015	79.0	\$ 1	\$ 5,984		\$ (6,716)	\$ 5,945	\$ (630)	\$ 75	\$ 4,659
<b>For the Year-to-Date Period Ended September 26, 2014:</b>									
Balance at December 31, 2013	85.8	\$ 1	\$ 5,652		\$ (5,288)	\$ 5,726	\$ (110)	\$ 75	\$ 6,056
Net income						461		9	470
Other comprehensive loss							(50)		(50)

Distributions to noncontrolling interests							(8)	(8)
Cash dividends declared on common stock (\$1.80 per share)						(159)		(159)
Shares issued:								
Employee savings plans	1.0		105					105
Exercise of stock options	1.1		102					102
Employee stock purchase plan	0.3		18					18
Vesting of restricted stock units	0.7							
Employee restricted stock units surrendered in lieu of income tax withholding	(0.2)		(27)					(27)
Stock-based compensation expense			39					39
Treasury stock purchased	(3.6)				(413)			(413)
Retirement of Convertible Contingent Debt Securities			(160)					(160)
Other			6					6
Balance at September 26, 2014	85.1	\$ 1	\$ 5,735	\$ (5,701)	\$ 6,028	\$ (160)	\$ 76	\$ 5,979

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>Year-to-Date Ended</b>	
	<b>September 25, 2015</b>	<b>September 26, 2014</b>
<b>Operating activities:</b>		
Net (loss) income	\$ (63)	\$ 470
Depreciation of property, plant and equipment	129	127
Amortization of intangibles and other assets	35	38
Deferred income tax (benefit) provision	(21)	91
Stock-based employee compensation expense	36	39
Excess income tax benefits related to share-based payment arrangements	(24)	(16)
Contributions to employee savings plans in L-3 Holdings common stock	95	105
Impairment charge	491	
Amortization of pension and postretirement benefit plans net loss and prior service cost	50	11
Amortization of bond discounts and deferred debt issue costs (included in interest expense)	6	5
Loss related to business divestitures	29	
Other non-cash items	(4)	(5)
Changes in operating assets and liabilities, excluding amounts from acquisitions and divestitures:		
Billed receivables	48	118
Contracts in process	(165)	(144)
Inventories	(77)	(11)
Other assets	(13)	
Accounts payable, trade	121	(119)
Accrued employment costs	47	26
Accrued expenses	(40)	(57)
Advance payments and billings in excess of costs incurred	2	39
Income taxes		(4)
Other current liabilities	(11)	(40)
Pension and postretirement benefits	(18)	(40)
All other operating activities	(22)	(28)
<b>Net cash from operating activities</b>	<b>631</b>	<b>605</b>
<b>Investing activities:</b>		
Business acquisitions, net of cash acquired	(260)	(57)
Proceeds from the sale of businesses, net of closing date cash balances	308	

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Capital expenditures	(140)	(115)
Dispositions of property, plant and equipment	2	4
Other investing activities	4	6
Net cash used in investing activities	(86)	(162)
<b>Financing activities:</b>		
Proceeds from sale of Senior Notes		996
Retirement of CODES		(935)
Borrowings under revolving credit facility	861	1,367
Repayment of borrowings under revolving credit facility	(861)	(1,367)
Common stock repurchased	(605)	(413)
Dividends paid on L-3 Holdings common stock	(163)	(158)
Proceeds from exercises of stock options	41	87
Proceeds from employee stock purchase plan	26	27
Excess income tax benefits related to share-based payment arrangements	24	16
Debt issue costs		(8)
Employee restricted stock units surrendered in lieu of income tax withholding	(33)	(27)
Other financing activities	(1)	(11)
Net cash used in financing activities	(711)	(426)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(14)	(9)
Change in cash balance in assets held for sale	61	
Net (decrease) increase in cash and cash equivalents	(119)	8
Cash and cash equivalents, beginning of the period	442	500
Cash and cash equivalents, end of the period	\$ 323	\$ 508

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 Intelligence, Surveillance and Reconnaissance (ISR) systems, aircraft sustainment (including modifications, logistics and maintenance), simulation and training, night vision and image intensification equipment, enterprise and mission information technology (IT) solutions and cyber operations. L-3 is also a leading provider of a broad range of communication and electronic systems and products 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), foreign governments, and domestic and international commercial customers.

The Company has the following four reportable segments: (1) Electronic Systems, (2) Aerospace Systems, (3) Communication Systems and (4) National Security Solutions (NSS). Electronic Systems provides a broad range of components, products, subsystems, systems and related services for military and commercial customers in several niche markets across several business areas. These business areas include precision engagement & training, sensor systems, power & propulsion systems, aviation products and security systems, warrior systems and advanced programs. Aerospace Systems delivers integrated solutions for the global ISR market and provides modernization, upgrade, sustainment, and maintenance and logistics support for a wide variety of aircraft and ground systems. Communication Systems delivers products and services for the global communications market, specializing in strategic and tactical airborne, space, ground and sea-based communication systems. NSS provides cybersecurity solutions, high-performance computing, enterprise IT services, analytics and intelligence analysis to the DoD, U.S. Government intelligence agencies, federal civilian agencies and foreign governments.

In April 2015, the Company realigned its Platform and Logistics Solutions sector within its Aerospace Systems segment to enhance the operational effectiveness and competitiveness of its platform systems business. The platform systems business was integrated within the ISR Systems sector and the new integrated organization was renamed the ISR and Aircraft Systems sector. The Logistics Solutions sector remains a separate sector within the Aerospace Systems segment. This realignment did not impact the composition of the Company's reporting units.

Financial information with respect to the Company's segments is included in Note 21 to the unaudited condensed consolidated financial statements and in Note 22 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

**2. Basis of Presentation**

These unaudited condensed consolidated financial statements for the quarterly and year-to-date periods ended September 25, 2015 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 year ended December 31, 2014.



***Principles of Consolidation and Reporting***

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,

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

its wholly-owned subsidiary, and its only obligations are: (1) its guarantee of borrowings under the Amended and Restated Revolving Credit Facility (Credit Facility) of L-3 Communications and (2) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. All issuances of and conversions into L-3 Holdings equity securities, including grants of stock options, restricted stock units and 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 Securities and Exchange Commission (SEC). Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. The December 31, 2014 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair statement 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.

It is the Company's established practice to close its books for the quarters ending March, June and September on the Friday preceding 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 books for annual periods on December 31 regardless of what day it falls on.

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

***Accounting Estimates***

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 for L-3 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 valuation 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.

Sales and profits on contracts that are covered by accounting standards for construction-type and production-type contracts and federal government contractors are recognized using percentage-of-completion (POC) methods of accounting. Approximately 46% of the Company's net sales in 2014 were accounted for under contract accounting standards, of which approximately 40% were fixed-price type contracts and approximately

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

6% were cost-plus type contracts. For contracts that are accounted for under contract accounting standards, sales and profits are recognized based on: (1) a POC method of accounting (fixed-price contracts), (2) allowable costs incurred plus the estimated profit on those costs (cost-plus contracts), or (3) direct labor hours expended multiplied by the contractual fixed rate per hour plus incurred costs for material (time-and-material contracts). Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the units-of-delivery method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to total estimated costs at completion of the contract, multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the cost-to-cost method). Under both POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

Accounting for the sales and profit on these fixed-price type contracts requires the preparation of estimates of: (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work, and (3) the measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to the current estimated total profit margin multiplied by the cumulative sales recognized, less the amount of cumulative profit previously recorded for the contract.

Sales and profits on cost-plus type contracts that are covered by contract accounting standards are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. The estimated profit on a cost-plus type contract is fixed or variable based on the contractual fee arrangement. Incentive and award fees are the primary variable fee contractual arrangement types for the Company. Incentive and award fees on cost-plus type contracts are included as an element of total estimated contract revenues and are recorded as sales when a basis exists for the reasonable prediction of performance in relation to established contractual targets and the Company is able to make reasonably dependable estimates for them.

Sales and profits on time-and-material type contracts are recognized on the basis of direct labor hours expended multiplied by the contractual fixed rate per hour, plus the actual costs of materials and other direct non-labor costs.

Revisions or adjustments to estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained, as facts and circumstances change and as new information is obtained, even though the scope of work required under the contract may not change. Revisions or adjustments may also be required if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to POC accounting are recognized on a cumulative catch-up basis in the

period in which the revisions are made. The revisions in contract estimates, if significant, can materially affect the Company's results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates amounted to increases of \$52 million, or 34% of consolidated operating income (8% of segment operating income) for the year-to-date period ended September 25, 2015, and increases of \$71 million, or 9% of consolidated operating income for the year-to-date period ended September 26, 2014.

