L 3 COMMUNICATIONS HOLDINGS INC
Form 10-Q
October 30, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 26, 2014

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

For the transition period from to

Commission file numbers 001-14141 and 333-46983

L-3 COMMUNICATIONS HOLDINGS, INC.

L-3 COMMUNICATIONS CORPORATION

(Exact names of registrants as specified in their charters)

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

(212) 697-1111

(Registrant s telephone number, including area code)

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

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

Indicate by check mark whether the registrant, L-3 Communications Holdings, Inc., is a large accelerated filer, accelerated filer, non-accelerated filer, or smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant, L-3 Communications Corporation, Inc., is a large accelerated filer, accelerated filer, non-accelerated filer, or smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

There were 85,133,193 shares of L-3 Communications Holdings, Inc. common stock with a par value of $0.01 outstanding as of the close of business on October 24, 2014.

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For the quarterly period ended September 26, 2014

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	(Unaudited) September 26, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 508	$ 500
Billed receivables, net of allowances of $24 in 2014 and $26 in 2013	871	991
Contracts in process	2,546	2,431
Inventories	371	359
Deferred income taxes	145	147
Other current assets	215	166
Total current assets	4,656	4,594
Property, plant and equipment, net	1,072	1,042
Goodwill	7,784	7,796
Identifiable intangible assets	263	285
Deferred debt issue costs	28	24
Other assets	238	247
Total assets	$ 14,041	$ 13,988
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable, trade	$ 415	$ 541
Accrued employment costs	577	545
Accrued expenses	400	458
Advance payments and billings in excess of costs incurred	609	576
Income taxes	25	31
Other current liabilities	366	383
Total current liabilities	2,392	2,534
Pension and postretirement benefits	684	727
Deferred income taxes	649	635

Other liabilities		399		406
Long-term debt		3,938		3,630
Total liabilities		8,062		7,932
Commitments and contingencies (see Note 18)				
Equity:				
L-3 shareholders equity:				
L-3 Communications Holdings, Inc. s common stock: $.01 par value; 300,000,000 shares authorized, 85,053,114 shares outstanding at September 26, 2014 and 85,828,485 shares outstanding at December 31, 2013 (L-3 Communications Corporation s common stock: $.01 par value, 100 shares authorized, issued and outstanding)		5,736		5,653
L-3 Communications Holdings, Inc. s treasury stock (at cost), 69,683,610 shares at September 26, 2014 and 66,118,406 shares at December 31, 2013		(5,701)		(5,288)
Retained earnings		6,028		5,726
Accumulated other comprehensive loss		(160)		(110)
Total L-3 shareholders equity		5,903		5,981
Noncontrolling interests		76		75
Total equity		5,979		6,056
Total liabilities and equity	$	14,041	$	13,988

See notes to unaudited condensed consolidated financial statements

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L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Third Quarter Ended	
	September 26, 2014	September 27, 2013
Net sales:		
Products	$ 1,644	$ 1,697
Services	1,296	1,305
Total net sales	2,940	3,002
Cost of sales:		
Products	(1,480)	(1,487)
Services	(1,203)	(1,209)
Total cost of sales	(2,683)	(2,696)
Operating income	257	306
Interest expense	(47)	(44)
Interest and other income, net	5	4
Income before income taxes	215	266
Provision for income taxes	(58)	(62)
Net income	$ 157	$ 204
Net income attributable to noncontrolling interests	(3)	(4)
Net income attributable to L-3	$ 154	$ 200
Earnings per share attributable to L-3 Holdings common shareholders:		
Basic	$ 1.81	$ 2.23
Diluted	$ 1.78	$ 2.19
Cash dividends paid per common share	$ 0.60	$ 0.55
L-3 Holdings weighted average common shares outstanding:		
Basic	85.1	89.6
Diluted	86.6	91.3

See notes to unaudited condensed consolidated financial statements

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L-3 COMMUNICATIONS HOLDINGS, INC.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Year-to-Date Ended	
	September 26, 2014	September 27, 2013
Net sales:		
Products	$ 4,991	$ 5,321
Services	3,925	4,067
Total net sales	8,916	9,388
Cost of sales:		
Products	(4,498)	(4,732)
Services	(3,636)	(3,750)
Total cost of sales	(8,134)	(8,482)
Operating income	782	906
Interest expense	(129)	(131)
Interest and other income, net	14	14
Income before income taxes	667	789
Provision for income taxes	(197)	(217)
Net income	$ 470	$ 572
Net income attributable to noncontrolling interests	(9)	(6)
Net income attributable to L-3	$ 461	$ 566
Earnings per share attributable to L-3 Holdings common shareholders:		
Basic	$ 5.38	$ 6.30
Diluted	$ 5.21	$ 6.20
Cash dividends paid per common share	$ 1.80	$ 1.65
L-3 Holdings weighted average common shares outstanding:		
Basic	85.7	89.9
Diluted	88.4	91.3

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L-3 COMMUNICATIONS HOLDINGS, INC.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

	Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
Net income	$ 157	$ 204	$ 470	$ 572
Other comprehensive (loss) income:				
Foreign currency translation adjustments	(63)	34	(57)	(18)
Unrealized (losses) gains on hedging instruments(1)	(3)	3		(1)
Pension and postretirement benefit plans:				
Amortization of net loss and prior service cost previously recognized(2)	2	13	7	40
Total other comprehensive (loss) income	(64)	50	(50)	21
Comprehensive income	93	254	420	593
Comprehensive income attributable to noncontrolling interests	(3)	(4)	(9)	(6)
Comprehensive income attributable to L-3	$ 90	$ 250	$ 411	$ 587

(1) Amounts are net of income tax benefits of $1 million and income taxes of $1 million for the quarterly periods ended September 26, 2014 and September 27, 2013, respectively, and an income tax benefit of $1 million for the year-to-date period ended September 27, 2013.

(2) Amounts are net of income taxes of $1 million and $7 million for the quarterly periods ended September 26, 2014 and September 27, 2013, respectively, and income taxes of $4 million and $23 million for the year-to-date periods ended September 26, 2014 and September 27, 2013, respectively.

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L-3 COMMUNICATIONS HOLDINGS, INC.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(in millions, except per share data)

	L-3 Holdings Common Stock Shares Outstanding	Par Value	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Noncontrolling Interests	Total Equity
For the Year-to-Date Period Ended September 26, 2014:								
Balance at December 31, 2013	85.8	$ 1	$ 5,652	$ (5,288)	$ 5,726	$ (110)	$ 75	$ 6,056
Net income					461		9	470
Other comprehensive loss						(50)		(50)
Distributions to noncontrolling interests							(8)	(8)
Cash dividends paid on common stock ($1.80 per share)					(155)			(155)
Shares issued:								
Employee savings plans	1.0		105					105
Exercise of stock options	1.1		102					102
Employee stock purchase plan	0.3		18					18
Stock-based compensation expense			39					39
Treasury stock purchased	(3.6)			(413)				(413)
Retirement of Convertible Contingent Debt Securities			(160)					(160)
Other	0.5		(21)		(4)			(25)
Balance at September 26, 2014	85.1	$ 1	$ 5,735	$ (5,701)	$ 6,028	$ (160)	$ 76	$ 5,979
For the Year-to-Date Period Ended September 27, 2013:								
Balance at December 31, 2012	90.4	$ 1	$ 5,313	$ (4,488)	$ 5,175	$ (550)	$ 76	$ 5,527

Net income					566		6	572
Other comprehensive income						21		21
Distributions to noncontrolling interests							(7)	(7)
Cash dividends paid on common stock ($1.65 per share)					(149)			(149)
Shares issued:								
Employee savings plans	1.3		97					97
Exercise of stock options	1.3		90					90
Employee stock purchase plan	0.5		18					18
Stock-based compensation expense			42					42
Treasury stock purchased	(4.8)			(404)				(404)
Other	0.3		(6)		(3)			(9)
Balance at September 27, 2013	89.0	$ 1	$ 5,554	$ (4,892)	$ 5,589	$ (529)	$ 75	$ 5,798

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L-3 COMMUNICATIONS HOLDINGS, INC.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	Year-to-Date Ended September 26, 2014	Year-to-Date Ended September 27, 2013
Operating activities:		
Net income	$ 470	$ 572
Depreciation of property, plant and equipment	127	122
Amortization of intangibles and other assets	38	36
Deferred income tax provision	91	38
Stock-based employee compensation expense	39	42
Contributions to employee savings plans in L-3 Holdings common stock	105	90
Amortization of pension and postretirement benefit plans net loss and prior service cost	11	63
Amortization of bond discounts and deferred debt issue costs (included in interest expense)	5	5
Other non-cash items	(5)	1
Changes in operating assets and liabilities, excluding amounts from acquisitions and divestitures:		
Billed receivables	118	(117)
Contracts in process	(157)	(70)
Inventories	(17)	(60)
Other assets		(48)
Accounts payable, trade	(125)	54
Accrued employment costs	26	37
Accrued expenses	(51)	(45)
Advance payments and billings in excess of costs incurred	39	(61)
Income taxes	(4)	31
Excess income tax benefits related to share-based payment arrangements	(16)	(3)
Other current liabilities	(21)	(5)
Pension and postretirement benefits	(40)	(23)
All other operating activities	(28)	(42)
Net cash from operating activities	605	617
Investing activities:		
Business acquisitions, net of cash acquired	(57)	(2)
Proceeds from the sale of a business and product line	5	4
Capital expenditures	(115)	(147)
Dispositions of property, plant and equipment	4	10

Other investing activities	1	(6)
Net cash used in investing activities	(162)	(141)
Financing activities:		
Proceeds from sale of senior notes	996	
Retirement of CODES	(935)	
Borrowings under revolving credit facility	1,367	1,382
Repayment of borrowings under revolving credit facility	(1,367)	(1,382)
Common stock repurchased	(413)	(404)
Dividends paid on L-3 Holdings common stock	(158)	(151)
Proceeds from exercises of stock options	87	91
Proceeds from employee stock purchase plan	27	28
Excess income tax benefits related to share-based payment arrangements	16	3
Debt issue costs	(8)	
Other financing activities	(38)	(13)
Net cash used in financing activities	(426)	(446)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(9)	(2)
Net increase in cash and cash equivalents	8	28
Cash and cash equivalents, beginning of the period	500	349
Cash and cash equivalents, end of the period	$ 508	$ 377

See notes to unaudited condensed consolidated financial statements

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L-3 COMMUNICATIONS HOLDINGS, INC.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

1. Description of Business

L-3 Communications Holdings, Inc. derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a prime contractor in aerospace systems and national security solutions. L-3 is also a leading provider of a broad range of communication and electronic systems and products used on military and commercial platforms. The Company s customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), allied international governments, and domestic and international commercial customers.

