HUNTINGTON INGALLS INDUSTRIES, INC.
Form 10-Q
August 02, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-34910

HUNTINGTON INGALLS INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	90-0607005
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4101 Washington Avenue, Newport News, Virginia 23607
(Address of principal executive offices and zip code)
(757) 380-2000
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its 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 registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

As of July 27, 2018, 43,318,382 shares of the registrant's common stock were outstanding.

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HUNTINGTON INGALLS INDUSTRIES, INC.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

	Three Months Ended June 30		Six Months Ended June 30	
(in millions, except per share amounts)	2018	2017	2018	2017
Sales and service revenues				
Product sales	$1,499	$1,397	$2,869	$2,697
Service revenues	521	461	1,025	885
Sales and service revenues	2,020	1,858	3,894	3,582
Cost of sales and service revenues				
Cost of product sales	1,147	1,061	2,210	2,088
Cost of service revenues	421	375	853	728
Income (loss) from operating investments, net	2	1	4	3
Other income and gains	12	—	14	—
General and administrative expenses	209	182	401	360
Operating income (loss)	257	241	448	409
Other income (expense)				
Interest expense	(15)	(17)	(30)	(35)
Non-operating retirement expense	19	(4)	37	(8)
Other, net	1	(2)	2	(1)
Earnings (loss) before income taxes	262	218	457	365
Federal and foreign income taxes	23	71	62	99
Net earnings (loss)	$239	$147	$395	$266
Basic earnings (loss) per share	$5.41	$3.22	$8.88	$5.78
Weighted-average common shares outstanding	44.2	45.7	44.5	46.0
Diluted earnings (loss) per share	$5.40	$3.21	$8.86	$5.77
Weighted-average diluted shares outstanding	44.3	45.8	44.6	46.1
Dividends declared per share	$0.72	$0.60	$1.44	$1.20
Net earnings (loss) from above	$239	$147	$395	$266
Other comprehensive income (loss)				
Change in unamortized benefit plan costs	21	23	41	45
Other	(2)	3	(2)	7
Tax benefit (expense) for items of other comprehensive income	(6)	(10)	(11)	(20)
Other comprehensive income (loss), net of tax	13	16	28	32
Comprehensive income (loss)	$252	$163	$423	$298

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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HUNTINGTON INGALLS INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

($ in millions)	June 30 2018	December 31 2017
Assets		
Current Assets		
Cash and cash equivalents	$398	$ 701
Accounts receivable, net of allowance for doubtful accounts of $13 million as of each of 2018 and 2017	364	429
Contract assets	1,078	759
Inventoried costs, net	174	183
Prepaid expenses and other current assets	138	123
Total current assets	2,152	2,195
Property, plant, and equipment, net of accumulated depreciation of $1,775 million as of 2018 and $1,770 million as of 2017	2,258	2,215
Goodwill	1,217	1,217
Other intangible assets, net of accumulated amortization of $546 million as of 2018 and $528 million as of 2017	490	508
Deferred tax assets	92	114
Miscellaneous other assets	166	125
Total assets	$6,375	$ 6,374
Liabilities and Stockholders' Equity		
Current Liabilities		
Trade accounts payable	$378	$ 375
Accrued employees’ compensation	252	245
Current portion of postretirement plan liabilities	139	139
Current portion of workers’ compensation liabilities	253	250
Contract liabilities	210	146
Other current liabilities	277	236
Total current liabilities	1,509	1,391
Long-term debt	1,281	1,279
Pension plan liabilities	836	922
Other postretirement plan liabilities	414	414
Workers’ compensation liabilities	506	509
Other long-term liabilities	130	101
Total liabilities	4,676	4,616
Commitments and Contingencies (Note 15)		
Stockholders’ Equity		
Common stock, $0.01 par value; 150 million shares authorized; 53.1 million shares issued and 43.5 million shares outstanding as of June 30, 2018, and 53.0 million shares issued and 45.1 million shares outstanding as of December 31, 2017	1	1
Additional paid-in capital	1,932	1,942
Retained earnings (deficit)	2,236	1,687
Treasury stock	(1,385)	(972)
Accumulated other comprehensive income (loss)	(1,085)	(900)
Total stockholders’ equity	1,699	1,758
Total liabilities and stockholders’ equity	$6,375	$ 6,374

