

LOCKHEED MARTIN CORP  
Form 10-Q  
October 24, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 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 28, 2008**

**Commission file number 1-11437**

**LOCKHEED MARTIN CORPORATION**

(Exact name of registrant as specified in its charter)

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

**52-1893632**  
(I.R.S. Employer  
Identification Number)

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**6801 ROCKLEDGE DRIVE, BETHESDA, MD**  
(Address of principal executive offices)

**20817**  
(Zip Code)

**(301) 897-6000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has 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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act). (Check one)

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                       | Outstanding as of September 28, 2008 |
|-----------------------------|--------------------------------------|
| Common stock, \$1 par value | 400,607,757                          |

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| Exhibit 31.2 | Rule 13a-14(a) Certification of Bruce L. Tanner  |
| Exhibit 32.1 | Certification Pursuant to 18 U.S.C. Section 1350 of Robert J. Stevens  |
| Exhibit 32.2 | Certification Pursuant to 18 U.S.C. Section 1350 of Bruce L. Tanner  |

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Lockheed Martin Corporation****Unaudited Condensed Consolidated Statement of Earnings**

|   | Quarter Ended                               |                       | Nine Months Ended     |                       |
|---|---|-----------------------|-----------------------|-----------------------|
|   | September 28,<br>2008                       | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|   | <i>(In millions, except per share data)</i> |                       |                       |                       |
| <b>Net sales</b>                                    |   |                       |                       |                       |
| Products  | \$ 8,475                                    | \$ 9,237              | \$ 26,047             | \$ 26,078             |
| Services  | 2,102                                       | 1,858                 | 5,552                 | 4,943                 |
|   | 10,577                                      | 11,095                | 31,599                | 31,021                |
| <b>Cost of sales</b>                                |   |                       |                       |                       |
| Products  | 7,528                                       | 8,157                 | 23,058                | 23,284                |
| Services  | 1,872                                       | 1,708                 | 5,055                 | 4,394                 |
| Unallocated Corporate costs                         | 55  | 84                    | 104                   | 233                   |
|   | 9,455                                       | 9,949                 | 28,217                | 27,911                |
|   | 1,122                                       | 1,146                 | 3,382                 | 3,110                 |
| Other income (expense), net                         | 120   | 17                    | 401                   | 202                   |
| <b>Operating profit</b>                             | 1,242                                       | 1,163                 | 3,783                 | 3,312                 |
| Interest expense                                    | 85  | 79                    | 264                   | 265                   |
| Other non-operating income (expense), net           | (13)  | 35                    | 14                    | 139                   |
| Earnings before income taxes                        | 1,144                                       | 1,119                 | 3,533                 | 3,186                 |
| Income tax expense                                  | 362   | 353                   | 1,139                 | 952                   |
| <b>Net earnings</b>                                 | \$ 782                                      | \$ 766                | \$ 2,394              | \$ 2,234              |
| <b>Earnings per common share</b>                    |   |                       |                       |                       |
| Basic   | \$ 1.97                                     | \$ 1.85               | \$ 5.97               | \$ 5.35               |
| Diluted   | \$ 1.92                                     | \$ 1.80               | \$ 5.82               | \$ 5.21               |
| <b>Cash dividends per common share (see Note 7)</b> | \$ 0.42                                     | \$ 0.35               | \$ 1.26               | \$ 1.05               |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**Lockheed Martin Corporation**  
**Condensed Consolidated Balance Sheet**

|   | <i>(Unaudited)</i><br>September 28,<br>2008 | December 31,<br>2007 |
|---|---|----------------------|
|   | <i>(In millions, except per share data)</i> |                      |
| <b>Assets</b>   |   |                      |
| Current assets  |   |                      |
| Cash and cash equivalents                                 | \$ 2,463                                    | \$ 2,648             |
| Short-term investments                                    | 71  | 333                  |
| Receivables   | 5,391                                       | 4,925                |
| Inventories   | 1,736                                       | 1,718                |
| Deferred income taxes                                     | 653   | 756                  |
| Other current assets                                      | 396   | 560                  |
| <b>Total current assets</b>                               | <b>10,710</b>                               | <b>10,940</b>        |
| Property, plant and equipment, net                        | 4,294                                       | 4,320                |
| Goodwill  | 9,560                                       | 9,387                |
| Purchased intangibles, net                                | 390   | 463                  |
| Prepaid pension asset                                     | 326   | 313                  |
| Deferred income taxes                                     | 937   | 760                  |
| Other assets  | 3,140                                       | 2,743                |
|   | <b>\$ 29,357</b>                            | <b>\$ 28,926</b>     |
| <b>Liabilities and Stockholders Equity</b>                |   |                      |
| Current liabilities                                       |   |                      |
| Accounts payable  | \$ 2,030                                    | \$ 2,163             |
| Customer advances and amounts in excess of costs incurred | 4,313                                       | 4,254                |
| Salaries, benefits and payroll taxes                      | 1,669                                       | 1,544                |
| Current maturities of long-term debt                      | 1   | 104                  |
| Other current liabilities                                 | 2,520                                       | 1,806                |
| <b>Total current liabilities</b>                          | <b>10,533</b>                               | <b>9,871</b>         |
| Long-term debt, net                                       | 3,804                                       | 4,303                |
| Accrued pension liabilities                               | 1,551                                       | 1,192                |
| Other postretirement benefit liabilities                  | 960   | 928                  |
| Other liabilities   | 2,701                                       | 2,827                |
| <b>Total liabilities</b>                                  | <b>19,549</b>                               | <b>19,121</b>        |
| Stockholders equity                                       |   |                      |
| Common stock, \$1 par value per share                     | 398   | 409                  |
| Additional paid-in capital                                |   |                      |
| Retained earnings   | 11,243                                      | 11,247               |
| Accumulated other comprehensive loss                      | (1,833)                                     | (1,851)              |
| <b>Total stockholders equity</b>                          | <b>9,808</b>                                | <b>9,805</b>         |
|   | <b>\$ 29,357</b>                            | <b>\$ 28,926</b>     |

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.*

## Lockheed Martin Corporation

## Unaudited Condensed Consolidated Statement of Cash Flows

|   | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|
|   | September 28,<br>2008 | September 30,<br>2007 |
|   | (In millions)         |                       |
| <b>Operating Activities</b>   |                       |                       |
| Net earnings  | \$ 2,394              | \$ 2,234              |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                       |                       |
| Depreciation and amortization   | 522                   | 454                   |
| Amortization of purchased intangibles   | 90                    | 117                   |
| Stock-based compensation  | 115                   | 116                   |
| Excess tax benefits on stock compensation   | (90)                  | (102)                 |
| Changes in operating assets and liabilities:  |                       |                       |
| Receivables   | (426)                 | (332)                 |
| Inventories   | (18)                  | 274                   |
| Accounts payable  | (141)                 | (264)                 |
| Customer advances and amounts in excess of costs incurred                           | 91                    | 412                   |
| Other   | 869                   | 912                   |
| Net cash provided by operating activities   | 3,406                 | 3,821                 |
| <b>Investing Activities</b>   |                       |                       |
| Expenditures for property, plant and equipment                                      | (503)                 | (480)                 |
| Sale of short-term investments, net   | 262                   | 46                    |
| Acquisitions of businesses / investments in affiliates                              | (195)                 | (325)                 |
| Divestiture of investment in affiliate  |                       | 26                    |
| Other   | (27)                  | (43)                  |
| Net cash used for investing activities  | (463)                 | (776)                 |
| <b>Financing Activities</b>   |                       |                       |
| Issuances of common stock and related amounts                                       | 242                   | 312                   |
| Repurchases of common stock   | (2,338)               | (1,805)               |
| Excess tax benefits on stock compensation   | 90                    | 102                   |
| Common stock dividends  | (510)                 | (440)                 |
| Issuance of long-term debt and related costs  | 491                   |                       |
| Repayments of long-term debt  | (1,103)               | (32)                  |
| Net cash used for financing activities  | (3,128)               | (1,863)               |
| Net (decrease) increase in cash and cash equivalents                                | (185)                 | 1,182                 |
| Cash and cash equivalents at beginning of period                                    | 2,648                 | 1,912                 |
| <b>Cash and cash equivalents at end of period</b>                                   | <b>\$ 2,463</b>       | <b>\$ 3,094</b>       |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.



**Lockheed Martin Corporation**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 28, 2008**

**NOTE 1 BASIS OF PRESENTATION**

We have prepared the unaudited condensed consolidated financial statements in this Form 10-Q in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. We have continued to follow the accounting policies disclosed in the consolidated financial statements included in our 2007 Form 10-K filed with the United States Securities and Exchange Commission (SEC).

It is our practice to close our books and records on the Sunday prior to the end of the calendar quarter to align our financial closing with our business processes. The interim financial statements and tables of financial information included herein are labeled based on that convention. This practice only affects interim periods, as our fiscal year ends on December 31.

The interim financial information in this Form 10-Q reflects all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of our results of operations for the interim periods. The results of operations for the nine months ended September 28, 2008 are not necessarily indicative of results to be expected for the full year.

We have reclassified certain amounts for prior periods to conform with the 2008 presentation, primarily to reclassify interest income from segment Operating profit and Unallocated Corporate income (expense), net to Other non-operating income (expense), net (see Note 6).

**NOTE 2 EARNINGS PER SHARE**

We compute basic and diluted per share amounts based on Net earnings for the periods presented. We use the weighted average number of common shares outstanding during the period to calculate basic earnings per share. The weighted average number of common shares used in our calculation of diluted per share amounts includes the dilutive effects of stock options and restricted stock units based on the treasury stock method, and shares related to our convertible debentures discussed below.

On June 26, 2008, we announced the planned redemption of any and all of the \$1.0 billion of floating rate convertible debentures that remained outstanding on August 15, 2008 (see Note 7). At August 15, 2008, all of the \$1.0 billion of debentures had been delivered for conversion or were redeemed. Upon conversion of the debentures, we paid cash for the principal amount of the debentures relative to our conversion obligations, and satisfied the conversion obligations in excess of the principal amount by issuing 5.0 million shares of our common stock.

Statement of Financial Accounting Standards (FAS) 128, *Earnings Per Share*, required that shares to be used to pay the conversion obligations in excess of the accreted principal amount be included in our calculation of weighted average common shares outstanding for the diluted earnings per share computation up to the date the convertible securities were converted. The number of shares included in the computations in the three- and nine-month periods ended September 28, 2008 and September 30, 2007 did not have a material impact on earnings per share.