In the first quarter of 2014, the Company completed a realignment of its segments to better align its organizational structure with customer priorities and increase operational efficiencies. As a result of the realignment, L-3 s structure consists of four segments: (1) Electronic Systems, (2) Aerospace Systems, (3) Communication Systems and (4) National Security Solutions (NSS). Electronic Systems provides a broad range of components, products, subsystems, systems and related services for military and commercial customers in several niche markets across several business areas. These business areas include precision engagement & training, sensor systems, power & propulsion systems, marine systems international, aviation products, warrior systems and security & detection systems. Aerospace Systems delivers integrated solutions for the global Intelligence, Surveillance and Reconnaissance (ISR) market and provides modernization, upgrade, sustainment, and maintenance and logistics support for a wide variety of aircraft and ground systems. Communication Systems delivers products and services for the global communications market, specializing in strategic and tactical airborne, space, ground and sea-based communication systems. NSS provides cybersecurity solutions, high-performance computing, enterprise information technology (IT) services, analytics and intelligence analysis to the DoD, U.S. Government intelligence agencies, federal civilian agencies and allied international governments.

Financial information with respect to the Company s segments is included in Note 22 to the unaudited condensed consolidated financial statements and Note 23 to the audited consolidated financial statements included in its Form 10-K/A. Financial information for the quarterly and year-to-date periods ended September 27, 2013 in these unaudited condensed consolidated financial statements has been revised for the segment realignment discussed above and the revision to previously issued financial statements discussed in Note 3 to the unaudited condensed consolidated financial statements.

2. Basis of Presentation

These unaudited condensed consolidated financial statements for the quarterly and year-to-date periods ended September 26, 2014 should be read in conjunction with the audited consolidated financial statements of L-3 Holdings and L-3 Communications included in their Form 10-K/A filed on October 10, 2014.

Principles of Consolidation and Reporting

The accompanying financial statements comprise the consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings only asset is its investment in the common stock of L-3 Communications, its wholly-owned subsidiary, and its only obligations are: (1) its guarantee of borrowings under the Amended and Restated Revolving Credit Facility of L-3 Communications and (2) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. As of the date of this report, L-3 Holdings obligation for its

L-3 COMMUNICATIONS HOLDINGS, INC.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued on July 29, 2005, have been fully retired. See Note 10 to these unaudited financial statements. L-3 Holdings obligations relating to the CODES were jointly, severally, fully and unconditionally guaranteed by L-3 Communications and certain of its wholly-owned domestic subsidiaries. Accordingly, such debt was reflected as debt of L-3 Communications in its consolidated financial statements at December 31, 2013 in accordance with the accounting standards for pushdown accounting. All issuances of and conversions into L-3 Holdings equity securities, including grants of stock options, restricted stock, restricted stock units and performance units by L-3 Holdings to employees and directors of L-3 Communications and its subsidiaries, have been reflected in the consolidated financial statements of L-3 Communications. As a result, the consolidated financial positions, results of operations and cash flows of L-3 Holdings and L-3 Communications are substantially the same. See Note 24 for additional information regarding the unaudited financial information of L-3 Communications and its subsidiaries.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. The December 31, 2013 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year.

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

Accounting Estimates

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

Sales and profits on contracts that are covered by accounting standards for construction-type and production-type contracts and federal government contractors are recognized using percentage-of-completion (POC) methods of accounting. Approximately 47% of the Company s net sales in 2013 were accounted for under contract accounting standards, of which approximately 38% were fixed-price type contracts and approximately

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FINANCIAL STATEMENTS (continued)

9% were cost-plus type contracts. For contracts accounted for under contract accounting standards, sales and profits are recognized based on: (1) a POC method of accounting (fixed-price contracts), (2) allowable costs incurred plus the estimated profit on those costs (cost-plus contracts), or (3) direct labor hours expended multiplied by the contractual fixed rate per hour plus incurred costs for material (time-and-material contracts). Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the units-of-delivery method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to total estimated costs at completion of the contract multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the cost-to-cost method). Under both POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

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

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

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

Revisions or adjustments to estimates for a contract s revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained, as facts and circumstances change and as new information is obtained, even though the scope of work required under the contract may not change. Revisions or adjustments may also be required if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to POC accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. The revisions in contract estimates, if significant, can materially affect the Company s results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates increased consolidated operating income by $62 million, or 8%, for the year-to-date period ended September 26, 2014 and $92 million, or 10%, for the year-to-date period ended September 27, 2013.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

For a more complete discussion of these estimates and assumptions, see the Form 10-K/A filed on October 10, 2014.

3. Revisions to Previously Issued Financial Statements

As disclosed on October 10, 2014, the Company is revising its previously issued financial statements for the quarterly and year-to-date periods ended September 27, 2013 to update for: (1) accounting adjustments due to the internal review at its Aerospace Systems segment, (2) accounting related to a sales-type lease transaction for flight simulator systems within its Electronic Systems segment, and (3) previously identified immaterial errors already recognized in its financial statements but not recorded in the appropriate periods. The accounting errors related to the sales-type lease transaction and immaterial out of period amounts are not related to the internal review at its Aerospace Systems segment.

Internal Review of Aerospace Systems Segment: The Company conducted an internal review related to instances of misconduct and accounting errors at its Aerospace Systems segment. This review was conducted with the assistance of outside legal and accounting advisors, and has been completed. As a result of the internal review, the Company identified and recorded aggregate pre-tax charges as follows: (1) $75 million for the six months ended June 27, 2014, (2) $60 million for 2013, (3) $25 million for 2012, (4) $5 million for 2011, and (5) $4 million for periods prior to 2011. The pre-tax charges related to the quarterly and year-to-date periods ended September 27, 2013 were approximately $7 million and $36 million, respectively.

The adjustments related to the internal review only affected the Logistics Solutions and Platform Systems sectors of the Aerospace Systems segment. The cumulative aggregate adjustments attributable to the Logistics Solutions sector are approximately $117 million, and at the Platform Systems sector are approximately $52 million through June 27, 2014. The Logistics Solutions sector adjustments relate to: (1) losses of $69 million with respect to the U.S. Army C-12 fixed-price maintenance and logistics support contract due to cost overruns inappropriately deferred, sales invoices inappropriately prepared, and the failure to timely and accurately perform contract estimates at completion and valuation assessments of inventories and receivables, at the Army Sustainment Division, and (2) accounting errors of $48 million in connection with the valuation of inventories and receivables as well as the correction for certain accruals on other logistics support contracts. The Platform Systems sector adjustments are primarily due to: (1) losses of $37 million on two aircraft modification contracts and two contracts for rotary wing sub-assemblies and parts, and (2) write-offs of deferred costs of $15 million to design and test aerostructures for a new commercial aircraft.

Sales-Type Lease Transaction: The Company routinely performs on-site accounting and internal control review procedures on a rotational basis. As part of a previously planned review of the Simulation & Training business in its Electronic Systems segment and unrelated to the internal review at its Aerospace Systems segment, the Company evaluated the accounting treatment related to a sales-type lease transaction with the U.S. Army for rotary wing flight simulator systems. The period of performance under this contract began in 2004 and ends in 2023. Based on the results of this evaluation, the Company has adjusted its previously issued financial statements to: (1) increase interest income accretion on the net investment related to this sales-type lease transaction by an estimated aggregate amount of approximately $5 million for 2013, $3 million for each of 2012 and 2011, and $12 million for periods prior to 2011 and (2) decrease sales by approximately $8 million for 2014 and $7 million for 2013 and a related decrease in cost of sales by approximately $7 million for each of 2014 and 2013 and $5 million for periods prior to 2011.

Out of Period Amounts: The Company identified various out of period amounts included in its previously issued financial statements that were deemed to be immaterial individually and in the aggregate. In prior periods,

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FINANCIAL STATEMENTS (continued)

in accordance with Accounting Standards Codification (ASC) 250-10-S99 and S55 (formerly Staff Accounting Bulletins (SAB) No. 99 and No. 108), *Accounting Changes and Error Corrections*, the Company concluded that these errors were, individually, and in the aggregate, not material, quantitatively or qualitatively, to the financial statements in the period recorded or to the relevant prior periods. Accordingly, the Company recorded these errors in the financial statements in the period that the error was identified. The Company, on a voluntary basis, is revising its previously issued financial statements to correct for these errors already recognized in its financial statements but not recorded in the appropriate periods to reflect them in the appropriate period. These out of period amounts were not discovered as part of the internal review of the Aerospace Systems segment discussed above, but rather represent previously identified errors resulting from mathematical mistakes, mistakes in application of generally accepted accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared, as defined in ASC 250-10-20 *Accounting Changes and Error Corrections.* The Company, therefore, is not treating these amounts as changes in estimates. These errors consist of: (1) increases in development and material costs related to Broadband Communication Systems that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (2) a sub-contractor subscription deposit that was recorded as sales and income in the fourth quarter of 2012 but should have been amortized to sales and income during 2013, (3) costs accrued in the fourth quarter of 2012 for goods or services received in the first quarter of 2013, (4) several unrecorded liabilities that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (5) a correction of accrued vacation that was recorded in the fourth quarter of 2013 but should have been recorded in the fourth quarter of 2012 and the first, second and third quarters of 2013, and (6) a warranty reserve reduction recorded in the third quarter of 2012 that should have been recorded in the fourth quarter of 2011.

With respect to each of these immaterial out of period amounts included in the Company s previously issued financial statements, the table below presents the: (1) nature of the adjustments, (2) applicable segment and (3) amount of increase (or decrease) to sales and operating income for the quarters ended December 31, September 27, June 28, and March 29, 2013.

		December 31, 2013		September 27, 2013		June 28, 2013		March 29, 2013	
Nature of Adjustment	**Applicable Segment**	**Sales**	**Operating Income**	**Sales**	**Operating Income**	**Sales**	**Operating Income**	**Sales**	**Operating Income**
					($ in millions)				
Higher development and material costs for networked communications systems	Communication Systems	$	$	$	$	$	$	$ 10	$ 10

Sub-contractor subscription deposit	Aerospace Systems	5		7	1	7	1	7	1
Costs accruals for goods/services received	Aerospace Systems							5	1
Unrecorded liabilities	Aerospace Systems							(2)	
Accrued vacation	Aerospace Systems		6		(2)		(2)		(2)
Overstated revenue	Aerospace Systems	4		(4)					
Total		$ 9	$ 6	$ 3	$ (1)	$ 7	$ (1)	$ 20	$ 10

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The table below presents the impact of the matters discussed above on sales and pre-tax income in total, for the six month period ended June 27, 2014, years ended December 31, 2013, 2012, and 2011, and for the years ended prior to December 31, 2011.

