L 3 COMMUNICATIONS HOLDINGS INC
Form 10-Q
August 04, 2015
Table of Contents

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 June 26, 2015

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

For the transition period from to

Commission file numbers 001-14141 and 333-46983

L-3 COMMUNICATIONS HOLDINGS, INC.

L-3 COMMUNICATIONS CORPORATION

(Exact names of registrants as specified in their charters)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**13-3937434 and 13-3937436** **(I.R.S. Employer** **Identification Nos.)**
600 Third Avenue, New York, NY **(Address of principal executive offices)**	**10016** **(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 a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer 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 a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer 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 Exchange Act). ¨ Yes x No

There were 80,332,125 shares of L-3 Communications Holdings, Inc. common stock with a par value of $0.01 outstanding as of the close of business on July 30, 2015.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

INDEX TO QUARTERLY REPORT ON FORM 10-Q

For the quarterly period ended June 26, 2015

Table of Contents

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) June 26, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 353	$ 442
Billed receivables, net of allowances of $14 in 2015 and 2014	820	852
Contracts in process	2,422	2,295
Inventories	371	288
Deferred income taxes	129	127
Other current assets	208	186
Assets held for sale		547
Total current assets	4,303	4,737
Property, plant and equipment, net	1,118	1,088
Goodwill	7,649	7,501
Identifiable intangible assets	266	243
Deferred debt issue costs	24	27
Other assets	273	240
Total assets	$ 13,633	$ 13,836
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable, trade	$ 455	$ 382
Accrued employment costs	512	510
Accrued expenses	361	402
Advance payments and billings in excess of costs incurred	670	573
Income taxes	6	23
Other current liabilities	413	398
Liabilities held for sale		237
Total current liabilities	2,417	2,525

Pension and postretirement benefits	1,192	1,187
Deferred income taxes	427	443
Other liabilities	385	382
Long-term debt	3,940	3,939
Total liabilities	8,361	8,476
Commitments and contingencies (see Note 17)		
Equity:		
L-3 shareholders equity:		
L-3 Communications Holdings, Inc. s common stock: $.01 par value; 300,000,000 shares authorized, 80,802,725 shares outstanding at June 26, 2015 and 82,040,525 shares outstanding at December 31, 2014 (L-3 Communications Corporation s common stock: $.01 par value, 100 shares authorized, issued and outstanding)	5,935	5,799
L-3 Communications Holdings, Inc. s treasury stock (at cost), 75,875,799 shares at June 26, 2015 and 73,005,891 shares at December 31, 2014	(6,457)	(6,111)
Retained earnings	6,297	6,181
Accumulated other comprehensive loss	(578)	(584)
Total L-3 shareholders equity	5,197	5,285
Noncontrolling interests	75	75
Total equity	5,272	5,360
Total liabilities and equity	$ 13,633	$ 13,836

See notes to unaudited condensed consolidated financial statements.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Second Quarter Ended	
	June 26, 2015	June 27, 2014
Net sales:		
Products	$ 1,602	$ 1,698
Services	1,191	1,321
Total net sales	2,793	3,019
Cost of sales:		
Products	(1,530)	(1,552)
Services	(1,099)	(1,228)
Total cost of sales	(2,629)	(2,780)
Net gain related to business divestitures	2	
Operating income	166	239
Interest expense	(48)	(39)
Interest and other income, net	5	4
Income before income taxes	123	204
Benefit (provision) for income taxes	1	(63)
Net income	$ 124	$ 141
Net income attributable to noncontrolling interests	(4)	(4)
Net income attributable to L-3	$ 120	$ 137
Earnings per share attributable to L-3 Holdings common shareholders:		
Basic	$ 1.46	$ 1.59
Diluted	$ 1.44	$ 1.53
Cash dividends paid per common share	$ 0.65	$ 0.60
L-3 Holdings weighted average common shares outstanding:		
Basic	82.1	86.1

Diluted	83.2	89.3

See notes to unaudited condensed consolidated financial statements.

2

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	First Half Ended	
	June 26, 2015	June 27, 2014
Net sales:		
Products	$ 3,149	$ 3,347
Services	2,357	2,629
Total net sales	5,506	5,976
Cost of sales:		
Products	(2,918)	(3,018)
Services	(2,202)	(2,433)
Total cost of sales	(5,120)	(5,451)
Loss related to business divestitures	(20)	
Operating income	366	525
Interest expense	(92)	(82)
Interest and other income, net	8	9
Income before income taxes	282	452
Provision for income taxes	(49)	(139)
Net income	$ 233	$ 313
Net income attributable to noncontrolling interests	(8)	(6)
Net income attributable to L-3	$ 225	$ 307
Earnings per share attributable to L-3 Holdings common shareholders:		
Basic	$ 2.74	$ 3.57
Diluted	$ 2.69	$ 3.43
Cash dividends paid per common share	$ 1.30	$ 1.20
L-3 Holdings weighted average common shares outstanding:		
Basic	82.2	86.1

Diluted	83.5	89.4

See notes to unaudited condensed consolidated financial statements.

3

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
Net income	$ 124	$ 141	$ 233	$ 313
Other comprehensive income (loss):				
Foreign currency translation adjustments	58	22	(29)	6
Unrealized gains on hedging instruments[(1)]	7	8	4	3
Pension and postretirement benefit plans:				
Amortization of net loss and prior service cost previously recognized[(2)]	11	2	22	5
Net gain arising during the period[(3)]	9		9	
Total other comprehensive income	85	32	6	14
Comprehensive income	209	173	239	327
Comprehensive income attributable to noncontrolling interests	(4)	(4)	(8)	(6)
Comprehensive income attributable to L-3	$ 205	$ 169	$ 231	$ 321

(1) Amounts are net of income taxes of $2 million and $3 million for the quarterly periods ended June 26, 2015 and June 27, 2014, respectively, and income taxes of $1 million and $1 million for the first half periods ended June 26, 2015 and June 27, 2014, respectively.

(2) Amounts are net of income taxes of $5 million and $2 million for the quarterly periods ended June 26, 2015 and June 27, 2014, respectively, and income taxes of $11 million and $3 million for the first half periods ended June 26, 2015 and June 27, 2014, respectively.

(3) Represents the reclassification of actuarial losses into net income related to the Marine Systems International business divestiture in accordance with Accounting Standards Codification 715 *Defined Benefit Plans Pension.* Amounts are net of income taxes of $5 million for each of the quarterly and first half periods ended June 26, 2015.

See notes to unaudited condensed consolidated financial statements.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(in millions, except per share data)

	L-3 Holdings Common Stock Shares Outstanding	L-3 Holdings Common Stock Par Value	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Noncontrolling Interests	Total Equity
For the First Half Ended June 26, 2015:								
Balance at December 31, 2014	82.0	$ 1	$ 5,798	$ (6,111)	$ 6,181	$ (584)	$ 75	$ 5,360
Net income					225		8	233
Other comprehensive income						6		6
Distributions to noncontrolling interests							(8)	(8)
Cash dividends declared on common stock ($1.30 per share)					(109)			(109)
Shares issued:								
Employee savings plans	0.5		62					62
Exercise of stock options	0.5		62					62
Employee stock purchase plan	0.2		17					17
Vesting of restricted stock units	0.7							
Employee restricted stock units surrendered in lieu of income tax withholding	(0.2)		(33)					(33)
Stock-based compensation expense			24					24
Treasury stock purchased	(2.9)			(346)				(346)
Other			4					4
Balance at June 26, 2015	80.8	$ 1	$ 5,934	$ (6,457)	$ 6,297	$ (578)	$ 75	$ 5,272
For the First Half Ended June 27, 2014:								
Balance at December 31, 2013	85.8	$ 1	$ 5,652	$ (5,288)	$ 5,726	$ (110)	$ 75	$ 6,056
Net income					307		6	313
Other comprehensive income						14		14
Distributions to noncontrolling interests							(6)	(6)
Cash dividends declared on common stock ($1.20 per share)					(106)			(106)
Shares issued:								
Employee savings plans	0.7		74					74
Exercise of stock options	1.1		101					101
Employee stock purchase plan	0.2		18					18

Vesting of restricted stock units	0.6							
Employee restricted stock units surrendered in lieu of income tax withholding	(0.2)		(26)					(26)
Stock-based compensation expense			29					29
Treasury stock purchased	(2.9)			(333)				(333)
Retirement of Convertible Contingent Debt Securities			(160)					(160)
Other			5					5
Balance at June 27, 2014	85.3	$ 1	$ 5,693	$ (5,621)	$ 5,927	$ (96)	$ 75	$ 5,979

See notes to unaudited condensed consolidated financial statements.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	First Half Ended June 26, 2015	First Half Ended June 27, 2014
Operating activities:		
Net income	$ 233	$ 313
Depreciation of property, plant and equipment	87	84
Amortization of intangibles and other assets	23	25
Deferred income tax (benefit) provision	(13)	43
Stock-based employee compensation expense	24	29
Excess income tax benefits related to share-based payment arrangements	(24)	(16)
Contributions to employee savings plans in L-3 Holdings common stock	62	74
Amortization of pension and postretirement benefit plans net loss and prior service cost	33	8
Amortization of bond discounts and deferred debt issue costs (included in interest expense)	4	3
Loss related to business divestitures	20	
Other non-cash items	(6)	(4)
Changes in operating assets and liabilities, excluding amounts from acquisitions and divestitures:		
Billed receivables	32	(61)
Contracts in process	(132)	(182)
Inventories	(70)	(8)
Other assets	5	8
Accounts payable, trade	82	14
Accrued employment costs	2	(3)
Accrued expenses	(48)	(76)
Advance payments and billings in excess of costs incurred	36	49
Income taxes		(1)
Other current liabilities	2	(36)
Pension and postretirement benefits	13	(16)
All other operating activities	(51)	(32)
Net cash from operating activities	314	215
Investing activities:		
Business acquisitions, net of cash acquired	(260)	(57)
Proceeds from the sale of businesses, net of closing date cash balances	304	
Capital expenditures	(85)	(67)
Dispositions of property, plant and equipment	1	2
Other investing activities	5	5

Net cash used in investing activities	(35)	(117)
Financing activities:		
Proceeds from sale of Senior Notes		996
Retirement of CODES		(935)
Borrowings under revolving credit facility	600	1,031
Repayment of borrowings under revolving credit facility	(600)	(1,031)
Common stock repurchased	(346)	(333)
Dividends paid on L-3 Holdings common stock	(111)	(107)
Proceeds from exercises of stock options	39	86
Proceeds from employee stock purchase plan	17	18
Excess income tax benefits related to share-based payment arrangements	24	16
Debt issue costs		(8)
Employee restricted stock units surrendered in lieu of income tax withholding	(33)	(26)
Other financing activities	(11)	(6)
Net cash used in financing activities	(421)	(299)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(8)	
Change in cash balance in assets held for sale	61	
Net decrease in cash and cash equivalents	(89)	(201)
Cash and cash equivalents, beginning of the period	442	500
Cash and cash equivalents, end of the period	$ 353	$ 299

See notes to unaudited condensed consolidated financial statements.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

1. Description of Business

L-3 Communications Holdings, Inc. derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, aircraft sustainment (including modifications, logistics and maintenance), simulation and training, night vision and image intensification equipment, enterprise and mission information technology (IT) solutions and cyber operations. L-3 is also a leading provider of a broad range of communication and electronic systems and products used on military and commercial platforms. The Company s customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), foreign governments, and domestic and international commercial customers.

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

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

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

2. Basis of Presentation

These unaudited condensed consolidated financial statements for the quarterly and first half periods ended June 26, 2015 should be read in conjunction with the audited consolidated financial statements of L-3 Holdings and L-3 Communications included in their Annual Report on Form 10-K for the year ended December 31, 2014.

Principles of Consolidation and Reporting

The accompanying financial statements comprise the consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings only asset is its investment in the common stock of L-3 Communications, its wholly-owned subsidiary, and its only obligations are: (1) its guarantee of borrowings under the Amended and

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

Restated Revolving Credit Facility (Credit Facility) of L-3 Communications and (2) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. All issuances of and conversions into L-3 Holdings equity securities, including grants of stock options, restricted stock units and performance units by L-3 Holdings to employees and directors of L-3 Communications and its subsidiaries, have been reflected in the consolidated financial statements of L-3 Communications. As a result, the consolidated financial positions, results of operations and cash flows of L-3 Holdings and L-3 Communications are substantially the same. See Note 23 for additional information regarding the unaudited financial information of L-3 Communications and its subsidiaries.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. The December 31, 2014 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year.

It is the Company s established practice to close its books for the quarters ending March, June and September on the Friday 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.

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

Accounting Estimates

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

Sales and profits on contracts that are covered by accounting standards for construction-type and production-type contracts and federal government contractors are recognized using percentage-of-completion (POC) methods of accounting. Approximately 46% of the Company s net sales in 2014 were accounted for under contract accounting standards, of which approximately 40% were fixed-price type contracts and approximately 6% were cost-plus type contracts. For contracts that are accounted for under contract accounting standards, sales

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

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

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

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

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

Company s results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates amounted to increases of $12 million, or 3% of consolidated operating income for the first half period ended June 26, 2015, and increases of $55 million, or 11% of consolidated operating income for the first half period ended June 27, 2014.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

3. Recently Issued Accounting Standards

In July 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-11, which requires entities to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market, with market defined as replacement cost, net realizable value, or net realizable value less a normal profit margin. This update is effective for interim and annual periods beginning after December 15, 2016. The Company is currently evaluating the expected impact of the adoption of this standard on its consolidated financial statements.