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

For a more complete discussion of these estimates and assumptions, see the Annual Report on Form 10-K for the year ended December 31, 2014.

**3. Recently Issued Accounting Standards**

In July 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-11, to simplify the measurement of inventory. This update requires that inventory measured at first in, first out or average cost be measured at the lower of cost and net realizable value. This update is effective for interim and annual periods beginning after December 15, 2016. The Company is currently evaluating the expected impact of the adoption of this standard on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-3, to simplify the presentation of debt issuance costs. This update requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the associated debt liability, consistent with the required presentation for debt discounts. This update is effective for interim and annual periods beginning after December 15, 2015 and early adoption is permitted. The adoption of this standard will change the Company's current practice of presenting debt issuance costs as an asset and will result in a reduction of total assets and total liabilities in an amount equal to the balance of unamortized debt issuance costs at each balance sheet date. The Company has not elected to early adopt this standard and debt issuance costs amounted to \$22 million at September 25, 2015 and \$27 million at December 31, 2014.

In May 2014, the FASB issued ASU 2014-9, *Revenue from Contracts with Customers*, which will replace numerous requirements in U.S. GAAP, including industry-specific requirements, provide companies with a single revenue recognition model for recognizing revenue from contracts with customers and significantly expand the disclosure requirements for revenue arrangements. The new standard, as amended, will be effective for the Company for interim and annual reporting periods beginning on January 1, 2018, with early application permitted beginning on January 1, 2017. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The Company is currently evaluating the expected impact of the adoption of this standard on its consolidated financial statements and related disclosures and the transition alternatives available. As the new standard will supersede substantially all existing revenue guidance, it could impact revenue and cost recognition on substantially all of the Company's contracts, in addition to the Company's business processes and information technology systems. As a result, the Company's evaluation of the impact of the standard will extend over future periods.

Other accounting standard updates effective for interim and annual periods beginning after December 15, 2015 are not expected to have an impact on the Company's financial position, results of operations or cash flows.

**4. Acquisitions and Divestitures**

***Business Acquisitions***

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

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*2015 Business Acquisitions*

*CTC Aviation Group Acquisition.* On May 27, 2015, the Company acquired CTC Aviation Group, renamed L-3 CTC Ltd. (L-3 CTC), for a purchase price of £153 million (approximately \$236 million), which was financed with cash on hand. L-3 CTC is a global airline pilot training and crew resourcing specialist, based in the United Kingdom, which offers customized and innovative solutions to major airlines and flight training customers globally. This acquisition expands L-3's commercial aviation training business, which also includes L-3 Link UK, a provider of world-class flight training simulation devices, aftermarket solutions and training, to encompass a growing portfolio of airline and third-party training company customers. The aggregate goodwill recognized for this business was \$177 million, which was assigned to the Electronic Systems reportable segment, and is not expected to be deductible for income tax purposes. The final purchase price allocation, which is expected to be completed in the fourth quarter of 2015, will be based on final appraisals and other analysis of fair values of acquired assets and liabilities. The Company does not expect that differences between the preliminary and final purchase price allocations will have a material impact on its results of operations or financial position.

*MITEQ, Inc. Acquisition.* On January 21, 2015, the Company acquired the assets of MITEQ, Inc. (Miteq) for a purchase price of \$41 million, which was financed with cash on hand. The purchase price and purchase price allocation of Miteq was finalized as of September 25, 2015, with no significant changes to preliminary amounts. Miteq was combined with the Company's Narda Microwave-East business and the new organization was re-named L-3 Narda-Miteq. Miteq offers a broad product line of active and passive radio frequency (RF) microwave components and low-power satellite communications (SATCOM) products for space and military applications that complement the existing Narda Microwave East product line. The combined L-3 Narda-Miteq business will provide products for the DoD, other U.S. Government agencies, prime contractors and commercial customers. The aggregate goodwill recognized for this business was \$11 million, of which \$4 million is expected to be deductible for income tax purposes. The goodwill was assigned to the Communication Systems reportable segment.

*2014 Business Acquisition*

*Data Tactics Corporation Acquisition.* On March 4, 2014, the Company acquired Data Tactics Corporation, renamed L-3 Data Tactics, for a purchase price of \$57 million, which was financed with cash on hand. The purchase price and purchase price allocation for L-3 Data Tactics was finalized as of December 31, 2014, with no significant changes to preliminary amounts. L-3 Data Tactics is a specialized provider of large-scale data analytics, cybersecurity and cloud computing solution services, primarily to the DoD. Based on the final purchase price allocation, the aggregate goodwill recognized for this business was \$39 million, substantially all of which is expected to be deductible for income tax purposes. The goodwill was assigned to the NSS reportable segment.

*Business Acquisitions Completed After September 25, 2015*



*ForceX, Inc. Acquisition.* On October 13, 2015, the Company acquired ForceX, Inc., renamed L-3 ForceX, for a purchase price of \$60 million (subject to customary adjustments for final working capital), which was financed with cash on hand. L-3 ForceX will be incorporated into the Company's Sensor Systems sector within the Electronic Systems business segment. L-3 ForceX is an industry leader specializing in ISR mission management software and geospatial application technology programs, offering an array of advanced products, including cueing system software, hardware and video algorithms, and wide-area sensor integration solutions and software. L-3 ForceX's proprietary processing, exploitation and dissemination capability provides an integrated

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tactical operational picture, allowing users to make critical decisions in real time. L-3 ForceX also provides training courseware, materials and turnkey classroom training solutions for its customers and currently supports several key DoD ISR initiatives and classified programs. L-3 ForceX's customer base includes the U.S. Air Force, U.S. Special Operations Command, the Naval Surface Warfare Center and a variety of DoD agencies.

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

The following unaudited pro forma Statements of Operations data present the combined results of the Company and its business acquisitions completed during the year-to-date period ended September 25, 2015 and the year ended December 31, 2014, in each case assuming that the business acquisitions completed during these periods had occurred on January 1, 2014.

	<b>Third Quarter Ended</b>		<b>Year-to-Date Ended</b>	
	<b>September 25, 2015</b>	<b>September 26, 2014</b>	<b>September 25, 2015</b>	<b>September 26, 2014</b>
	<b>(in millions, except per share data)</b>			
Pro forma net sales	\$ 2,817	\$ 2,973	\$ 8,357	\$ 9,021
Pro forma net (loss) income attributable to				
L-3	\$ (299)	\$ 156	\$ (71)	\$ 466
Pro forma diluted (loss) earnings per share	\$ (3.74)	\$ 1.80	\$ (0.87)	\$ 5.27

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, 2014.

***Business Divestitures***

During the year-to-date period ended September 25, 2015, the Company completed the sales of Marine Systems International (MSI), Broadcast Sports Inc. (BSI) and the Tinsley Product Line. The adjustments recorded by the Company related to the business divestitures are included in the loss related to business divestitures captioned on the unaudited condensed consolidated statements of operations and are summarized and further discussed below.

**Third Quarter Ended      Year-to-Date Ended**

	<b>September 25, 2015</b>	<b>September 25, 2015</b>
		<b>(in millions)</b>
Loss on Tinsley Product Line divestiture	\$ (8)	\$ (8)
Loss on BSI divestiture	(1)	(4)
Gain on MSI divestiture		4
Non-cash impairment charge related to MSI assets held for sale		(17)
Loss on a forward contract to sell Euro proceeds from MSI divestiture		(4)
 Total loss related to the business divestitures	 \$ (9)	 \$ (29)

*MSI Divestiture.* On May 29, 2015, the Company completed the sale of its MSI business to Wärsilä Corporation for a preliminary purchase price of 295 million (approximately \$318 million), in addition to the assumption by Wärsilä Corporation of approximately 60 million of MSI employee pension-related liabilities.

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The purchase price is subject to finalization based on customary adjustments for closing date net working capital. MSI was a sector within the Company's Electronic Systems segment, primarily selling to the commercial shipbuilding industry. In accordance with ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, MSI's assets and liabilities are classified as held for sale in the Company's audited consolidated balance sheet as of December 31, 2014 and MSI's results of operations are included in income from continuing operations for all periods presented. During the quarterly period ended June 26, 2015, the Company recorded a realized pre-tax gain of \$4 million (\$8 million after income tax benefits), based on the total estimated proceeds from the sale.