	Total		Six Months 2014		2013		2012		2011		Prior to 2011	
	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income
					(in millions)							
Army C-12 Contract	$ (32)	$ (69)	$ (3)	$ (15)	$ (25)	$ (35)	$ (3)	$ (16)	$ (1)	$ (3)	$	$
Other Logistics Support Contracts	(5)	(48)		(20)	(2)	(11)	(2)	(11)		(2)	(1)	(4)
Logistics Solutions	(37)	(117)	(3)	(35)	(27)	(46)	(5)	(27)	(1)	(5)	(1)	(4)
Platform Systems	(21)	(52)	(12)	(40)	(12)	(14)	3	2				
Total Internal Review of Aerospace Systems Segment	(58)	(169)	(15)	(75)	(39)	(60)	(2)	(25)	(1)	(5)	(1)	(4)
Sales-Type Lease Transaction	(15)	29	(8)	1	(7)	5		3		3		17
Out of Period Amounts					39	14	(36)	(18)	(3)	4		
Total Revisions	$ (73)	$ (140)	$ (23)	$ (74)	$ (7)	$ (41)	$ (38)	$ (40)	$ (4)	$ 2	$ (1)	$ 13

The table below presents the impact of the matters discussed above on sales and pre-tax income for the quarters ended June 27 and March 28, 2014, December 31, September 27, June 28, 2013 and March 29, 2013.

	June 27, 2014		March 28, 2014		December 31, 2013		September 27, 2013		June 28, 2013		March 29, 2013	
	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income
					(in millions)							

Army C-12 Contract	$ (1)	$ (11)	$ (2)	$ (4)	$ (24)	$ (20)	$ 3	$ (2)	$ (3)	$ (7)	$ (1)	$ (6)
Other Logistics Support Contracts		(15)		(5)	(1)	(2)	(1)	(5)		(2)		(2)
Logistics Solutions	(1)	(26)	(2)	(9)	(25)	(22)	2	(7)	(3)	(9)	(1)	(8)
Platform Systems	(6)	(29)	(6)	(11)	(2)	(2)	1		(6)	(6)	(5)	(6)
Total Internal Review of Aerospace Systems Segment	(7)	(55)	(8)	(20)	(27)	(24)	3	(7)	(9)	(15)	(6)	(14)
Sales-Type Lease Transaction	(3)	1	(5)		(3)	1	(1)	2	(1)	1	(2)	1
Out of Period Amounts					9	6	3	(1)	7	(1)	20	10
Total Revisions	$ (10)	$ (54)	$ (13)	$ (20)	$ (21)	$ (17)	$ 5	$ (6)	$ (3)	$ (15)	$ 12	$ (3)

In accordance with ASC 250-10-S99 and S55, the Company performed an analysis to determine if the impact of the amounts disclosed above were material to its previously issued financial statements. Based on that analysis, the Company believes that its previously issued financial statements are not materially misstated on either a quantitative or qualitative basis. However, as a result of completing the review, the Company believed that correcting these errors in the quarterly report on Form 10-Q for the quarter ended June 27, 2014 would, in the aggregate, have caused a material misstatement to forecasted pre-tax income and net income for the fiscal year ending December 31, 2014. Accordingly, the Company is correcting these errors by revising its previously issued financial statements for the quarterly and year-to-date periods ended September 27, 2013 on this Form 10-Q to record all the adjustments in the tables above in the appropriate period. In addition, the Company revised its previously issued financial statements for the quarterly and first half periods ended June 28, 2013 on its Quarterly Report on Form 10-Q filed on October 10, 2014 for the quarterly and first half periods ended June 27, 2014, for the quarterly periods ended March 28, 2014 and March 29, 2013 on its Quarterly Report on Form 10-Q/A filed on October 10, 2014 for the quarterly period ended March 28, 2014, and its Annual Report on Form 10-K/A filed on October 10, 2014 for the years ended December 31, 2013, 2012 and 2011 to record all the adjustments in the tables above in the appropriate period.

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FINANCIAL STATEMENTS (continued)

The tables below present the Company s: (1) As Previously Reported, (2) Adjustments, and (3) As Revised Condensed Consolidated Statements of Operations for the quarterly and year-to-date periods ended September 27, 2013 and the Operating Activities for the Statement of Cash Flows for the year-to-date period ended September 27, 2013. The Adjustments correct for: (1) the results of the Aerospace Systems internal review, (2) the accounting related to a sales-type lease transaction within the Company s Electronic Systems segment and (3) immaterial out of period amounts previously recorded in the Company s financial statements but not recorded in the appropriate period to reflect them in the appropriate period.

	As Previously Reported	Adjustments for: Aerospace Systems Segment Internal Review	Sales-Type Lease Transaction	Out of Period Amounts	As Revised
	(in millions, except per share data)				
Unaudited Condensed Consolidated Statement of Operations, for the third quarter ended September 27, 2013:					
Net sales:					
Products	$ 1,696	$ 2	$ (1)	$	$ 1,697
Services	1,300	2		3	1,305
Total net sales	2,996	4[(1)]	(1)	3	3,002
Cost of sales:					
Products	(1,486)	(2)	1		(1,487)
Services	(1,196)	(9)		(4)	(1,209)
Total cost of sales	(2,682)	(11)	1	(4)	(2,696)
Operating income	314	(7)		(1)	306
Interest expense	(44)				(44)
Interest and other income, net	3		1		4
Income before income taxes	273	(7)	1[(1)]	(1)	266
Provision for income taxes	(65)	3			(62)

Net income	$	208	$	(4)	$	1	$	(1)	$	204
Net income attributable to noncontrolling interests		(4)								(4)
Net income attributable to L-3	$	204	$	(4)	$	1	$	(1)	$	200
Earnings per share attributable to L-3 Holdings common shareholders:										
Basic	$	2.28	$	(0.05)	$	0.01	$	(0.01)	$	2.23
Diluted	$	2.23	$	(0.04)	$	0.01	$	(0.01)	$	2.19
Cash dividends paid per common share	$	0.55	$		$		$		$	0.55
L-3 Holdings weighted average common shares outstanding:										
Basic		89.6								89.6
Diluted		91.3								91.3

(1) Includes rounding of $1 million.

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FINANCIAL STATEMENTS (continued)

	As Previously Reported	Adjustments for: Aerospace Systems Segment Internal Review	Sales-Type Lease Transaction	Out of Period Amounts	As Revised
	(in millions, except per share data)				
Unaudited Condensed Consolidated Statement of Operations, for the Year-to-Date Period Ended September 27, 2013:					
Net sales:					
Products	$ 5,319	$ (9)	$ (4)	$ 15	$ 5,321
Services	4,054	(2)		15	4,067
Total net sales	9,373	(11)[(1)]	(4)	30	9,388
Cost of sales:					
Products	(4,729)	(3)	5	(5)	(4,732)
Services	(3,710)	(22)		(18)	(3,750)
Total cost of sales	(8,439)	(25)	5	(23)	(8,482)
Operating income	934	(36)	1	7[(1)]	906
Interest expense	(131)				(131)
Interest and other income, net	11		3		14
Income before income taxes	814	(36)	4	7	789
Provision for income taxes	(226)	13	(1)	(3)	(217)
Net income	$ 588	$ (23)	$ 3	$ 4	$ 572
Net income attributable to noncontrolling interests	(6)				(6)
Net income attributable to L-3	$ 582	$ (23)	$ 3	$ 4	$ 566
Earnings per share attributable to L-3 Holdings common shareholders:					

Basic	$ 6.47	$ (0.25)	$ 0.04	$ 0.04	$ 6.30
Diluted	$ 6.37	$ (0.25)	$ 0.04	$ 0.04	$ 6.20
Cash dividends paid per common share	$ 1.65	$	$	$	$ 1.65
L-3 Holdings weighted average common shares outstanding:					
Basic	89.9				89.9
Diluted	91.3				91.3

(1) Includes rounding of $1 million.

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	As Previously Reported	Net Adjustments (in millions)	As Revised
Unaudited Consolidated Statement of Cash Flows for the Year-to-Date Period Ended September 27, 2013:			
Operating activities:			
Net income	$ 588	$ (16)	$ 572
Depreciation of property, plant and equipment	122		122
Amortization of intangibles and other assets	36		36
Deferred income tax provision	45	(7)	38
Stock-based employee compensation expense	42		42
Contributions to employee savings plans in L-3 Holdings common stock	90		90
Amortization of pension and postretirement benefit plans net loss and prior service cost	63		63
Amortization of bond discounts and deferred debt issue costs (included in interest expense)	5		5
Other non-cash items	1		1
Changes in operating assets and liabilities, excluding amounts from acquisitions and divestitures:			
Billed receivables	(117)		(117)
Contracts in process	(36)	(34)	(70)
Inventories	(55)	(5)	(60)
Other assets	(45)	(3)	(48)
Accounts payable, trade	65	(11)	54
Accrued employment costs	27	10	37
Accrued expenses	(41)	(4)	(45)
Advance payments and billings in excess of costs incurred	(109)	48	(61)
Income taxes	32	(1)	31
Excess income tax benefits related to share-based payment arrangements	(3)		(3)
Other current liabilities	(8)	3	(5)
Pension and postretirement benefits	(23)		(23)
All other operating activities	(62)	20	(42)
Net cash from operating activities	$ 617	$	$ 617

4. Recently Issued Accounting Standards

Effective January 1, 2014, the Company adopted Financial Accounting Standards Board (FASB) issued amendments to an accounting standard that require an unrecognized tax benefit or portion of an unrecognized tax benefit to be presented as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except when certain conditions exist. The adoption of this standard did not impact the Company s financial position, results of operations or cash flows.

In June 2014, the FASB issued Accounting Standard Update (ASU) 2014-12, which provides new guidance on accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. The update requires a reporting entity to treat a performance target

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that affects vesting and that could be achieved after the requisite service period as a performance condition under ASC 718 *Compensation Stock Compensation*, and apply existing guidance as it relates to awards with performance conditions that affect vesting to account for such awards. The update is effective for the Company for the interim and annual periods beginning after December 15, 2015. The Company is currently evaluating the impact of the adoption of this standard, if any, on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which will replace numerous requirements in U.S. GAAP, including industry-specific requirements, and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. One of the core principles of the new standard is that a company should recognize revenue based on the satisfaction of performance obligations, which depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard will be effective for the Company for interim and annual reporting periods beginning January 1, 2017. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The Company is currently evaluating the expected impact of the adoption of this standard on its consolidated financial statements and the transition alternatives available.

In April 2014, the FASB issued an accounting standards update that provides new guidance on the accounting and reporting of discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization s operations and financial results. Additionally, the new guidance requires additional disclosures about discontinued operations. The update is effective for the Company for interim and annual periods beginning January 1, 2015. The adoption of this standard is not expected to impact the Company s financial position, results of operations or cash flows and will only affect the treatment of future discontinued operations.