In May 2015, the FASB issued ASU 2015-7, which removes the requirement for reporting entities to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share as a practical expedient. ASU 2015-7 also removes the requirement to make certain disclosures for all investments that are measured at fair value using the net asset value per share as a practical expedient. This update is effective for interim and fiscal periods beginning after December 15, 2016. The adoption of this standard will not impact the Company s financial position, results of operations or cash flows.

In April 2015, the FASB issued ASU 2015-5, which is meant to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement by providing guidance as to whether an arrangement includes the sale or license of software. This update is effective for interim and annual periods beginning after December 15, 2015. The adoption of this standard will not materially impact the Company s financial position, results of operations or cash flows.

In April 2015, the FASB issued ASU 2015-3, to simplify the presentation of debt issuance costs. This update requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the associated debt liability, consistent with the required presentation for debt discounts. This update is effective for interim and annual periods beginning after December 15, 2015 and early adoption is permitted. The adoption of this standard will change the Company s current practice of presenting debt issuance costs as an asset and will result in a reduction of total assets and total liabilities in an amount equal to the balance of unamortized debt issuance costs at each balance sheet date. The Company has not elected to early adopt this standard and debt issuance costs amounted to $24 million at June 26, 2015 and $27 million at December 31, 2014.

In February 2015, the FASB issued ASU 2015-2, which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This update is effective for interim and annual periods beginning after December 15, 2015, and early adoption is permitted. The adoption of this standard will not have an impact on the Company s financial position, results of operations or cash flows.

In January 2015, the FASB issued ASU 2015-1, which eliminates from U.S. GAAP the concept of extraordinary items. The update is effective for the Company for interim and annual periods beginning after December 15, 2015. The adoption of this standard will not have an impact on the Company s financial position, results of operations or cash flows.

In June 2014, the FASB issued 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 that affects vesting and that

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

could be achieved after the requisite service period as a performance condition under Accounting Standards Codification (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 adoption of this standard will not have an impact on the Company s financial position, results of operations or cash flows.

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

4. Acquisitions and Divestitures

Business Acquisitions

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

2015 Business Acquisitions

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

MITEQ, Inc. Acquisition. January 21, 2015, the Company acquired the assets of MITEQ, Inc. (Miteq) for a purchase price of $41 million, which was financed with cash on hand. Miteq was combined with the Company s Narda Microwave-East business and the new organization was re-named L-3 Narda-Miteq. Miteq offers a broad product line of active and passive radio frequency (RF) microwave components and low-power satellite

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

communications (SATCOM) products for space and military applications that complement the existing Narda Microwave East product line. The combined L-3 Narda-Miteq business will provide products for the DoD, other U.S. Government agencies, prime contractors and commercial customers. The aggregate goodwill recognized for this business was $11 million, of which $3 million is expected to be deductible for income tax purposes. The goodwill was assigned to the Communication Systems reportable segment. The final purchase price allocation, which is expected to be completed in the fourth quarter of 2015, will be based on the 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.

2014 Business Acquisition

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

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 first half period ended June 26, 2015 and the year ended December 31, 2014, in each case assuming that the business acquisitions completed during these periods had occurred on January 1, 2014.

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(in millions, except per share data)			
Pro forma net sales	$ 2,807	$ 3,052	$ 5,540	$ 6,048
Pro forma net income attributable to L-3	$ 122	$ 138	$ 228	$ 310
Pro forma diluted earnings per share	$ 1.47	$ 1.55	$ 2.73	$ 3.47

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2014.

Business Divestitures

As previously disclosed on July 30, 2015, the Company has initiated a process to evaluate strategic alternatives for its NSS business. These strategic alternatives could include, among other possibilities, a potential sale, spin-off or other divestiture transactions for the business. The Company expects to conclude its review by the end of the year, although a timetable has not been set and there can be no assurances that a transaction will be completed. Furthermore, if a transaction should become probable, the value placed on the NSS business at that time may be lower than the carrying value of its net assets and could trigger a non-cash goodwill impairment charge.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

During the quarterly period ended June 26, 2015, the Company completed the sales of Marine Systems International (MSI) and Broadcast Sports Inc. (BSI). The adjustments recorded by the Company related to the business divestitures are included in the net gain (loss) related to business divestitures captions on the unaudited condensed consolidated statements of operations and are summarized and further discussed below.

	Second Quarter Ended June 26, 2015	First Half Ended June 26, 2015
	(in millions)	
Loss on BSI divestiture	$ (3)	$ (3)
Gain on MSI divestiture	4	4
Non-cash impairment charge related to MSI assets held for sale		(17)
Gain (loss) on a forward contract to sell Euro proceeds from MSI divestiture	1	(4)
Total gain (loss) related to the business divestitures	$ 2	$ (20)

MSI Divestiture. On May 29, 2015, the Company completed the sale of its MSI business to Wärtsilä Corporation for a preliminary purchase price of 295 million (approximately $318 million), in addition to the assumption by Wärtsilä Corporation of approximately 60 million of MSI employee pension-related liabilities. The purchase price is subject to finalization based on customary adjustments for closing date net working capital. MSI was a sector within the Company s Electronic Systems segment, primarily selling to the commercial shipbuilding industry. In accordance with ASU 2014-8, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity,* MSI s assets and liabilities are classified as held for sale in the Company s audited consolidated balance sheet as of December 31, 2014 and MSI s results of operations are included in income from continuing operations for all periods presented. During the quarterly period ended June 26, 2015, the Company recorded a realized pre-tax gain of $4 million ($8 million after income tax benefits), based on the total estimated proceeds from the sale.

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

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

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

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

BSI Divestiture. On April 24, 2015, the Company divested its BSI business for a sales price of $27 million, subject to customary adjustments. BSI is a provider of wireless technology and communications systems services for use in the field of sports television broadcasting, and was included in the Sensor Systems sector of the Electronic Systems segment. The divestiture resulted in a pre-tax loss of $3 million ($6 million after income taxes). In accordance with ASU 2014-8, BSI s assets and liabilities as of December 31, 2014, and results of operations for all periods presented are classified as held and used in the condensed consolidated financial statements.

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

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(in millions)			
Net sales	$ 85	$ 148	$ 192	$ 285
Income before income taxes	$ 5	$ 9	$ 2	$ 10

14

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

5. Contracts in Process

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

	June 26, 2015	December 31, 2014
	(in millions)	
Unbilled contract receivables, gross	$ 2,627	$ 2,280
Unliquidated progress payments	(1,088)	(887)
Unbilled contract receivables, net	1,539	1,393
Inventoried contract costs, gross	1,032	997
Unliquidated progress payments	(149)	(95)
Inventoried contract costs, net	883	902
Total contracts in process	$ 2,422	$ 2,295

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

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.

	Second Quarter Ended	First Half Ended

	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
		(in millions)		
Amounts included in inventoried contract costs at beginning of the period	$ 149	$ 141	$ 138	$ 138
Contract costs incurred:				
IRAD and B&P	75	72	140	143
Other G&A	217	217	421	415
Total	292	289	561	558
Amounts charged to cost of sales	(292)	(279)	(550)	(545)
Amounts included in inventoried contract costs at end of the period	$ 149	$ 151	$ 149	$ 151

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

The table below presents a summary of selling, general and administrative expenses and research and development expenses for the Company s commercial businesses, which are expensed as incurred and included in cost of sales on the unaudited condensed consolidated statements of operations.

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
		(in millions)		
Selling, general and administrative expenses	$ 69	$ 77	$ 145	$ 153
Research and development expenses	14	18	27	36
Total	$ 83	$ 95	$ 172	$ 189

6. Inventories

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

	June 26, 2015	December 31, 2014
	(in millions)	
Raw materials, components and sub-assemblies	$ 174	$ 127
Work in process	120	97
Finished goods	77	64
Total	$ 371	$ 288

7. Goodwill and Identifiable Intangible Assets

Goodwill. In accordance with the accounting standards for business combinations, the Company records the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). The table below presents the changes in goodwill by segment for the first half period ended June 26, 2015.

	Electronic Systems	Aerospace Systems	Communication Systems (in millions)	NSS	Consolidated Total
Balance at December 31, 2014	$ 3,773	$ 1,730	$ 992	$ 1,006	$ 7,501
Business acquisitions[(1)]	177		11		188
Business divestiture[(2)]	(11)				(11)
Foreign currency translation adjustments[(3)]	(15)	(14)			(29)
Balance at June 26, 2015	$ 3,924	$ 1,716	$ 1,003	$ 1,006	$ 7,649

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

(2) The decrease in goodwill for the Electronic Systems segment was due to the BSI business divestiture.

(3) The decrease in goodwill presented in the Electronic Systems segment was primarily due to the strengthening of the U.S. dollar against the Canadian dollar and the Euro, partially offset by the weakening of the U.S. dollar against the British pound during the first half period ended June 26, 2015. The decrease in goodwill presented in the Aerospace Systems segment was due to the strengthening of the U.S. dollar against the Canadian dollar during the first half period ended June 26, 2015.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

The Company s accumulated goodwill impairment losses were $58 million at June 26, 2015 and December 31, 2014, of which $43 million and $15 million were recorded in the Electronic Systems and Communication Systems segments, respectively.

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

		June 26, 2015			December 31, 2014		
	Weighted Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
				(in millions)			
Customer contractual relationships	19	$ 461	$ 276	$ 185	$ 440	$ 262	$ 178
Technology	11	186	115	71	165	111	54
Other	18	27	17	10	27	16	11
Total	17	$ 674	$ 408	$ 266	$ 632	$ 389	$ 243

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

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
		(in millions)		
Amortization Expense	$ 9	$ 11	$ 19	$ 21

Based on gross carrying amounts at June 26, 2015, the Company s estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2015 through 2019 is presented in the table below.

	Year Ending December 31,				
	2015	2016	2017	2018	2019
	(in millions)				
Estimated amortization expense	$ 38	$ 38	$ 34	$ 30	$ 27

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

8. Other Current Liabilities and Other Liabilities

The table below presents the components of other current liabilities.

	June 26, 2015	December 31, 2014
	(in millions)	
Other Current Liabilities:		
Accruals for pending and threatened litigation (see Note 17)	$ 51	$ 38
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	84	75
Accrued product warranty costs	58	59
Accrued interest	44	46
Deferred revenues	41	30
Other	135	150
Total other current liabilities	$ 413	$ 398

The table below presents the components of other liabilities.

	June 26, 2015	December 31, 2014
	(in millions)	
Other Liabilities:		
Non-current income taxes payable (see Note 10)	$ 187	$ 196
Deferred compensation	46	43
Accrued workers compensation	36	38
Accrued product warranty costs	36	34
Notes payable and capital lease obligations	8	1
Other	72	70
Total other liabilities	$ 385	$ 382

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

	First Half Ended	
	June 26, 2015	June 27, 2014
	(in millions)	
Accrued product warranty costs:[1]		
Balance at January 1	$ 93	$ 99
Acquisitions during the period	1	
Accruals for product warranties issued during the period	33	33
Settlements made during the period	(32)	(33)
Foreign currency translation adjustments	(1)	
Balance at end of period	$ 94	$ 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.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

9. Debt

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

	June 26, 2015	December 31, 2014
	(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	350
5.20% Senior Notes due 2019	1,000	1,000
4.75% Senior Notes due 2020	800	800
4.95% Senior Notes due 2021	650	650
3.95% Senior Notes due 2024	650	650
Principal amount of long-term debt	3,950	3,950
Unamortized discounts	(10)	(11)
Carrying amount of long-term debt	$ 3,940	$ 3,939

[1] During the first half period ended June 26, 2015, L-3 Communications aggregate borrowings and repayments under the Credit Facility were each $600 million. At June 26, 2015, L-3 Communications had the full availability of its $1 billion Credit Facility, which expires on February 3, 2017.

10. Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. As of June 26, 2015, 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. In the second quarter of 2015, the Company reached agreements relating to the audit of the Company s 2010 and 2011 U.S. Federal income tax returns with the U.S. Internal Revenue Service (IRS), as well as audits of several state and foreign jurisdictions. As a result of these agreements, the Company reversed previously accrued income tax expense of $10 million, including interest and penalties. The statutes of limitations for the 2010 and 2011 U.S. Federal income tax returns is expected to close on March 30, 2016. The IRS commenced an audit of the Company s U.S. Federal income tax return for 2012. The Company cannot predict the outcome of the audit at this time.

The effective tax rate for the first half period ended June 26, 2015 decreased to 17.4% from 30.8% for the first half period ended June 27, 2014. The decrease was primarily due to $36 million of tax benefits recorded in the quarterly period ended June 26, 2015, including: (1) $17 million of foreign tax benefits related to a legal restructuring of the Company s foreign entities, (2) a $10 million benefit related to the resolution of various outstanding income tax matters with U.S. and foreign tax authorities, as discussed above, and (3) $9 million related to deferred tax benefits. As of June 26, 2015, the Company anticipates that unrecognized tax benefits will decrease by approximately $77 million over the next 12 months due to the potential resolution of unrecognized tax benefits involving several jurisdictions and tax periods. The actual amount of the decrease over the next 12 months could vary significantly depending on the ultimate timing and nature of any settlements.