Unless otherwise noted, we present all per share amounts on a per diluted share basis.

## Lockheed Martin Corporation

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

The calculations of basic and diluted earnings per share are as follows:

|  | Quarter Ended                               |                       | Nine Months Ended     |                       |
|--|---|-----------------------|-----------------------|-----------------------|
|  | September 28,<br>2008                       | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|  | <i>(In millions, except per share data)</i> |                       |                       |                       |
| <b>Net earnings for basic and diluted computations</b>               | <b>\$ 782</b>                               | <b>\$ 766</b>         | <b>\$ 2,394</b>       | <b>\$ 2,234</b>       |
| <b>Weighted average common shares outstanding:</b>                   |   |                       |                       |                       |
| Average number of common shares outstanding for basic computations   | <b>397.4</b>                                | 413.5                 | <b>401.1</b>          | 417.2                 |
| Dilutive stock options, restricted stock and convertible securities  | <b>9.7</b>                                  | 11.0                  | <b>10.0</b>           | 11.3                  |
| Average number of common shares outstanding for diluted computations | <b>407.1</b>                                | 424.5                 | <b>411.1</b>          | 428.5                 |
| <b>Earnings per common share</b>                                     |   |                       |                       |                       |
| Basic  | <b>\$ 1.97</b>                              | \$ 1.85               | <b>\$ 5.97</b>        | \$ 5.35               |
| Diluted  | <b>\$ 1.92</b>                              | \$ 1.80               | <b>\$ 5.82</b>        | \$ 5.21               |

**NOTE 3 INVENTORIES**

|  | September 28,<br>2008 | December 31,<br>2007 |
|--|-----------------------|----------------------|
|  | <i>(In millions)</i>  |                      |
| Work in process, primarily related to long-term contracts and programs in progress | <b>\$ 4,163</b>       | \$ 4,039             |
| Less customer advances and progress payments                                       | <b>(2,966)</b>        | (2,839)              |
|  | <b>1,197</b>          | 1,200                |
| Other inventories  | <b>539</b>            | 518                  |
|  | <b>\$ 1,736</b>       | \$ 1,718             |

## Lockheed Martin Corporation

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

**NOTE 4 POSTRETIREMENT BENEFIT PLANS**

The net pension cost as determined by FAS 87, *Employers Accounting for Pensions*, and the net postretirement benefit cost as determined by FAS 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*, related to our postretirement benefit plans include the following components:

|   | Quarter Ended         |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|   | <i>(In millions)</i>  |                       |                       |                       |
| <b>Defined benefit pension plans</b>            |                       |                       |                       |                       |
| Service cost                                    | \$ 206                | \$ 215                | \$ 617                | \$ 646                |
| Interest cost                                   | 436                   | 408                   | 1,306                 | 1,223                 |
| Expected return on plan assets                  | (546)                 | (512)                 | (1,637)               | (1,544)               |
| Amortization of prior service cost              | 20                    | 22                    | 60                    | 67                    |
| Recognized net actuarial losses                 |                       | 42                    | 1                     | 126                   |
| <b>Total net pension expense</b>                | <b>\$ 116</b>         | <b>\$ 175</b>         | <b>\$ 347</b>         | <b>\$ 518</b>         |
| <b>Retiree medical and life insurance plans</b> |                       |                       |                       |                       |
| Service cost                                    | \$ 11                 | \$ 12                 | \$ 33                 | \$ 38                 |
| Interest cost                                   | 45                    | 47                    | 135                   | 142                   |
| Expected return on plan assets                  | (38)                  | (36)                  | (115)                 | (109)                 |
| Amortization of prior service cost              | (7)                   | (6)                   | (19)                  | (18)                  |
| Recognized net actuarial losses                 |                       | 5                     | 1                     | 16                    |
| <b>Total net postretirement expense</b>         | <b>\$ 11</b>          | <b>\$ 22</b>          | <b>\$ 35</b>          | <b>\$ 69</b>          |

In 2007, we made discretionary prepayments totaling \$335 million to our defined benefit pension plans trust and \$156 million to our retiree medical plans. In 2008, there will be no required contributions to the defined benefit plans pension trust or the retiree medical and life insurance plans, after giving consideration to the 2007 prepayments. These prepayments will also reduce our cash funding requirements for 2009. There were no contributions in the first nine months of 2008.

**NOTE 5 LEGAL PROCEEDINGS AND CONTINGENCIES**

We are a party to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment. We believe the probability is remote that the outcome of these matters will have a material adverse effect on our consolidated results of operations, financial position or cash flows. We cannot predict the outcome of legal proceedings with certainty. These matters include the following items which have been previously reported.

**Legal Proceedings**

On November 30, 2007, the Department of Justice (DoJ) filed a complaint in partial intervention in a lawsuit filed under the qui tam provisions of the Civil False Claims Act in the U.S. District Court for the Northern District of Texas, United States ex rel. Becker and Spencer v. Lockheed Martin Corporation et al., alleging that we should have known that a subcontractor falsified and inflated invoices submitted to us that were passed through to the government. We dispute the allegations and are defending against them.



**Lockheed Martin Corporation**

**Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

On February 22, 2007, we received a subpoena issued by a grand jury in the United States District Court for the District of Columbia. The subpoena requests documents related to our participation in a competition conducted in 2004-2005 by the National Archives and Records Administration for a \$3 million contract to provide Electronic Document System (eDOCS) Support Services. We are cooperating with the investigation.

On February 6, 2004, we submitted a certified contract claim to the United States requesting contractual indemnity for remediation and litigation costs (past and future) related to our former facility in Redlands, California. We submitted the claim consistent with a claim sponsorship agreement with The Boeing Company (Boeing), executed in 2001, in Boeing's role as the prime contractor on the Short Range Attack Missile (SRAM) program. The contract for the SRAM program, which formed a significant portion of our work at the Redlands facility, had special contractual indemnities from the U.S. Air Force, as authorized by Public Law 85-804. On August 31, 2004, the United States denied the claim. Our appeal of that decision is pending with the Armed Services Board of Contract Appeals.

On August 28, 2003, the DoJ filed complaints in partial intervention in two lawsuits filed under the qui tam provisions of the Civil False Claims Act in the United States District Court for the Western District of Kentucky, United States ex rel. Natural Resources Defense Council, et al., v. Lockheed Martin Corporation, et al., and United States ex rel. John D. Tillson v. Lockheed Martin Energy Systems, Inc., et al. The DoJ alleges that we committed violations of the Resource Conservation and Recovery Act at the Paducah Gaseous Diffusion Plant by not properly handling, storing, and transporting hazardous waste and that we violated the False Claims Act by misleading Department of Energy officials and state regulators about the nature and extent of environmental noncompliance at the plant. We dispute the allegations and are defending against them.

As described in the *Environmental Matters* discussion below, we are subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites. As a result, we are a party to or have property subject to various other lawsuits or proceedings involving environmental matters and remediation obligations.

We have been in litigation with certain residents of Redlands, California since 1997 before the California Superior Court for San Bernardino County regarding allegations of personal injury, property damage, and other tort claims on behalf of individuals arising from our alleged contribution to regional groundwater contamination. On July 11, 2006, the California Court of Appeal dismissed the plaintiffs' punitive damages claim. On September 23, 2008, the trial court dismissed the remaining first tier plaintiffs, ending the first round of individual trials. The first tier plaintiffs are pursuing their appellate remedies, and opposing counsel has asked the trial court to consider procedures for the litigation of the next round of individual plaintiffs.

***Environmental Matters***

We are involved in environmental proceedings and potential proceedings relating to soil and groundwater contamination, disposal of hazardous waste and other environmental matters at several of our current or former operating facilities. Environmental cleanup activities usually span several years, which make estimating liabilities a matter of judgment because of such factors as changing remediation technologies, assessments of the extent of contamination and continually evolving regulatory environmental standards. We consider these and other factors in estimates of the timing and amount of any future costs that may be required for remediation actions, which generally results in the calculation of a range of estimates for a particular environmental site. We record a liability for the amount within the range which we determine to be our best estimate of the cost of remediation or, in cases where no amount within the range is better than another, we record an amount at the low end of the range. We do not discount the recorded liabilities, as the timing of cash payments is not fixed or cannot be reliably determined.

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**Lockheed Martin Corporation**

**Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

At September 28, 2008 and December 31, 2007, the aggregate amount of liabilities recorded relative to environmental matters was \$810 million and \$572 million. A portion of environmental costs is eligible for future recovery in the pricing of our products and services on U.S. Government contracts. We have recorded assets totaling \$680 million and \$480 million as of September 28, 2008 and December 31, 2007 for the estimated future recovery of these costs, as we consider the recovery probable based on government contracting regulations and our history of receiving reimbursement for such costs.

We perform quarterly reviews of the status of our environmental remediation sites and the related liabilities and assets. Based on the review completed this quarter, we increased the liability by \$191 million and the asset deemed probable of recovery by \$160 million from the amounts recorded at June 29, 2008. We also recorded a charge in the quarter of \$31 million, net of state income tax benefits, for the portion of the increased liability that was not considered probable of future recovery. The majority of the increase reflects the estimated long-term costs of new treatment systems and remediation activities at two former operating facilities, in addition to increased estimated costs at other existing remediation sites.

We cannot reasonably determine the extent of our financial exposure at all environmental sites with which we are involved. There are a number of former operating facilities which we are monitoring or investigating for potential future remediation. In some cases, although a loss may be probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation activities because of uncertainties with respect to assessing the extent of the contamination or the applicable regulatory standard. We also are pursuing claims for contribution to site cleanup costs against other potentially responsible parties (PRPs), including the U.S. Government.

We are conducting remediation activities under various consent decrees and orders relating to soil or groundwater contamination at certain other sites of former operations. Under an agreement related to our Burbank and Glendale, California sites, the U.S. Government reimburses us an amount equal to approximately 50% of expenditures for certain remediation activities in its capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

***Letters of Credit and Other Arrangements***

We have entered into standby letter of credit agreements, surety bonds and other arrangements with financial institutions and other third parties primarily relating to advances received from customers and/or the guarantee of future performance on certain contracts. We have total outstanding letters of credit, surety bonds and other arrangements aggregating \$3.2 billion and \$3.3 billion at September 28, 2008 and December 31, 2007. Letters of credit and surety bonds are generally available for draw down in the event we do not perform.