5. Acquisitions

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

2014 Business Acquisition

On March 4, 2014, the Company acquired Data Tactics Corporation, renamed L-3 Data Tactics, for a purchase price of $57 million, which was financed with cash on hand. The purchase price is subject to adjustment based on closing date net working capital. L-3 Data Tactics is a specialized provider of large-scale data analytics, cybersecurity and cloud computing solution services, primarily to the DoD. Based on the preliminary purchase price, the aggregate goodwill recognized for this business was $39 million, most of which is expected to be deductible for income tax purposes. The goodwill was assigned to the NSS reportable segment. The final purchase price allocation, which is expected to be completed in the fourth quarter of 2014, will be based on the final purchase price and final appraisals and other analysis of fair values of acquired assets and liabilities. The Company does not expect that differences between the preliminary and final purchase price allocations will have a material impact on its results of operations or financial position.

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2013 Business Acquisition

On December 19, 2013, the Company acquired Mustang Technology Group, L.P. (Mustang) business for a purchase price of $54 million, which was financed with cash on hand. The purchase price and purchase price allocation for Mustang was finalized as of June 27, 2014, with no significant changes from preliminary amounts. Mustang develops and manufactures radar-based sensors and systems used in precision-guided weapons, electronic warfare, unmanned systems and other military applications. Based on the final purchase price allocation, the aggregate goodwill recognized for this business was $41 million, most of which is expected to be deductible for income tax purposes. The goodwill was assigned to the Electronic Systems reportable segment.

Unaudited Pro Forma Statements of Operations Data

The following unaudited pro forma Statements of Operations data present the combined results of the Company and its business acquisitions completed during the year-to-date period ended September 26, 2014 and the year ended December 31, 2013, in each case assuming that the business acquisitions completed during these periods had occurred on January 1, 2013.

	Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
	(in millions, except per share data)			
Pro forma net sales	$ 2,940	$ 3,025	$ 8,923	$ 9,450
Pro forma net income attributable to L-3	$ 154	$ 200	$ 460	$ 567
Pro forma diluted earnings per share	$ 1.78	$ 2.19	$ 5.20	$ 6.21

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2013.

6. Contracts in Process

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

	September 26, 2014	December 31, 2013

	(in millions)	
Unbilled contract receivables, gross	$ 2,449	$ 2,502
Unliquidated progress payments	(900)	(1,035)
Unbilled contract receivables, net	1,549	1,467
Inventoried contract costs, gross	1,069	1,044
Unliquidated progress payments	(72)	(80)
Inventoried contract costs, net	997	964
Total contracts in process	$ 2,546	$ 2,431

Inventoried Contract Costs. In accordance with contract accounting standards, the Company s U.S. Government contractor businesses account for the portion of their general and administrative (G&A),

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independent research and development (IRAD) and bids and proposal (B&P) costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on their U.S. Government contracts (revenue arrangements) as inventoried contract costs. G&A, IRAD and B&P costs are allocated to contracts for which the U.S. Government is the end customer and are charged to costs of sales when sales on the related contracts are recognized. The Company s U.S. Government contractor businesses record the unallowable portion of their G&A, IRAD and B&P costs to expense as incurred, and do not include them in inventoried contract costs.

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

	Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
	(in millions)			
Amounts included in inventoried contract costs at beginning of the period:	$ 151	$ 115	$ 138	$ 110
IRAD and B&P costs	70	66	215	219
Other G&A costs	239	216	658	653
Total contract costs incurred	309	282	873	872
Amounts charged to cost of sales	(309)	(271)	(860)	(856)
Amounts included in inventoried contract costs at end of the period	$ 151	$ 126	$ 151	$ 126

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

	Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013

		(in millions)		
Selling, general and administrative expenses	$ 70	$ 70	$ 213	$ 214
Research and development expenses	14	17	48	62
Total	$ 84	$ 87	$ 261	$ 276

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7. Inventories

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

	September 26, 2014	December 31, 2013
	(in millions)	
Raw materials, components and sub-assemblies	$ 156	$ 160
Work in process	137	125
Finished goods	78	74
Total	$ 371	$ 359

8. Goodwill and Identifiable Intangible Assets

Goodwill. In accordance with the accounting standards for business combinations, the Company records the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). The table below presents the changes in goodwill by segment for the year-to-date period ended September 26, 2014.

	Electronic Systems	Aerospace Systems	Communication Systems	NSS	Consolidated Total
			(in millions)		
Balance at December 31, 2013	$ 4,085	$ 1,751	$ 992	$ 968	$ 7,796
Business acquisition[1]	(3)			39	36
Foreign currency translation adjustments[2]	(39)	(9)			(48)
Balance at September 26, 2014	$ 4,043	$ 1,742	$ 992	$ 1,007	$ 7,784

(1)

The decrease in goodwill for the Electronic Systems segment was due to the final purchase price allocation for the Mustang business acquisition. The increase in goodwill for the NSS segment was due to the L-3 Data Tactics business acquisition.

(2) The decrease in goodwill presented in the Electronic Systems segment was primarily due to the strengthening of the U.S. dollar against the Euro, the Canadian dollar and the British pound during the year-to-date period ended September 26, 2014. The decrease in goodwill presented in the Aerospace Systems segment was due to the strengthening of the U.S. dollar against the Canadian dollar during the year-to-date period ended September 26, 2014.

The Company s accumulated goodwill impairment losses were $58 million at September 26, 2014 and December 31, 2013, of which $43 million and $15 million were recorded in the Electronic Systems and Communication Systems segments, respectively.

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

		September 26, 2014			December 31, 2013		
	Weighted Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
				(in millions)			
Customer contractual relationships	19	$ 474	$ 275	$ 199	$ 466	$ 253	$ 213
Technology	11	168	115	53	168	108	60
Other	18	27	16	11	27	15	12
Total	17	$ 669	$ 406	$ 263	$ 661	$ 376	$ 285

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

	Third Quarter Ended		Year-to-Date Ended	
	(in millions)			
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
Amortization Expense	$ 11	$ 10	$ 32	$ 29

Based on gross carrying amounts at September 26, 2014, the Company s estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2014 through 2018 is presented in the table below.

	Year Ending December 31,				
	2014	2015	2016	2017	2018
	(in millions)				
Estimated amortization expense	$ 42	$ 41	$ 34	$ 32	$ 26

9. Other Current Liabilities and Other Liabilities

The table below presents the components of other current liabilities.

	September 26, 2014	December 31, 2013
	(in millions)	
Other Current Liabilities:		
Accruals for pending and threatened litigation (see Note 18)	$ 7	$ 6
Accrued product warranty costs	79	75
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	71	78
Accrued interest	52	52
Deferred revenues	36	35
Notes payable and capital lease obligation	16	10
Other	105	127
Total other current liabilities	$ 366	$ 383

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The table below presents the components of other liabilities.

	September 26, 2014	December 31, 2013
	(in millions)	
Other Liabilities:		
Non-current income taxes payable (see Note 11)	$ 193	$ 177
Deferred compensation	46	45
Accrued workers compensation	40	46
Accrued product warranty costs	26	24
Notes payable and capital lease obligations	2	15
Other	92	99
Total other liabilities	$ 399	$ 406

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

	Year-to-Date Ended	
	September 26, 2014	September 27, 2013
	(in millions)	
Accrued product warranty costs:(1)		
Balance at January 1	$ 99	$ 99
Accruals for product warranties issued during the period	53	56
Settlements made during the period	(46)	(56)
Foreign currency translation adjustments	(1)	
Balance at end of period	$ 105	$ 99

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

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FINANCIAL STATEMENTS (continued)

10. Debt

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

	September 26, 2014	December 31, 2013
	(in millions)	
L-3 Communications:		
Borrowings under Amended and Restated Revolving Credit Facility[1]	$	$
3.95% Senior Notes due 2016	500	500
1.50% Senior Notes due 2017	350	
5.20% Senior Notes due 2019	1,000	1,000
4.75% Senior Notes due 2020	800	800
4.95% Senior Notes due 2021	650	650
3.95% Senior Notes due 2024	650	
Subtotal	3,950	2,950
L-3 Holdings:		
3% Convertible Contingent Debt Securities due 2035 (CODES)		689
Principal amount of long-term debt	3,950	3,639
Unamortized discounts	(12)	(9)
Carrying amount of long-term debt	$ 3,938	$ 3,630

[1] During the year-to-date period ended September 26, 2014, L-3 Communications aggregate borrowings and repayments under the Amended and Restated Revolving Credit Facility were $1,367 million. At September 26, 2014, L-3 Communications had the availability of all of its $1 billion Amended and Restated Revolving Credit Facility, which expires on February 3, 2017.

L-3 Communications

Senior Notes: On May 28, 2014, L-3 Communications issued two series of Senior Notes, which are unsecured senior obligations of L-3 Communications. The terms of each series of Senior Notes are presented in the table below.

Note	Date of Issuance	Amount Issued	Bond Discount[1]	Net Cash Proceeds[2]	Effective Interest Rate	Redemption at Treasury Rate[3][4]
		(in millions)				
1.50% Senior Notes due May 28, 2017 (2017 Notes)	May 28, 2014	$ 350	$ 1	$ 347	1.55%	10 bps
3.95% Senior Notes due May 28, 2024 (2024 Notes)	May 28, 2014	$ 650	$ 3	$ 641	4.02%	20 bps

(1) Bond discounts are recorded as a reduction to the principal amount of the notes and are amortized as interest expense over the term of the notes.

(2) The net cash proceeds of $988 million (after deduction of the bond discount, underwriting expenses and commissions and other related expenses) were used primarily to fund the CODES Retirement as discussed below. The remaining net proceeds are available for general corporate purposes.

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(3) The 2017 Senior Notes may be redeemed at any time prior to their maturity and the 2024 Notes may be redeemed at any time prior to February 28, 2024 (three months prior to their maturity) at the option of L-3 Communications, in whole or in part, at a redemption price equal to the greater of (1) 100% of the principal amount, or (2) the present value of the remaining principal and interest payments discounted to the date of redemption, on a semi-annual basis, at the Treasury Rate (as defined in the Indentures governing the Senior Notes), plus the spread indicated in the table above. In addition, if the 2024 Senior Notes are redeemed at any time on or after February 28, 2024, the redemption price would be equal to 100% of the principal amount.

(4) Upon the occurrence of a change in control (as defined in the Indentures governing the Senior Notes), each holder of the notes will have the right to require L-3 Communications to repurchase all or any part of such holder s notes at a price in cash equal to 101% of the aggregate principal amount plus accrued and unpaid interest, if any, but not including, the date of purchase.