Non-current income taxes payable include accrued potential interest of $16 million ($10 million after income taxes) at June 26, 2015 and $15 million ($9 million after income taxes) at December 31, 2014, and potential penalties of $9 million at June 26, 2015 and December 31, 2014.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

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

	Foreign currency translation	Unrealized (losses) gains on hedging instruments	Unrecognized losses and prior service cost, net	Total accumulated other comprehensive (loss) income
		(in millions)		
Balance at December 31, 2014	$ 19	$ (5)	$ (598)	$ (584)
Other comprehensive loss before reclassifications, net of tax	(70)	(2)		(72)
Amounts reclassified from AOCI, net of tax	41	6	31	78
Net current period other comprehensive (loss) income	(29)	4	31	6
Balance at June 26, 2015	$ (10)	$ (1)	$ (567)	$ (578)
Balance at December 31, 2013	$ 142	$ 1	$ (253)	$ (110)
Other comprehensive income before reclassifications, net of tax	6	(2)		4
Amounts reclassified from AOCI, net of tax		5	5	10
Net current period other comprehensive income	6	3	5	14
Balance at June 27, 2014	$ 148	$ 4	$ (248)	$ (96)

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

Details About AOCI Components	Amount Reclassified from AOCI[a] Second Quarter Ended June 26, 2015	June 27, 2014	First Half Ended June 26, 2015	June 27, 2014	Affected Line Item in the Unaudited Condensed Consolidated Statements of Operations
	(in millions)				
Foreign currency translation adjustment:					
MSI divestiture	$ (41)	$	$ (41)	$	Gain (loss) related to business divestitures
	(41)		(41)		Income before income taxes
					Provision for income taxes
	$ (41)	$	$ (41)	$	Net income
Losses on hedging instruments:					
MSI divestiture	$ (2)	$	$ (2)	$	Gain (loss) related to business divestitures
Other	(4)	(2)	(6)	(7)	Cost of sales-products
	(6)	(2)	(8)	(7)	Income before income taxes
	2		2	2	Provision for income taxes
	$ (4)	$ (2)	$ (6)	$ (5)	Net income
Amortization of defined benefit pension items:					
MSI divestiture	$ (14)	$	$ (14)	$	Gain (loss) related to business divestitures
Net loss	(16)	(4)	(33)	(8)	(b)

		(30)		(4)		(47)		(8)	Income before income taxes
		10		2		16		3	Provision for income taxes
	$	(20)	$	(2)	$	(31)	$	(5)	Net income
Total reclassification for the period	$	(65)	$	(4)	$	(78)	$	(10)	Net income

(a) Amounts in parenthesis indicate charges to the unaudited condensed consolidated statements of operations.

(b) Amounts related to pension and postretirement benefit plans were reclassified from AOCI and recorded as a component of net periodic benefit cost (see Note 18 for additional information).

12. Equity

On February 5, 2013, L-3 Holdings Board of Directors approved a share repurchase program that authorizes L-3 Holdings to repurchase up to $1.5 billion of its common stock through June 30, 2015. On December 4, 2014, L-3 Holdings Board of Directors approved a new share repurchase program that authorizes L-3 Holdings to repurchase up to an additional $1.5 billion of its common stock through June 30, 2017. Repurchases of L-3 Holdings common stock are made from time to time at management s discretion in accordance with applicable U.S. Federal securities laws. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including, but not limited to, the Company s

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

financial position, earnings, legal requirements, other investment opportunities (including acquisitions) and market conditions. L-3 Holdings repurchased 2,869,908 shares of its common stock at an average price of $120.61 per share for an aggregate amount of $346 million from January 1, 2015 through June 26, 2015. All share repurchases of L-3 Holdings common stock have been recorded as treasury shares.

At June 26, 2015, the remaining dollar value under share repurchase programs authorized by L-3 Holdings Board of Directors was $1,199 million.

From June 27, 2015 through July 30, 2015, L-3 Holdings repurchased 726,180 shares of its common stock at an average price of $115.99 per share for an aggregate amount of $84 million.

On May 5, 2015, L-3 Holdings Board of Directors declared a cash dividend of $0.65 per share, paid on June 15, 2015, to shareholders of record at the close of business on May 18, 2015. During the first half period ended June 26, 2015, the Company paid $111 million of cash dividends, including a $2 million net reduction of accrued dividends for employee held stock awards.

13. L-3 Holdings Earnings Per Common Share

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

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(in millions, except per share data)			
Reconciliation of net income:				
Net income	$ 124	$ 141	$ 233	$ 313
Net income attributable to noncontrolling interests	(4)	(4)	(8)	(6)
Net income attributable to L-3 Holdings common shareholders	$ 120	$ 137	$ 225	$ 307
Earnings per share attributable to L-3 Holdings common shareholders:				
Basic:				
Weighted average common shares outstanding	82.1	86.1	82.2	86.1
Basic earnings per share:				

Net income	$ 1.46	$ 1.59	$ 2.74	$ 3.57
Diluted:				
Common and potential common shares:				
Weighted average common shares outstanding	82.1	86.1	82.2	86.1
Assumed exercise of stock options	2.2	2.9	2.5	3.2
Unvested restricted stock awards	1.2	1.6	1.3	1.6
Employee stock purchase plan contributions	0.2	0.2	0.2	0.1
Performance unit awards	0.1	0.1	0.1	0.2
Assumed purchase of common shares for treasury	(2.6)	(3.3)	(2.8)	(3.4)
Assumed conversion of the CODES[(1)]		1.7		1.6
Common and potential common shares	83.2	89.3	83.5	89.4
Diluted earnings per share:				
Net income	$ 1.44	$ 1.53	$ 2.69	$ 3.43

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

(1) L-3 Holdings 3% Convertible Contingent Debt Securities (CODES) due 2035 were retired on June 20, 2014 and were dilutive for the quarterly and first half periods ended June 27, 2014 as the average market price of L-3 Holdings common stock during the period that the CODES were outstanding was greater than the price at which the CODES would have been convertible into L-3 Holdings common stock. As of June 18, 2014, the final date of conversion, the conversion price was $88.71.

The computation of diluted EPS excludes shares for stock options of 0.7 million and 0.5 million for the quarterly and first half periods ended June 26, 2015, respectively, and shares for stock options and employee stock purchase plan contributions of 0.5 million and 0.4 million for the quarterly and first half periods ended June 27, 2014, respectively, as they were anti-dilutive.

14. Fair Value Measurements

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

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

	June 26, 2015			December 31, 2014		
Description	**Level 1(1)**	**Level 2(2)**	**Level 3(3)**	**Level 1(1)**	**Level 2(2)**	**Level 3(3)**
			(in millions)			
Assets						
Cash equivalents	$ 229	$	$	$ 416	$	$
Derivatives (foreign currency forward contracts)		7			5	
Total assets	$ 229	$ 7	$	$ 416	$ 5	$
Liabilities						
Derivatives (foreign currency forward contracts)	$	$ 8	$	$	$ 11	$

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

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

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

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

15. Financial Instruments

At June 26, 2015 and December 31, 2014, the Company s financial instruments consisted primarily of cash and cash equivalents, billed receivables, trade accounts payable, Senior Notes and foreign currency forward contracts. The carrying amounts of cash and cash equivalents, billed receivables and trade accounts payable are representative of their respective fair values because of the short-term maturities or the expected settlement dates of these instruments. The carrying amounts and estimated fair values of the Company s other financial instruments are presented in the table below.

	June 26, 2015		December 31, 2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Senior Notes[1]	$ 3,940	$ 4,111	$ 3,939	$ 4,178
Foreign currency forward contracts[2]	$ (1)	$ (1)	$ (6)	$ (6)

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

(2) The Company measures the fair values of foreign currency forward contracts based on forward exchange rates. See Note 16 for additional disclosures regarding the notional amounts and fair values of foreign currency forward contracts.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

16. Derivative Financial Instruments

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

Foreign Currency Forward Contracts. The Company s U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, the Company enters into foreign currency forward contracts. The Company s activities involving foreign currency forward contracts are designed to hedge the changes in the functional currency equivalent cash flows due to movements in foreign exchange rates compared to the functional currency. The foreign currencies hedged are primarily the Canadian dollar, the U.S. dollar, the Euro and the British pound. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. Foreign currency forward contracts are recorded in the Company s condensed consolidated balance sheets at fair value and are generally designated and accounted for as cash flow hedges in accordance with the accounting standards for derivative instruments and hedging activities. Gains and losses on designated foreign currency forward contracts that are highly effective in offsetting the corresponding change in the cash flows of the hedged transactions are recorded net of income taxes in AOCI and then recognized in income when the underlying hedged transaction affects income. Gains and losses on foreign currency forward contracts that do not meet hedge accounting criteria are recognized in income immediately. Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The table below presents the notional amounts of the Company s outstanding foreign currency forward contracts by currency at June 26, 2015.

Currency	Notional Amounts (in millions)
Canadian dollar	$ 180
U.S. dollar	96
Euro	25
British pound	4
Total	$ 305

At June 26, 2015, the Company s foreign currency forward contracts had maturities through 2018.

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

	June 26, 2015				December 31, 2014			
	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)(2)	$ 4	$ 3	$ 7	$ 1	$ 4	$ 1	$ 10	$ 1
Total derivative instruments	$ 4	$ 3	$ 7	$ 1	$ 4	$ 1	$ 10	$ 1

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

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

The effect of gains or losses from foreign currency forward contracts was not material to the unaudited condensed consolidated statements of operations for the quarterly or first half periods ended June 26, 2015 and June 27, 2014. At June 26, 2015, the estimated net amount of existing losses that are expected to be reclassified into income within the next 12 months is $3 million.

17. Commitments and Contingencies

Guarantees

In connection with the spin-off of Engility Holdings, Inc. (Engility) in 2012, L-3 entered into a Distribution Agreement and several other agreements that govern certain aspects of L-3 s relationship with Engility, including employee matters, tax matters, transition services, and the future supplier/customer relationship between L-3 and Engility. These agreements generally provide cross-indemnities that, except as otherwise provided, are principally designed to place the financial responsibility for the obligations and liabilities of each entity with that respective entity. Engility has joint and several liability with L-3 to the U.S. Internal Revenue Service (IRS) for the consolidated U.S. Federal income taxes of L-3 s consolidated group for taxable periods in which Engility was a part of that group. However, the Tax Matters Agreement specifies the portion of this tax liability for which L-3 and Engility will each bear responsibility, and L-3 and Engility have agreed to indemnify each other against any amounts for which the other is not responsible. The Tax Matters Agreement also allocates responsibility between L-3 and Engility for other taxes, including special rules for allocating tax liabilities in the event that the spin-off is determined not to be tax-free. Though valid as between the parties, the Tax Matters Agreement is not binding on the IRS.

Procurement Regulations

A substantial majority of the Company s revenues are generated from providing products and services under legally binding agreements or contracts with U.S. Government and foreign government customers. U.S. Government contracts are subject to extensive legal and regulatory requirements, and, from time to time, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. The Company is currently cooperating with the U.S. Government on several investigations from which civil, criminal or administrative proceedings have or could result and give rise to fines, penalties, compensatory and treble damages, restitution and/or forfeitures. In that regard, as of June 26, 2015, the Company has recognized an aggregate liability of $26 million in anticipation of a settlement related to a product specification matter regarding a holographic weapon sight product in the Warrior Systems sector of the Electronic Systems segment. The Company has other ongoing government investigations, including investigations into the pricing of certain contracts entered into by the Communication Systems segment. The Company does not currently anticipate that any of these investigations will have a material adverse effect, individually or in the aggregate, on its consolidated financial position, results of operations or cash flows. However, under U.S. Government regulations, an indictment of the Company by a federal grand jury, or an administrative finding against the Company as to its present responsibility to be a U.S. Government contractor or subcontractor, could result in the Company being suspended for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges. A conviction, or an administrative

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

finding against the Company that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specified term. In addition, all of the Company s U.S. Government contracts: (1) are subject to audit and various pricing and cost controls, (2) include standard provisions for termination for the convenience of the U.S. Government or for default, and (3) are subject to cancellation if funds for contracts become unavailable. Foreign government contracts generally include comparable provisions relating to terminations for convenience or default, as well as other procurement clauses relevant to the foreign government.