***Sale of International Launch Services***

Under the agreement to sell our ownership interests in Lockheed Khronichev Energia International, Inc. (LKEI) and International Launch Services, Inc. (ILS) in 2006, we continue to have responsibility under a guaranty to one remaining ILS customer if launch services are not provided by ILS. At September 28, 2008, the approximate total contract value of the guaranteed launch was \$63 million. We continue to retain \$14 million of cash from the sale transaction, which partially would mitigate any exposure under the guarantee. We are obligated to pay the buyer the remaining cash we retained upon the successful completion of the final launch.

Our Balance Sheet at September 28, 2008 included current assets relating to LKEI and ILS totaling \$76 million and current liabilities totaling \$90 million which will be reduced when the final launch services are provided. The assets relate primarily to advances we have made to

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**Lockheed Martin Corporation****Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

Khrunichev State Research and Production Space Center for the future launch referred to above, and the liabilities relate primarily to advances we have received from the customer for the launch.

Any potential earnings impact resulting from the guaranty and ILS's failure to perform, partially would be mitigated by the unrecognized deferred net gain we recorded on the transaction at the end of 2006. Based on the launches that had occurred through September 28, 2008, we recognized, net of state income taxes, \$44 million of the deferred gain in the third quarter of 2008 which increased net earnings by \$28 million (\$0.07 per share), and \$16 million of the deferred gain in the first quarter of 2008 which increased net earnings by \$10 million (\$0.02 per share). The remaining unrecognized deferred gain, net of state and federal income taxes, of \$31 million at September 28, 2008, will be recognized when the final launch occurs. This launch is scheduled to take place in the fourth quarter of 2008 per the Proton launch schedule, which is subject to change.

**Investment in ULA**

In connection with the formation of United Launch Alliance, LLC (ULA), both we and Boeing have each committed to providing up to \$25 million in additional capital contributions and \$200 million in other financial support to ULA, as required. The non-capital financial support will be made in the form of a revolving credit facility between us and ULA or guarantees of ULA financing with third parties, in either case to the extent necessary for ULA to meet its working capital needs. We have agreed to provide this support for at least five years from December 1, 2006, the closing date of the transaction, and would expect to fund our requirements with cash on hand. To satisfy our non-capital financial support commitment, we and Boeing put into place at closing a revolving credit agreement with ULA. As of December 31, 2007, we had provided a total of \$3 million of funding to ULA under the additional capital contribution commitment. We did not provide further funding to ULA during the first nine months of 2008. In addition, both we and Boeing have cross-indemnified ULA related to certain financial support arrangements (*e.g.*, letters of credit, surety bonds or foreign exchange contracts provided by either party) and guarantees by us and Boeing of the performance and financial obligations of ULA under certain launch service contracts. Through September 28, 2008, ULA has fully performed its obligations, and it has not been necessary to make payments under the cross-indemnities.

**NOTE 6 INFORMATION ON BUSINESS SEGMENTS**

We operate in four principal business segments: Aeronautics, Electronic Systems, Information Systems & Global Services (IS&GS) and Space Systems. We organize our business segments based on the nature of the products and services offered.

Amounts in 2007 reflect the reclassification of interest income from segment Operating profit and Unallocated Corporate income (expense), net to Other non-operating income (expense), net to conform to the 2008 consolidated Statement of Earnings presentation. In the third quarter of 2007, we reclassified \$35 million, including \$29 million from Unallocated Corporate income (expense), net and \$6 million from across the business segments. During the nine-month period ended September 30, 2007, we reclassified \$139 million, including \$125 million from Unallocated Corporate income (expense), net and \$14 million from across the business segments. The amounts from Unallocated Corporate income (expense), net were primarily attributable to U.S. bank accounts, and amounts from the business segments were attributable to interest from foreign bank accounts. The impact of the reclassification on the individual segments' operating results was not material.

In the following table relative to the caption Operating profit, total Operating profit of the business segments is reconciled to the corresponding consolidated amount. The reconciling item Unallocated Corporate income (expense), net includes the FAS/CAS pension adjustment (see discussion below), costs for certain stock-based compensation programs, the effects of items not

## Lockheed Martin Corporation

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

considered part of management's evaluation of segment operating performance, Corporate costs not allocated to the operating segments and other miscellaneous Corporate activities.

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated for financial reporting purposes in accordance with FAS 87, and pension costs calculated and funded in accordance with U.S. Government Cost Accounting Standards (CAS), which are reflected in the business segment results. CAS is a major factor in determining pension funding requirements, and governs the extent of allocability and recoverability of pension costs on government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts and, therefore, recognized in segment Net sales. The results of operations of our segments only include pension expense as determined and funded in accordance with CAS rules.

Transactions between segments are generally negotiated and accounted for under terms and conditions that are similar to other government and commercial contracts; however, these intercompany transactions are eliminated in consolidation and for purposes of the presentation of Net sales in the related table that follows.

## Selected Financial Data by Business Segment

|   | Quarter Ended         |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|   | <i>(In millions)</i>  |                       |                       |                       |
| <b>Net sales</b>                            |                       |                       |                       |                       |
| Aeronautics                                 | \$ 2,917              | \$ 3,342              | \$ 8,608              | \$ 9,299              |
| Electronic Systems                          | 2,802                 | 2,827                 | 8,686                 | 8,269                 |
| Information Systems & Global Services       | 2,950                 | 2,713                 | 8,312                 | 7,378                 |
| Space Systems                               | 1,908                 | 2,213                 | 5,993                 | 6,075                 |
| Total                                       | \$ 10,577             | \$ 11,095             | \$ 31,599             | \$ 31,021             |
| <b>Operating profit</b>                     |                       |                       |                       |                       |
| Aeronautics                                 | \$ 375                | \$ 414                | \$ 1,064              | \$ 1,091              |
| Electronic Systems                          | 364                   | 346                   | 1,139                 | 1,050                 |
| Information Systems & Global Services       | 267                   | 245                   | 769                   | 674                   |
| Space Systems                               | 244                   | 221                   | 743                   | 620                   |
| Total business segments                     | 1,250                 | 1,226                 | 3,715                 | 3,435                 |
| Unallocated Corporate income (expense), net | (8)                   | (63)                  | 68                    | (123)                 |
| Total                                       | \$ 1,242              | \$ 1,163              | \$ 3,783              | \$ 3,312              |
| <b>Intersegment revenue</b>                 |                       |                       |                       |                       |
| Aeronautics                                 | \$ 40                 | \$ 45                 | \$ 111                | \$ 117                |
| Electronic Systems                          | 157                   | 159                   | 443                   | 427                   |
| Information Systems & Global Services       | 229                   | 280                   | 687                   | 809                   |
| Space Systems                               | 37                    | 38                    | 104                   | 111                   |
| Total business segments                     | \$ 463                | \$ 522                | \$ 1,345              | \$ 1,464              |





## Lockheed Martin Corporation

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

## Selected Financial Data by Business Segment (continued)

|                                       | September 28,<br>2008 | December 31,<br>2007 |
|---------------------------------------|-----------------------|----------------------|
|                                       | <i>(In millions)</i>  |                      |
| <b>Assets</b>                         |                       |                      |
| Aeronautics                           | \$ 3,490              | \$ 3,014             |
| Electronic Systems                    | 8,479                 | 8,500                |
| Information Systems & Global Services | 7,405                 | 7,477                |
| Space Systems                         | 3,024                 | 2,977                |
| Total business segments               | 22,398                | 21,968               |
| Corporate activities <sup>(1)</sup>   | 6,959                 | 6,958                |
| Total                                 | \$ 29,357             | \$ 28,926            |

1) Assets primarily include Cash and cash equivalents, Short-term investments, Deferred income taxes and the Prepaid pension asset.

**NOTE 7 OTHER****Matters Included in Earnings**

In the third quarter of 2008, we recognized, net of state income taxes, a gain of \$44 million in Other income (expense), net representing a portion of the deferred net gain recorded in connection with the transaction to sell our ownership interests in LKEI and ILS in 2006 (see Note 5). The gain increased Net earnings by \$28 million (\$0.07 per share). In the first quarter of 2008, we recognized, net of state income taxes, \$16 million of the deferred net gain from the LKEI and ILS transaction, which increased Net earnings by \$10 million (\$0.02 per share).

In the second quarter of 2008, we recognized, net of state income taxes, \$85 million in Other income (expense), net due to the elimination of reserves related to various land sales in California. Reserves were originally recorded at the time of each land sale in 2007 and prior years based on the U.S. Government's assertion that a significant portion of the sale proceeds should be allocated to the buildings and improvements on the properties, thereby giving the U.S. Government the right to share in the gains associated with the land sales. At the time the land sales occurred, we believed the value of the properties sold was attributable to the land versus the buildings and improvements. The dispute ultimately went to trial with the Armed Services Board of Contract Appeals (ASBCA), subsequent to which the ASBCA determined that our accounting for the land sales was in accordance with the Federal Acquisition Regulation and CAS. We reached a settlement with the U.S. Government in the second quarter of 2008, and the previously recorded reserves were no longer required. Resolution of this matter increased our Net earnings in the second quarter by \$56 million (\$0.14 per share).

In the second quarter of 2007, we sold our remaining 20% interest in COMSAT International for \$26 million in cash. The transaction resulted in a gain, net of state income taxes, of \$25 million which we recorded in Other income (expense), net and an increase in Net earnings of \$16 million (\$0.04 per share).

In the first quarter of 2007, we reached closure with the Internal Revenue Service (IRS) on their examination of our Federal income tax returns for 2003 and 2004, as well as claims we filed for additional extraterritorial income (ETI) tax benefits for years prior to 2005. As a result, we recognized additional tax benefits and reduced our income tax expense in the first quarter of 2007 by \$59 million (\$0.14 per share), including related interest.



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**Lockheed Martin Corporation**

**Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

In the first quarter of 2007, we sold certain surplus land in California for \$36 million in cash. The transaction resulted in a gain, net of state income taxes, of \$25 million which we recorded in Other income (expense), net and an increase in Net earnings of \$16 million (\$0.04 per share).