L-3 Holdings

On May 13, 2014, the Company called for full the redemption of all of its outstanding CODES effective on June 2, 2014 (the Redemption Date). The redemption price for the CODES was $1,000 per $1,000 principal amount of the CODES, plus accrued and unpaid interest to, but excluding, the Redemption Date. Holders of the CODES were entitled to convert all or a portion thereof (in integral multiples of $1,000) at any time prior to the close of business on the business day immediately preceding the Redemption Date (the Redemption Conversion Period). The conversion value of CODES of $935 million was calculated in accordance with the indenture governing the CODES based on the closing sales price of L-3 Holdings common stock and the conversion rate for each trading day in the 20 trading day period as follows: (1) for conversion notices received by May 16, 2014 (5 p.m.), the 20 trading day conversion period began on the third trading day following receipt of the conversion notice and (2) for conversion notices received after that time, the 20 trading day conversion period began on May 2, 2014 and ended on May 30, 2014, the trading day immediately preceding the Redemption Date. The Company settled the entire conversion value with respect to converted CODES in cash. As of June 27, 2014, the CODES were retired. As a result of the conversion, the Company recorded a reduction to shareholders equity of $160 million related to the excess conversion value over the fair value of the debt component of the CODES, net of deferred tax liability.

Interest expense recognized for the CODES was $2 million for the year-to-date period ended September 26, 2014 and $5 million and $15 million for the quarterly and year-to-date periods ended September 27, 2013.

11. Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. As of September 26, 2014, the statutes of limitations for the Company s U.S. Federal income tax returns for the years ended December 31, 2010 through 2013 were open. The U.S. Internal Revenue Service (IRS) commenced audits of the Company s U.S. Federal income tax returns for 2011 and 2010. The Company cannot predict the outcome of the audits at this time.

The effective tax rate for the year-to-date period ended September 26, 2014 increased to 29.5% from 27.5% for the year-to-date period ended September 27, 2013. The increase was primarily due to a tax benefit in the year-to-date period ended September 27, 2013 of $28 million related to the retroactive reinstatement in January 2013 of the U.S. Federal research and experimentation tax credit for 2012 and 2013, which did not recur in 2014 and the reversal of previously accrued amounts of $10 million in the quarterly period ended September 27, 2013 for the expiration of the statutes of limitations for several tax returns.

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As of September 26, 2014, the Company anticipates that unrecognized tax benefits will decrease by approximately $20 million over the next 12 months due to the potential resolution of unrecognized tax benefits involving several jurisdictions and tax periods. The actual amount of the decrease over the next 12 months could vary significantly depending on the ultimate timing and nature of any settlement.

Non-current income taxes payable include accrued potential interest of $14 million ($8 million after income taxes) at September 26, 2014 and $11 million ($7 million after income taxes) at December 31, 2013, and potential penalties of $8 million at both September 26, 2014 and December 31, 2013.

12. Amounts Reclassified Out of Accumulated Other Comprehensive (Loss) Income

The amounts reclassified from Accumulated Other Comprehensive (Loss) Income (AOCI) for the year-to-date periods ended September 26, 2014 and September 27, 2013 are presented in the table below.

	Foreign currency translation	Unrealized gains (losses) on hedging instruments	Unrecognized (losses) and prior service cost, net	Total accumulated other comprehensive (loss) income
		(in millions)		
Balance at December 31, 2012	$ 167	$ 3	$ (720)	$ (550)
Other comprehensive loss before reclassifications, net of tax	(18)	(2)		(20)
Amounts reclassified from other comprehensive income, net of tax		1	40	41
Net current period other comprehensive (loss) income	$ (18)	$ (1)	$ 40	$ 21
Balance at September 27, 2013	$ 149	$ 2	$ (680)	$ (529)
Balance at December 31, 2013	$ 142	$ 1	$ (253)	$ (110)
Other comprehensive income before reclassifications, net of tax	(57)	5		(52)
		(5)	7	2

Amounts reclassified from other comprehensive (loss) income, net of tax				
Net current period other comprehensive income	(57)		7	(50)
Balance at September 26, 2014	$ 85	$ 1	$ (246)	$ (160)

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Further details regarding the amounts reclassified from AOCI for the quarterly and year-to-date periods ended September 26, 2014 and September 27, 2013 are presented in the table below.

	Amount Reclassified from AOCI				Affected Line Item in the
	Third Quarter Ended		Year-to-Date Ended		Unaudited Condensed Consolidated
Details About AOCI Components	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013	Statements of Operations
	(in millions)				
Gain (loss) on hedging instruments	$ 1	$	$ (6)	$ 1	Cost of sales-products
	1		(6)	1	Income before income taxes
	(1)		1		Benefit (Provision) for income taxes
	$	$	$ (5)	$ 1	Net income
Amortization of defined benefit pension items:					
Net loss	$ 3	$ 20	$ 11	$ 63	(a)
	3	20	11	63	Income before income taxes
	(1)	(7)	(4)	(23)	Provision for income taxes
	$ 2	$ 13	$ 7	$ 40	Net Income
Total reclassification for the period	$ 2	$ 13	$ 2	$ 41	Net Income

(a) Amounts related to pension and postretirement benefit plans were reclassified from AOCI and recorded as a component of net periodic benefit cost (see Note 19 for additional information).

13. Equity

On February 5, 2013, L-3 Holdings Board of Directors approved a share repurchase program that authorizes L-3 Holdings to repurchase up to $1.5 billion of its common stock through June 30, 2015. Repurchases of L-3 Holdings common stock under the share repurchase program are made at management s discretion in accordance with applicable U.S. Federal securities laws in the open market or otherwise. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including, but not limited to, the Company s financial position, earnings, legal requirements, other investment opportunities (including acquisitions) and market conditions. L-3 Holdings repurchased 3.6 million shares of its common stock at an average price of $115.91 per share for an aggregate amount of $413 million from January 1, 2014 through September 26, 2014. All share repurchases of L-3 Holdings common stock have been recorded as treasury shares.

At September 26, 2014, the remaining dollar value of authorization under the share repurchase program was $455 million.

On June 24, 2014, L-3 Holdings Board of Directors declared a cash dividend of $0.60 per share, which resulted in the Company paying total cash dividends of $51 million on September 15, 2014. Also, on October 20, 2014, L-3 Holdings Board of Directors declared a quarterly cash dividend of $0.60 per share, payable on December 15, 2014, to shareholders of record at the close of business on November 17, 2014.

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14. L-3 Holdings Earnings Per Common Share

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

	Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
	(in millions, except per share data)			
Reconciliation of net income:				
Net income	$ 157	$ 204	$ 470	$ 572
Net income attributable to noncontrolling interests	(3)	(4)	(9)	(6)
Net income attributable to L-3 Holdings common shareholders	$ 154	$ 200	$ 461	$ 566
Earnings per share attributable to L-3 Holdings common shareholders:				
Basic:				
Weighted average common shares outstanding	85.1	89.6	85.7	89.9
Basic earnings per share:				
Net income	$ 1.81	$ 2.23	$ 5.38	$ 6.30
Diluted:				
Common and potential common shares:				
Weighted average common shares outstanding	85.1	89.6	85.7	89.9
Assumed exercise of stock options	2.8	4.7	3.0	3.9
Unvested restricted stock awards	1.5	1.8	1.6	1.8
Employee stock purchase plan contributions		0.2	0.1	0.2
Performance unit awards	0.1	0.1	0.1	0.1
Assumed purchase of common shares for treasury	(2.9)	(5.2)	(3.2)	(4.7)

Assumed conversion of the CODES[(1)]		0.1	1.1	0.1
Common and potential common shares	86.6	91.3	88.4	91.3
Diluted earnings per share:				
Net income	$ 1.78	$ 2.19	$ 5.21	$ 6.20

(1) As of June 18, 2014, the final date of conversion, the conversion price during the year-to-date period ended June 27, 2014 was $88.71. Although the CODES were retired during the year-to-date period ended June 27, 2014, they were dilutive for the year-to-date period ended September 26, 2014 as the average market price of L-3 Holdings common stock during the period that the CODES were outstanding was greater than the price at which the CODES would have been convertible into L-3 Holdings common stock. See Note 10 regarding the retirement of the CODES.

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The computation of diluted EPS excluded shares for stock options and employee stock purchase plan contributions of 0.6 million and 0.5 million for the quarterly and year-to-date periods ended September 26, 2014, respectively, and shares for stock options of 1.2 million for the year-to-date period ended September 27, 2013, as they were anti-dilutive.

15. Fair Value Measurements

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

	September 26, 2014			December 31, 2013		
Description	**Level 1[1]**	**Level 2[2]**	**Level 3[3]**	**Level 1[1]**	**Level 2[2]**	**Level 3[3]**
	(in millions)					
Assets						
Cash equivalents	$ 359	$	$	$ 299	$	$
Derivatives (foreign currency forward contracts)		5			6	
Total assets	$ 359	$ 5	$	$ 299	$ 6	$
Liabilities						
Derivatives (foreign currency forward contracts)	$	$ 4	$	$	$ 5	$

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

(2) Level 2 is based on pricing inputs other than quoted prices in active markets, which are either directly or indirectly observable. The fair value is determined using a valuation model based on observable market inputs, including quoted foreign currency forward exchange rates and consideration of non-performance risk.

(3)

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

16. Financial Instruments

At September 26, 2014 and December 31, 2013, the Company s financial instruments consisted primarily of cash and cash equivalents, billed receivables, trade accounts payable, Senior Notes, CODES and foreign currency forward contracts. The carrying amounts of cash and cash equivalents, billed receivables and trade accounts payable are representative of their respective fair values because of their short-term maturities or the expected settlement dates of these instruments. The carrying amounts and estimated fair values of the Company s other financial instruments are presented in the table below.

	September 26, 2014		December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
		(in millions)		
Senior Notes[(1)]	$ 3,938	$ 4,181	$ 2,941	$ 3,121
CODES[(1)]			689	830
Foreign currency forward contracts[(2)]	1	1	1	1

(1) The Company measures the fair value of its Senior Notes (and its CODES prior to their redemption) using Level 2 inputs based primarily on current market yields for its existing debt traded in the secondary market.

(2) See Note 17 for additional disclosures regarding the notional amounts and fair values of foreign currency forward contracts.

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17. Derivative Financial Instruments

The Company s derivative financial instruments include foreign currency forward contracts, which are entered into for risk management purposes, and an embedded derivative, at December 31, 2013, representing the contingent interest payment provision related to the CODES.