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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HUNTINGTON INGALLS INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30	
($ in millions)	2018	2017
Operating Activities		
Net earnings (loss)	$395	$266
Adjustments to reconcile to net cash provided by (used in) operating activities		
Depreciation	85	82
Amortization of purchased intangibles	18	20
Amortization of debt issuance costs	2	3
Provision for doubtful accounts	—	22
Stock-based compensation	15	20
Deferred income taxes	11	28
Change in		
Contract balances	(184)	(132)
Inventoried costs	9	5
Prepaid expenses and other assets	(17)	(1)
Accounts payable and accruals	78	(2)
Retiree benefits	(56)	(27)
Other non-cash transactions, net	3	—
Net cash provided by (used in) operating activities	359	284
Investing Activities		
Capital expenditures		
Capital expenditure additions	(177)	(137)
Grant proceeds for capital expenditures	19	—
Acquisitions of businesses, net of cash received	—	3
Investment in affiliates	(10)	—
Proceeds from disposition of assets	3	1
Net cash provided by (used in) investing activities	(165)	(133)
Financing Activities		
Dividends paid	(64)	(55)
Repurchases of common stock	(408)	(207)
Employee taxes on certain share-based payment arrangements	(25)	(56)
Net cash provided by (used in) financing activities	(497)	(318)
Change in cash and cash equivalents	(303)	(167)
Cash and cash equivalents, beginning of period	701	720
Cash and cash equivalents, end of period	$398	$553
Supplemental Cash Flow Disclosure		
Cash paid for income taxes	$21	$100
Cash paid for interest	$31	$36
Non-Cash Investing and Financing Activities		
Capital expenditures accrued in accounts payable	$7	$3

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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HUNTINGTON INGALLS INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)

Six Months Ended June 30, 2018 and 2017 ($ in millions)	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance as of December 31, 2016	$ 1	$ 1,964	$ 1,323	$ (684)	$ (951)	$ 1,653
Net earnings (loss)	—	—	266	—	—	266
Dividends declared ($1.20 per share)	—	—	(55)	—	—	(55)
Additional paid-in capital	—	(36)	—	—	—	(36)
Other comprehensive income (loss), net of tax	—	—	—	—	32	32
Treasury stock activity	—	—	—	(210)	—	(210)
Balance as of June 30, 2017	$ 1	$ 1,928	$ 1,534	$ (894)	$ (919)	$ 1,650
Balance as of December 31, 2017	$ 1	$ 1,942	$ 1,687	$ (972)	$ (900)	$ 1,758
Net earnings (loss)	—	—	395	—	—	395
Dividends declared ($1.44 per share)	—	—	(64)	—	—	(64)
Additional paid-in capital	—	(10)	—	—	—	(10)
Other comprehensive income (loss), net of tax	—	—	—	—	28	28
Treasury stock activity	—	—	—	(413)	—	(413)
Effect of Accounting Standards Update 2014-09	—	—	5	—	—	5
Effect of Accounting Standards Update 2016-01	—	—	11	—	(11)	—
Effect of Accounting Standards Update 2018-02	—	—	202	—	(202)	—
Balance as of June 30, 2018	$ 1	$ 1,932	$ 2,236	$ (1,385)	$ (1,085)	$ 1,699

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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HUNTINGTON INGALLS INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. DESCRIPTION OF BUSINESS

Huntington Ingalls Industries, Inc. ("HII" or the "Company") is one of America's largest military shipbuilding companies and a provider of professional services to partners in government and industry. HII is organized into three reportable segments: Ingalls Shipbuilding ("Ingalls"), Newport News Shipbuilding ("Newport News"), and Technical Solutions. For more than a century, the Company's Ingalls segment in Mississippi and Newport News segment in Virginia have built more ships in more ship classes than any other U.S. naval shipbuilder. The Technical Solutions segment provides a range of services to the governmental, energy, and oil and gas markets.

HII conducts most of its business with the U.S. Government, principally the Department of Defense ("DoD"). As prime contractor, principal subcontractor, team member, or partner, the Company participates in many high-priority U.S. defense technology programs. Through its Ingalls segment, HII is a builder of amphibious assault and expeditionary ships for the U.S. Navy, the sole builder of National Security Cutters for the U.S. Coast Guard, and one of only two companies that builds the Navy's current fleet of Arleigh Burke class (DDG 51) destroyers. Through its Newport News segment, HII is the nation's sole designer, builder, and refueler of nuclear-powered aircraft carriers, and one of only two companies currently designing and building nuclear-powered submarines for the U.S. Navy. The Technical Solutions segment provides a wide range of professional services, including fleet support, integrated mission solutions, nuclear and environmental, and oil and gas services.

2. BASIS OF PRESENTATION

Principles of Consolidation - The unaudited condensed consolidated financial statements of HII and its subsidiaries have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and the instructions to Form 10-Q promulgated by the Securities and Exchange Commission ("SEC"). All intercompany transactions and balances are eliminated in consolidation. For classification of current assets and liabilities related to its long-term production contracts, the Company uses the duration of these contracts as its operating cycle, which is generally longer than one year. Additionally, certain prior year amounts have been reclassified to conform to the current year presentation. See Note 3: Accounting Standards Updates.