The accounting standards for long-lived assets to be disposed of by sale require the Company to measure assets and liabilities of a disposal group, classified as held for sale, at the lower of its carrying amount or fair value less costs to sell, at the end of each reporting period. As a result of the decline in the estimated U.S. dollar equivalent divestiture proceeds due to the weakening of the Euro against the U.S. dollar, the carrying value of the MSI disposal group exceeded its fair value at March 27, 2015. Accordingly, a pre-tax non-cash impairment charge of \$17 million (\$12 million after income taxes) was recorded during the quarterly period ended March 27, 2015.

In March 2015, L-3 entered into a forward contract to sell 285 million of the proceeds obtained from the divestiture of MSI at a rate of \$1.0782. The Company accounted for this contract as an economic hedge and recorded a mark to market adjustment to earnings based on the fair value of the forward contract at March 27, 2015. Accordingly, the Company recorded an unrealized pre-tax loss of \$5 million (\$3 million after income taxes) during the quarterly period ended March 27, 2015. On May 29, 2015, upon settlement of the contract, the Company realized \$4 million of the \$5 million previously recorded pre-tax loss and recorded a \$1 million pre-tax gain (\$1 million after income taxes) in the quarterly period ended June 26, 2015.

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The major classes of assets and liabilities included as held for sale related to MSI are presented in the table below.

	<b>December 31, 2014 (in millions)</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 61
Billed receivables, net of allowances of \$6	77
Contracts in process	70
Inventories	70
Other current assets	10
<b>Total current assets</b>	<b>288</b>
Goodwill	231
Other assets	28
<b>Total assets classified as held for sale</b>	<b>\$ 547</b>
<b>Liabilities</b>	
Accounts payable, trade	\$ 31
Accrued employment costs	22
Accrued expenses	33
Advance payments and billings in excess of costs incurred	55
Other current liabilities	21
<b>Total current liabilities</b>	<b>162</b>
Pension and postretirement benefits	56
Other liabilities	19
<b>Total liabilities classified as held for sale</b>	<b>\$ 237</b>

*BSI Divestiture.* On April 24, 2015, the Company divested its BSI business for a sales price of \$26 million. BSI is a provider of wireless technology and communications systems services for use in the field of sports television broadcasting, and was included in the Sensor Systems sector of the Electronic Systems segment. The divestiture

resulted in a pre-tax loss of \$4 million (\$6 million after income taxes) during the year-to-date period ended September 25, 2015. In accordance with ASU 2014-08, BSI's assets and liabilities as of December 31, 2014, and results of operations for all periods presented are classified as held and used in the condensed consolidated financial statements.

*Tinsley Product Line Divestiture.* On July 27, 2015, the Company divested its Tinsley Product Line for a sales price of \$4 million. Tinsley is a provider of optical components, sub-assemblies and passive sub-systems and was included in the Sensor Systems sector of the Electronic Systems segment. The divestiture resulted in a pre-tax loss of \$8 million (\$6 million after income taxes) during the quarterly period ended September 25, 2015. In accordance with ASU 2014-08, Tinsley's assets and liabilities as of December 31, 2014, and results of operations for all periods presented are classified as held and used in the condensed consolidated financial statements.

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Net sales and income before income taxes for MSI, BSI and the Tinsley Product Line, included in L-3's unaudited condensed consolidated statements of operations, are presented in the table below on an aggregate basis, and are included in income from continuing operations for all periods presented.

	<b>Third Quarter Ended</b>		<b>Year-to-Date Ended</b>	
	<b>September 25,</b>	<b>September 26,</b>	<b>September 25,</b>	<b>September 26,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
	<b>(in millions)</b>			
Net sales	\$ 1	\$ 126	\$ 201	\$ 420
Income before income taxes	\$ 1	\$ 3	\$ 2	\$ 13

**5. Contracts in Process**

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

	<b>September 25,</b>	<b>December 31,</b>
	<b>2015</b>	<b>2014</b>
	<b>(in millions)</b>	
Unbilled contract receivables, gross	\$ 2,626	\$ 2,280
Unliquidated progress payments	(1,057)	(887)
Unbilled contract receivables, net	1,569	1,393
Inventoried contract costs, gross	1,033	997
Unliquidated progress payments	(119)	(95)
Inventoried contract costs, net	914	902
Total contracts in process	\$ 2,483	\$ 2,295

*Inventoried Contract Costs.* In accordance with contract accounting standards, the Company's U.S. Government contractor businesses account for the portion of their general and administrative (G&A), independent research and development (IRAD) and bids and proposal (B&P) costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on their 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 U.S. Government contractor businesses record the unallowable portion of their G&A, IRAD and B&P costs to expense as incurred, and do not include them in inventoried contract costs.



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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 by the Company's U.S. Government contractor businesses for the periods presented.

	<b>Third Quarter Ended</b>		<b>Year-to-Date Ended</b>	
	<b>September 25, 2015</b>	<b>September 26, 2014</b>	<b>September 25, 2015</b>	<b>September 26, 2014</b>
	<b>(in millions)</b>			
Amounts included in inventoried contract costs at beginning of the period	\$ 149	\$ 146	\$ 138	\$ 133
Contract costs incurred:				
IRAD and B&P	70	70	210	213
Other G&A	219	230	640	645
<b>Total</b>	<b>289</b>	<b>300</b>	<b>850</b>	<b>858</b>
Amounts charged to cost of sales	(269)	(300)	(819)	(845)
Amounts included in inventoried contract costs at end of the period	\$ 169	\$ 146	\$ 169	\$ 146

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 included in cost of sales on the unaudited condensed consolidated statements of operations.

	<b>Third Quarter Ended</b>		<b>Year-to-Date Ended</b>	
	<b>September 25, 2015</b>	<b>September 26, 2014</b>	<b>September 25, 2015</b>	<b>September 26, 2014</b>
	<b>(in millions)</b>			
Selling, general and administrative expenses	\$ 53	\$ 72	\$ 198	\$ 225
Research and development expenses	13	15	40	51

Total	\$ 66	\$	87	\$ 238	\$	276
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## 6. Inventories

*Inventories at Lower of Cost or Market.* The table below presents the components of inventories at the lower of cost (first-in, first-out or average cost) or realizable value.

	September 25, 2015	December 31, 2014
	(in millions)	
Raw materials, components and sub-assemblies	\$ 188	\$ 127
Work in process	114	97
Finished goods	72	64
Total	\$ 374	\$ 288

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**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 by segment for the year-to-date period ended September 25, 2015.

	<b>Electronic Systems</b>	<b>Aerospace Systems</b>	<b>Communication Systems (in millions)</b>	<b>NSS</b>	<b>Consolidated Total</b>
<b>Balance at December 31, 2014</b>	\$ 3,773	\$ 1,730	\$ 992	\$ 1,006	\$ 7,501
Business acquisitions <sup>(1)</sup>	177		11		188
Business divestitures <sup>(2)</sup>	(12)				(12)
Impairment loss				(491)	(491)
Foreign currency translation adjustments <sup>(3)</sup>	(43)	(31)			(74)
<b>Balance at September 25, 2015</b>	\$ 3,895	\$ 1,699	\$ 1,003	\$ 515	\$ 7,112

(1) The increase in goodwill for the Electronic Systems segment was due to the L-3 CTC business acquisition. The increase in goodwill for the Communication Systems segment was due to the Miteq business acquisition.

(2) The decrease in goodwill for the Electronic Systems segment was due to the divestitures of BSI and the Tinsley Product Line.

(3) The decrease in goodwill presented in the Electronic Systems segment was due to the strengthening of the U.S. dollar against the Canadian dollar, the British pound, the Euro and the Australian dollar during the year-to-date period ended September 25, 2015. The decrease in goodwill presented in the Aerospace Systems segment was due to the strengthening of the U.S. dollar against the Canadian dollar during the year-to-date period ended September 25, 2015.