Foreign Currency Forward Contracts. The Company s U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, the Company enters into foreign currency forward contracts. The Company s activities involving foreign currency forward contracts are designed to hedge the changes in the functional currency equivalent cash flows due to movements in foreign exchange rates compared to the functional currency. The foreign currencies hedged are primarily the Canadian dollar, the U.S. dollar, the Euro, and the British pound. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts with major financial institutions that are expected to fully perform under the terms of such contracts. Foreign currency forward contracts are recorded in the Company s condensed consolidated balance sheets at fair value and are generally designated and accounted for as cash flow hedges in accordance with the accounting standards for derivative instruments and hedging activities. Gains and losses on designated foreign currency forward contracts that are highly effective in offsetting the corresponding change in the cash flows of the hedged transactions are recorded net of income taxes in AOCI and then recognized in income when the underlying hedged transaction affects income. Gains and losses on foreign currency forward contracts that do not meet hedge accounting criteria are recognized in income immediately. Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The table below presents the notional amounts of the Company s outstanding foreign currency forward contracts by currency at September 26, 2014.

Currency	**Notional Amounts (in millions)**	
Canadian dollar	$	161
U.S. dollar		101
Euro		66
British pound		9
Total	$	337

At September 26, 2014, the Company s foreign currency forward contracts had maturities through 2018.

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

	September 26, 2014				December 31, 2013			
	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities
	(in millions)							
Derivatives designated as hedging instruments:								
Foreign currency forward contracts[1]	$ 4	$ 1	$ 3	$ 1	$ 5	$ 1	$ 3	$ 2
Derivatives not designated as hedging instruments:								
Foreign currency forward contracts[1]								
Embedded derivative related to the CODES[2]								
Total derivative instruments	$ 4	$ 1	$ 3	$ 1	$ 5	$ 1	$ 3	$ 2

(1) See Note 15 for a description of the fair value hierarchy related to the Company s foreign currency forward contracts.

(2) See Note 10 for a description of the CODES Retirement.

The effect of gains or losses from foreign currency forward contracts was not material to the unaudited condensed consolidated statements of operations for the quarterly or year-to-date periods ended September 26, 2014 and September 27, 2013. At September 26, 2014, the estimated amount of existing losses that are expected to be reclassified into income within the next 12 months is less than $1 million.

18. Commitments and Contingencies

Guarantees

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

Procurement Regulations

A substantial majority of the Company s revenues are generated from providing products and services under legally binding agreements or contracts with U.S. Government and international government customers. U.S.

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Government contracts are subject to extensive legal and regulatory requirements, and, from time to time, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. The Company is currently cooperating with the U.S. Government on several investigations from which civil, criminal or administrative proceedings have or could result and give rise to fines, penalties, compensatory and treble damages, restitution and/or forfeitures. The Company does not currently anticipate that any of these investigations will have a material adverse effect, individually or in the aggregate, on its consolidated financial position, results of operations or cash flows. However, under U.S. Government regulations, an indictment of the Company by a federal grand jury, or an administrative finding against the Company as to its present responsibility to be a U.S. Government contractor or subcontractor, could result in the Company being suspended for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges. A conviction, or an administrative finding against the Company that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specified term. In addition, all of the Company s U.S. Government contracts: (1) are subject to audit and various pricing and cost controls, (2) include standard provisions for termination for the convenience of the U.S. Government or for default, and (3) are subject to cancellation if funds for contracts become unavailable. International government contracts generally include comparable provisions relating to terminations for convenience or default, as well as other procurement clauses relevant to the international government.

Litigation Matters

The Company is also subject to litigation, proceedings, claims or assessments and various contingent liabilities incidental to its businesses, including those specified below. Furthermore, in connection with certain business acquisitions, the Company has assumed some or all claims against, and liabilities of, such acquired businesses, including both asserted and unasserted claims and liabilities.

In accordance with the accounting standard for contingencies, the Company records a liability when management believes that it is both probable that a liability has been incurred and the Company can reasonably estimate the amount of the loss. Generally, the loss is recorded at the amount the Company expects to resolve the liability. The estimated amounts of liabilities recorded for pending and threatened litigation are disclosed in Note 9. Amounts recoverable from insurance contracts or third parties are recorded as assets when deemed probable. At September 26, 2014, the Company did not record any amounts for recoveries from insurance contracts or third parties in connection with the amount of liabilities recorded for pending and threatened litigation. Legal defense costs are expensed as incurred. The Company believes it has recorded adequate provisions for its litigation matters. The Company reviews these provisions quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. While it is reasonably possible that an unfavorable outcome may occur in one or more of the following matters, unless otherwise stated below, the Company believes that it is not probable that a loss has been incurred in any of these matters. With respect to the litigation matters below for which it is reasonably possible that an unfavorable outcome may occur, an estimate of loss or range of loss is disclosed when such amount or amounts can be reasonably estimated. Although the Company believes that it has valid defenses with respect to legal matters and investigations pending against it, the results of litigation can be difficult to predict, particularly those involving jury trials. Accordingly, our current judgment as to the likelihood of our loss (or our current estimate as to the potential range of loss, if applicable) with respect to any particular litigation matter may turn out to be wrong. Therefore, it is possible that the financial position, results of operations or cash flows of the Company could be materially adversely affected in any particular period by the unfavorable resolution of one or more of these or other contingencies.

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Class Action. In August 2014, Zubair Patel, Alan Nguyen and Carmen Valentino filed separate, putative class action complaints in the United States District Court for the Southern District of New York against the Company and certain of its officers. Each complaint alleges violations of federal securities laws related to misconduct and accounting errors identified by the Company at its Aerospace Systems segment, and seeks monetary damages, pre- and post-judgment interest, and fees and expenses. On October 20, 2014, these cases were consolidated into a single, putative class action in the United States District Court for the Southern District of New York. The Company believes the action lacks merit and intends to defend against it vigorously. The Company is unable to reasonably estimate any amount or range of loss, if any, that may be incurred in connection with this matter because the proceedings are in their early stages. For a discussion of the Company s internal review relating to the accounting matters at issue, see Note 3.

Government Inquiries. On July 30, 2014, the Company voluntarily contacted the SEC to report information concerning its internal review related to misconduct and accounting errors identified by the Company at its Aerospace Systems segment. The Company is in contact with the SEC and the U.S. Department of Justice, has received subpoenas for documents and other materials from both agencies concerning these self-reported matters, and is fully cooperating. The Company is unable to reasonably estimate any amount or range of loss, if any, that may be incurred in connection with these inquiries because they are in their early stages.

Bashkirian Airways. On July 1, 2004, lawsuits were filed on behalf of the estates of 31 Russian children in the state courts of Washington, Arizona, California, Florida, New York and New Jersey against Honeywell, Honeywell TCAS, Thales USA, Thales France, the Company and Aviation Communications & Surveillance Systems (ACSS), which is a joint venture of L-3 and Thales. The suits relate to the crash over southern Germany of a Bashkirian Airways Tupelov TU 154M aircraft and a DHL Boeing 757 cargo aircraft. On-board the Tupelov aircraft were 9 crew members and 60 passengers, including 45 children. The Boeing aircraft carried a crew of two. Both aircraft were equipped with Honeywell/ACSS Model 2000, Change 7 Traffic Collision and Avoidance Systems (TCAS). Sensing the other aircraft, the on-board DHL TCAS instructed the DHL pilot to descend, and the Tupelov on-board TCAS instructed the Tupelov pilot to climb. However, the Swiss air traffic controller ordered the Tupelov pilot to descend. The Tupelov pilot disregarded the on-board TCAS and put the Tupelov aircraft into a descent striking the DHL aircraft in midair at approximately 35,000 feet. All crew and passengers of both planes were lost. Investigations by the National Transportation Safety Board after the crash revealed that both TCAS units were performing as designed. The suits allege negligence and strict product liability based upon the design of the units and the training provided to resolve conflicting commands and seek approximately $315 million in damages, including $150 million in punitive damages. The Company s insurers have accepted defense of this matter and have retained counsel. The matters were consolidated in the U.S. District Court for the District of New Jersey, which then dismissed the actions on the basis of forum non conveniens. Plaintiffs representing 30 of the estates re-filed their complaint against ACSS on April 23, 2007 with the Barcelona Court s Registry in Spain. On March 9, 2010, the court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of approximately $6.7 million, all of which represented compensatory damages. Both ACSS and the plaintiffs appealed the judgment. In May 2012, the appellate court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of $48 million. ACSS filed an appeal of the judgment with the Supreme Court of Spain on September 28, 2012. On July 1, 2013, the Supreme Court agreed to consider the appeal, and the parties are awaiting the Supreme Court s decision. The Company believes that the ruling and the damages awarded are inconsistent with the law and evidence presented and, accordingly, that it is not probable that the Company has incurred a loss with respect to this matter. As of the date of this filing, 18 out of the 30 plaintiffs have released their claims against ACSS in consideration for payments made by the Company s insurance carriers.

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

19. Pension and Other Postretirement Benefits

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

	Pension Plans				Postretirement Benefit Plans			
	Third Quarter Ended		Year-to-Date Ended		Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
	(in millions)							
Components of net periodic benefit cost:								
Service cost	$ 26	$ 30	$ 80	$ 95	$ (2)	$ 1	$	$ 3
Interest cost	37	33	110	99	4	2	8	5
Expected return on plan assets	(48)	(41)	(145)	(124)	(1)		(3)	(2)
Amortization of prior service costs (credits)		1	1	1		(1)	(1)	(2)
Amortization of net loss (gain)	4	20	13	63	(1)		(2)	1
Curtailment loss		2	1	2	(1)		(1)	
Net periodic benefit cost	$ 19	$ 45	$ 60	$ 136	$ (1)	$ 2	$ 1	$ 5

Contributions. The Company contributed cash of $85 million to its pension plans and $5 million to its other postretirement benefit plans during the year-to-date period ended September 26, 2014. The Company expects to contribute an additional $12 million to its pension plans and $5 million to its other postretirement benefit plans during the remainder of 2014.

20. Stock-Based Compensation

During the year-to-date period ended September 26, 2014, the Company granted stock-based compensation under the Amended and Restated 2008 Long Term Performance Plan (2008 LTPP) in the form of stock options, restricted stock units and performance units further discussed below.

Stock Options. The Company granted 472,992 stock options with an exercise price of $113.67 per option, which was equal to the closing price of L-3 Holdings common stock on the date of grant. The options expire after 10 years from the date of grant and vest ratably over a three-year period on the annual anniversary of the

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date of grant. The options granted to our Chairman, President and Chief Executive Officer are also subject to performance-based vesting conditions. The weighted average grant date fair value for the options of $20.02 per option was estimated using the Black-Scholes option-pricing model. The weighted average assumptions used in the valuation model for this grant are presented in the table below.

Expected holding period (in years)	5.5
Expected volatility	24.4%
Expected dividend yield	2.7%
Risk-free interest rate	1.7%

Restricted Stock Units. The Company granted 414,694 restricted stock units with a weighted average grant date fair value of $113.69 per share. Restricted stock units automatically convert into shares of L-3 Holdings common stock upon vesting, and are subject to forfeiture until certain restrictions have lapsed, including a three year cliff vesting period for employees and a one year cliff vesting period for non-employee directors, in each case starting on the date of grant.