Litigation Matters

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

In accordance with the accounting standard for contingencies, the Company records a liability when management believes that it is both probable that a liability has been incurred and the Company can reasonably estimate the amount of the loss. Generally, the loss is recorded at the amount the Company expects to resolve the liability. The estimated amounts of liabilities recorded for pending and threatened litigation are disclosed in Note 8. Amounts recoverable from insurance contracts or third parties are recorded as assets when deemed probable. At June 26, 2015 and December 31, 2014, the Company recorded approximately $11 million of receivables for recoveries from insurance contracts or third parties in connection with the Bashkirian Airways matter discussed below. Legal defense costs are expensed as incurred. The Company believes it has recorded adequate provisions for its litigation matters. The Company reviews these provisions quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. While it is reasonably possible that an unfavorable outcome may occur in one or more of the following matters, unless otherwise stated below, the Company believes that it is not probable that a loss has been incurred in any of these matters. With respect to the litigation matters below for which it is reasonably possible that an unfavorable outcome may occur, an estimate of loss or range of loss is disclosed when such amount or amounts can be reasonably estimated. Although the Company believes that it has valid defenses with respect to legal matters and investigations pending against it, the results of litigation can be difficult to predict, particularly those involving jury trials. Accordingly, the Company s current judgment as to the likelihood of loss (or our current estimate as to the potential range of loss, if any) with respect to any particular litigation matter may turn out to be wrong. Therefore, it is possible that the financial position, results of operations or cash flows of the Company could be materially adversely affected in any particular period by the unfavorable resolution of one or more of these or other contingencies.

Class Action. In August 2014, three separate, putative class actions were filed in the United States District Court for the Southern District of New York (the District Court) against the Company and certain of its officers. These cases were consolidated into a single action on October 24, 2014. A consolidated amended complaint was filed in the

District Court on December 22, 2014, which was further amended and restated on March 13, 2015. The complaint alleges violations of federal securities laws related to misconduct and accounting errors identified by the Company at its Aerospace Systems segment, and seeks monetary damages, pre- and post-judgment interest, and fees and expenses. The Company believes the action lacks merit and intends to defend itself vigorously. On April 24, 2015, the Company moved to dismiss the amended and restated complaint. The motion has been fully briefed. The Company is unable to reasonably estimate any amount or range of loss, if any, that may be incurred in connection with this matter because the proceedings are in their early stages.

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

Bashkirian Airways. On July 1, 2004, lawsuits were filed on behalf of the estates of 31 Russian children in the state courts of Washington, Arizona, California, Florida, New York and New Jersey against Honeywell, Honeywell TCAS, Thales USA, Thales France, the Company and Aviation Communications & Surveillance Systems (ACSS), which is a joint venture of L-3 and Thales. The suits relate to the crash over southern Germany of a Bashkirian Airways Tupelov TU 154M aircraft and a DHL Boeing 757 cargo aircraft. On-board the Tupelov aircraft were 9 crew members and 60 passengers, including 45 children. The Boeing aircraft carried a crew of two. Both aircraft were equipped with Honeywell/ACSS Model 2000, Change 7 Traffic Collision and Avoidance Systems (TCAS). Sensing the other aircraft, the on-board DHL TCAS instructed the DHL pilot to descend, and the Tupelov on-board TCAS instructed the Tupelov pilot to climb. However, the Swiss air traffic controller ordered the Tupelov pilot to descend. The Tupelov pilot disregarded the on-board TCAS and put the Tupelov aircraft into a descent striking the DHL aircraft in midair at approximately 35,000 feet. All crew and passengers of both planes were lost. Investigations by the National Transportation Safety Board after the crash revealed that both TCAS units were performing as designed. The suits allege negligence and strict product liability based upon the design of the units and the training provided to resolve conflicting commands. The Company s insurers accepted defense of these matters and retained counsel. The matters were consolidated in the U.S. District Court for the District of New Jersey, which then dismissed the actions on the basis of forum non conveniens. Plaintiffs representing 30 of the estates re-filed their complaint against ACSS on April 23, 2007 with the Barcelona Court s Registry in Spain. On March 9, 2010, the court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of approximately $6.7 million, all of which represented compensatory damages. Both ACSS and the plaintiffs appealed the judgment. In May 2012, the appellate court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of $48 million. ACSS filed an appeal of the judgment with the Supreme Court of Spain (the Supreme Court) on September 28, 2012. During the Supreme Court s consideration of the appeal, 18 of 30 plaintiffs released their claims against ACSS in consideration for payments made by the Company s insurance carriers. On February 10, 2015, the Supreme Court issued a ruling that awarded the remaining 12 plaintiffs approximately $11 million in the aggregate (including interest), plus certain legal expenses incurred by the plaintiffs in connection with the appeal to the Supreme Court. The Company s insurers have paid the $11 million award amount into an escrow account held by the Company s legal representatives for payment to the plaintiffs if and when the award becomes due, and have confirmed that they will pay the plaintiffs legal expenses on behalf of the Company once they are certified and become due. On May 20, 2015, an appeal was filed on behalf of ACSS to annul the Supreme Court decision on constitutional grounds. Settlement discussions between the parties remain ongoing.

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

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

18. Pension and Other Postretirement Benefits

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

	Pension Plans				Postretirement Benefit Plans			
	Second Quarter Ended		First Half Ended		Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(in millions)							
Components of net periodic benefit cost:								
Service cost	$ 32	$ 27	$ 64	$ 54	$ 1	$ 1	$ 2	$ 2
Interest cost	37	37	74	73	2	2	4	4
Expected return on plan assets	(52)	(49)	(104)	(97)	(1)	(1)	(2)	(2)
Amortization of prior service costs (credits)			1	1	(1)		(2)	(1)
Amortization of net loss (gain)	17	5	34	9		(1)		(1)
Curtailment loss				1				
Net periodic benefit cost	$ 34	$ 20	$ 69	$ 41	$ 1	$ 1	$ 2	$ 2

Contributions. The Company contributed cash of $30 million to its pension plans and $3 million to its other postretirement benefit plans during the first half period ended June 26, 2015. The Company expects to contribute an additional $70 million to its pension plans and $7 million to its other postretirement benefit plans during the remainder of 2015.

19. Stock-Based Compensation

During the first half period ended June 26, 2015, the Company granted stock-based compensation under its Amended and Restated 2008 Long Term Performance Plan (2008 LTPP) in the form of stock options, restricted stock units and performance units. The stock-based compensation awards granted during the first half period ended June 26, 2015 are further discussed below.

Stock Options. The Company granted 453,358 stock options with a weighted average exercise price of $129.05 per option, which was equal to the closing price of L-3 Holdings common stock on the date of grant. The options expire after 10 years from the date of grant and vest ratably over a three-year period on the annual

29

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

anniversary of the 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 $19.77 per option was estimated using the Black-Scholes option-pricing model. The weighted average assumptions used in the valuation model for this grant are presented in the table below.

Expected holding period (in years)	5.0
Expected volatility	21.4%
Expected dividend yield	2.4%
Risk-free interest rate	1.5%

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

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

20. Supplemental Cash Flow Information

	First Half Ended	
	June 26, 2015	June 27, 2014
	(in millions)	
Interest paid on outstanding debt	$ 90	$ 86
Income tax payments	66	104
Income tax refunds	4	6

21. Segment Information

The Company has four reportable segments, which are described in Note 1. The Company evaluates the performance of its reportable segments based on their sales and operating income. All corporate expenses are allocated to the

Company s operating segments using an allocation methodology prescribed by U.S. Government regulations for government contractors. Accordingly, all costs and expenses, except for the gains or losses related to business divestitures (which were not included in the Company s segment performance measures), are included in the Company s measure of segment profitability.

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(in millions)			
Net Sales:				
Electronic Systems	$ 1,061	$ 1,123	$ 2,099	$ 2,221
Aerospace Systems	997	1,062	2,024	2,136
Communication Systems	514	538	958	1,055
NSS	262	336	507	641
Elimination of intercompany sales	(41)	(40)	(82)	(77)
Consolidated total	$ 2,793	$ 3,019	$ 5,506	$ 5,976
Operating Income (Loss):				
Electronic Systems	$ 119	$ 133	$ 233	$ 258
Aerospace Systems	(17)	39	45	132
Communication Systems	52	48	87	98
NSS	10	19	21	37
Segment total	$ 164	$ 239	$ 386	$ 525
Gain (loss) related to business divestitures(1)	2		(20)	
Consolidated total	$ 166	$ 239	$ 366	$ 525
Depreciation and amortization:				
Electronic Systems	$ 27	$ 30	$ 55	$ 59
Aerospace Systems	12	9	24	19
Communication Systems	13	13	25	25
NSS	3	3	6	6
Consolidated total	$ 55	$ 55	$ 110	$ 109

(1) See Note 4 for information regarding the Company s business divestitures.

	June 26, 2015	December 31, 2014
	(in millions)	
Total Assets:		
Electronic Systems	$ 6,729	$ 6,287
Aerospace Systems	3,080	3,011
Communication Systems	2,020	1,997
NSS	1,281	1,287
Corporate	523	707
Assets held for sale		547
Consolidated total	$ 13,633	$ 13,836

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

22. Employee Severance and Termination Costs

Consistent with the Company s strategy to continuously improve its cost structure and right-size its businesses, especially in view of U.S. defense budget constraints, L-3 is completing employment reduction actions across several of its businesses to reduce both direct and indirect costs, including overhead and general and administrative costs. As a result of these initiatives and due to the impact of U.S. defense budget constraints at certain affected business units, the Company recorded $4 million and $6 million in employee severance and other termination costs, with respect to approximately 520 employees, during the quarterly and first half periods ended June 26, 2015, respectively. During the year ended December 31, 2014, the Company recorded a total of $30 million in employee severance and other termination costs with respect to approximately 2,000 employees. Employee severance and other termination costs are reported within cost of sales on the unaudited condensed consolidated statements of operations. The remaining balance to be paid in connection with these initiatives was $6 million at June 26, 2015 and $11 million at December 31, 2014, which is expected to be paid primarily by the first half of 2016. Employee severance and other termination costs incurred by reportable segment for the quarterly and first half periods ended June 26, 2015 and June 27, 2014 are presented in the table below.

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(in millions)			
Reportable Segment				
Electronic Systems	$ 2	$ 10	$ 2	$ 14
Aerospace Systems	1	2	2	2
Communication Systems	1		2	3
NSS				1
Consolidated	$ 4	$ 12	$ 6	$ 20

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

L-3 Communications is a 100% owned subsidiary of L-3 Holdings. The debt of L-3 Communications, including the Senior Notes and borrowings under amounts drawn against the Credit Facility is guaranteed, on a joint and several, full and unconditional basis, by certain of its domestic subsidiaries (the Guarantor Subsidiaries) and, in the case of the Credit Facility, by L-3 Holdings. See Note 10 to the audited consolidated financial statements for the year ended December 31, 2014, included in the Company s Annual Report on Form 10-K for additional information. The foreign subsidiaries and certain domestic subsidiaries of L-3 Communications (the Non-Guarantor Subsidiaries) do not guarantee the debt of L-3 Communications or L-3 Holdings. None of the debt of L-3 Communications has been issued by its subsidiaries. There are no restrictions on the payment of dividends from the Guarantor Subsidiaries to L-3 Communications or from L-3 Communications to L-3 Holdings.

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

Table of Contents

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (continued)

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.

	L-3 Holdings (Parent)	L-3 Communications	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated L-3
			(in millions)			
Condensed Combining Balance Sheets:						
At June 26, 2015:						
Current assets:						
Cash and cash equivalents	$	$ 197	$ 3	$ 164	$ (11)	$ 353
Billed receivables, net		295	296	229		820
Contracts in process		887	1,189	346		2,422
Other current assets		411	166	131		708
Total current assets		1,790	1,654	870	(11)	4,303
Goodwill		2,319	4,268	1,062		7,649
Other assets		839	563	279		1,681
Investment in and amounts due from consolidated subsidiaries	5,197	6,886	4,306		(16,389)	
Total assets	$ 5,197	$ 11,834	$ 10,791	$ 2,211	$ (16,400)	$ 13,633
Current liabilities	$	$ 936	$ 979	$ 513	$ (11)	$ 2,417
Amounts due to consolidated subsidiaries				29	(29)	
Other long-term liabilities		1,761	204	39		2,004
Long-term debt		3,940				3,940
Total liabilities		6,637	1,183	581	(40)	8,361
L-3 shareholders equity	5,197	5,197	9,608	1,630	(16,435)	5,197
Noncontrolling interests					75	75

Total equity	5,197	5,197	9,608	1,630	(16,360)	5,272
Total liabilities and equity	$ 5,197	$ 11,834	$ 10,791	$ 2,211	$ (16,400)	$ 13,633

Table of Contents

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)			
At December 31, 2014:						
Current assets:						
Cash and cash equivalents	$	$ 361	$ 1	$ 142	$ (62)	$ 442
Billed receivables, net		320	329	203		852
Contracts in process		867	1,144	284		2,295
Other current assets		365	141	95		601
Assets held for sale			52	495		547
Total current assets		1,913	1,667	1,219	(62)	4,737
Goodwill		2,308	4,280	913		7,501
Other assets		817	576	205		1,598
Investment in and amounts due from consolidated subsidiaries	5,285	6,855	4,157		(16,297)	
Total assets	$ 5,285	$ 11,893	$ 10,680	$ 2,337	$ (16,359)	$ 13,836
Current liabilities	$	$ 878	$ 1,017	$ 455	$ (62)	$ 2,288
Liabilities held for sale			10	227		237
Amounts due to consolidated subsidiaries				333	(333)	
Other long-term liabilities		1,791	190	31		2,012
Long-term debt		3,939				3,939
Total liabilities		6,608	1,217	1,046	(395)	8,476
L-3 shareholders equity	5,285	5,285	9,463	1,291	(16,039)	5,285
Noncontrolling interests					75	75
Total equity	5,285	5,285	9,463	1,291	(15,964)	5,360
Total liabilities and equity	$ 5,285	$ 11,893	$ 10,680	$ 2,337	$ (16,359)	$ 13,836