As previously disclosed on October 29, 2015, the Company continues to evaluate strategic alternatives for NSS. These strategic alternatives could include, among other possibilities, a potential sale, spin-off or other divestiture transactions

for the business. During the quarterly period ended September 25, 2015, a decline in the projected future cash flows of NSS indicated that the carrying amount of the goodwill for the NSS business may not be recoverable. As such, the Company performed the first step of the impairment test for the NSS business. The first step of the impairment test indicated that a portion of the \$1,006 million of goodwill for the NSS business may not be recoverable. The Company performed the second step of the impairment test in accordance with the accounting standards for goodwill to measure the impairment loss and determined that the implied goodwill was \$491 million lower than the carrying amount. Accordingly, the Company recorded a non-cash impairment charge of \$491 million (\$463 million after income taxes) for the impairment of goodwill. The goodwill impairment charge was due to a decline in the estimated fair value of the NSS business as a result of a decline in the projected future cash flows of NSS caused by NSS's inability to achieve its planned 2015 orders, sales and operating income, primarily due to lower than expected new commercial and international business awards, and a reduced outlook for operating margin and international sales. The Company's accumulated goodwill impairment losses were \$549 million at September 25, 2015, of which \$491 million, \$43 million and \$15 million were recorded in the NSS, Electronic Systems and Communication Systems segments, respectively.

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*Identifiable Intangible Assets.* The table below presents information for the Company's identifiable intangible assets that are subject to amortization.

	September 25, 2015			December 31, 2014			
	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	19	\$ 461	\$ 283	\$ 178	\$ 440	\$ 262	\$ 178
Technology	11	186	118	68	165	111	54
Other	18	27	17	10	27	16	11
Total	17	\$ 674	\$ 418	\$ 256	\$ 632	\$ 389	\$ 243

The table below presents amortization expense recorded by the Company for its identifiable intangible assets.

	Third Quarter Ended		Year-to-Date Ended	
	September 25, 2015	September 26, 2014	September 25, 2015	September 26, 2014
	(in millions)			
Amortization Expense	\$ 10	\$ 11	\$ 29	\$ 32

Based on gross carrying amounts at September 25, 2015, the Company's estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2015 through 2019 is presented in the table below.

Year Ending December 31,				
2015	2016	2017	2018	2019
(in millions)				

Estimated amortization expense	\$ 38	\$ 38	\$ 35	\$ 30	\$ 27
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## 8. Other Current Liabilities and Other Liabilities

The table below presents the components of other current liabilities.

	September 25, 2015	December 31, 2014
	(in millions)	
<b>Other Current Liabilities:</b>		
Accruals for pending and threatened litigation (see Note 17)	\$ 45	\$ 38
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	79	75
Accrued product warranty costs	59	59
Accrued interest	52	46
Deferred revenues	29	30
Other	132	150
<b>Total other current liabilities</b>	<b>\$ 396</b>	<b>\$ 398</b>

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The table below presents the components of other liabilities.

	September 25, 2015	December 31, 2014
	(in millions)	
<b>Other Liabilities:</b>		
Non-current income taxes payable (see Note 10)	\$ 193	\$ 196
Deferred compensation	45	43
Accrued workers' compensation	35	38
Accrued product warranty costs	34	34
Notes payable and capital lease obligations	9	1
Other	87	70
<b>Total other liabilities</b>	<b>\$ 403</b>	<b>\$ 382</b>

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

	Year-to-Date Ended September 25, 2015	September 26, 2014
	(in millions)	
<b>Accrued product warranty costs:<sup>(1)</sup></b>		
Balance at January 1	\$ 93	\$ 99
Acquisitions during the period	1	
Accruals for product warranties issued during the period	46	53
Settlements made during the period	(46)	(46)
Foreign currency translation adjustments	(1)	(1)
<b>Balance at end of period</b>	<b>\$ 93</b>	<b>\$ 105</b>

<sup>(1)</sup> Warranty obligations incurred in connection with long-term production contracts that are accounted for under the POC cost-to-cost method are included within the contract estimates at completion and are

excluded from the above amounts. The balances above include both the current and non-current amounts.



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**9. Debt**

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

	September 25, 2015	December 31, 2014
	(in millions)	
<b>L-3 Communications:</b>		
Borrowings under Amended and Restated Revolving Credit Facility <sup>(1)</sup>	\$	\$
3.95% Senior Notes due 2016	500	500
1.50% Senior Notes due 2017	350	350
5.20% Senior Notes due 2019	1,000	1,000
4.75% Senior Notes due 2020	800	800
4.95% Senior Notes due 2021	650	650
3.95% Senior Notes due 2024	650	650
Principal amount of long-term debt	3,950	3,950
Unamortized discounts	(10)	(11)
Carrying amount of long-term debt	\$ 3,940	\$ 3,939

<sup>(1)</sup> During the year-to-date period ended September 25, 2015, L-3 Communications' aggregate borrowings and repayments under the Credit Facility were each \$861 million. At September 25, 2015, L-3 Communications had the full availability of its \$1 billion Credit Facility, which expires on February 3, 2017.

**10. Income Taxes**

The Company and its subsidiaries file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. As of September 25, 2015, the statutes of limitations for the Company's U.S. Federal income tax returns for the years ended December 31, 2010 through 2014 were open. In the second quarter of 2015, the Company reached agreements relating to the audit of the Company's 2010 and 2011 U.S. Federal income tax returns with the U.S. Internal Revenue Service (IRS), as well as audits of several state and foreign jurisdictions. As a result of these agreements, the Company reversed previously accrued income tax expense of \$10 million, including interest and

penalties. The IRS commenced an audit of the Company's U.S. Federal income tax return for 2012. The Company cannot predict the outcome of the audit at this time.

The effective income tax rate for the year-to-date period ended September 25, 2015 is not meaningful because income tax expense was greater than pre-tax income during the period due to the goodwill impairment charge. The marginal income tax rate on the goodwill impairment charge relating to the NSS segment was 6% because a significant portion of the NSS goodwill is not deductible for tax. Excluding the goodwill impairment charge and related income tax benefit, the effective income tax rate for the year-to-date period ended September 25, 2015 would have decreased to 22.3%, compared to 29.5% for the same period last year primarily due to \$36 million of tax benefits recorded in the quarterly period ended June 26, 2015, including: (1) \$17 million of foreign tax benefits related to a legal restructuring of the Company's foreign entities, (2) a \$10 million benefit related to the resolution of various outstanding income tax matters with U.S. and foreign tax authorities, as discussed above, and (3) \$9 million related to deferred tax benefits. As of September 25, 2015, the Company anticipates that unrecognized tax benefits will decrease by approximately \$25 million over the next 12 months due to the potential resolution of unrecognized tax benefits involving several jurisdictions and tax periods. The actual amount of the decrease over the next 12 months could vary significantly depending on the ultimate timing and nature of any settlements.

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Non-current income taxes payable include accrued potential interest of \$18 million (\$11 million after income taxes) at September 25, 2015 and \$15 million (\$9 million after income taxes) at December 31, 2014, and potential penalties of \$9 million at September 25, 2015 and December 31, 2014.

**11. Accumulated Other Comprehensive (Loss) Income (AOCI)**

The changes in the AOCI balances, including amounts reclassified from AOCI into net income, are presented in the table below.

	Foreign currency translation	Unrealized (losses) gains on hedging instruments	Unrecognized losses and prior service cost, net	Total accumulated other comprehensive (loss) income
	(in millions)			
<b>Balance at December 31, 2014</b>	\$ 19	\$ (5)	\$ (598)	\$ (584)
Other comprehensive loss before reclassifications, net of tax	(125)	(13)		(138)
Amounts reclassified from AOCI, net of tax	41	10	41	92
Net current period other comprehensive (loss) income	(84)	(3)	41	(46)
<b>Balance at September 25, 2015</b>	\$ (65)	\$ (8)	\$ (557)	\$ (630)
<b>Balance at December 31, 2013</b>	\$ 142	\$ 1	\$ (253)	\$ (110)
Other comprehensive loss before reclassifications, net of tax	(57)	(5)		(62)
Amounts reclassified from AOCI, net of tax		5	7	12
Net current period other comprehensive (loss) income	(57)		7	(50)
<b>Balance at September 26, 2014</b>	\$ 85	\$ 1	\$ (246)	\$ (160)



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Further details regarding the amounts reclassified from AOCI into net income are presented in the table below.