In 2004, we recorded a charge associated with certain litigation related to a waste remediation contract with the Department of Energy. In the first quarter of 2007, we reversed, net of state income tax benefits, \$21 million of legal reserves into Other income (expense), net in connection with the settlement of that litigation. This settlement increased Net earnings by \$14 million (\$0.03 per share).

***Long-term Debt***

On June 26, 2008, we announced the planned redemption of any and all of our \$1.0 billion in original principal amount of floating rate convertible debentures that remained outstanding on August 15, 2008. Holders could elect to convert their debentures at any time prior to the close of business on August 14, 2008. Any debentures not delivered for conversion by the close of business on that date were no longer available for conversion and were redeemed at \$1,000 for each \$1,000 in principal amount on August 15, 2008.

At August 15, 2008, all of the \$1.0 billion of debentures had been delivered for conversion or were redeemed. The aggregate amount paid in cash subsequent to conversion of the debentures was \$1.0 billion, representing the principal amount of the debentures relative to our conversion obligations, which was equal to the original principal amount of the debentures. In addition, the conversion rate for the debentures from the time of our announcement in June through August 15 was 13.7998 shares of common stock for each \$1,000 in original principal amount of debentures, equating to a conversion price of \$72.46. The conversion obligations in excess of the principal amount, computed based on the closing price of our common stock over the cash settlement averaging period as defined in the indenture, totaled \$571 million, and resulted in the issuance of 5.0 million shares of our common stock. The issuance of the common shares for the conversion obligations was recognized in Stockholders' equity as a \$5 million increase to Common stock and a corresponding decrease to Additional paid-in capital. Also, a deferred tax liability of \$63 million attributable to interest deductions associated with the debentures was credited to Additional paid-in capital upon conversion.

In the first quarter of 2008, we issued \$500 million of long-term notes. The notes have a fixed coupon interest rate of 4.121% and are due in 2013.

***Stockholders' Equity***

***Share Repurchase Program***

We used cash to repurchase common shares during the first nine months of both 2008 and 2007 as follows:

In the first nine months of 2008, \$2,338 million was used to repurchase 22.1 million common shares that were executed and settled during the nine-month period, and an additional \$18 million was paid for 0.2 million common shares purchased in September 2008 that were settled in October 2008; and

In the first nine months of 2007, \$1,805 million was used to repurchase 18.6 million common shares, all of which were executed and settled during the nine-month period.

As we repurchase our common shares, we reduce Common stock for the \$1 of par value of the shares repurchased, with the remainder of the purchase price over par value recorded as a reduction of Additional paid-in capital. Due to the volume of repurchases made under our share repurchase program, Additional paid-in capital was reduced to zero, with the remainder of the



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**Lockheed Martin Corporation**
**Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

excess of purchase price over par value of \$1,659 million recorded as a reduction of Retained earnings.

Our share repurchase program authorizes the repurchase of shares of our common stock from time-to-time at management's discretion. In September 2008, our Board authorized the repurchase of an additional 30 million shares, bringing the total authorized for repurchase under the program to 158 million. As of September 28, 2008, we had repurchased a total of 117.6 million shares under the program, and there remained 40.4 million shares that may be repurchased in the future.

*Dividends*

During the first nine months of 2008, we declared and paid quarterly dividends totaling \$510 million (\$0.42 per share per quarter). We also declared our fourth quarter 2008 dividend, which was increased to \$0.57 per share. The fourth quarter dividend totaled \$229 million and was recorded as a current liability and a reduction of Retained earnings. This dividend will be paid in December 2008. In the first nine months of 2007, we declared and paid dividends totaling \$440 million (\$0.35 per share per quarter).

*Comprehensive Income*

The components of comprehensive income for the three months and nine months ended September 28, 2008 and September 30, 2007 consisted of the following:

|                                   | Quarter Ended         |                       | Nine Months Ended     |                       |
|-----------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                   | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|                                   | <i>(In millions)</i>  |                       |                       |                       |
| Net earnings                      | \$ 782                | \$ 766                | \$ 2,394              | \$ 2,234              |
| Other comprehensive income (loss) | (17)                  | (31)                  | 18                    | (27)                  |
| Comprehensive income              | \$ 765                | \$ 735                | \$ 2,412              | \$ 2,207              |

Other comprehensive income (loss) primarily relates to foreign currency translation adjustments and unrealized gains and losses from foreign currency hedging activities.

*Income Taxes and Interest Payments*

We made federal and foreign income tax payments, net of refunds received, of \$918 million and \$861 million during the nine-month periods ended September 28, 2008 and September 30, 2007. Our total interest payments were \$226 million and \$218 million during the same respective periods.

Over the next 12 months, it is expected that the IRS examination of our U.S. Federal income tax returns for 2005-2007 and certain non-domestic income tax issues will be resolved. Resolution of these matters is expected to change our unrecognized tax benefit balance, but due to the current stage of the examination, we are not able at this time to estimate the impact on our consolidated results of operations, financial position or cash flows.

*Recent Accounting Pronouncements*

In the first quarter of 2008, we adopted FAS 157, *Fair Value Measurements*, which defines fair value, establishes a market-based framework or hierarchy for measuring fair value and expands disclosures about fair value measurements. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value, but does not require any new fair value measurements. The adoption of FAS 157 did not have a



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**Lockheed Martin Corporation**

**Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

material impact on our results of operations, financial position or cash flows. The FAS 157 requirements for certain non-financial assets and liabilities have been deferred until the first quarter of 2009 in accordance with Financial Accounting Standards Board (FASB) Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*. We currently do not expect that the adoption of FAS 157 as it relates to certain non-financial assets and liabilities will have a material impact on our results of operations, financial position or cash flows.

The fair-value hierarchy established in FAS 157 prioritizes the inputs used in valuation techniques into three levels as follows:

Level 1 Observable inputs quoted prices in active markets for identical assets and liabilities;

Level 2 Observable inputs other than the quoted prices in active markets for identical assets and liabilities includes quoted prices for similar instruments, quoted prices for identical or similar instruments in inactive markets, and amounts derived from valuation models where all significant inputs are observable in active markets; and

Level 3 Unobservable inputs includes amounts derived from valuation models where one or more significant inputs are unobservable and require us to develop relevant assumptions.

The amount of net assets we recorded at fair value at September 28, 2008 totaled \$429 million, which includes: \$71 million of Short-term investments; \$562 million of other investments we hold in a trust related to certain of our non-qualified benefit plans; \$180 million of liabilities associated with non-qualified deferred compensation plans; and \$24 million of net liabilities related to derivative financial instruments. We determined the fair values of the assets included in Short-term investments using the Level 2 methodology. The fair values of approximately 59% of the investments held in the trust for non-qualified benefit plans were determined using the Level 1 methodology, with the remainder of those assets valued based on the Level 2 methodology. We record assets and liabilities related to our derivative financial instruments and liabilities associated with non-qualified deferred compensation plans at fair value using the Level 2 methodology.

We elected not to adopt the fair value option included in FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*, which became effective January 1, 2008 for companies electing adoption.

In May 2008, the FASB issued FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, which is effective beginning with our first quarter 2009 financial reporting. The FSP requires retrospective application to all periods presented and does not grandfather existing debt instruments. The FSP changes the accounting for our \$1.0 billion in original principal amount of floating rate convertible debentures in that it requires that we bifurcate the proceeds from the debt issuance between a debt and equity component as of the August 2003 issuance date and through the August 2008 date that they were converted or redeemed. The equity component would reflect the value of the conversion feature of the debentures. The impact of the new rule will not be material to our previously reported financial statements.

In December 2007, the FASB issued FAS 141(R), *Business Combinations*, which will become effective January 1, 2009. The new standard will replace existing guidance and significantly change accounting and reporting relative to business combinations in consolidated financial statements, including requirements to recognize acquisition-related transaction and post-acquisition restructuring costs in our results of operations as incurred. FAS 141(R) will be effective for businesses acquired after the effective date.



**Lockheed Martin Corporation**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors

Lockheed Martin Corporation

We have reviewed the condensed consolidated balance sheet of Lockheed Martin Corporation as of September 28, 2008, and the related condensed consolidated statements of earnings for the three- and nine-month periods ended September 28, 2008 and September 30, 2007, and the condensed consolidated statements of cash flows for the nine-month periods ended September 28, 2008 and September 30, 2007. These financial statements are the responsibility of the Corporation's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Lockheed Martin Corporation as of December 31, 2007, and the related consolidated statements of earnings, stockholders' equity, and cash flows for the year then ended (not presented herein) and in our report dated February 26, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Baltimore, Maryland

October 21, 2008

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**Lockheed Martin Corporation**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**September 28, 2008**

We principally research, design, develop, manufacture, integrate, operate and sustain advanced technology systems and products, and provide a broad range of management, engineering, technical, scientific, logistics and information services. We serve both domestic and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government. Our sales to agencies of the U.S. Government, including those to the Department of Defense (DoD), represented 84% of our sales in 2007. Of the remaining 16% of sales, approximately 13% related to sales to international customers (including foreign military sales funded, in whole or in part, by the U.S. Government), with the remainder attributable to commercial and other customers. Our main areas of focus are in defense, space, intelligence, homeland security, and government information technology.

We operate in four principal business segments: Aeronautics, Electronic Systems, Information Systems & Global Services (IS&GS) and Space Systems. As a systems integrator, our products and services range from electronics and information systems, including integrated net-centric solutions, to missiles, aircraft and spacecraft.

The following discussion should be read along with our 2007 Form 10-K filed with the Securities and Exchange Commission, and with the unaudited condensed consolidated financial statements included in this Form 10-Q.

**Consolidated Results of Operations**

Since our operating cycle is long-term and involves many types of development and production contracts with varying production delivery schedules, the results of operations of a particular quarter, or quarter-to-quarter comparisons of recorded sales and profits, may not be indicative of our future operating results. The following discussions of comparative results among periods should be viewed in this context. All per share amounts cited in the following discussions are presented on a per diluted share basis.

The following discussion of Net sales and operating results provides an overview of our operations by focusing on key elements set forth in our Unaudited Condensed Consolidated Statement of Earnings. The Discussion of Business Segments section which follows describes the comparative results of operations of each of our business segments for the quarter and nine-month periods ended September 28, 2008 and September 30, 2007. We follow an integrated approach for managing the performance of our businesses and generally focus the discussion of our results of operations around major lines of business, versus distinguishing between products and services. Product sales are predominantly generated in the Aeronautics, Electronic Systems and Space Systems segments, while most of our services revenues are generated in our IS&GS segment.