Performance Units. The Company granted 47,467 performance units with a weighted average grant date fair value per unit of $113.67. The final payout for these units is based on the achievement of pre-determined EPS goals established by the compensation committee of the Company s Board of Directors for the three-year period ending December 31, 2016. The payout can range from zero to 200% of the original number of units awarded, which are converted into shares of L-3 Holdings common stock based on the then existing closing price at the end of the performance period.

21. Supplemental Cash Flow Information

	Year-to-Date Ended	
	September 26, 2014	September 27, 2013
	(in millions)	
Interest paid on outstanding debt	$ 123	$ 133
Income tax payments	116	168
Income tax refunds	8	20

22. Segment Information

The Company has four reportable segments, as described in Note 1. The Company evaluates the performance of its operating segments and reportable segments based on their sales and operating income. All corporate expenses are allocated to the Company s operating segments using an allocation methodology prescribed by U.S. Government regulations for government contractors. Accordingly, all costs and expenses are included in the Company s measure of segment profitability.

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FINANCIAL STATEMENTS (continued)

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

	Third Quarter Ended		Year-to-Date Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
	(in millions)			
Net Sales:				
Electronic Systems	$ 1,128	$ 1,139	$ 3,349	$ 3,438
Aerospace Systems	1,037	1,092	3,173	3,416
Communication Systems	507	486	1,562	1,667
NSS	307	323	948	987
Elimination of intercompany sales	(39)	(38)	(116)	(120)
Consolidated total	$ 2,940	$ 3,002	$ 8,916	$ 9,388
Operating Income:				
Electronic Systems	$ 125	$ 144	$ 383	$ 388
Aerospace Systems	64	105	196	336
Communication Systems	49	31	147	116
NSS	19	26	56	66
Consolidated total	$ 257	$ 306	$ 782	$ 906
Depreciation and amortization:				
Electronic Systems	$ 30	$ 28	$ 89	$ 87
Aerospace Systems	11	10	30	28
Communication Systems	13	12	38	35
NSS	2	2	8	8
Consolidated total	$ 56	$ 52	$ 165	$ 158

	September 26, 2014	December 31, 2013

	(in millions)	
Total Assets:		
Electronic Systems	$ 6,998	$ 6,928
Aerospace Systems	2,961	3,087
Communication Systems	2,076	2,130
NSS	1,312	1,247
Corporate	694	596
Consolidated total	$ 14,041	$ 13,988

23. Employee Severance and Termination Costs

Consistent with the Company s strategy to continuously improve its cost structure and right-size its businesses, especially in view of sequestration and other DoD budget reductions, L-3 is completing employment reduction actions across several of its businesses to reduce both direct and indirect costs, including overhead and general and administrative costs. As a result of these initiatives and due to the impact of sequestration at certain

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L-3 COMMUNICATIONS HOLDINGS, INC.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

affected business units, the Company recorded $23 million in employee severance and other termination costs with respect to approximately 1,500 employees during the year-to-date period ended September 26, 2014. During the year ended December 31, 2013, the Company recorded a total of $29 million in employee severance and other termination costs with respect to approximately 2,000 employees. Employee severance and other termination costs are reported within cost of sales on the unaudited condensed consolidated statement of operations. The remaining balance to be paid in connection with these initiatives was $11 million at September 26, 2014 and December 31, 2013. Employee severance and other termination costs incurred by reportable segment for the year-to-date periods ended September 26, 2014 and September 27, 2013 are presented in the table below.

	Year-to-Date Ended	
	September 26, 2014	September 27, 2013
	(in millions)	
Reportable Segment		
Electronic Systems	$ 14	$ 11
Aerospace Systems	3	1
Communication Systems	5	6
NSS	1	1
Consolidated	$ 23	$ 19

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

L-3 Communications is a 100% owned subsidiary of L-3 Holdings. The debt of L-3 Communications, including the Senior Notes and borrowings under amounts drawn against the Amended and Restated Revolving Credit Facility is guaranteed, on a joint and several, full and unconditional basis, by certain of its domestic subsidiaries (the Guarantor Subsidiaries) and, in the case of the Amended and Restated Revolving Credit Facility, by L-3 Holdings. The CODES, prior to the CODES Retirement, were guaranteed on a joint and several, full and unconditional basis, by L-3 Communications and the Guarantor Subsidiaries. See Note 11 to the audited consolidated financial statements for the year ended December 31, 2013, included in the Company s Form 10-K/A. The foreign subsidiaries and certain domestic subsidiaries of L-3 Communications (the Non-Guarantor Subsidiaries) do not guarantee the debt of L-3 Communications or L-3 Holdings. None of the debt of L-3 Communications has been issued by its subsidiaries. There are no restrictions on the payment of dividends from the Guarantor Subsidiaries to L-3 Communications or from L-3 Communications to L-3 Holdings.

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

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

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FINANCIAL STATEMENTS (continued)

As discussed in Note 3, the Company is revising its previously issued financial statements. As part of that revision, the Company has revised the accompanying condensed combining financial statements contained herein. The adjustments related to the internal review of the Aerospace Systems segment, excluding certain adjustments related to the Platform Systems segment, were recorded as adjustments to the Guarantor Subsidiaries financial statement amounts. Adjustments from the internal review that related to a foreign subsidiary of the Platform Systems segment, with a cumulative operating impact through September 26, 2014 of $28 million, were recorded to the Non-Guarantor Subsidiaries financial statement amounts. The adjustments for the accounting related to a sales-type lease transaction for flight simulator systems within its Electronic Systems segment have been recorded as adjustments to the L-3 Communications financial statement amounts. The adjustments for the previously identified immaterial errors were recorded as adjustments to the Guarantor Subsidiaries financial statement amounts.

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FINANCIAL STATEMENTS (continued)

	L-3 Holdings (Parent)	L-3 Communications	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated L-3
			(in millions)			
Condensed Combining Balance Sheets:						
At September 26, 2014:						
Current assets:						
Cash and cash equivalents	$	$ 330	$ 1	$ 239	$ (62)	$ 508
Billed receivables, net		296	348	227		871
Contracts in process		994	1,165	387		2,546
Other current assets		410	145	176		731
Total current assets		2,030	1,659	1,029	(62)	4,656
Goodwill		2,324	4,320	1,140		7,784
Other assets		800	568	233		1,601
Investment in and amounts due from consolidated subsidiaries	5,903	6,993	4,049		(16,945)	
Total assets	$ 5,903	$ 12,147	$ 10,596	$ 2,402	$ (17,007)	$ 14,041
Current liabilities	$	$ 872	$ 999	$ 583	$ (62)	$ 2,392
Amounts due to consolidated subsidiaries				366	(366)	
Other long-term liabilities		1,434	187	111		1,732
Long-term debt		3,938				3,938
Total liabilities		6,244	1,186	1,060	(428)	8,062
L-3 shareholders equity	5,903	5,903	9,410	1,342	(16,655)	5,903
Noncontrolling interests					76	76
Total equity	5,903	5,903	9,410	1,342	(16,579)	5,979
Total liabilities and equity	$ 5,903	$ 12,147	$ 10,596	$ 2,402	$ (17,007)	$ 14,041
At December 31, 2013:						
Current assets:						

Cash and cash equivalents	$	$ 258	$	$ 261	$ (19)	$ 500
Billed receivables, net		364	401	226		991
Contracts in process		925	1,152	354		2,431
Other current assets		344	159	169		672
Total current assets		1,891	1,712	1,010	(19)	4,594
Goodwill		2,324	4,320	1,152		7,796
Other assets		838	532	228		1,598
Investment in and amounts due from consolidated subsidiaries	6,670	6,923	3,750		(17,343)	
Total assets	$ 6,670	$ 11,976	$ 10,314	$ 2,390	$ (17,362)	$ 13,988
Current liabilities	$	$ 914	$ 1,011	$ 628	$ (19)	$ 2,534
Amounts due to consolidated subsidiaries				259	(259)	
Other long-term liabilities		1,451	193	124		1,768
Long-term debt	689	3,630			(689)	3,630
Total liabilities	689	5,995	1,204	1,011	(967)	7,932
L-3 shareholders equity	5,981	5,981	9,110	1,379	(16,470)	5,981
Noncontrolling interests					75	75
Total equity	5,981	5,981	9,110	1,379	(16,395)	6,056
Total liabilities and equity	$ 6,670	$ 11,976	$ 10,314	$ 2,390	$ (17,362)	$ 13,988

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L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

	L-3 Holdings (Parent)	L-3 Communications	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated L-3
			(in millions)			
Condensed Combining Statements of Operations:						
For the quarter ended September 26, 2014:						
Total net sales	$	$ 860	$ 1,628	$ 525	$ (73)	$ 2,940
Total cost of sales	(10)	(787)	(1,500)	(469)	83	(2,683)
Operating (loss) income	(10)	73	128	56	10	257
Interest expense		(46)	(2)	1		(47)
Interest and other income, net		4		1		5
(Loss) income before income taxes	(10)	31	126	58	10	215
Benefit (provision) for income taxes	3	(8)	(34)	(16)	(3)	(58)
Equity in net income of consolidated subsidiaries	161	131			(292)	
Net income	154	154	92	42	(285)	157
Net income attributable to noncontrolling interests					(3)	(3)
Net income attributable to L-3	$ 154	$ 154	$ 92	$ 42	$ (288)	$ 154
Comprehensive income attributable to L-3	$ 90	$ 90	$ 89	$ (22)	$ (157)	$ 90
For the quarter ended September 27, 2013:						
Total net sales	$	$ 912	$ 1,646	$ 543	$ (99)	$ 3,002
Total cost of sales	(14)	(854)	(1,458)	(483)	113	(2,696)
Operating (loss) income	(14)	58	188	60	14	306

Interest expense	(5)	(43)		(1)	5	(44)
Interest and other income, net		3	1			4
(Loss) income before income taxes	(19)	18	189	59	19	266
Benefit (provision) for income taxes	5	(3)	(45)	(14)	(5)	(62)
Equity in net income of consolidated subsidiaries	214	185			(399)	
Net income	200	200	144	45	(385)	204
Net income attributable to noncontrolling interests					(4)	(4)
Net income attributable to L-3	$ 200	$ 200	$ 144	$ 45	$ (389)	$ 200
Comprehensive income attributable to L-3	$ 250	$ 250	$ 145	$ 77	$ (472)	$ 250

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L-3 COMMUNICATIONS HOLDINGS, INC.