Details About AOCI Components	Amount Reclassified from AOCI <sup>(a)</sup> Year-to-Date				Affected Line Item in the Unaudited Condensed Consolidated Statements of Operations
	Third Quarter Ended September 25, 2015	Third Quarter Ended September 26, 2014	Third Quarter Ended September 25, 2015	Third Quarter Ended September 26, 2014	
<b>Foreign currency translation adjustment:</b>					
MSI divestiture	\$	\$	\$ (41)	\$	Loss related to business divestitures
			(41)		Income before income taxes
					Provision for income taxes
	\$	\$	\$ (41)	\$	Net income
<b>(Losses) gains on hedging instruments:</b>					
MSI divestiture	\$	\$	\$ (2)	\$	Loss related to business divestitures
Other	(4)	1	(10)	(6)	Cost of sales-products
	(4)	1	(12)	(6)	Income before income taxes
		(1)	2	1	Provision for income taxes
	\$ (4)	\$	\$ (10)	\$ (5)	Net income
<b>Amortization of defined benefit pension items:</b>					
MSI divestiture	\$	\$	\$ (14)	\$	Loss related to business divestitures
Net loss	(17)	(3)	(50)	(11)	(b)
	(17)	(3)	(64)	(11)	Income before income taxes
	7	1	23	4	Provision for income taxes
	\$ (10)	\$ (2)	\$ (41)	\$ (7)	Net income
Total reclassification for the period	\$ (14)	\$ (2)	\$ (92)	\$ (12)	Net income

- (a) Amounts in parenthesis indicate charges to the unaudited condensed consolidated statements of operations.
- (b) Amounts related to pension and postretirement benefit plans were reclassified from AOCI and recorded as a component of net periodic benefit cost (see Note 18 for additional information).

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**12. Equity**

On February 5, 2013, L-3 Holdings' Board of Directors approved a share repurchase program that authorizes L-3 Holdings to repurchase up to \$1.5 billion of its common stock through June 30, 2015. On December 4, 2014, L-3 Holdings' Board of Directors approved a new share repurchase program that authorizes L-3 Holdings to repurchase up to an additional \$1.5 billion of its common stock through June 30, 2017. Repurchases of L-3 Holdings' common stock are made from time to time at management's discretion in accordance with applicable U.S. Federal securities laws. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including, but not limited to, the Company's financial position, earnings, legal requirements, other investment opportunities (including acquisitions) and market conditions. L-3 Holdings repurchased 5,171,908 shares of its common stock at an average price of \$117.01 per share for an aggregate amount of \$605 million from January 1, 2015 through September 25, 2015. All share repurchases of L-3 Holdings' common stock have been recorded as treasury shares.

At September 25, 2015, the remaining dollar value under share repurchase programs authorized by L-3 Holdings' Board of Directors was \$940 million.

From September 26, 2015 through October 23, 2015, L-3 Holdings repurchased 702,650 shares of its common stock at an average price of \$106.70 per share for an aggregate amount of \$75 million.

On June 10, 2015, L-3 Holdings' Board of Directors declared a cash dividend of \$0.65 per share, paid on September 15, 2015 to shareholders of record at the close of business on August 17, 2015. During the year-to-date period ended September 25, 2015, the Company paid \$163 million of cash dividends, including a \$1 million net reduction of accrued dividends for employee held stock awards.

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**13. L-3 Holdings Earnings (Loss) Per Common Share**

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

	Third Quarter Ended		Year-to-Date Ended	
	September 25, 2015	September 26, 2014	September 25, 2015	September 26, 2014
	(in millions, except per share data)			
<b>Reconciliation of net (loss) income:</b>				
Net (loss) income	\$ (296)	\$ 157	\$ (63)	\$ 470
Net income attributable to noncontrolling interests	(3)	(3)	(11)	(9)
Net (loss) income attributable to L-3 Holdings common shareholders	\$ (299)	\$ 154	\$ (74)	\$ 461
<b>Earnings (loss) per share attributable to L-3 Holdings common shareholders:</b>				
<b>Basic:</b>				
Weighted average common shares outstanding	80.0	85.1	81.5	85.7
<b>Basic (loss) earnings per share:</b>				
Net (loss) income	\$ (3.74)	\$ 1.81	\$ (0.91)	\$ 5.38
<b>Diluted:</b>				
Common and potential common shares <sup>(1)</sup> :				
Weighted average common shares outstanding	80.0	85.1	81.5	85.7
Assumed exercise of stock options		2.8		3.0
Unvested restricted stock awards		1.5		1.6
Employee stock purchase plan contributions				0.1
Performance unit awards		0.1		0.1
Assumed purchase of common shares for treasury		(2.9)		(3.2)
Assumed conversion of the CODES <sup>(2)</sup>				1.1



Common and potential common shares	80.0	86.6	81.5	88.4
<b>Diluted (loss) earnings per share:</b>				
Net (loss) income	\$ (3.74)	\$ 1.78	\$ (0.91)	\$ 5.21

- (1) Due to a loss for the quarterly and year-to-date periods ended September 25, 2015, zero incremental weighted average potential common shares are included because the effect would be antidilutive.
- (2) L-3 Holdings 3% Convertible Contingent Debt Securities (CODES) due 2035 were retired on June 20, 2014, and were dilutive for the year-to-date period ended September 26, 2014 as the average market price of L-3 Holdings common stock during the period that the CODES were outstanding was greater than the price at which the CODES would have been convertible into L-3 Holdings common stock. As of June 18, 2014, the final date of conversion, the conversion price was \$88.71.

The computation of diluted EPS excludes shares for stock options, restricted stock awards, employee stock plan contributions and performance unit awards of 4.5 million for each of the quarterly and year-to-date periods ended September 25, 2015, and shares for stock options and employee stock purchase plan contributions of 0.6 million and 0.5 million for the quarterly and year-to-date periods ended September 26, 2014, respectively, as they were anti-dilutive.

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**14. Fair Value Measurements**

L-3 applies the accounting standards for fair value measurements to all of the Company's assets and liabilities that are measured and recorded at fair value. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants. The standards establish a fair value hierarchy that gives the highest priority to observable inputs and the lowest priority to unobservable inputs.

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	September 25, 2015			December 31, 2014		
	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	\$ 182	\$	\$	\$ 416	\$	\$
Derivatives (foreign currency forward contracts)		2			5	
Total assets	\$ 182	\$ 2	\$	\$ 416	\$ 5	\$
<b>Liabilities</b>						
Derivatives (foreign currency forward contracts)	\$	\$ 15	\$	\$	\$ 11	\$

(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 September 25, 2015 and December 31, 2014, the Company's financial instruments consisted primarily of cash and cash equivalents, billed receivables, trade accounts payable, Senior Notes 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 the expected settlement dates of these instruments. The carrying amounts and estimated fair values of the Company's other financial instruments are presented in the table below.

	September 25, 2015		December 31, 2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Senior Notes <sup>(1)</sup>	\$ 3,940	\$ 4,068	\$ 3,939	\$ 4,178
Foreign currency forward contracts <sup>(2)</sup>	\$ (13)	\$ (13)	\$ (6)	\$ (6)

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- (1) The Company measures the fair value of its Senior Notes using Level 2 inputs based primarily on current market yields for its existing debt traded in the secondary market.
- (2) The Company measures the fair values of foreign currency forward contracts based on forward exchange rates. See Note 16 for additional disclosures regarding the notional amounts and fair values of foreign currency forward contracts.

**16. Derivative Financial Instruments**

The Company's derivative financial instruments include foreign currency forward contracts, which are entered into for risk management purposes.

*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 U.S. dollar, the Euro and the British pound. 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 AOCI 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. 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 at September 25, 2015.

Currency	Notional Amounts (in millions)
Canadian dollar	\$ 141

U.S. dollar	94
Euro	21
British pound	2
Total	\$ 258

At September 25, 2015, the Company's foreign currency forward contracts had maturities through 2018.

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The table below presents the location of the Company's derivative instruments recorded at fair value on the condensed consolidated balance sheets.

	September 25, 2015				December 31, 2014			
	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities
<b><u>Derivatives designated as hedging instruments:</u></b>								
Foreign currency forward contracts <sup>(1)(2)</sup>	\$ 1	\$ 1	\$ 13	\$ 2	\$ 4	\$ 1	\$ 10	\$ 1
<b>Total derivative instruments</b>	<b>\$ 1</b>	<b>\$ 1</b>	<b>\$ 13</b>	<b>\$ 2</b>	<b>\$ 4</b>	<b>\$ 1</b>	<b>\$ 10</b>	<b>\$ 1</b>

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

(2) Assets held for sale at December 31, 2014 include \$2 million, of other current assets relating to the fair value of derivative instruments, and liabilities held for sale at December 31, 2014 include \$2 million of other current liabilities relating to the fair value of derivative instruments.