Net sales for the third quarter of 2008 were \$10.6 billion, a 5% decrease from the third quarter 2007 sales of \$11.1 billion. Net sales for the nine months of 2008 were \$31.6 billion, a 2% increase over the \$31.0 billion recorded in the comparable 2007 period. For the three months ended September 28, 2008, the overall decrease in Net sales primarily was due to lower deliveries of combat aircraft in Aeronautics and commercial satellites in Space Systems. For the nine months ended September 28, 2008, net sales increases in IS&GS and Electronic Systems partially were offset by declines in Aeronautics and Space Systems. The net sales increase in Electronic Systems primarily was due to higher volume on Missiles & Fire Control programs. The increase in IS&GS net sales was due to higher volume on Global Services activities. These

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**Lockheed Martin Corporation**

**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

increases partially were offset by declines in combat aircraft deliveries in Aeronautics and commercial satellite deliveries in Space Systems.

Other income (expense), net was \$120 million for the third quarter of 2008 compared to \$17 million recorded in the comparable 2007 period. Other income (expense), net for the nine months ended September 28, 2008 and September 30, 2007 was \$401 million and \$202 million, respectively. In both periods, the increase was primarily due to higher equity earnings from ULA and the benefits from the impact of certain items included in Other income (expense), net (see Note 7 under the caption Matters Included in Earnings ).

Operating profit for the third quarter of 2008 was \$1,242 million, an increase of 7% from the \$1,163 million recorded in the comparable 2007 period. Operating profit for the nine months ended September 28, 2008 was \$3,783 million, a 14% increase over the \$3,312 million recorded in the comparable 2007 period. During the quarter and nine months ended September 28, 2008, Operating profit increased in every business unit except Aeronautics, which declined slightly due to the lower volume on F-16 programs. In both periods, Operating profit was favorably impacted by the decline in the FAS/CAS pension adjustment and by the benefits of certain items included in Other income (expense), net.

Other non-operating income (expense), net was an expense of \$13 million in the third quarter of 2008 as compared to income of \$35 million in the third quarter of 2007. For the nine months ended September 28, 2008, Other non-operating income (expense), net was income of \$14 million compared to income of \$139 million for the nine months ended September 30, 2007. In both periods, the decrease was primarily due to lower interest income on invested cash balances and unrealized losses on marketable securities held to fund certain employee benefit obligations.

Interest expense for the third quarter and nine months ended September 28, 2008 was \$85 million and \$264 million, respectively, as compared to \$79 million and \$265 million in the comparable 2007 periods. The increase for the three months ended September 28, 2008 was mainly driven by interest expense related to the new debt issued in the first quarter of 2008. For the nine months ended September 28, 2008, the slight decrease was caused by the August 2008 redemption of the contingent convertibles offset by interest expense on the new debt issued in the first quarter of 2008.

Our effective income tax rates were 31.6% and 32.2% for the quarter and nine months ended September 28, 2008 and 31.5% and 29.9% for the comparable 2007 periods. The effective rates for all periods were lower than the statutory rate of 35% due to tax deductions for U.S. manufacturing activities and dividends related to our employee stock ownership plan. The effective tax rate for the nine month period in 2008 is higher than the comparable period in 2007 primarily due to the expiration of the research tax credit at the end of 2007 and a benefit recorded in the first quarter of 2007 arising from the closure of the IRS examination of the 2003 and 2004 tax years.

The Emergency Economic Stabilization Act of 2008 signed by the President on October 3, 2008 retroactively extends the research and development tax credit for 2 years, from January 1, 2008 to December 31, 2009, and increases the alternative simplified R&D credit rate from 12% to 14% for calendar year 2009. As a result of these changes, we expect to record additional earnings of approximately \$38 million in the fourth quarter of 2008.

Net earnings for the third quarter of 2008 were \$782 million (\$1.92 per share) compared to \$766 million (\$1.80 per share) reported in the third quarter of 2007. Net earnings for the nine months ended September 28, 2008 were \$2,394 million (\$5.82 per share) compared to \$2,234 million (\$5.21 per share) reported in the comparable 2007 period.

**Lockheed Martin Corporation**

**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

**DISCUSSION OF BUSINESS SEGMENTS**

The following tables of financial information and related discussions of the results of operations of our business segments are consistent with the presentation of segment information in Note 6. In our discussions of comparative results, changes in Net sales and Operating profit are generally expressed in terms of volume and/or performance. Volume refers to increases (or decreases) in sales resulting from varying production activity levels, deliveries or service levels on individual contracts. Volume changes typically include a corresponding change in Operating profit based on the estimated profit rate at completion for a particular contract for design, development and production activities.

Changes in segment Operating profit are also expressed in terms of performance. Performance generally refers to changes in contract profit rates at completion. These changes on our contracts for products usually relate to profit recognition associated with revisions to total estimated costs at completion of the contract that reflect improved (or deteriorated) operating or award fee performance on a particular contract. Changes in estimates of Net sales and Operating profit on contracts for products are recognized by recording adjustments in the current period for the inception-to-date effect of the changes on current and prior periods.

The Aeronautics segment generally includes fewer programs that have much larger sales and operating results than programs included in the other segments. Therefore, due to the larger number of comparatively smaller programs in the remaining segments, the discussions of the results of operations of these business segments generally focus on lines of business within the segments rather than on specific programs.

**Aeronautics**

Aeronautics operating results included the following:

|                  | Quarter Ended         |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|                  | <i>(In millions)</i>  |                       |                       |                       |
| Net sales        | \$ 2,917              | \$ 3,342              | \$ 8,608              | \$ 9,299              |
| Operating profit | \$ 375                | \$ 414                | \$ 1,064              | \$ 1,091              |

Net sales for Aeronautics decreased by 13% for the quarter and 7% during the nine months of 2008 from the comparable 2007 periods. In both periods, decreases in Combat Aircraft and Air Mobility sales more than offset increases in Other Aeronautics Programs. The decrease in Combat Aircraft for both the quarter and the nine months primarily was due to lower volume on F-16 and F-35 programs. The decrease in Air Mobility for the quarter and nine months primarily was due to lower volume on the C-130J program, including deliveries and support activities, and lower volume on other air mobility programs. There were three C-130J deliveries in the third quarter of 2008 and four in the comparable 2007 period. There were nine C-130J deliveries during the nine months in both 2008 and 2007. The increase in Other Aeronautics Programs for both periods mainly was due to higher volume in sustainment services activities.

Operating profit decreased by 9% for the quarter and 2% for the nine months of 2008 from the comparable 2007 periods. During the quarter, operating profit declined in Combat Aircraft, Air Mobility and Other Aeronautics Programs. In Combat Aircraft, the decline mainly was due to lower volume on F-16 programs. The decrease in operating profit in Air Mobility primarily was attributable to lower volume on C-130 programs. The decrease in Other Aeronautics Programs mainly was due to performance on a P-3 modification contract. During the nine month period,



**Lockheed Martin Corporation**

**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

operating profit declines in Combat Aircraft and Air Mobility partially were offset by an increase in Other Aeronautics Programs. In Combat Aircraft, the decline mainly was due to lower volume on F-16 programs. In Air Mobility, operating profit decreased mainly due to performance on C-5 programs and lower volume on C-130J support programs, which partially were offset by improved performance on the C-130J deliveries in 2008. The increase in Other Aeronautics Programs mainly was due to higher volume in sustainment services activities, which partially was offset by a decrease in operating profit due to performance on a P-3 modification contract.

**Electronic Systems**

Electronic Systems' operating results included the following:

|                  | Quarter Ended         |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|                  | <i>(In millions)</i>  |                       |                       |                       |
| Net sales        | \$ 2,802              | \$ 2,827              | \$ 8,686              | \$ 8,269              |
| Operating profit | \$ 364                | \$ 346                | \$ 1,139              | \$ 1,050              |

Net sales for Electronic Systems decreased by 1% for the quarter and increased 5% for the nine months of 2008 from the comparable 2007 periods. During the quarter, lower sales volume on platform integration activities at Platform, Training & Energy (PT&E) and radar systems activities at Maritime Systems & Sensors (MS2) were offset by higher sales volume on tactical missile and fire control programs at Missiles & Fire Control (M&FC). For the nine month period, sales increases in M&FC and MS2 more than offset a decline in PT&E. The increase in M&FC mainly was due to higher volume on tactical missile and fire control programs. The increase in MS2 was attributable to higher volume on surface systems, radar systems and undersea systems activities. The decline in PT&E mainly was due to lower volume on platform integration activities.

Operating profit for Electronic Systems increased by 5% for the quarter and 8% for the nine months of 2008 from the comparable 2007 periods. In the quarter, operating profit increases in MS2 and PT&E more than offset a decline in M&FC. The increase in MS2 mainly was attributable to improved performance on surface systems programs. The increase at PT&E primarily was due to improved performance on distribution technology and platform integration activities. The decline in M&FC was attributable to fire control and tactical missile programs. During the nine month period, operating profit increases at M&FC and MS2 more than offset a decrease at PT&E. The increase in M&FC mainly was due to higher volume on tactical missile programs and improved performance on air defense programs. The increase in MS2 mainly was attributable to higher volume and improved performance on surface systems and radar systems programs. The decrease at PT&E primarily was due to performance on platform integration activities.

**Information Systems & Global Services**

Information Systems & Global Services' operating results included the following:

|                  | Quarter Ended         |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|                  | <i>(In millions)</i>  |                       |                       |                       |
| Net sales        | \$ 2,950              | \$ 2,713              | \$ 8,312              | \$ 7,378              |
| Operating profit | \$ 267                | \$ 245                | \$ 769                | \$ 674                |

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Net sales for IS&GS increased by 9% for the quarter and 13% for the nine months of 2008 from the comparable 2007 periods. Sales increased in all three lines of business for both the

**Lockheed Martin Corporation**

**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

quarter and the nine month periods. The increase in Global Services principally was due to global and mission services activities and Pacific Architect & Engineers (PAE) programs. The increase in Information Systems was due to higher volume on enterprise solutions & services activities. The increase in Mission Solutions primarily was driven by mission and combat support solutions activities as well as by transportation and security solutions.