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	L-3 Holdings (Parent)	L-3 Communications	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated L-3
			(in millions)			
Condensed Combining Statements of Operations:						
For the Year-to-Date Period Ended September 26, 2014:						
Total net sales	$	$ 2,606	$ 4,908	$ 1,623	$ (221)	$ 8,916
Total cost of sales	(39)	(2,354)	(4,533)	(1,468)	260	(8,134)
Operating (loss) income	(39)	252	375	155	39	782
Interest expense	(2)	(127)	(2)		2	(129)
Interest and other income, net		12		2		14
(Loss) income before income taxes	(41)	137	373	157	41	667
Benefit (provision) for income taxes	12	(41)	(110)	(46)	(12)	(197)
Equity in net income of consolidated subsidiaries	490	365			(855)	
Net income	461	461	263	111	(826)	470
Net income attributable to noncontrolling interests					(9)	(9)
Net income attributable to L-3	$ 461	$ 461	$ 263	$ 111	$ (835)	$ 461
Comprehensive income attributable to L-3	$ 411	$ 411	$ 264	$ 53	$ (728)	$ 411
For the Year-to-Date Period Ended September 27, 2013:						
Total net sales	$	$ 2,847	$ 5,104	$ 1,705	$ (268)	$ 9,388
Total cost of sales	(42)	(2,625)	(4,598)	(1,527)	310	(8,482)
Operating (loss) income	(42)	222	506	178	42	906
Interest expense	(15)	(130)		(1)	15	(131)

Interest and other income, net		9	1	4		14
(Loss) income before income taxes	(57)	101	507	181	57	789
Benefit (provision) for income taxes	16	(28)	(139)	(50)	(16)	(217)
Equity in net income of consolidated subsidiaries	607	493			(1,100)	
Net income	566	566	368	131	(1,059)	572
Net income attributable to noncontrolling interests					(6)	(6)
Net income attributable to L-3	$ 566	$ 566	$ 368	$ 131	$ (1,065)	$ 566
Comprehensive income attributable to L-3	$ 587	$ 587	$ 369	$ 108	$ (1,064)	$ 587

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FINANCIAL STATEMENTS (continued)

	L-3 Holdings (Parent)	L-3 Communications	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated L-3
			(in millions)			
Condensed Combining Statements of Cash Flows:						
For the Year-to-Date Period Ended September 26, 2014:						
Operating activities:						
Net cash from operating activities	$ 1,506	$ 201	$ 382	$ 69	$ (1,553)	$ 605
Investing activities:						
Business acquisitions, net of cash acquired		(57)				(57)
Investments in L-3 Communications	(87)				87	
Other investing activities		(37)	(52)	(16)		(105)
Net cash used in investing activities	(87)	(94)	(52)	(16)	87	(162)
Financing activities:						
Proceeds from sale of senior notes		996				996
Retirement of CODES	(935)					(935)
Common stock repurchased	(413)					(413)
Dividends paid on L-3 Holdings common stock	(158)					(158)
Dividends paid to L-3 Holdings		(1,506)			1,506	
Investments from L-3 Holdings		87			(87)	
Other financing activities	87	388	(329)	(66)	4	84
Net cash used in financing activities	(1,419)	(35)	(329)	(66)	1,423	(426)
Effect of foreign currency exchange rate changes on cash				(9)		(9)

Net increase (decrease) in cash		72	1	(22)	(43)	8
Cash and cash equivalents, beginning of the period		258		261	(19)	500
Cash and cash equivalents, end of the period	$	$ 330	$ 1	$ 239	$ (62)	$ 508
<u>For the Year-to-Date Period Ended September 27, 2013:</u>						
Net cash from operating activities	$ 555	$ 86	$ 523	$ 101	$ (648)	$ 617
Investing activities:						
Business acquisitions, net of cash acquired		(2)				(2)
Investments in L-3 Communications	(104)				104	
Other investing activities		(70)	(53)	(16)		(139)
Net cash used in investing activities	(104)	(72)	(53)	(16)	104	(141)
Financing activities:						
Common stock repurchased	(404)					(404)
Dividends paid on L-3 Holdings common stock	(151)					(151)
Dividends paid to L-3 Holdings		(555)			555	
Investments from L-3 Holdings		104			(104)	
Other financing activities	104	345	(469)	(81)	210	109
Net cash used in financing activities	(451)	(106)	(469)	(81)	661	(446)
Effect of foreign currency exchange rate changes on cash				(2)		(2)
Net (decrease) increase in cash		(92)	1	2	117	28
Cash and cash equivalents, beginning of the period		246		242	(139)	349
Cash and cash equivalents, end of the period	$	$ 154	$ 1	$ 244	$ (22)	$ 377

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ITEM 2.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview and Outlook

Controls and Procedures: As part of the internal review of our Aerospace Systems segment, discussed below, we identified material weaknesses in our internal controls over financial reporting (ICFR). The material weaknesses, further discussed in Item 4, *Controls and Procedures* are: (1) the Company did not maintain an effective control environment at its Aerospace Systems segment, with respect to: (i) inadequate execution of existing controls around the annual review and approval of contract (revenue arrangement) estimates; (ii) not following established Company accounting policies, controls and procedures, and (iii) intentional override of numerous transactional and monitoring internal controls at our Army Sustainment division; and (2) Company personnel did not perform reviews of certain employee concerns regarding violations of our accounting policies and ICFR in a sufficient and effective manner.

As disclosed on October 10, 2014, we are revising our previously issued financial statements for the quarterly and year-to-date periods ended September 27, 2013 to update for: (1) accounting adjustments due to the internal review at our Aerospace Systems segment, (2) accounting error related to a sales-type lease transaction for flight simulator systems within our Electronic Systems segment, and (3) previously identified immaterial errors already recognized in its financial statements but not recorded in the appropriate periods. The accounting errors related to the sales-type lease and immaterial out of period amounts are not related to the internal review at our Aerospace Systems segment.

Internal Review of Aerospace Systems Segment: The Company conducted an internal review related to instances of misconduct and accounting errors at its Aerospace Systems segment. This review was conducted with the assistance of outside legal and accounting advisors, and has been completed. As a result of the internal review, the Company identified and recorded aggregate pre-tax charges as follows: (1) $75 million for the six months ended June 27, 2014, (2) $60 million for 2013, (3) $25 million for 2012, (4) $5 million for 2011, and (5) $4 million for periods prior to 2011. The pre-tax charges related to the quarterly and year-to-date periods ended September 27, 2013 were approximately $7 million and $36 million, respectively.

The adjustments related to the internal review only affected the Logistics Solutions and Platform Systems sectors of the Aerospace Systems segment. The cumulative aggregate adjustments attributable to the Logistics Solutions sector are approximately $117 million, and at the Platform Systems sector are approximately $52 million through June 27, 2014. The Logistics Solutions sector adjustments relate to: (1) losses of $69 million with respect to the U.S. Army C-12 fixed-price maintenance and logistics support contract due to cost overruns inappropriately deferred, sales invoices inappropriately prepared, and the failure to timely and accurately perform contract estimates at completion and valuation assessments of inventories and receivables, at our Army Sustainment Division, and (2) accounting errors of $48 million in connection with the valuation of inventories and receivables, as well as the correction for certain accruals on other logistics support contracts. The Platform Systems sector adjustments are primarily due to: (1) losses of $37 million on two aircraft modification contracts and two contracts for rotary wing sub-assemblies and parts, and (2) write-offs of deferred costs of $15 million to design and test aerostructures for a new commercial aircraft.

Sales-Type Lease Transaction: We routinely perform on-site accounting and internal control review procedures on a rotational basis. As part of a previously planned review of our Simulation & Training business in the Electronic Systems segment and unrelated to the internal review at the Aerospace Systems segment, we evaluated the accounting treatment related to a sales-type lease transaction with the U.S. Army for rotary wing flight simulator systems. The period of performance under this contract began in 2004 and ends in 2023. Based on the results of this evaluation, we have adjusted our previously issued financial statements to: (1) increase interest

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income accretion on the net investment related to this sales-type lease transaction by an estimated aggregate amount of approximately $5 million for 2013, $3 million for each of 2012 and 2011 and $12 million for periods prior to 2011, and (2) decrease sales by approximately $8 million for 2014 and $7 million for 2013 and a related decrease cost of sales by approximately $7 million for each of 2014 and 2013 and $5 million for periods prior to 2011.

Out of Period Amounts: We had identified various out of period amounts included in our previously issued financial statements that were deemed to be immaterial individually and in the aggregate. In prior periods, in accordance with Accounting Standards Codification (ASC) 250-10-S99 and S55 (formerly Staff Accounting Bulletins (SAB) No. 99 and No. 108), *Accounting Changes and Error Corrections*, we concluded that these errors were, individually, and in the aggregate, not material, quantitatively or qualitatively, to the financial statements in the period recorded or to the relevant prior periods. Accordingly, we recorded these errors in our financial statements in the period that the error was identified. We are, on a voluntary basis, revising our previously issued financial statements to correct for these errors already recognized in our financial statements but not recorded in the appropriate periods to reflect them in the appropriate period. These out of period amounts were not discovered as part of the internal review of the Aerospace Systems segment discussed above, but rather represent previously identified errors resulting from mathematical mistakes, mistakes in application of generally accepted accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared, as defined in ASC 250-10-20 *Accounting Changes and Error Corrections*. We are, therefore, not treating these amounts as changes in estimates. These errors consist of: (1) increases in development and material costs related to Broadband Communication Systems that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (2) a sub-contractor subscription deposit that was recorded as sales and income in the fourth quarter of 2012 but should have been amortized to sales and income during 2013, (3) costs accrued in the fourth quarter of 2012 for goods or services received in the first quarter of 2013, (4) several unrecorded liabilities that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (5) a correction of accrued vacation that was recorded in the fourth quarter of 2013 but should have been recorded in the fourth quarter of 2012 and the first, second and third quarters of 2013, and (6) a warranty reserve reduction recorded in the third quarter of 2012 that should have been recorded in the fourth quarter of 2011.

With respect to each of these immaterial out of period amounts included in the Company s previously issued financial statements, the table below presents the: (1) nature of the adjustments, (2) applicable segment, and (3) amount of increase (or decrease) to sales and operating income for the quarters ended December 31, September 27, June 28, and March 29, 2013.

		December 31, 2013		September 27, 2013		June 28, 2013		March 29, 2013	
Nature of Adjustment	**Applicable Segment**	**Sales**	**Operating Income**	**Sales**	**Operating Income**	**Sales**	**Operating Income**	**Sales**	**Operating Income**
		($ in millions)							
Higher development and material costs for networked communications systems	Communication Systems	$	$	$	$	$	$	$ 10	$ 10
Sub-contractor subscription deposit	Aerospace Systems	5		7	1	7	1	7	1
Costs accruals for goods/services received	Aerospace Systems							5	1

Unrecorded liabilities	Aerospace Systems	(2)