The effect of gains or losses from foreign currency forward contracts was not material to the unaudited condensed consolidated statements of operations for the quarterly or year-to-date periods ended September 25, 2015 and September 26, 2014. At September 25, 2015, the estimated net amount of existing losses that are expected to be reclassified into income within the next 12 months is \$10 million.

## **17. Commitments and Contingencies**

### ***Guarantees***

In connection with the spin-off of Engility Holdings, Inc. (Engility) in 2012, L-3 entered into a Distribution Agreement and several other agreements that govern certain aspects of L-3's relationship with Engility, including employee matters, tax matters, transition services, and the future supplier/customer relationship between L-3 and

Engility. These agreements generally provide cross-indemnities that, except as otherwise provided, are principally designed to place the financial responsibility for the obligations and liabilities of each entity with that respective entity. Engility has joint and several liability with L-3 to the U.S. Internal Revenue Service (IRS) for the consolidated U.S. Federal income taxes of L-3's consolidated group for taxable periods in which Engility was a part of that group. However, the Tax Matters Agreement specifies the portion of this tax liability for which L-3 and Engility will each bear responsibility, and L-3 and Engility have agreed to indemnify each other against any amounts for which the other is not responsible. The Tax Matters Agreement also allocates responsibility between L-3 and Engility for other taxes, including special rules for allocating tax liabilities in the event that the spin-off is determined not to be tax-free. Though valid as between the parties, the Tax Matters Agreement is not binding on the IRS.

The Company had two existing real estate lease agreements, which included residual guarantee amounts, were due to expire on August 31, 2015 and were accounted for as operating leases. Before the lease expiration date, the Company exercised an option to renew the leases for another five years, with similar lease terms, except the aggregate residual guarantee amount increased by \$17 million to \$40 million, reflecting the appreciation of the estimated fair value of the leased properties. The Company received \$17 million in cash from

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the lessor at the inception of the new leases, which is included in cash flows from financing activities in the unaudited condensed consolidated statement of cash flows for the year-to-date period ended September 25, 2015, and recorded a deferred gain in other liabilities in the unaudited condensed consolidated balance sheet as of September 25, 2015.

***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 have or could result and give rise to fines, penalties, compensatory and treble damages, restitution and/or forfeitures. In that regard, as of September 25, 2015, the Company has recognized an aggregate liability of \$26 million in anticipation of a settlement related to a product specification matter regarding a holographic weapon sight product in the Warrior Systems sector of the Electronic Systems segment. The Company has other ongoing government investigations, including investigations into the pricing of certain contracts entered into by the Communication Systems segment. 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, or an administrative finding against the Company as to its present responsibility to be a U.S. Government contractor or subcontractor, could result in the Company being suspended for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges. A conviction, or an administrative finding against the Company that satisfies the requisite level of seriousness, 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 or default, as well as other procurement clauses relevant to the foreign government.

***Litigation Matters***

The Company is also subject to litigation, 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, such acquired businesses, 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 are disclosed in Note 8. Amounts recoverable from insurance contracts or third parties are recorded as assets when deemed probable. At September 25, 2015 and December 31, 2014, the Company recorded approximately \$11 million of receivables for recoveries from insurance contracts or third parties in connection with the Bashkirian Airways matter discussed below. 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

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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. With respect to the litigation matters below for which it is reasonably possible that an unfavorable outcome may occur, an estimate of loss or range of loss is disclosed when such amount or amounts can be reasonably estimated. Although the Company believes that it has valid defenses with respect to legal matters and investigations pending against it, the results of litigation can be difficult to predict, particularly those involving jury trials. Accordingly, the Company's current judgment as to the likelihood of loss (or our current estimate as to the potential range of loss, if any) with respect to any particular litigation matter may turn out to be wrong. 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.

*Class Action.* In August 2014, three separate, putative class actions were filed in the United States District Court for the Southern District of New York (the District Court) against the Company and certain of its officers. These cases were consolidated into a single action on October 24, 2014. A consolidated amended complaint was filed in the District Court on December 22, 2014, which was further amended and restated on March 13, 2015. The complaint alleges violations of federal securities laws related to misconduct and accounting errors identified by the Company at its Aerospace Systems segment, and seeks monetary damages, pre- and post-judgment interest, and fees and expenses. The Company believes the action lacks merit and intends to defend itself vigorously. On April 24, 2015, the Company moved to dismiss the amended and restated complaint. The motion has been fully briefed. The Company is unable to reasonably estimate any amount or range of loss, if any, that may be incurred in connection with this matter because the proceedings are in their early stages.

*Government Inquiries.* On July 30, 2014, the Company voluntarily contacted the Securities and Exchange Commission (SEC) to report information concerning its internal review related to misconduct and accounting errors identified by the Company at its Aerospace Systems segment. The Company has received requests for interviews of current and former employees, and subpoenas for documents and other materials from the SEC and the Department of Justice concerning these self-reported matters. The Company is fully cooperating with both agencies. The Company is unable to reasonably estimate any amount or range of loss, if any, that may be incurred in connection with these inquiries based on the nature of the inquiries to date.

*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 a 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. The Company's insurers accepted defense of these matters and retained counsel. The matters were consolidated in the U.S. District Court

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for the District of New Jersey, which then dismissed the actions on the basis of forum non conveniens. Plaintiffs representing 30 of the estates re-filed their complaint against ACSS 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. Both ACSS and the plaintiffs appealed the judgment. In May 2012, the appellate court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of \$48 million. ACSS filed an appeal of the judgment with the Supreme Court of Spain (the Supreme Court) on September 28, 2012. During the Supreme Court's consideration of the appeal, 18 of 30 plaintiffs released their claims against ACSS in consideration for payments made by the Company's insurance carriers. On February 10, 2015, the Supreme Court issued a ruling that awarded the remaining 12 plaintiffs approximately \$11 million in the aggregate (including interest), plus certain legal expenses incurred by the plaintiffs in connection with the appeal to the Supreme Court. The Company's insurers have paid the \$11 million award amount into an escrow account held by the Company's legal representatives for payment to the plaintiffs if and when the award becomes due, and have confirmed that they will pay the plaintiffs' legal expenses on behalf of the Company once they are certified and become due. On May 20, 2015, an appeal was filed on behalf of ACSS to annul the Supreme Court decision on constitutional grounds. In October 2015, eight of the remaining 12 plaintiffs released their claims against ACSS in consideration for approximately \$7.0 million in aggregate payments made from the escrow account (representing a discount of approximately \$0.1 million from the portion of the \$11 million award attributable to these plaintiffs). Settlement discussions with the remaining four plaintiffs are ongoing.

*HVC Alkmaar.* On July 23, 2014, a notice of claim was received by our former JovyAtlas business unit. The notice relates to losses resulting from a fire that occurred at an HVC Alkmaar bio-energy plant on July 21, 2013. The notice states that the fire resulted from the failure of an uninterruptible power supply (UPS) to provide sufficient power to act as a back-up energy supply, alleges that JovyAtlas was the manufacturer and service provider for the UPS and claims \$11 million in estimated property damages and \$35 million in estimated business interruption damages. The Company has tendered the notice of claim to its insurance carriers, who have commenced their own investigation.

*Qui Tam Action.* On March 14, 2012, the Company was served with a *qui tam* lawsuit filed in the District Court for the Northern District of Texas, in which the U.S. Government has declined to intervene. The complaint alleges violations of the False Claims Act and seeks unquantified treble damages, penalties, attorney's fees, costs, and pre-judgment interest. Plaintiff alleges that between 2004 and 2012, the Company overbilled the U.S. Government for labor hours under contracts for helicopter maintenance and repair services in Southwest Asia. On July 8, 2015, the court denied the Company's motion for summary judgment. A jury trial is scheduled for the first quarter of 2016. The Company is currently unable to reasonably estimate the amount or range of loss, if any, that may be incurred in connection with this matter because: (1) significant factual issues remain in dispute, (2) the results of litigation can be difficult to predict, particularly those involving jury trials and (3) the plaintiff has not yet indicated the specific amount of damages that will be sought at trial. The Company believes the action lacks merit and intends to defend itself vigorously.