Operating profit for IS&GS increased by 9% for the quarter and 14% for the nine months of 2008 from the comparable 2007 periods. In both the quarter and the nine month periods, the increase in operating profit was driven by Global Services and Mission Solutions. Mission Solutions operating profit increased due to higher volume and improved performance on secure enterprise solutions as well as mission and combat support solutions activities. The increase in Global Services operating profit primarily was attributable to improved performance on global services and PAE programs. In the quarter, Information Systems operating profit declines mainly were due to performance on mission service and enterprise solutions & services activities. During the nine month period, Information Systems operating profit increased due to higher volume on information technology programs and a benefit from a contract restructuring during the first quarter of 2008, which more than offset declines in mission services activities.

**Space Systems**

Space Systems' operating results included the following:

|                  | Quarter Ended         |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|                  | <i>(In millions)</i>  |                       |                       |                       |
| Net sales        | \$ 1,908              | \$ 2,213              | \$ 5,993              | \$ 6,075              |
| Operating profit | \$ 244                | \$ 221                | \$ 743                | \$ 620                |

Net sales for Space Systems decreased by 14% for the quarter and 1% for the nine months of 2008 from the comparable 2007 periods. In both periods, a sales decline in Satellites partially was offset by growth in Space Transportation. In Satellites, sales declined due to lower volume in commercial and government satellite activities in both periods. No commercial satellites were delivered during the third quarter of 2008 as compared to two deliveries in the comparable 2007 period. There were two commercial satellite deliveries during the nine months of 2008 and three during the comparable 2007 period. The sales growth in Space Transportation primarily was due to higher volume on the Orion program.

Operating profit increased by 10% for the quarter and 20% for the nine months of 2008 from the comparable 2007 periods. In both periods, the increase in operating profit was due to Space Transportation, which partially was offset by a decline in Satellites. In Space Transportation, the increase mainly was attributable to higher equity earnings on the United Launch Alliance joint venture, volume on the Orion program and the results from successful negotiations of a terminated commercial launch service contract in the first quarter of 2008. The improvement in ULA's earnings also reflects the absence in 2008 of a charge recognized in the third quarter of 2007 for an asset impairment on the Delta II medium lift launch vehicles. In Satellites, operating profit declined in the quarter due to lower volume on commercial satellite activities and declined during the nine month period due to lower volume on government satellite programs.



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**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

***Unallocated Corporate Income (Expense), Net***

The following table shows the components of Unallocated Corporate income (expense), net. For a discussion of the FAS/CAS pension adjustment and other types of items included in Unallocated Corporate income (expense), net, see Note 6 to the financial statements in this Form 10-Q.

|   | Quarter Ended         |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|   | <i>(In millions)</i>  |                       |                       |                       |
| FAS/CAS pension adjustment                            | \$ 32                 | \$ (18)               | \$ 96                 | \$ (46)               |
| Items not considered in segment operating performance | 44                    |                       | 145                   | 71                    |
| Stock compensation expense                            | (40)                  | (34)                  | (115)                 | (116)                 |
| Other, net  | (44)                  | (11)                  | (58)                  | (32)                  |
|   | <b>\$ (8)</b>         | <b>\$ (63)</b>        | <b>\$ 68</b>          | <b>\$ (123)</b>       |

The following table shows the CAS cost that is included as expense in the segments' operating results, the related FAS expense, and the resulting FAS/CAS pension adjustment:

|   | Quarter Ended         |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 28,<br>2008 | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|   | <i>(In millions)</i>  |                       |                       |                       |
| FAS 87 expense                              | \$ (116)              | \$ (175)              | \$ (347)              | \$ (518)              |
| Less: CAS cost                              | (148)                 | (157)                 | (443)                 | (472)                 |
| FAS/CAS pension adjustment income (expense) | <b>\$ 32</b>          | <b>\$ (18)</b>        | <b>\$ 96</b>          | <b>\$ (46)</b>        |

The FAS/CAS pension adjustment resulted in income in the third quarter and first nine months of 2008 versus expense in the prior-year periods due to an increase in the discount rate and other factors such as our actual return on plan assets. This is consistent with the assumptions we used in computing the FAS 87 expense and CAS cost amounts as discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our 2007 Form 10-K under the caption Critical Accounting Policies.

Certain items are excluded from segment results as part of senior management's evaluation of segment operating performance consistent with the management approach promulgated by FAS 131, *Disclosures about Segments of an Enterprise and Related Information*. For example, gains and losses related to the disposition of businesses or investments managed by Corporate, as well as other Corporate activities, are not considered by management in evaluating the operating performance of business segments. Therefore, for purposes of segment reporting, the following items were included in Unallocated Corporate income (expense), net for the respective quarters:

*Third Quarter 2008*

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A gain, net of state income taxes, of \$44 million representing recognition of a portion of the deferred net gain recorded in connection with the transaction to sell our ownership interests in LKEI and ILS in 2006 (see Note 5).

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**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

*First and Second Quarters of 2008*

Earnings, net of state income taxes, of \$85 million from the elimination of reserves associated with various land sales that occurred in prior years (see Note 7); and

A gain, net of state income taxes, of \$16 million representing recognition of a portion of the deferred net gain recorded on the LKEI and ILS transaction in 2006.

On an aggregate basis, these items increased our Net earnings by \$28 million (\$0.07 per share) and \$94 million (\$0.23 per share) during the quarter and nine month periods ended September 28, 2008.

*Third Quarter 2007 None*

*First and Second Quarters of 2007*

A gain, net of state income taxes, of \$25 million related to the sale of our remaining 20% interest in COMSAT International;

A gain, net of state income taxes, of \$25 million related to the sale of certain surplus land in California; and

Earnings, net of state income taxes, of \$21 million from the reversal of legal reserves following the settlement of certain litigation related to a waste remediation contract with the Department of Energy.

On an aggregate basis, these items increased our Net earnings by \$46 million (\$0.11 per share) during the nine months ended September 30, 2007. The first quarter of 2007 also was favorably affected by the closure of certain IRS examinations disclosed previously (see Note 7) which resulted in a reduction in our first quarter 2007 Income tax expense of \$59 million (\$0.14 per share). On a combined basis, these items increased Net earnings for the first six months of 2007 by \$105 million (\$0.25 per share).

**LIQUIDITY AND CASH FLOWS**

We have a balanced cash deployment and disciplined growth strategy to enhance shareholder value and position ourselves to take advantage of new business opportunities when they arise. Consistent with that strategy, we have invested in our business (*e.g.*, capital expenditures, independent research and development), made selective acquisitions of businesses, repurchased shares, increased our dividends and opportunistically reduced and refinanced our debt.

**Operating Activities**

Net cash provided by operating activities for the nine months ended September 28, 2008 was \$3,406 million, \$415 million lower than the same period in 2007. The decrease primarily was attributable to a \$584 million decline in cash provided by operating working capital as compared to 2007. This decline in operating working capital was primarily due to an increase in inventories on Combat Aircraft programs at Aeronautics and a decrease in customer advances and amounts in excess of costs incurred on government satellite programs at Space Systems and various programs in the Missiles & Fire Control line of business at Electronic Systems. The decrease in operating working capital partially was offset by an increase in cash between the nine month periods due to higher Net earnings. Operating working capital accounts consist of Receivables, Inventories, Accounts payable, and Customer

advances and amounts in excess of cost incurred.

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**Lockheed Martin Corporation**

**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

**Investing Activities**

*Capital expenditures* Capital expenditures for Property, plant and equipment amounted to \$503 million during the first nine months of 2008 and \$480 million in the comparable 2007 period. We expect our annual capital expenditures over the next three years to exceed 2007 expenditures consistent with the expected growth in our business and to support specific program requirements.

*Acquisitions, divestitures and other activities* We have a process in place to selectively identify businesses for acquisition that meet our financial targets and help build a balanced portfolio. We paid \$195 million in the first nine months of 2008 and \$325 million in the comparable 2007 period related to acquisition activities. The 2007 amount includes \$177 million that was paid to United Launch Alliance to finalize our contribution.

There were no divestiture activities in the first nine months of 2008. We received proceeds of \$26 million in the first nine months of 2007 related to the sale of our 20% interest in COMSAT International.

During the first nine months of 2008, we decreased our Short-term investments by \$262 million compared to a decrease of \$46 million in the same period of 2007.

**Financing Activities**

*Share activity and dividends* Cash received from the issuance of our common stock during the first nine months of 2008 related to the exercise of stock options and associated tax benefits totaled \$332 million, compared to \$414 million during the same period in 2007. Those activities resulted in the issuance of 4.5 million shares and 6.4 million shares during the respective periods.

We used \$2,338 million and \$1,805 million of cash to repurchase common shares during the first nine months of 2008 and 2007 (see Note 7 under the caption "Stockholders' Equity"). These purchases were made under our share repurchase program. As of September 28, 2008, we had repurchased a total of 117.6 million shares under the program, and there remained 40.4 million shares that may be repurchased in the future, including 30 million additional shares that our Board authorized for repurchase under the program in September 2008. See Part II, Item 2 of this Form 10-Q, for additional information regarding the repurchase of shares during the quarter ended September 28, 2008.

During the first nine months of 2008, we paid dividends of \$510 million compared to \$440 million in the comparable 2007 period. We paid quarterly dividends of \$0.42 per share in 2008 compared to \$0.35 per share in 2007. We also declared our fourth quarter dividend of \$229 million in September 2008, which was recorded as a current liability and a reduction of Retained earnings. This dividend will be paid in December 2008. In September 2008, our board of directors authorized an increase in our quarterly dividend to \$0.57 per share from \$0.42 per share beginning in the fourth quarter of 2008.

*Issuance and repayment of long-term debt* In the first quarter of 2008, we issued \$500 million of long-term notes due in 2013. The notes have a fixed coupon interest rate of 4.121%. Cash from operations has been our principal source of funds to reduce our long-term debt. In the third quarter of 2008, we paid a total of \$1.0 billion representing the principal amount of our floating rate convertible debentures that were delivered for conversion or otherwise redeemed, and issued 5.0 million shares of our common stock to satisfy conversion obligations of \$571 million in excess of the principal amount (see Note 7 under the caption "Long-term Debt"). We also paid another \$103 million during the first nine months of 2008 related to other repayments of long-term debt, compared to \$32 million in debt repayments in the comparable 2007 period.