Table of Contents

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 June 26, 2015:						
Total net sales	$	$ 878	$ 1,490	$ 501	$ (76)	$ 2,793
Total cost of sales	(11)	(805)	(1,465)	(435)	87	(2,629)
(Loss) gain related to business divestitures		(5)	(25)	32		2
Operating (loss) income	(11)	68		98	11	166
Interest expense		(47)	(1)			(48)
Interest and other income, net		4		1		5
(Loss) income before income taxes	(11)	25	(1)	99	11	123
Benefit (provision) for income taxes			15	(14)		1
Equity in net income of consolidated subsidiaries	131	95			(226)	
Net income	120	120	14	85	(215)	124
Net income attributable to noncontrolling interests					(4)	(4)
Net income attributable to L-3	$ 120	$ 120	$ 14	$ 85	$ (219)	$ 120
Comprehensive income attributable to L-3	$ 205	$ 205	$ 18	$ 157	$ (380)	$ 205
For the quarter ended June 27, 2014:						
Total net sales	$	$ 883	$ 1,655	$ 555	$ (74)	$ 3,019
Total cost of sales	(14)	(798)	(1,552)	(504)	88	(2,780)

Operating (loss) income	(14)	85	103	51	14	239
Interest expense	3	(38)		(1)	(3)	(39)
Interest and other income, net		3		1		4
(Loss) income before income taxes	(11)	50	103	51	11	204
Benefit (provision) for income taxes	3	(18)	(31)	(14)	(3)	(63)
Equity in net income of consolidated subsidiaries	145	105			(250)	
Net income	137	137	72	37	(242)	141
Net income attributable to noncontrolling interests					(4)	(4)
Net income attributable to L-3	$ 137	$ 137	$ 72	$ 37	$ (246)	$ 137
Comprehensive income attributable to L-3	$ 169	$ 169	$ 79	$ 60	$ (308)	$ 169

35

Table of Contents

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 first half ended June 26, 2015:						
Total net sales	$	$ 1,666	$ 2,990	$ 993	$ (143)	$ 5,506
Total cost of sales	(24)	(1,523)	(2,853)	(887)	167	(5,120)
(Loss) gain related to business divestitures		(5)	(28)	13		(20)
Operating (loss) income	(24)	138	109	119	24	366
Interest expense		(91)	(1)			(92)
Interest and other income, net		7		1		8
(Loss) income before income taxes	(24)	54	108	120	24	282
Benefit (provision) for income taxes	4	(9)	(19)	(21)	(4)	(49)
Equity in net income of consolidated subsidiaries	245	180			(425)	
Net income	225	225	89	99	(405)	233
Net income attributable to noncontrolling interests					(8)	(8)
Net income attributable to L-3	$ 225	$ 225	$ 89	$ 99	$ (413)	$ 225
Comprehensive income attributable to L-3	$ 231	$ 231	$ 90	$ 82	$ (403)	$ 231
For the first half ended June 27, 2014:						
Total net sales	$	$ 1,746	$ 3,280	$ 1,098	$ (148)	$ 5,976
Total cost of sales	(29)	(1,567)	(3,033)	(999)	177	(5,451)

Operating (loss) income	(29)	179	247	99	29	525
Interest expense	(2)	(81)		(1)	2	(82)
Interest and other income, net		8		1		9
(Loss) income before income taxes	(31)	106	247	99	31	452
Benefit (provision) for income taxes	9	(33)	(76)	(30)	(9)	(139)
Equity in net income of consolidated subsidiaries	329	234			(563)	
Net income	307	307	171	69	(541)	313
Net income attributable to noncontrolling interests					(6)	(6)
Net income attributable to L-3	$ 307	$ 307	$ 171	$ 69	$ (547)	$ 307
Comprehensive income attributable to L-3	$ 321	$ 321	$ 175	$ 75	$ (571)	$ 321

36

Table of Contents

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 Cash Flows						
For the first half ended June 26, 2015:						
Operating activities:						
Net cash from (used in) operating activities	$ 457	$ 273	$ 144	$ (18)	$ (542)	$ 314
Investing activities:						
Business acquisitions, net of cash acquired		(260)				(260)
Proceeds from sale of businesses, net of closing date cash balances			28	276		304
Investments in L-3 Communications	(23)				23	
Other investing activities		(46)	(25)	(8)		(79)
Net cash (used in) from investing activities	(23)	(306)	3	268	23	(35)
Financing activities:						
Common stock repurchased	(346)					(346)
Dividends paid on L-3 Holdings common stock	(111)					(111)
Dividends paid to L-3 Holdings		(457)			457	
Investments from L-3 Holdings		23			(23)	
Other financing activities	23	303	(146)	(280)	136	36
Net cash used in financing activities	(434)	(131)	(146)	(280)	570	(421)
				(8)		(8)

Effect of foreign currency exchange rate changes on cash						
Change in cash balance in assets held for sale			1	60		61
Net (decrease) increase in cash		(164)	2	22	51	(89)
Cash and cash equivalents, beginning of the period		361	1	142	(62)	442
Cash and cash equivalents, end of the period	$	$ 197	$ 3	$ 164	$ (11)	$ 353
For the first half ended June 27, 2014:						
Operating activities:						
Net cash from operating activities	$ 1,375	$ 107	$ 152	$ 3	$ (1,422)	$ 215
Investing activities:						
Business acquisitions, net of cash acquired		(57)				(57)
Investments in L-3 Communications	(77)				77	
Other investing activities		(25)	(24)	(11)		(60)
Net cash used in investing activities	(77)	(82)	(24)	(11)	77	(117)
Financing activities:						
Proceeds from sale of Senior Notes		996				996
Retirement of CODES	(935)					(935)
Common stock repurchased	(333)					(333)
Dividends paid on L-3 Holdings common stock	(107)					(107)
Dividends paid to L-3 Holdings		(1,375)			1,375	
Investments from L-3 Holdings		77			(77)	
Other financing activities	77	111	(126)	(40)	58	80
Net cash used in financing activities	(1,298)	(191)	(126)	(40)	1,356	(299)
Net (decrease) increase in cash		(166)	2	(48)	11	(201)
Cash and cash equivalents, beginning of the period		258		261	(19)	500
Cash and cash equivalents, end of the period	$	$ 92	$ 2	$ 213	$ (8)	$ 299

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview and Outlook

L-3 s Business

L-3 Holdings derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications. L-3 Communications is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, aircraft sustainment (including modifications, logistics and maintenance), simulation and training, night vision and image intensification equipment, enterprise and mission information technology (IT) solutions and cyber operations. L-3 is also a leading provider of a broad range of communication and electronic systems and products used on military and commercial platforms. The Company s customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), foreign governments, and domestic and international commercial customers.

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

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

Financial information with respect to our segments is included in Results of Operations within this section, Note 21 to our unaudited condensed consolidated financial statements and Note 22 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014.

For the year ended December 31, 2014, we generated sales of $12,124 million and our primary customer was the DoD. The table below presents a summary of our consolidated 2014 sales by major category of end customer and the percent contributed by each to our consolidated 2014 sales.

	2014 Sales	% of 2014 Sales

	(in millions)	
DoD	$ 7,961	66%
Other U.S. Government	623	5
Total U.S. Government	8,584	71%
International (foreign governments)	1,847	15
Commercial international	1,105	9
Commercial domestic	588	5
Total sales	$ 12,124	100%

Table of Contents

We currently expect the percentage of our consolidated sales to the U.S. Government to decline from 71% of our consolidated 2014 sales to approximately 70% of our consolidated 2015 sales. U.S. Government sales include sales to the DoD, which we expect to decrease from approximately 66% of our consolidated 2014 sales to 65% of our consolidated 2015 sales. We also expect sales to international and commercial customers to increase to approximately 30% of our 2015 sales, compared to 29% of our consolidated 2014 sales.

Business Environment

U.S. Government Markets. Sales to U.S. Government customers represented 71% of our 2014 sales, and were primarily to DoD customers, which comprised 66% of our consolidated sales. Therefore, our annual sales are generally highly correlated to changes in U.S. Government spending levels, especially DoD budget levels.

The DoD budget peaked in the fiscal year ended September 30, 2010 (FY 2010) at $690 billion and has declined since. The total budget for FY 2014 was $581 billion, which increased slightly compared to the FY 2013 budget due to an increase in the Overseas Contingency Operations (OCO) budget. The FY 2014 base budget remained at $496 billion compared to FY 2013. The total DoD budget for FY 2015 is $560 billion, which decreased by 4% due to a decrease in the OCO budget. The FY 2015 DoD base budget remains flat at $496 billion compared to FY 2014.

The enacted FY 2013 and FY 2014 DoD budgets and the FY 2015 DoD budget, which was fully appropriated by Congress on December 13, 2014, comply with the sequestration cuts required by the Budget Control Act of 2011 (BCA), as amended by The American Taxpayer Relief Act (ATRA) and the Bipartisan Budget Act of 2013 (BBA). ATRA, enacted on January 2, 2013, reduced the sequester cuts to the FY 2013 DoD budget by $9 billion. The BBA, enacted on December 26, 2013, reduced budget sequester cuts to the DoD base budget by approximately $22 billion for FY 2014 and $9 billion for FY 2015 and increased the FY 2014 OCO budget by $6 billion compared to the amount requested by the Obama Administration (Administration).

On February 2, 2015, the Administration submitted its FY 2016 DoD Proposed Budget Request (PBR). The total FY 2016 DoD budget request is $585 billion ($534 billion base budget, $51 billion OCO), a requested increase of 4% compared to the appropriated FY 2015 DoD budget. However, Congress has not approved the FY 2016 budget. The FY 2016 PBR, for the base budget, exceeds the BCA sequestration cut spending caps by $34 billion in FY 2016, $35 billion in FY 2017, $31 billion in FY 2018 and $27 billion in FY 2019. The table below excludes the base budget amounts that exceed the BCA spending caps for FY 2016 to FY 2019.

Fiscal Year (Ending September 30)	DoD Budget (includes Sequestration Cuts/BBA) Base	OCO	Total	Annual Total Budget Change
	(in billions)			
2011	$ 528	$ 159	$ 687	0%
2012	$ 530	$ 115	$ 645	-6%
2013	$ 496	$ 82	$ 578	-10%
2014	$ 496	$ 85	$ 581	+1%
2015	$ 496	$ 64	$ 560	-4%
2016	$ 500	$ 51	$ 551	-2%
2017	$ 512	$ 27	$ 539	-2%
2018	$ 525	$ 27	$ 552	+2%

2019	$ 537	$ 27	$ 564	+2%

In May 2015, Congress passed a budget resolution for FY 2016, which begins October 1, 2015, authorizing appropriations that meet the Administration s PBR. The budget resolution authorizes base budget funding at the BCA sequestration spending caps and places the Administration PBR amounts that exceed the BCA sequestration spending caps in increased funding for the FY 2016 OCO budget. The Administration has threatened to veto all appropriations bills marked to BCA spending caps. We expect members of Congress and the Administration to continue to debate the DoD budget throughout the FY 2016 appropriations bill process and it is possible that a FY 2016 budget is not appropriated before October 1, 2015. We cannot predict the outcome of these efforts or its impact on L-3.

While we believe that L-3 is well positioned to benefit from several of the DoD s focus areas, the decline in the DoD budgets in 2015 and the potential decline in the FY 2016 budget, depending on if Congress provides relief from sequestration cuts, will generally pressure and possibly reduce funding for some of our contracts, which could reduce our sales and operating income and negatively impact our results of operations and cash flows. Uncertainty continues to exist, even with the passage of the BBA, regarding how sequestration cuts will be implemented in DoD budgets for FY 2016 and beyond and what challenges this may present for the defense industry, including L-3, our customers and suppliers. Furthermore, while members of Congress and the Administration continue to discuss various options to address sequestration and the U.S. Government s overall fiscal challenges, we cannot predict the outcome of these efforts. We do not believe the FY 2015 sequester cuts to the DoD budget will have a significant negative impact on our results of operations or cash flows for the year ending December 31, 2015. However, depending on how future sequestration cuts are implemented, we believe that sequestration could have a material, negative impact on our results of operations and cash flows in the future. In addition, declining DoD budgets due to sequestration or other reductions could also potentially trigger non-cash goodwill impairment charges depending on how these reductions impact each of our reporting units. (See the discussion regarding goodwill in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies included in our Annual Report on Form 10-K for the year ended December 31, 2014).

International and Commercial Markets. Sales to end customers other than the U.S. Government represented 29% of our 2014 sales and we expect those sales to represent 30% of our consolidated 2015 sales, including 1.6% of our consolidated sales related to Marine Systems International (MSI), which we divested on May 29, 2015. These sales are generally affected by international government security and military priorities, as well as the fiscal situations of our international government end customers, global economic conditions for our commercial end markets and our competitive success in winning new business and increasing market share.

Key Performance Measures

The primary financial performance measures that we use to manage our businesses and monitor results of operations are sales and operating income trends. Management believes that these financial performance measures are the primary growth drivers for our earnings and cash flow per common share. Generally, in evaluating our businesses and contract performance, we focus on net sales, operating income and operating margin, which we define as operating income as a percentage of sales, and not by type or amount of operating costs.