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**18. Pension and Other Postretirement Benefits**

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

	<b>Pension Plans</b>				<b>Postretirement Benefit Plans</b>			
	<b>Third Quarter Ended</b>	<b>Year-to-Date Ended</b>	<b>Third Quarter Ended</b>	<b>Year-to-Date Ended</b>	<b>Third Quarter Ended</b>	<b>Year-to-Date Ended</b>	<b>Third Quarter Ended</b>	<b>Year-to-Date Ended</b>
	<b>September 25,</b>	<b>September 26,</b>	<b>September 25,</b>	<b>September 26,</b>	<b>September 25,</b>	<b>September 26,</b>	<b>September 25,</b>	<b>September 26,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
	<b>(in millions)</b>							
<b>Components of net periodic benefit cost:</b>								
Service cost	\$ 29	\$ 26	\$ 93	\$ 80	\$ (1)	\$ (2)	\$ 2	\$ (1)
Interest cost	38	37	112	110	1	4	5	8
Expected return on plan assets	(51)	(48)	(155)	(145)	(1)	(1)	(3)	(3)
Amortization of prior service costs (credits)			1	1			(2)	(1)
Amortization of net loss (gain)	17	4	51	13		(1)		(2)
Curtailment loss	3		3	1		(1)		(1)
Net periodic benefit cost	\$ 36	\$ 19	\$ 105	\$ 60	\$ (1)	\$ (1)	\$ 2	\$ 1

*Contributions.* The Company contributed cash of \$80 million to its pension plans and \$5 million to its other postretirement benefit plans during the year-to-date period ended September 25, 2015. The Company expects to contribute an additional \$18 million to its pension plans and \$5 million to its other postretirement benefit plans during the remainder of 2015.

**19. Stock-Based Compensation**

During the year-to-date period ended September 25, 2015, the Company granted stock-based compensation under its Amended and Restated 2008 Long Term Performance Plan (2008 LTPP) in the form of stock options, restricted stock units and performance units. The stock-based compensation awards granted during the year-to-date period ended September 25, 2015 are further discussed below.

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*Stock Options.* The Company granted 453,358 stock options with a weighted average exercise price of \$129.05 per option, which was equal to the closing price 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 options granted to our Chairman and Chief Executive Officer are also subject to performance-based vesting conditions. The weighted average grant date fair value for the options of \$19.77 per option 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)	5.0
Expected volatility	21.4%
Expected dividend yield	2.4%
Risk-free interest rate	1.5%

*Restricted Stock Units.* The Company granted 360,915 restricted stock units with a weighted average grant date fair value of \$128.84 per share. Restricted stock units automatically convert into shares of L-3 Holdings' common stock upon vesting, and are subject to forfeiture until certain restrictions have lapsed, including a three year cliff vesting period for employees and a one year cliff vesting period for non-employee directors, in each case starting on the date of grant.

*Performance Units.* The Company granted 41,138 performance units with a weighted average grant date fair value per unit of \$129.03. The final payout for these units is based on the achievement of pre-determined EPS goals established by the compensation committee of the Company's Board of Directors for the three-year period ending December 31, 2017. Units earned under the award can range from zero to 200% of the original number of units awarded, which are converted into shares of L-3 Holdings' common stock.

**20. Supplemental Cash Flow Information**

	Year-to-Date Ended	
	September 25, 2015	September 26, 2014
	(in millions)	
Interest paid on outstanding debt	\$ 127	\$ 123
Income tax payments	114	116
Income tax refunds	6	8

**21. Segment Information**



The Company has four reportable segments, which are described in Note 1. The Company evaluates the performance of its reportable segments based on their sales and operating income. All corporate expenses are allocated to the Company's operating segments using an allocation methodology prescribed by U.S. Government regulations for government contractors. Accordingly, all costs and expenses, except for the NSS goodwill impairment charge and the loss related to business divestitures (which were not included in the Company's segment performance measures), are included in the Company's measure of segment profitability.

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The tables below present net sales, operating income, depreciation and amortization and total assets by reportable segment.

	<b>Third Quarter Ended</b>		<b>Year-to-Date Ended</b>	
	<b>September 25,</b>	<b>September 26,</b>	<b>September 25,</b>	<b>September 26,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
	<b>(in millions)</b>			
<b>Net Sales:</b>				
Electronic Systems	\$ 1,014	\$ 1,128	\$ 3,113	\$ 3,349
Aerospace Systems	1,068	1,037	3,092	3,173
Communication Systems	516	507	1,474	1,562
NSS	267	307	774	948
Elimination of intercompany sales	(48)	(39)	(130)	(116)
<b>Consolidated total</b>	<b>\$ 2,817</b>	<b>\$ 2,940</b>	<b>\$ 8,323</b>	<b>\$ 8,916</b>
<b>Operating Income (Loss):</b>				
Electronic Systems	\$ 123	\$ 125	\$ 356	\$ 383
Aerospace Systems	103	64	148	196
Communication Systems	53	49	140	147
NSS	7	19	28	56
<b>Segment total</b>	<b>\$ 286</b>	<b>\$ 257</b>	<b>\$ 672</b>	<b>\$ 782</b>
Loss related to business divestitures <sup>(1)</sup>	(9)		(29)	
Impairment charge <sup>(2)</sup>	(491)		(491)	
<b>Consolidated total</b>	<b>\$ (214)</b>	<b>\$ 257</b>	<b>\$ 152</b>	<b>\$ 782</b>
<b>Depreciation and amortization:</b>				
Electronic Systems	\$ 26	\$ 30	\$ 81	\$ 89
Aerospace Systems	13	11	37	30
Communication Systems	12	13	37	38
NSS	3	2	9	8
<b>Consolidated total</b>	<b>\$ 54</b>	<b>\$ 56</b>	<b>\$ 164</b>	<b>\$ 165</b>

- (1) See Note 4 for information regarding the Company's business divestitures.
- (2) Represents a non-cash goodwill impairment charge recorded in the third quarter of 2015 due to a decline in the estimated fair value of the NSS business. See Note 7 for additional information.

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	September 25, 2015	December 31, 2014
	(in millions)	
<b>Total Assets:</b>		
Electronic Systems	\$ 6,672	\$ 6,287
Aerospace Systems	3,103	3,011
Communication Systems	1,990	1,997
NSS	777	1,287
Corporate	494	707
Assets held for sale		547
Consolidated total	\$ 13,036	\$ 13,836

**22. Employee Severance and Termination Costs**

Consistent with the Company's strategy to continuously improve its cost structure and right-size its businesses, especially in view of U.S. defense budget constraints, L-3 is completing employment reduction actions across several of its businesses to reduce both direct and indirect costs, including overhead and general and administrative costs. As a result of these initiatives and due to the impact of U.S. defense budget constraints at certain affected business units, the Company recorded \$4 million and \$10 million in employee severance and other termination costs, with respect to approximately 740 employees, during the quarterly and year-to-date periods ended September 25, 2015, respectively. During the year ended December 31, 2014, the Company recorded a total of \$30 million in employee severance and other termination costs with respect to approximately 2,000 employees. Employee severance and other termination costs are reported within cost of sales on the unaudited condensed consolidated statements of operations. The remaining balance to be paid in connection with these initiatives was \$6 million at September 25, 2015 and \$11 million at December 31, 2014, which is expected to be paid primarily by the first half of 2016. Employee severance and other termination costs incurred by reportable segment for the quarterly and year-to-date periods ended September 25, 2015 and September 26, 2014 are presented in the table below.

	Third Quarter Ended		Year-to-Date Ended	
	September 25, 2015	September 26, 2014	September 25, 2015	September 26, 2014
	(in millions)			
<b>Reportable Segment</b>				
Electronic Systems	\$ 2	\$	\$ 4	\$ 14
Aerospace Systems	1	1	3	3

Communication Systems	1	2	3	5
NSS				1
Consolidated	\$ 4	\$ 3	\$ 10	\$ 23

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

L-3 Communications is a 100% owned subsidiary of L-3 Holdings. The debt of L-3 Communications, including the Senior Notes and borrowings under amounts drawn against the Credit Facility is guaranteed, on a joint and several, full and unconditional basis, by certain of its domestic subsidiaries (the Guarantor Subsidiaries ) and, in the case of the Credit Facility, by L-3 Holdings. See Note 10 to the audited consolidated

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financial statements for the year ended December 31, 2014, included in the Company's Annual Report on Form 10-K for additional information. The foreign subsidiaries and certain domestic subsidiaries of L-3 Communications (the Non-Guarantor Subsidiaries) do not guarantee the debt of L-3 Communications or L-3 Holdings. 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 or from L-3 Communications to L-3 Holdings.