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**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

**CAPITAL RESOURCES**

At September 28, 2008, we held Cash and cash equivalents of approximately \$2.5 billion and Short-term investments of \$71 million. Our total debt, net of unamortized discounts, amounted to \$3,805 million at September 28, 2008, a decrease of \$602 million from the December 31, 2007 balance, resulting from the third quarter conversion of our \$1.0 billion of convertible debentures and other repayments of long-term debt, offset partially by the first quarter debt issuance of \$500 million.

Our Long-term debt is mainly in the form of publicly issued notes and debentures. Our debt-to-total capital ratio, net of unamortized discounts, decreased from 31% at December 31, 2007 to 28% at September 28, 2008.

As of August 15, 2008, all of our \$1.0 billion of floating rate convertible debentures had been delivered for conversion or otherwise redeemed consistent with our previous announcement of their planned redemption, and we issued 5.0 million shares of our common stock to satisfy conversion obligations of \$571 million in excess of the principal amount (see Note 7).

Our Stockholders' equity amounted to \$9,808 million at September 28, 2008, an increase of \$3 million from December 31, 2007. The following items were the drivers of the increase:

|   | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br><i>(In millions)</i> | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total    |
|---|-----------------|----------------------------------|--|---|----------|
| Balance at December 31, 2007                        | \$ 409          | \$                               | \$ 11,247                                    | \$ (1,851)  | \$ 9,805 |
| Net earnings  |                 |                                  | 2,394  |   | 2,394    |
| Common stock dividends declared                     |                 |                                  | (739)  |   | (739)    |
| Stock-based awards and ESOP activity <sup>(1)</sup> | 6               | 617                              |  |   | 623      |
| Common stock repurchases                            | (22)            | (675)                            | (1,659)                                      |   | (2,356)  |
| Conversion of debentures                            | 5               | 58                               |  |   | 63       |
| Other comprehensive income                          |                 |                                  |  | 18  | 18       |
| Net activity  | (11)            |                                  | (4)  | 18  | 3        |
| Balance at September 28, 2008                       | \$ 398          | \$                               | \$ 11,243                                    | \$ (1,833)  | \$ 9,808 |

<sup>(1)</sup> Common stock and Additional paid-in capital include amounts related to the exercise of 4.5 million stock options, resulting in the issuance of a like number of common shares.

We actively seek to finance our business in a manner that preserves financial flexibility while minimizing borrowing costs to the extent practicable. We review changes in financial, market and economic conditions to manage the types, amounts and maturities of our indebtedness. We may at times refinance existing indebtedness, vary our mix of variable-rate and fixed-rate debt, or seek alternative financing sources for our cash and operational needs.

Cash and cash equivalents, short-term investments, cash flow from operations and other available financing resources are expected to be sufficient to meet anticipated operating, capital expenditure and debt service requirements.

**CRITICAL ACCOUNTING POLICIES**

The foregoing discussion of our financial condition and results of operations is based on the consolidated financial statements included in this Form 10-Q, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the

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**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

reported amounts of assets, liabilities, sales and expenses, and the related disclosures of contingencies. We base these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

During the nine months ended September 28, 2008, there were no significant changes to the critical accounting policies we disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007.

**OTHER MATTERS**

***Defined Benefit Pension Plans***

As disclosed in our 2007 Form 10-K, FAS 87, *Employers' Accounting for Pensions*, requires that the amounts we record related to our defined benefit pension plans, including the expense or income for those plans, be computed using actuarial valuations. These valuations require many assumptions, including assumptions we make relating to financial market and other economic conditions. Changes in key economic indicators can result in changes in the assumptions we use, which can impact our total Stockholders equity at any given year's end, and the amount of expense we record for and the cash contributions we will be required to make to our defined benefit plans in the following year. The difference between the actual return on plan assets for a given year and the expected long-term rate of return on assets of 8.5% also affects these amounts.

One of the key year-end assumptions used is the discount rate, which we review annually based on changes in interest rates. We evaluate several data points in order to arrive at an appropriate discount rate, including quoted rates from long-term bond indices and changes in long-term bond rates over the past year, and approximate average yields on securities that are selected to match our projected pension-related cash flows. An increase in the discount rate from year to year will decrease our projected benefit obligation (PBO), while a decrease will increase our PBO. Changes in the PBO due to changes in the discount rate, as well as the difference between our expected long-term rate of return on plan assets and our actual return, are reflected as adjustments to unrecognized net actuarial losses, which are recorded as an adjustment in Stockholders' equity as a component of Other comprehensive loss. This adjustment is amortized over time as part of future years' expense for our defined benefit pension plans.

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated for financial reporting purposes in accordance with FAS 87, and pension costs calculated and funded in accordance with U.S. Government Cost Accounting Standards (CAS). CAS is a major factor in determining pension funding requirements, and governs the extent of allocability and recoverability of pension costs on government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts and, therefore, recognized in our Net sales.

We will not finalize the discount rate or other assumptions, or determine the actual return on plan assets, until the end of 2008. These factors impact both the calculation of our PBO at the end of the year, and the amount of expense we record for and the cash contributions we will be required to make to our defined benefit plans in 2009. Recent volatility in the financial markets has intensified the challenge of trying to accurately estimate the discount rate we will use at the end of 2008 and the actual return on our benefit plan assets for 2008. The following table summarizes five scenarios relative to a change in the discount rate and changes in our actual return on plan assets. In the Baseline scenario, we have assumed that 1) the discount rate increased to 7.5% (based on an assessment of interest rates and market activity during the current year) from the discount rate used at the end of 2007 of 6.375%; 2) the actual return on plan assets was negative (25)% for 2008 (based on volatile market activity in 2008);



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**and Results of Operations (continued)**

and 3) all other assumptions used at the end of 2007 have remained constant. In consideration of the volatile market conditions, Scenarios 1 and 2 presented below assume a possible improvement of plus 1,000 and 500 basis points in the hypothetical return on plan assets of (25)%, while Scenarios 3 and 4 assume a possible further degradation of 500 and 1,000 basis points in the hypothetical return on plan assets of (25)%. In each of those scenarios, we have assumed that all other assumptions used in Scenario 1 were held constant.

The table presents the results of these assumptions on the projected FAS/CAS pension adjustment in 2009, on the projected required cash contributions in 2009 (after taking into consideration discretionary contributions made in 2007) and the noncash impact on Stockholders' equity at December 31, 2008. The FAS/CAS pension adjustment for the year ended December 31, 2008 is income of \$125 million, and there are no required contributions related to our defined benefit plans in 2008. The table also presents the impact of the assumptions on Stockholders' equity for the year ended December 31, 2008. The impact in each case would result in an increase to Other comprehensive loss which is included in Stockholders' equity, and therefore the hypothetical amounts in the table would represent decreases to our Stockholders' equity at December 31, 2008.

|  | Baseline                                 | Scenario 1 | Scenario 2 | Scenario 3 | Scenario 4 |
|--|--|------------|------------|------------|------------|
|  | <i>(In millions, except percentages)</i> |            |            |            |            |
| <b>Assumptions</b>   |  |            |            |            |            |
| Discount rate  | 7.5%                                     | 7.5%       | 7.5%       | 7.5%       | 7.5%       |
| Actual return on plan assets                                   | (25)%                                    | (15)%      | (20)%      | (30)%      | (35)%      |
| <b>Result of assumptions:</b>                                  |  |            |            |            |            |
| Projected FAS/CAS Pension adjustment for 2009 income (expense) | \$ (60)                                  | \$ 20      | \$ (15)    | \$ (95)    | \$ (100)   |
| Projected required contributions for 2009                      | 100                                      |            |            | 150        | 825        |
| Projected impact on Stockholders' equity at December 31, 2008  | (3,360)                                  | (1,700)    | (2,530)    | (4,190)    | (5,010)    |

The scenarios presented are for illustration purposes only and are intended to give the reader an understanding of the variability of the FAS/CAS Pension adjustment, required contributions and the impact on Stockholders' equity associated with our defined benefit pension plans based on changes in the return on plan assets and in the assumed discount rate from the rate used at the end of 2007. There is the potential that the assumptions we have used will differ materially from actual results. In addition, other scenarios and variations are possible, and the scenarios presented may not accurately depict the assumptions that will be used when the assumptions are finalized at year-end. The results of these scenarios also should not be extrapolated to assess other scenarios, because there is not a direct correlation between a change in the return on plan assets and the changes in the FAS/CAS pension adjustment, required contributions and the impact on Stockholders' equity. We will not finalize our defined benefit plan assumptions until year-end consistent with our December 31, 2008 measurement date.

**Other**

Following our sale of Lockheed Khrunichev Energia International, Inc. (LKEI) and ILS in 2006, we continue to be responsible to refund customer advances to one of ILS' customers if launch services are not provided and ILS does not refund the advance (see Note 5). At September 28, 2008, the total amount that could be payable under the guarantee, approximating the total contract value of the guaranteed launch, was \$63 million. That amount may be partially mitigated

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**Management's Discussion and Analysis of Financial Condition**

**and Results of Operations (continued)**

by approximately \$14 million of cash we retained that, absent any requirements to make payments under the guarantee, will be paid to the buyer when the launch occurs.

Our Balance Sheet at September 28, 2008 included current assets relating to LKEI and ILS totaling \$76 million, and current liabilities totaling \$90 million which will be reduced as the launch services are provided. Any potential earnings impact resulting from our inability to realize the assets we have recorded related to LKEI and ILS partially would be mitigated by the unrecognized deferred net gain we recorded on the transaction at the end of 2006. The remaining unrecognized deferred gain, net of state and federal income taxes, of \$31 million at September 28, 2008, will be recognized when the final launch occurs. We believe this launch will take place in 2008 based on the Proton launch schedule, which is subject to change.

In connection with the formation of ULA, we and Boeing have cross-indemnified ULA related to certain financial support arrangements (*e.g.*, letters of credit, surety bonds or foreign exchange contracts provided by either party) and guarantees by us and Boeing of the performance and financial obligations of ULA under certain launch service contracts. We believe ULA will be able to fully perform its obligations, as it has done through September 28, 2008, and that it will not be necessary to make payments under the cross-indemnities.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We maintain active relationships with a broad and diverse group of domestic and international financial institutions, who remain committed to provide us with access to the general and trade credit we require to conduct business. We continue to closely monitor the market environment and actively manage credit and counterparty exposure to mitigate the impact from any single credit provider while ensuring availability of, and access to, sufficient credit resources.