One of our primary business objectives is to increase sales organically and through select business acquisitions. We define organic sales growth as the increase or decrease in sales for the current period compared to the prior period, excluding sales in the: (1) current period from business acquisitions that are included in our actual results of operations for less than twelve months, and (2) prior period from business divestitures that are included in our actual results of operations for the twelve-month period prior to the divestiture date. We expect to supplement, strengthen and enhance our existing businesses by selectively acquiring businesses that: (1) add important new technologies and products, (2) provide access to select customers, programs and contracts and (3) provide attractive returns on investment. Another important financial performance measure that we use is operating margin, because sales growth combined with operating margin levels determine our operating income levels.

Sales Trend. For the quarter ended June 26, 2015 (2015 Second Quarter), consolidated net sales of $2,793 million decreased by $226 million, or 7%, compared to the quarter ended June 27, 2014 (2014 Second Quarter), due to a decrease in organic sales of $188 million, or 6%, and a decrease of $61 million, or 2%, related to business divestitures. These decreases were partially offset by net sales from business acquisitions of $23 million, or 1%.

For the first half period ended June 26, 2015 (2015 First Half), consolidated net sales of $5,506 million decreased by $470 million, or 8%, compared to the first half period ended June 27, 2014 (2014 First Half) due to a decrease in organic sales of $447 million, or 8%, and a decrease of $62 million, or 1%, related to business divestitures. These decreases were partially offset by net sales from business acquisitions of $39 million, or 1%. See Results of Operations, including segment results below for a further discussion of sales.

For the year ended December 31, 2014, our largest contract (revenue arrangement) in terms of annual sales was the Fort Rucker Maintenance Support contract with the U.S. Army Aviation and Missile Life Cycle Management Command (AMCOM), which is included in our Aerospace Systems segment. Under this contract, which generated 3.6% of our 2014 sales, we provide maintenance, logistics and other related sustainment support services for rotary wing aircraft assigned to Fort Rucker and satellite units in Alabama. Our period of performance, including unexercised annual options, continues through September 30, 2017.

We derived approximately 66% of our 2014 sales from DoD customers and, as a result, our sales are highly correlated to DoD budget levels. DoD budgets are a function of several factors and uncertainties beyond our control, including, but not limited to, changes in U.S. procurement policies, budget considerations, current and future economic conditions, presidential administration priorities, U.S. military engagements, changing national security and defense requirements, geo-political developments, actual fiscal year congressional appropriations for defense budgets, and sequestration and other DoD budget reductions. Any of these factors could result in a significant increase, decrease or redirection of DoD budgets and impact L-3 s future results of operations, including our sales and operating income growth rates. Additionally, L-3 s future results of operations will be affected by our ability to retain our existing business, including our revenue arrangements with DoD customers, and to successfully re-compete for existing business and compete for new business, which largely depends on: (1) our successful performance on existing contracts, (2) the effectiveness and innovation of our technologies and research and development activities, (3) our ability to offer better program performance than our competitors at an affordable cost, and (4) our ability to retain our employees and hire new ones, particularly those employees who have U.S. Government security clearances. We expect our 2015 consolidated sales to decline by approximately 5% compared to 2014, primarily due to the divestiture of MSI, discussed below, and declines in DoD budgets. See Other Events for information related to the MSI divestiture.

Operating Income Trend. For the 2015 Second Quarter, our consolidated operating income was $166 million and our consolidated operating margin was 5.9%. Our consolidated operating income and consolidated operating margin for the 2015 Second Quarter were impacted by a net pre-tax gain of $2 million related to business divestitures, which are further discussed below. The net gain related to business divestitures is excluded from segment operating income because it is excluded by management for purposes of assessing segment operating performance. Our segment operating income was $164 million for the 2015 Second Quarter, a decrease of 31% from $239 million for the 2014 Second Quarter, and our segment operating income as a percentage of sales (segment operating margin) was 5.9% for the 2015 Second Quarter, a decrease of 200 basis points from 7.9% for the 2014 Second Quarter.

For the 2015 First Half, our consolidated operating income was $366 million and our consolidated operating margin was 6.6%. Our consolidated operating income and consolidated operating margin for the 2015 First Half were reduced by a pre-tax loss of $20 million related to business divestitures. Our segment operating income was $386 million for the 2015 First Half, a decrease of 26% from $525 million for the 2014 First Half, and our segment operating margin was 7.0% for the 2015 First Half, a decrease of 180 basis points from 8.8% for the 2014 First Half. See Results of Operations , including segment results below for a further discussion of operating margin.

The 2015 Second Quarter and 2015 First Half results were impacted by contract cost growth charges of $103 million ($64 million after income taxes), or $0.77 per diluted share, at the Platform Integration division in the Aerospace Systems segment, comprised of: (1) additional losses on international head-of-state aircraft modification contracts of $84 million ($52 million after income taxes), or $0.63 per diluted share, and (2) cost growth on three other aircraft modification contracts of $19 million ($12 million after income taxes), or $0.14 per diluted share. The additional losses on international head-of-state contracts resulted from higher estimated engineering, production and support labor, and material costs. The increased costs are primarily driven by additional delays in aircraft delivery caused by rework identified during the quarter as a result of internal program reviews, customer inspections, functional check flights and internal design reviews. During the quarter actions were taken to: (i) provide increased program management resources, (ii) improve engineering practices, (iii) in-source certain work previously expected to be performed by subcontractors to reduce future rework and help us manage to the updated schedule, (iv) improve assembly processes and (v) improve quality assurance processes. The cost growth on the three other aircraft modification contracts include $9 million ($6 million after income taxes), or $0.07 per diluted share, for additional software modifications and warranty obligations related to a foreign government C-130 aircraft modification contract.

Our effective management of labor, material, subcontractor and other direct costs is an important element of cost control and favorable contract performance. We believe that proactively re-sizing our businesses to their anticipated sales, combined with continuous cost improvement will enable us to increase our cost competitiveness. While we continue to undertake cost management actions, such as reducing our indirect costs, resizing select business units and improving our productivity and contract performance in an effort to maintain or even increase operating margin, these efforts may not be successful and may be partially or fully offset by other cost increases. Changes in the competitive environment and DoD procurement practices, reductions to the DoD budget, lower consolidated sales and changes in annual pension expense, including related assumptions such as the benefit obligation discount rates could result in lower operating margin. Furthermore, select business acquisitions and new business, including contract renewals and new contracts, could have lower future operating margins compared to L-3 s operating margins on existing contracts, and could reduce future consolidated and segment operating margins. We expect our 2015 annual consolidated operating margin to decrease as compared to 2014, primarily due to the items impacting the 2015 Second Quarter discussed above.

Reduced future consolidated and segment operating margins could also potentially trigger non-cash goodwill impairment charges depending on how these reductions impact each of our reporting units. In addition to the annual goodwill impairment assessment, we review goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount of a reporting unit s goodwill may not be recoverable. As such, listed below are certain circumstances, depending on their outcomes, that may require us to review goodwill for impairment for one or more of our reporting units prior to the next annual assessment (November 30, 2015):

- lower than expected annual sales from our contracts with the DoD, arising from unanticipated changes or reductions to future DoD budgets; and

- the ability of the reporting units, in particular NSS, to achieve: (1) 2015 projected sales, operating income and cash flow, and (2) the win-loss experience on 2015 contract re-competitions and new business pursuits.

For a further discussion regarding the valuation of our goodwill, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Table of Contents

Other Events

Business Acquisitions

CTC Aviation Group Acquisition. On May 27, 2015, we acquired CTC Aviation Group, renamed L-3 CTC Ltd. (L-3 CTC), for a purchase price of £153 million (approximately $236 million), which was financed with cash on hand. L-3 CTC is a global airline pilot training and crew resourcing specialist, based in the United Kingdom, that offers customized and innovative solutions to major airlines and flight training customers globally. This acquisition expands L-3 s commercial aviation training business, which also includes L-3 Link UK, a provider of world-class flight training simulation devices, aftermarket solutions and training, to encompass a growing portfolio of airline and third-party training company customers.

MITEQ, Inc. Acquisition. On January 21, 2015, we acquired the assets of MITEQ, Inc. (Miteq) for a purchase price of $41 million, which was financed with cash on hand. Miteq was combined with our Narda Microwave-East business and the new organization was re-named L-3 Narda-Miteq. Miteq offers a broad product line of active and passive radio frequency (RF) microwave components and low-power satellite communications (SATCOM) products for space and military applications that complement the existing Narda Microwave East product line. The combined L-3 Narda-Miteq business will provide products for the DoD, other U.S. Government agencies, prime contractors and commercial customers.

Business Divestitures

As previously disclosed on July 30, 2015, we have initiated a process to evaluate strategic alternatives for our NSS business. These strategic alternatives could include, among other possibilities, a potential sale, spin-off or other divestiture transactions for the business. We expect to conclude our review by the end of the year, although a timetable has not been set and there can be no assurances that a transaction will be completed. Furthermore, if a transaction should become probable, the value placed on the NSS business at that time may be lower than the carrying value of its net assets and could trigger a non-cash goodwill impairment charge.

During the 2015 Second Quarter, we completed the sales of MSI and Broadcast Sports Inc. (BSI). The adjustments recorded related to the business divestitures are included in the net gain (loss) related to business divestitures captions on the unaudited condensed consolidated statements of operations and are summarized and further discussed below.

	Second Quarter Ended June 26, 2015	First Half Ended June 26, 2015
	(in millions)	
Loss on BSI divestiture	$ (3)	$ (3)
Gain on MSI divestiture	4	4
Non-cash impairment charge related to MSI assets held for sale		(17)
Gain (loss) on a forward contract to sell Euro proceeds from MSI divestiture	1	(4)
Total gain (loss) related to the business divestitures	$ 2	$ (20)

MSI Divestiture. On May 29, 2015, we completed the sale of our MSI business to Wärtsilä Corporation for a preliminary purchase price of 295 million (approximately $318 million), in addition to the assumption by Wärtsilä Corporation of approximately 60 million of MSI employee pension-related liabilities. The purchase price is subject to finalization based on customary adjustments for closing date net working capital. MSI was a sector within our Electronic Systems segment, primarily selling to the commercial shipbuilding industry. In accordance with Accounting Standards Update (ASU) 2014-8, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity,* MSI s assets and liabilities are classified as held for sale in our audited consolidated balance sheet at December 31, 2014 and MSI s results of operations are included in income from continuing operations for all periods presented. See Note 4 to our unaudited condensed consolidated financial statements for the major assets and liabilities included in held for sale relating to MSI at December 31, 2014. During the 2015 Second Quarter, we recorded a realized pre-tax gain of $4 million ($8 million after income tax benefits, or $0.10 per diluted share) based on the total estimated proceeds from the sale.

The accounting standards for long-lived assets to be disposed of by sale require us to measure assets and liabilities of a disposal group, classified as held for sale, at the lower of its carrying amount or fair value less costs to sell, at the end of each reporting period. As a result of the decline in the estimated U.S. dollar equivalent divestiture proceeds due to the weakening of the Euro against the U.S. dollar, the carrying value of the MSI disposal group exceeded its fair value at March 27, 2015. Accordingly, a pre-tax non-cash impairment charge of $17 million ($12 million after income taxes, or $0.15 per diluted share) was recorded during the quarterly period ended March 27, 2015.

In March 2015, we entered into a forward contract to sell 285 million of the proceeds obtained from the divestiture of MSI at a rate of $1.0782. We accounted for this contract as an economic hedge and recorded a mark to market adjustment to earnings based on the fair value of the forward contract at March 27, 2015. Accordingly, we recorded an unrealized pre-tax loss of $5 million ($3 million after income taxes, or $0.03 per diluted share) during the quarterly period ended March 27, 2015. On May 29, 2015, upon settlement of the contract, we realized $4 million of the $5 million previously recorded pre-tax loss and recorded a $1 million pre-tax gain ($1 million after income taxes, or $0.01 per diluted share) in the 2015 Second Quarter.

BSI Divestiture. On April 24, 2015, we divested our BSI business for a sales price of $27 million, subject to customary adjustments. BSI is a provider of wireless technology and communications systems services for use in the field of sports television broadcasting, and was included in the Sensor Systems sector of the Electronic Systems segment. The divestiture resulted in a pre-tax loss of $3 million ($6 million after income taxes, or $0.08 per diluted share). In accordance with ASU 2014-08, BSI s assets and liabilities as of December 31, 2014, and results of operations for all periods presented are classified as held and used in the condensed consolidated financial statements.

Business Acquisitions and Dispositions

Our Annual Report on Form 10-K summarizes the business acquisitions and dispositions that we completed during the three years ended December 31, 2014. Business acquisitions are included in our consolidated results of operations from their dates of acquisition. See Note 4 to our unaudited condensed consolidated financial statements contained in this quarterly report for a further discussion of our business acquisitions and dispositions during the 2015 First Half.

Results of Operations

The following information should be read in conjunction with our unaudited condensed consolidated financial statements contained in this quarterly report. Our results of operations for the periods presented are affected by our business acquisitions and divestitures.