Under the terms of the indentures governing the Senior Notes, the guarantees of the Senior Notes will automatically and unconditionally be released and discharged: (1) upon the release of all guarantees of all other outstanding indebtedness of L-3 Communications Corporation, or (2) upon the determination that such guarantor is no longer a domestic subsidiary. In addition, the guarantees of the Senior Notes will be automatically and unconditionally released and discharged in the event of a sale or other disposition of all of the assets of any guarantor, by way of merger, consolidation or otherwise, or a sale of all of the capital stock of such guarantor.

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 Communications</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 September 25, 2015:</u></b>						
Current assets:						
Cash and cash equivalents	\$	\$	170	\$	1	\$
Billed receivables, net		260	318	218	(15)	\$
Contracts in process		938	1,197	348		2,483
Other current assets		413	163	117		693
Total current assets		1,781	1,679	850	(15)	4,295
Goodwill		2,317	3,777	1,018		7,112
Other assets		800	552	277		1,629
Investment in and amounts due from consolidated subsidiaries	4,584	6,294	4,475		(15,353)	

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Total assets	\$ 4,584	\$ 11,192	\$ 10,483	\$ 2,145	\$ (15,368)	\$ 13,036
Current liabilities	\$	\$ 931	\$ 1,044	\$ 504	\$ (15)	\$ 2,464
Amounts due to consolidated subsidiaries				16	(16)	
Other long-term liabilities		1,737	203	33		1,973
Long-term debt		3,940				3,940
Total liabilities		6,608	1,247	553	(31)	8,377
L-3 shareholders equity	4,584	4,584	9,236	1,592	(15,412)	4,584
Noncontrolling interests					75	75
Total equity	4,584	4,584	9,236	1,592	(15,337)	4,659
Total liabilities and equity	\$ 4,584	\$ 11,192	\$ 10,483	\$ 2,145	\$ (15,368)	\$ 13,036

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	<b>L-3</b>	<b>L-3</b>	<b>Guarantor</b>	<b>Non-</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>Holdings</b>	<b>Communications</b>	<b>Subsidiaries</b>	<b>Guarantor</b>	<b>Subsidiaries</b>	<b>L-3</b>
	<b>(Parent)</b>			<b>Subsidiaries</b>		
				<b>(in millions)</b>		
<b>At December 31, 2014:</b>						
Current assets:						
Cash and cash equivalents	\$	\$	361	\$	142	\$ 442
Billed receivables, net			320	329	203	852
Contracts in process			867	1,144	284	2,295
Other current assets			365	141	95	601
Assets held for sale				52	495	547
Total current assets			1,913	1,667	1,219	4,737
Goodwill			2,308	4,280	913	7,501
Other assets			817	576	205	1,598
Investment in and amounts due from consolidated subsidiaries	5,285	6,855	4,157		(16,297)	
Total assets	\$ 5,285	\$ 11,893	\$ 10,680	\$ 2,337	\$ (16,359)	\$ 13,836
Current liabilities						
Liabilities held for sale				10	227	237
Amounts due to consolidated subsidiaries					333	(333)
Other long-term liabilities			1,791	190	31	2,012
Long-term debt			3,939			3,939
Total liabilities		6,608	1,217	1,046	(395)	8,476
L-3 shareholders equity	5,285	5,285	9,463	1,291	(16,039)	5,285
Noncontrolling interests					75	75
Total equity	5,285	5,285	9,463	1,291	(15,964)	5,360
Total liabilities and equity	\$ 5,285	\$ 11,893	\$ 10,680	\$ 2,337	\$ (16,359)	\$ 13,836





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	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communications</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</u></b>						
<b><u>Statements of Operations:</u></b>						
<b><u>For the quarter ended</u></b>						
<b><u>September 25, 2015:</u></b>						
Total net sales	\$	\$ 873	\$ 1,584	\$ 449	\$ (89)	\$ 2,817
Total cost of sales	(12)	(790)	(1,442)	(388)	101	(2,531)
Loss related to business divestitures		(8)	(1)			(9)
Impairment charge			(491)			(491)
Operating (loss) income	(12)	75	(350)	61	12	(214)
Interest expense		(47)				(47)
Interest and other income, net		2		1		3
(Loss) income before income taxes	(12)	30	(350)	62	12	(258)
Benefit (provision) for income taxes	7	(10)	(14)	(14)	(7)	(38)
Equity in net loss of consolidated subsidiaries	(294)	(319)			613	
Net (loss) income	(299)	(299)	(364)	48	618	(296)
Net income attributable to noncontrolling interests					(3)	(3)
Net (loss) income attributable to L-3	\$ (299)	\$ (299)	\$ (364)	\$ 48	\$ 615	\$ (299)
Comprehensive loss attributable to L-3	\$ (351)	\$ (351)	\$ (370)	\$ (9)	\$ 730	\$ (351)
<b><u>For the quarter ended</u></b>						
<b><u>September 26, 2014:</u></b>						
Total net sales	\$	\$ 860	\$ 1,628	\$ 525	\$ (73)	\$ 2,940
Total cost of sales	(10)	(787)	(1,500)	(469)	83	(2,683)

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Operating (loss) income	(10)	73	128	56	10	257
Interest expense		(46)	(2)	1		(47)
Interest and other income, net		4		1		5
(Loss) income before income taxes	(10)	31	126	58	10	215
Benefit (provision) for income taxes	3	(8)	(34)	(16)	(3)	(58)
Equity in net income of consolidated subsidiaries	161	131			(292)	
Net income	154	154	92	42	(285)	157
Net income attributable to noncontrolling interests					(3)	(3)
Net income attributable to L-3	\$ 154	\$ 154	\$ 92	\$ 42	\$ (288)	\$ 154
Comprehensive income (loss) attributable to L-3	\$ 90	\$ 90	\$ 89	\$ (22)	\$ (157)	\$ 90

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	<b>L-3</b>			<b>Non-</b>		<b>Consolidated</b>
	<b>Holdings</b>	<b>L-3</b>	<b>Guarantor</b>	<b>Guarantor</b>	<b>Eliminations</b>	<b>L-3</b>
	<b>(Parent)</b>	<b>Communications</b>	<b>Subsidiaries</b>	<b>Subsidiaries</b>		
	<b>(in millions)</b>					
<b><u>Condensed Combining</u></b>						
<b><u>Statements of Operations:</u></b>						
<b><u>For the year-to-date period</u></b>						
<b><u>ended September 25, 2015:</u></b>						
Total net sales	\$	\$ 2,539	\$ 4,574	\$ 1,442	\$ (232)	\$ 8,323
Total cost of sales	(36)	(2,313)	(4,295)	(1,275)	268	(7,651)
(Loss) gain related to business divestitures		(13)	(29)	13		(29)
Impairment charge			(491)			(491)
Operating (loss) income	(36)	213	(241)	180	36	152
Interest expense		(138)	(1)			(139)
Interest and other income, net		9		2		11
(Loss) income before income taxes	(36)	84	(242)	182	36	24
Benefit (provision) for income taxes	11	(19)	(33)	(35)	(11)	(87)
Equity in net loss of consolidated subsidiaries	(49)	(139)			188	
Net (loss) income	(74)	(74)	(275)	147	213	(63)
Net income attributable to noncontrolling interests					(11)	(11)
Net (loss) income attributable to L-3	\$ (74)	\$ (74)	\$ (275)	\$ 147	\$ 202	\$ (74)
Comprehensive (loss) income attributable to L-3	\$ (120)	\$ (120)	\$ (280)	\$ 73	\$ 327	\$ (120)
<b><u>For the year-to-date period</u></b>						
<b><u>ended September 26, 2014:</u></b>						
Total net sales	\$	\$ 2,606	\$ 4,908	\$ 1,623	\$ (221)	\$ 8,916

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Total cost of sales	(39)	(2,354)	(4,533)	(1,468)	260	(8,134)
Operating (loss) income	(39)	252	375	155	39	782
Interest expense	(2)	(127)	(2)		2	(129)
Interest and other income, net		12		2		14
(Loss) income before income taxes	(41)	137	373	157	41	667
Benefit (provision) for income taxes	12	(41)	(110)	(46)	(12)	(197)
Equity in net income of consolidated subsidiaries	490	365			(855)	
Net income	461	461	263	111	(826)	470
Net income attributable to noncontrolling interests					(9)	(9)
Net income attributable to L-3	\$ 461	\$ 461	\$ 263	\$ 111	\$ (835)	\$ 461
Comprehensive income attributable to L-3	\$ 411	\$ 411	\$ 264	\$ 53	\$ (728)	\$ 411

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(in millions)

**Condensed Combining Statements of  
Cash Flows**