Our main exposure to market risk relates to interest rates and foreign currency exchange rates. Our financial instruments that are subject to interest rate risk principally include fixed-rate long-term debt. Our long-term debt portfolio bears interest at fixed rates.

We use forward foreign exchange contracts and, to a lesser extent, foreign exchange option contracts to manage our exposure to fluctuations in foreign currency exchange rates, and generally do so in ways that qualify for hedge accounting treatment. These foreign exchange contracts hedge the fluctuations in cash flows associated with firm commitments or specific anticipated transactions contracted in foreign currencies, or hedge the exposure to rate changes affecting foreign currency denominated assets or liabilities. Related gains and losses on these contracts, to the extent they are effective hedges, are recognized in income at the same time the hedged transaction is recognized. To the extent the hedges are ineffective, gains and losses on the contracts are recognized in the current period. At September 28, 2008, the fair value of forward exchange contracts outstanding and the amounts of gains and losses recorded during the quarter and nine-month periods then ended were not material.

We evaluate the credit quality of potential counterparties to derivative transactions and only enter into agreements with those deemed to have minimal credit risk at the time the agreements are executed. Our foreign exchange hedge portfolio is diversified across several credit line banks. We carefully monitor the amount of exposure we have with any given bank. We periodically monitor changes to counterparty credit quality as well as our concentration of credit exposure to individual counterparties. We do not hold or issue derivative financial instruments for trading or speculative purposes.

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**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures, including internal control over financial reporting, which are designed to ensure that information required to be disclosed in our periodic filings with the SEC is reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that assets are safeguarded and transactions are properly executed and recorded. Our disclosure controls and procedures are also designed to ensure that information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating such controls and procedures, we recognize that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in certain unconsolidated entities. As we do not control or manage these entities, our controls and procedures with respect to those entities are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

We performed an evaluation of the effectiveness of our disclosure controls and procedures, including internal control over financial reporting, as of September 28, 2008. The evaluation was performed with the participation of senior management of each business segment and key Corporate functions, and under the supervision of the CEO and CFO. Based on our evaluation, we concluded that our disclosure controls and procedures were effective as of September 28, 2008.

We routinely review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating the activities of two or more business units, and migrating certain processes to our shared services centers. In addition, when we acquire new businesses, we review the controls and procedures of the acquired business as part of our integration activities.

There were no changes in our internal control over financial reporting during the most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**FORWARD-LOOKING STATEMENTS**

This Form 10-Q contains statements which, to the extent that they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws, and are based on our current expectations and assumptions. The words believe, estimate, anticipate, project, intend, expect, plan, outlook, forecast and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties. Actual results could differ materially because of factors such as: the availability of government funding for our products and services both domestically and internationally; changes in government and customer priorities and requirements (including changes to respond to election cycles, Congressional actions, Department of Defense reviews, budgetary constraints and cost-cutting initiatives); the impact of economic recovery and stimulus plans and continued military operations in Iraq and Afghanistan on funding for existing defense programs; the award or termination of contracts; returns or losses on pension plan assets, interest and discount rates, and other changes that may impact pension plan assumptions; changes in counter-party credit risk exposure; difficulties in developing and producing operationally advanced technology systems; the timing and customer acceptance of product deliveries; materials availability and performance by key suppliers, subcontractors and customers; charges from any future impairment reviews that may result in the recognition of losses and a reduction in the book value of goodwill or other long-term assets; the future impact of legislation, changes in accounting interpretations or pronouncements, tax rules, or export policies; the future impact of acquisitions or divestitures, joint ventures or teaming arrangements; the outcome of legal proceedings and other contingencies (including lawsuits, government/regulatory investigations or audits, and environmental remediation efforts); the competitive environment for our products and services; and economic, business and political conditions domestically and internationally.

These are only some of the factors that may affect the forward-looking statements contained in this Form 10-Q. For a discussion identifying additional important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see our filings with the SEC including, but not limited to, the discussions of Government Contracts and Regulations and Risk Factors on page 16, and pages 18 through 24, respectively, of our Annual Report on Form 10-K for the year ended December 31, 2007; Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 19 through 30 of this Form 10-Q; and Note 4 Postretirement Benefit Plans and Note 5 Legal Proceedings and Contingencies of the Notes to Consolidated Financial Statements of the Unaudited Consolidated Financial Statements on page 9 and pages 9 through 12, respectively, included in this Form 10-Q.

Our actual financial results likely will be different from those projected due to the inherent nature of projections. Given these uncertainties, you should not rely on forward-looking statements in making investment decisions. The forward-looking statements contained in this Form 10-Q speak only as of the date of its filing. We expressly disclaim a duty to provide updates to forward-looking statements after the date of this Form 10-Q to reflect subsequent events that have occurred, changed circumstances, changes in expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Form 10-Q are intended to be subject to the safe harbor protection provided by the federal securities laws.

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**Lockheed Martin Corporation**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are a party to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment, as described in Note 5 Legal Proceedings and Contingencies in this Form 10-Q, and in our 2007 Annual Report on Form 10-K filed with the Securities Exchange Commission (Form 10-K), or arising in the ordinary course of business. In the opinion of management and in-house counsel, the probability is remote that the outcome of any such litigation or other proceedings will have a material adverse effect on our consolidated results of operations, financial position or cash flows. The results of legal proceedings, however, cannot be predicted with certainty.

We are primarily engaged in providing products and services under contracts with the U.S. Government and, to a lesser degree, under direct foreign sales contracts, some of which are funded by the U.S. Government. These contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance with these requirements. U.S. Government investigations, whether relating to these contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed on us, or could lead to our suspension or debarment from future U.S. Government contracting. U.S. Government investigations often take years to complete and many result in no adverse action against us.

We are subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites. As a result, we are a party to or have our property subject to various other lawsuits or proceedings involving environmental protection matters. Due in part to their complexity and pervasiveness, such requirements have resulted in our being involved with related legal proceedings, claims and remediation obligations. The extent of our financial exposure cannot in all cases be reasonably estimated at this time. For information regarding these matters, including current estimates of the amounts that we believe are required for remediation or clean-up to the extent estimable, see Note 5 Legal Proceedings and Contingencies on pages 9 through 12 of this Form 10-Q.

As previously reported, we and BAE Systems Information and Electronic Systems Integration, Inc. (BAE) were both named in a civil administrative proceeding by the U.S. Environmental Protection Agency alleging violations of the Resource Conservation and Recovery Act in connection with a solvent collection system operated by BAE at a facility that we own and lease to them. In September 2008, we resolved this matter by entering into a Consent Decree and Final Order, in which we agreed to pay \$162,500 in penalties and to implement certain remedial actions with respect to the alleged violations.

In addition, see the Legal Proceedings section of the Form 10-K for a description of previously reported matters.

**Item 1A. Risk Factors**

While we attempt to identify, manage and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our 2007 Form 10-K (pages 18 through 24) describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results and future prospects. We do not believe that there have been any material changes to the risk factors previously disclosed in our 2007 Form 10-K.

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**Lockheed Martin Corporation**
**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information about our purchases during the three-month period ended September 28, 2008 of our equity securities that are registered pursuant to Section 12 of the Exchange Act.

## Issuer Purchases of Equity Securities

| Period         | Total Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid<br>Per Share | Total Number of<br>Shares Purchased<br>as Part of Publicly<br>Announced<br>Programs <sup>(1)</sup> | Maximum Number<br>of Shares That May<br>Yet Be Purchased<br>Under the<br>Programs <sup>(2)</sup> |
|----------------|--|---------------------------------------|--|--|
| July 2008      | 1,627,419                              | \$ 101.11                             | 1,627,419  | 12,504,048   |
| August 2008    | 1,000,564                              | \$ 110.51                             | 1,000,564  | 11,503,484   |
| September 2008 | 1,121,900                              | \$ 112.38                             | 1,121,900  | 40,381,584   |

<sup>(1)</sup> We repurchased a total of 3,749,883 shares of our common stock during the quarter ended September 28, 2008 under a share repurchase program that we announced in October 2002.

<sup>(2)</sup> Our Board of Directors has approved a share repurchase program for the repurchase of up to 158 million shares of our common stock from time-to-time, including 30 million shares authorized for repurchase by our board of directors in September 2008. Under the program, management has discretion to determine the number and price of the shares to be repurchased, and the timing of any repurchases in compliance with applicable law and regulation.

As previously disclosed, Lockheed Martin satisfied its conversion obligations in excess of the accreted principal amount of its outstanding Floating Rate Convertible Senior Debentures due 2033 in shares of common stock. Fractional shares were paid in cash. The debentures were convertible by holders into shares of the Corporation's common stock until August 14, 2008 as provided in the indenture. Lockheed Martin issued a total of 5.0 million shares of its common stock in connection with conversion of the debentures. The issuance of the shares of common stock upon conversion by holders was exempt from registration under Section 3(a)(9) of the Securities Act of 1933, because no commission or other remuneration was paid in connection with the conversion of the debentures and the issuance of the shares.

As the debentures were convertible prior to redemption, the shares issuable upon conversion previously had been incorporated into the calculation of the Corporation's diluted share count and diluted earnings per share.

The debentures originally were issued in August 2003 in a private placement under Rule 144A. The resale of the debentures subsequently was registered by a registration statement (No. 333-108333) on Form S-3 filed with the SEC on August 28, 2003.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**  
None.



**Lockheed Martin Corporation**

**Item 6. Exhibits**

(a) Exhibits

|              |  |
|--------------|--|
| Exhibit 12   | Lockheed Martin Corporation Computation of Ratio of Earnings to Fixed Charges for the Nine Months Ended September 28, 2008 |
| Exhibit 15   | Acknowledgement of Independent Registered Public Accounting Firm   |
| Exhibit 31.1 | Rule 13a-14(a) Certification of Robert J. Stevens  |
| Exhibit 31.2 | Rule 13a-14(a) Certification of Bruce L. Tanner  |
| Exhibit 32.1 | Certification Pursuant to 18 U.S.C. Section 1350 of Robert J. Stevens  |
| Exhibit 32.2 | Certification Pursuant to 18 U.S.C. Section 1350 of Bruce L. Tanner  |

**Lockheed Martin Corporation**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Lockheed Martin Corporation

(Registrant)

Date: October 23, 2008

by: /s/ Martin T. Stanislav  
Martin T. Stanislav  
Vice President and Controller

(Chief Accounting Officer)