Table of Contents

Consolidated Results of Operations

The table below provides L-3 s selected financial data for the 2015 Second Quarter compared with the 2014 Second Quarter and the 2015 First Half compared to the 2014 First Half.

	Second Quarter Ended			First Half Ended		
(in millions, except per share data)	**June 26, 2015**	**June 27, 2014**	**Increase/ (decrease)**	**June 26, 2015**	**June 27, 2014**	**Increase/ (decrease)**
Net sales	$ 2,793	$ 3,019	(7)%	$ 5,506	$ 5,976	(8)%
Operating income	$ 166	$ 239	(31)%	$ 366	$ 525	(30)%
Segment operating income	$ 164	$ 239	(31)%	$ 386	$ 525	(26)%
Operating margin	5.9%	7.9%	(200) bpts	6.6%	8.8%	(220) bpts
Segment operating margin	5.9%	7.9%	(200) bpts	7.0%	8.8%	(180) bpts
Interest expense	$ 48	$ 39	23%	$ 92	$ 82	12%
Interest and other income, net	$ 5	$ 4	25%	$ 8	$ 9	(11)%
Effective income tax rate	(0.8)%	30.9%	nm	17.4%	30.8%	nm
Net income attributable to L-3	$ 120	$ 137	(12)%	$ 225	$ 307	(27)%
Adjusted net income attributable to L-3[(1)]	$ 117	$ 137	(15)%	$ 237	$ 307	(23)%
Diluted earnings per share	$ 1.44	$ 1.53	(6)%	$ 2.69	$ 3.43	(22)%
Adjusted diluted earnings per share[(1)]	$ 1.41	$ 1.53	(8)%	$ 2.84	$ 3.43	(17)%
Diluted weighted average common shares outstanding	83.2	89.3	(7)%	83.5	89.4	(7)%

nm not meaningful

(1) Non-GAAP metric that excludes the aggregate gain or loss related to business divestitures. See the table on page 48 for a reconciliation of this measure, and a discussion of why we are presenting this information.

Net Sales: For the 2015 Second Quarter, consolidated net sales of $2.8 billion decreased $226 million, or 7%, compared to the 2014 Second Quarter. Sales to the U.S. Government declined 6%, or $129 million, to $2,042 million in the 2015 Second Quarter, compared to $2,171 million in the 2014 Second Quarter, driven primarily by the U.S. military drawdown in Afghanistan and U.S. defense budget reductions. Sales to international and commercial customers, declined 11%, or $97 million, to $751 million in the 2015 Second Quarter, compared to $848 million in the 2014 Second Quarter driven by: (1) a $61 million decline related to the MSI and BSI business divestitures, partially offset by $23 million of sales from the L-3 CTC and Miteq business acquisitions, (2) a $46 million decline on international head-of-state aircraft modification contracts primarily due to unfavorable contract performance adjustments and (3) a $33 million decline due to foreign currency exchange rate changes. These decreases were partially offset by an increase of $20 million primarily due to higher volume for small ISR aircraft systems to a foreign government.

Sales from products decreased by $96 million to $1,602 million for the 2015 Second Quarter, compared to $1,698 million for the 2014 Second Quarter. Sales from products represented approximately 57% of consolidated net sales for the 2015 Second Quarter, compared to 56% for the 2014 Second Quarter. Sales from products declined by: (1) $83 million for Aircraft Systems due primarily to unfavorable contract performance adjustments on international head-of-state aircraft modification contracts and lower volume to the U.S. Air Force (USAF) from the DoD s planned reduction of the Compass Call aircraft fleet and the DoD s retirement of the Joint Cargo Aircraft (JCA), (2) $42 million related to the divestiture of MSI in the 2015 Second Quarter, (3) $31 million for Space & Power Systems due to reduced demand for power devices for commercial satellites and for satellite command and control software for U.S. Government agencies and (4) $26 million related to foreign currency exchange rate changes. These decreases were partially offset by an increase in sales of $56 million for large ISR aircraft systems for U.S. Government customers and small ISR aircraft systems to the DoD and a foreign government and an increase in sales of $30 million primarily for Broadband Communication systems and the Miteq business acquisition.

Table of Contents

Sales from services decreased by $130 million to $1,191 million for the 2015 Second Quarter, compared to $1,321 million for the 2014 Second Quarter. Sales from services represented approximately 43% of consolidated net sales for the 2015 Second Quarter, compared to 44% for the 2014 Second Quarter. Sales from services declined by: (1) $62 million for NSS, primarily related to reduced tasking for technical support services for a U.S. Government agency due to defense budget reductions, and lower demand for intelligence support services driven by the U.S. military drawdown in Afghanistan and completed contracts, (2) $36 million related to lower volume for small ISR aircraft fleet management services to the DoD due to the U.S. military drawdown in Afghanistan and (3) $19 million related to the MSI and BSI business divestitures. The remaining decrease in sales of $13 million was primarily due to foreign currency exchange rate changes. See the reportable segment results below for additional discussion of our segment sales trends.

For the 2015 First Half, consolidated net sales of $5.5 billion decreased $470 million, or 8%, compared to the 2014 First Half. Sales to the U.S. Government, including $5 million of sales from acquired businesses, declined 8%, or $337 million, to $3,941 million in the 2015 First Half compared to $4,278 million in the 2014 First Half, driven primarily by the U.S. military drawdown in Afghanistan and U.S. defense budget reductions. Sales to international and commercial customers declined 8%, or $133 million, to $1,565 million in the 2015 First Half, compared to $1,698 million in the 2014 First Half driven by: (1) a $67 million decline due to foreign currency exchange rate changes, (2) a $62 million decline primarily relating to the MSI and BSI business divestitures, partially offset by $34 million of sales from L-3 CTC and Miteq business acquisitions and (3) a $59 million decline on international head-of-state aircraft modification contracts primarily due to unfavorable contract performance adjustments. These decreases were partially offset by an increase of $21 million primarily due to higher volume for small ISR aircraft systems to a foreign government.

Sales from products decreased by $198 million to $3,149 million for the 2015 First Half, compared to $3,347 million for the 2014 First Half. Sales from products represented approximately 57% of consolidated net sales for the 2015 First Half, compared to 56% for the 2014 First Half. Sales from products declined by: (1) $107 million for Aircraft Systems due primarily to unfavorable contract performance adjustments on international head-of-state aircraft modification contracts and lower volume to the USAF from the DoD s planned reduction of the Compass Call aircraft fleet and the DoD s retirement of the JCA, (2) $52 million related to foreign currency exchange rate changes, (3) $49 million for Space & Power Systems due to lower volume and reduced deliveries on lower demand for satellite command and control software for U.S. Government agencies, power devices for commercial satellites and high frequency radios for a foreign government, (4) $42 million related to the divestiture of MSI in the 2015 Second Quarter and (5) $22 million for Warrior Systems due to temporarily suspended shipments of holographic weapon sights in connection with a product specification matter and lower volume for night vision goggles and precision targeting equipment. These decreases were partially offset by an increase of $74 million primarily for large ISR aircraft systems for U.S. Government customers and small ISR aircraft systems to the DoD and a foreign government.

Sales from services decreased by $272 million to $2,357 million for the 2015 First Half, compared to $2,629 million for the 2014 First Half. Sales from services represented approximately 43% of consolidated net sales for the 2015 First Half, compared to 44% for the 2014 First Half. Sales from services declined by: (1) $127 million for NSS, primarily related to reduced tasking for technical support services for a U.S. Government agency due to defense budget reductions, and lower demand for intelligence support services driven by the U.S. military drawdown in Afghanistan and completed contracts, (2) $82 million related to lower volume for small ISR aircraft fleet management services to the DoD due to the U.S. military drawdown in Afghanistan, (3) $30 million related to lower volume for field maintenance and sustainment services, primarily for USAF and U.S. Navy training aircraft due to lower demand and lower prices due to competitive pressures and (4) $19 million related to the MSI and BSI business divestitures. The remaining decrease in sales of $14 million was primarily due to foreign currency exchange rate changes. See the reportable segment results below for additional discussion of our segment sales trends.

Table of Contents

Operating income and operating margin: Consolidated operating income for the 2015 Second Quarter decreased $73 million, or 31%, compared to the 2014 Second Quarter. Segment operating income for the 2015 Second Quarter decreased by $75 million, or 31%, compared to the 2014 Second Quarter. Segment operating margin decreased by 200 basis points to 5.9% for the 2015 Second Quarter compared to 7.9% for the 2014 Second Quarter. Segment operating margin decreased by: (1) 210 basis points due to unfavorable contract performance adjustments at Aerospace Systems segment, (2) 50 basis points due to higher pension expense of $14 million and (3) 30 basis points related to a product specification matter in the Electronics Systems segment. These decreases were partially offset by improved contract performance in Communication Systems and Electronic Systems, which increased segment operating margin by 90 basis points. See the reportable segment results below for additional discussion of operating margin trends.

Consolidated operating income for the 2015 First Half decreased $159 million, or 30%, compared to the 2014 First Half. Segment operating income for the 2015 First Half decreased by $139 million, or 26%, compared to the 2014 First Half. Segment operating margin decreased by 180 basis points to 7.0% for the 2015 First Half compared to 8.8% for the 2014 First Half. Segment operating margin decreased by: (1) 120 basis points due to unfavorable contract performance adjustments at Aerospace Systems segment, (2) 50 basis points due to higher pension expense of $28 million, (3) 30 basis points due to lower sales and mix changes and (4) 20 basis points related to a product specification matter. Improved contract performance in Communication Systems and Electronic Systems increased segment operating margin by 40 basis points. See the reportable segment results below for additional discussion of operating margin trends.

Interest Expense: Interest expense in the 2015 Second Quarter increased by $9 million compared to the 2014 Second Quarter due to: (1) the issuance of $1 billion in new debt on May 28, 2014 and (2) the redemption of our 3% Convertible Contingent Debt Securities in June 2014, which resulted in a $3 million reversal of previously accrued interest expense during the 2014 Second Quarter.

Interest expense in the 2015 First Half increased by $10 million compared to the 2014 First Half due to the issuance of $1 billion in new debt on May 28, 2014.

Effective income tax rate: The effective income tax rate for the 2015 Second Quarter was a benefit of 0.8% compared to a provision of 30.9% for the same period last year. The 2015 Second Quarter tax benefit included: (1) $17 million of foreign tax benefits related to a legal restructuring of our foreign entities, (2) a $10 million benefit related to the resolution of various outstanding income tax matters with U.S. and foreign tax authorities and (3) $9 million related to deferred tax benefits.

The effective income tax rate for the 2015 First Half decreased to 17.4% from 30.8% for the same period last year primarily due to $36 million of tax benefits in the 2015 Second Quarter, which are discussed above.

Net income attributable to L-3 and diluted earnings per share (EPS): Net income attributable to L-3 in the 2015 Second Quarter decreased 12% to $120 million compared to the 2014 Second Quarter, and diluted EPS decreased 6% to $1.44 from $1.53. Net income attributable to L-3 and diluted EPS were affected by the factors discussed herein.

Net income attributable to L-3 in the 2015 First Half decreased 27% to $225 million compared to the 2014 First Half, and diluted EPS decreased 22% to $2.69 from $3.43. Net income attributable to L-3 and diluted EPS were affected by the factors discussed herein.

Adjusted net income attributable to L-3 and adjusted diluted EPS: Adjusted net income attributable to L-3 decreased 15% to $117 million compared to the 2014 Second Quarter, and adjusted diluted EPS decreased 8% to $1.41. Adjusted net income attributable to L-3 and adjusted diluted EPS were affected by the factors discussed herein.

Table of Contents

Adjusted net income attributable to L-3 decreased 23% to $237 million compared to the 2014 First Half, and adjusted diluted EPS decreased 17% to $2.84. Adjusted net income attributable to L-3 and adjusted diluted EPS were affected by the factors discussed herein.

The table below presents a reconciliation of net income attributable to L-3 to adjusted net income attributable to L-3 and diluted EPS to adjusted diluted EPS.

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
Net income attributable to L-3	$ 120	$ 137	$ 225	$ 307
Net gain on business divestitures	(2)		(2)	
Non-cash impairment charge related to MSI assets held for sale			12	
(Gain) loss on a forward contract to sell Euro proceeds from the MSI divestiture	(1)		2	
Adjusted net income attributable to L-3[1]	$ 117	$ 137	$ 237	$ 307
Diluted EPS attributable to L-3 Holdings common stockholders	$ 1.44	$ 1.53	$ 2.69	$ 3.43
EPS impact of net gain on business divestitures[A]	(0.02)		(0.02)	
EPS impact of the non-cash impairment charge related to MSI assets held for sale[B]			0.15	
EPS impact of the gain (loss) on a forward contract to sell Euro proceeds from the MSI divestiture[C]	(0.01)		0.02	
Adjusted diluted EPS[1]	$ 1.41	$ 1.53	$ 2.84	$ 3.43
(A) Net gain on business divestitures	$ 1	$	$ 1	$
Tax benefit	1		1	
After-tax impact	2		2	
Diluted weighted average common shares outstanding	83.2		83.5	
Per share impact	$ 0.02	$	$ 0.02	$
(B) Non-cash impairment charge related to MSI assets held for sale	$	$	$ (17)	$
Tax benefit			5	
After-tax impact			(12)	
Diluted weighted average common shares outstanding			83.5	
Per share impact[2]	$	$	$ (0.15)	$
(C) Gain (loss) on a forward contract to sell Euro proceeds from the MSI divestiture	$ 1	$	$ (4)	$

Tax benefit				2	
After-tax impact		1		(2)	
Diluted weighted average common shares outstanding		83.2		83.5	
Per share impact	$	0.01	$	$ (0.02)	$

(1) Adjusteddiluted EPS is diluted EPS attributable to L-3 Holdings common stockholders, excluding the charges or credits relating to business divestitures. Adjusted net income attributable to L-3 is net income attributable to L-3, excluding the charges or credits relating to business divestitures. These amounts are not measures of financial performance under accounting principles generally accepted in the United States of America (U.S. GAAP). We believe that the charges or credits relating to business divestitures affect the comparability of the results of operations for 2015 to the results of operations for 2014. We also believe that disclosing net income and diluted EPS excluding the charges or credits relating to business divestitures will allow investors to more easily compare the 2015 results to the 2014 results. However, these measures may not be defined or calculated by other companies in the same manner.

(2) Amounts may not recalculate directly due to rounding.

48

Table of Contents

Diluted weighted average common shares outstanding: Diluted weighted average common shares outstanding for the 2015 Second Quarter and 2015 First Half declined by 7% compared to the same periods last year. The decline was due to repurchases of L-3 common stock in connection with our share repurchase programs authorized by our Board of Directors.

Reportable Segment Results of Operations

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

	Second Quarter Ended		First Half Ended	
	June 26, 2015	June 27, 2014	June 26, 2015	June 27, 2014
	(dollars in millions)			
Net sales:[1]				
Electronic Systems	$ 1,036	$ 1,103	$ 2,045	$ 2,180
Aerospace Systems	995	1,061	2,021	2,134
Communication Systems	501	520	936	1,023
NSS	261	335	504	639
Consolidated net sales	$ 2,793	$ 3,019	$ 5,506	$ 5,976
Operating income (loss):				
Electronic Systems	$ 119	$ 133	$ 233	$ 258
Aerospace Systems	(17)	39	45	132
Communication Systems	52	48	87	98
NSS	10	19	21	37
Total segment operating income	$ 164	$ 239	$ 386	$ 525
Gain (loss) related to business divestitures	2		(20)	
Consolidated operating income	$ 166	$ 239	$ 366	$ 525
Operating margin:				
Electronic Systems	11.5%	12.1%	11.4%	11.8%
Aerospace Systems	(1.7)%	3.7%	2.2%	6.2%
Communication Systems	10.4%	9.2%	9.3%	9.6%
NSS	3.8%	5.7%	4.2%	5.8%
Total segment operating margin	5.9%	7.9%	7.0%	8.8%
Gain (loss) related to business divestitures			(0.4)%	
Consolidated operating margin	5.9%	7.9%	6.6%	8.8%

(1) Net sales after intercompany eliminations.

Electronic Systems

	Second Quarter Ended			First Half Ended		
	June 26, 2015	June 27, 2014	Decrease	June 26, 2015	June 27, 2014	Decrease
(dollars in millions)						
Net sales	$ 1,036	$ 1,103	(6.1)%	$ 2,045	$ 2,180	(6.2)%
Operating income	$ 119	$ 133	(10.5)%	$ 233	$ 258	(9.7)%
Operating margin	11.5%	12.1%	(60) bpts	11.4%	11.8%	(40) bpts

Electronic Systems net sales for the 2015 Second Quarter decreased by $67 million, or 6%, compared to the 2014 Second Quarter. Sales declined by: (1) $61 million related to the MSI and BSI business divestitures,

Table of Contents

partially offset by $7 million of sales related to the L-3 CTC acquisition, (2) $28 million due to foreign currency exchange rate changes and (3) $10 million due to temporarily suspending shipments of holographic weapon sights for most of the 2015 Second Quarter in connection with a product specification matter. These decreases were partially offset by an increase of $25 million primarily for Aviation Products & Security Systems driven by timing of shipments of airport security system products to international customers and the U.S. Transportation Security Administration.

Electronic Systems operating income for the 2015 Second Quarter decreased by $14 million, or 11%, compared to the 2014 Second Quarter. Operating margin decreased by 60 basis points to 11.5%. Operating margin decreased by: (1) 80 basis points due to an increased provision of $8 million in anticipation of a settlement with the U.S. Government related to a product specification matter regarding our holographic weapon sight product in the Warrior Systems sector, (2) 70 basis points for sales mix changes, (3) 60 basis points due to a $6 million charge related to an adverse arbitration ruling to resolve a dispute for the termination of a supply arrangement in the Aviation Products & Security business and (4) 30 basis points due to higher pension expense of $3 million. These decreases were partially offset by 100 basis points for favorable contract performance adjustments and 80 basis points due to lower severance expense of $8 million. Severance expense for the 2015 Second Quarter was $2 million, compared to $10 million for the 2014 Second Quarter.

Electronic Systems net sales for the 2015 First Half decreased by $135 million, or 6%, compared to the 2014 First Half. Sales declined by: (1) $62 million primarily related to the MSI and BSI business divestitures, partially offset by $7 million of sales related to the L-3 CTC acquisition and (2) $58 million due to foreign currency exchange rate changes. The remaining decrease of $22 million is primarily due to reduced sales at Warrior Systems. This decline is due to temporarily suspended shipments of holographic weapon sights for most of the 2015 Second Quarter in connection with a product specification matter and lower volume for night vision goggles and precision targeting equipment.

Electronic Systems operating income for the 2015 First Half decreased by $25 million, or 10%, compared to the 2014 First Half. Operating margin decreased by 40 basis points to 11.4% due to trends similar to the 2015 Second Quarter, as well as higher pension expense of $6 million.

Aerospace Systems

	Second Quarter Ended			**First Half Ended**		
	June 26, 2015	**June 27, 2014**	**Decrease**	**June 26, 2015**	**June 27, 2014**	**Decrease**
(dollars in millions)						
Net sales	$ 995	$ 1,061	(6.2)%	$ 2,021	$ 2,134	(5.3)%
Operating (loss) income	$ (17)	$ 39	nm	$ 45	$ 132	(65.9)%
Operating margin	(1.7)%	3.7%	(540) bpts	2.2%	6.2%	(400) bpts

nm not meaningful

Aerospace Systems net sales for the 2015 Second Quarter decreased by $66 million, or 6%, compared to the 2014 Second Quarter. Sales decreased $83 million for Aircraft Systems and $3 million for Logistics Solutions. Sales for ISR Systems increased by $20 million. Sales decreased for Aircraft Systems due to lower volume of: (1) $46 million on international head-of-state aircraft modification contracts primarily due to unfavorable contract performance adjustments and (2) $37 million primarily to the USAF from the DoD s planned reduction of the Compass Call aircraft fleet and the DoD s retirement of the JCA. The decrease in sales for Logistics Solutions was due to lower volume for field maintenance and sustainment services, primarily for USAF and U.S. Navy training aircraft because of lower demand and lower prices due to competitive pressures, mostly offset by higher volume on the Army C-12 contract. The increase in ISR Systems was due to an increase in sales of $56 million on higher volume for large ISR aircraft systems for U.S. Government customers and small ISR aircraft

Table of Contents

systems to the DoD and a foreign government, partially offset by $36 million of lower sales for small ISR aircraft fleet management services primarily to the DoD due to the U.S. military drawdown in Afghanistan.

Aerospace Systems operating income for the 2015 Second Quarter decreased by $56 million compared to the 2014 Second Quarter. Operating margin decreased by 540 basis points to a negative 1.7%. Operating margin decreased by: (1) 740 basis points due to contract performance adjustments at Aircraft Systems, which includes $84 million of cost growth related to international head-of-state aircraft modification contracts, compared to $11 million of cost growth on the same contracts in the 2014 Second Quarter, (2) 70 basis points due to higher pension expense of $7 million and (3) 40 basis points primarily due to reduced flight hours and lower pricing due to competitive pressures at Logistics Solutions, including the U.S Navy T-45 contract, partially offset by cost improvements on the Army C-12 contract. These decreases were partially offset by: (1) 170 basis points due to a $17 million increase in reserves for excess and obsolete inventory at Logistics Solutions recorded during the 2014 Second Quarter that did not recur and (2) 140 basis points due to favorable contract performance adjustments at ISR Systems.

Aerospace Systems net sales for the 2015 First Half decreased by $113 million, or 5%, compared to the 2014 First Half. Sales decreased $107 million for Aircraft Systems and $31 million for Logistic Solutions. Sales for ISR Systems increased by $25 million. Sales decreased for Aircraft Systems due to lower volume of: (1) $59 million on international head-of-state aircraft modification contracts primarily due to unfavorable contract performance adjustments and (2) $48 million primarily to the USAF from the DoD s planned reduction of the Compass Call aircraft fleet and the DoD s retirement of the JCA. The decrease in sales for Logistics Solutions was due to lower volume for field maintenance and sustainment services, primarily for USAF and U.S. Navy training aircraft due to lower demand and lower prices due to competitive pressures, partially offset by higher volume on the Army C-12 contract. The increase in ISR Systems was due to an increase in sales of $107 million primarily on higher volume for large ISR aircraft systems for U.S. Government customers and small ISR aircraft systems to the DoD and a foreign government, partially offset by $82 million of lower sales for small ISR aircraft fleet management services to the DoD due to the U.S. military drawdown in Afghanistan.

Aerospace Systems operating income for the 2015 First Half decreased by $87 million, or 66%, compared to the 2014 First Half. Operating margin decreased by 400 basis points to 2.2%. Operating margin decreased by: (1) 480 basis points due to contract performance adjustments at Aircraft Systems, which includes $101 million of cost growth on international head-of-state aircraft modification contracts, compared to $11 million of cost growth on the same contracts in the 2014 First Half, (2) 80 basis points primarily due to reduced flight hours and lower pricing due to competitive pressures at Logistics Solutions, including the U.S Navy T-45 contract, partially offset by cost improvements on the Army C-12 contract and (3) 70 basis points due to higher pension expense of $13 million. These decreases were partially offset by 150 basis points due to favorable contract performance adjustments at ISR Systems and by 80 basis points due to a $17 million increase in reserves for excess and obsolete inventory at Logistics Solutions recorded during the 2014 First Half that did not recur.

Communication Systems

	Second Quarter Ended			First Half Ended		
	June 26, 2015	**June 27, 2014**	**Increase (Decrease)**	**June 26, 2015**	**June 27, 2014**	**Decrease**
(dollars in millions)						
Net sales	$ 501	$ 520	(3.7)%	$ 936	$ 1,023	(8.5)%
Operating income	$ 52	$ 48	8.3%	$ 87	$ 98	(11.2)%

Operating margin	10.4%	9.2%	120 bpts	9.3%	9.6%	(30) bpts

Communication Systems net sales for the 2015 Second Quarter decreased by $19 million, or 4%, compared to the 2014 Second Quarter. Sales decreased $31 million for Space & Power Systems, due to reduced demand for power devices for commercial satellites and for satellite command and control software from U.S. Government agencies. Sales also decreased $14 million for Advanced Communications products, due to lower volume for data recorders and secure communications equipment for the U.S. military as contracts near completion and $12 million for Tactical Satellite Communications products due to reduced deliveries of mobile and ground-based satellite communication systems for the U.S. military. These decreases were partially offset by increases of: (1) $22 million for Broadband Communication Systems primarily due to increased deliveries of remote video terminals to the United States Special Operations Command and higher demand for engineering support services for the DoD and (2) $16 million related to the Miteq acquisition.

Communication Systems operating income for the 2015 Second Quarter increased by $4 million, or 8%, compared to the 2014 Second Quarter. Operating margin increased by 120 basis points to 10.4%. Improved contract performance, partially offset by lower sales and mix changes, increased operating margin by 200 basis points. Higher pension expense of $4 million decreased operating margin by 80 basis points.

Communication Systems net sales for the 2015 First Half decreased by $87 million, or 9%, compared to the 2014 First Half due to lower volume and reduced deliveries on lower demand. Sales decreased: (1) $49 million for Space & Power Systems, primarily satellite command and control software for U.S. Government agencies, power devices for commercial satellites and high frequency radios for a foreign government, (2) $33 million for Tactical Satellite Communications products, primarily mobile and ground-based satellite communication systems for the U.S. military and (3) $32 million primarily for Advanced Communications products, primarily data recorders and secure communications equipment for the U.S. military as contracts near completion. The Miteq acquisition increased sales by $27 million.

Communication Systems operating income for the 2015 First Half decreased by $11 million, or 11%, compared to the 2014 First Half. Operating margin decreased by 30 basis points to 9.3%. Operating margin decreased by 100 basis points due to higher pension expense of $9 million. Improved contract performance, partially offset by lower sales and mix changes, increased operating margin by 70 basis points.

NSS

	Second Quarter Ended			**First Half Ended**		
	June 26, 2015	**June 27, 2014**	**Decrease**	**June 26, 2015**	**June 27, 2014**	**Decrease**
(dollars in millions)						
Net sales	$ 261	$ 335	(22.1)%	$ 504	$ 639	(21.1)%
Operating income	$ 10	$ 19	(47.4)%	$		