These unaudited condensed consolidated financial statements include all adjustments of a normal recurring nature considered necessary by management for a fair presentation of the unaudited condensed consolidated financial position, results of operations, and cash flows and should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The quarterly information is labeled using a calendar convention; that is, first quarter is consistently labeled as ending on March 31, second quarter as ending on June 30, and third quarter as ending on September 30. It is management's long-standing practice to establish interim closing dates using a "fiscal" calendar, which requires the businesses to close their books on a Friday near these quarter-end dates in order to normalize the potentially disruptive effects of quarterly closings on business processes. The effects of this practice only exist for interim periods within a reporting year.

Accounting Estimates - The preparation of the Company's unaudited condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared on the basis of the most current and best available information, and actual results could differ materially from those estimates.

In August 2011, the Budget Control Act established limits on U.S. Government discretionary spending and provided for potential sequestration cuts to defense spending and non-defense discretionary spending. The Bipartisan Budget Act of 2018 (the "BBA 2018") provided sequestration relief for fiscal years 2018 and 2019. Sequestration remains in effect for fiscal years 2020 and 2021 and could result in significant decreases in DoD spending that could negatively impact the Company's consolidated financial position, results of operations, or cash flows, as well as its estimated recovery of goodwill and other long-lived assets.

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Revenue Recognition - Effective January 1, 2018, the Company adopted the requirements of Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) and related amendments. Prior to January 1, 2018, the Company recognized revenue in accordance with Accounting Standards Codification Topic 605-35 Construction-Type and Production-Type Contracts utilizing the cost-to-cost measure of the percentage-of-completion method of accounting, primarily based upon total costs incurred, with incentive fees included in sales when the amounts could be reasonably determined and estimated. Amounts representing change orders, claims, requests for equitable adjustment, or limitations of funding were included in sales only when they could be reliably estimated and realization was probable. For additional information on the new standard and the impact to the Company's results of operations, refer to Note 3: Accounting Standards Updates.

Most of the Company's revenues are derived from long-term contracts for the production of goods and services provided to its U.S. Government customers. The Company generally recognizes revenues on contracts with U.S. Government customers over time using a cost-to-cost measure of progress. The use of the cost-to-cost method to measure performance progress over time is supported by clauses in the related contracts that allow the customer to unilaterally terminate the contract for convenience, pay the Company for costs incurred plus a reasonable profit, and take control of any work in process. The Company utilizes the cost-to-cost method to measure performance progress, because it best reflects the continuous transfer of control over the related goods and services to the customer as the Company satisfies its performance obligations.

Where the customer is not a U.S. Government entity, the Company may recognize revenue over time or at a point in time when control transfers upon delivery, depending upon the facts and circumstances of the related arrangement. Where the Company determines that revenue should be recognized over time, the Company utilizes a measure of progress that best depicts the transfer of control of the relevant goods and services to the customer. Generally, the terms and conditions of the contracts result in a transfer of control over the related goods and services as the Company satisfies its performance obligations. Accordingly, the Company recognizes revenue over time using the cost-to-cost method to measure performance progress. The Company may, however, utilize a measure of progress other than cost-to-cost, such as a labor-based measure of progress, or recognize revenue at the point in time at which control is transferred to the customer if the terms and conditions of the arrangement require such accounting.

When using the cost-to-cost method to measure performance progress, certain contracts may include costs that are not representative of performance progress, such as large upfront purchases of uninstalled materials, unexpected waste, or inefficiencies. In these cases, the Company adjusts its measure of progress to exclude such costs, with the goal of better reflecting the transfer of control over the related goods or services to the customer and recognizing revenue only to the extent of the costs incurred that reflect the Company's performance under the contract.

A performance obligation is a promise to transfer a distinct good or service to the customer and is the unit of account for which revenue is recognized. To determine the proper revenue recognition method, consideration is given to whether two or more contracts should be combined and accounted for as one contract and whether a single contract consists of more than one performance obligation. For contracts with multiple performance obligations, the contract transaction price is allocated to each performance obligation using an estimate of the standalone selling price based upon expected cost plus a margin at contract inception, which is generally the price disclosed in the contract. Contracts are often modified to account for changes in contract specifications and requirements. In the majority of circumstances, modifications do not result in additional performance obligations that are distinct from the existing performance obligations in the contract and the effects of the modifications are recognized as an adjustment to revenue on a cumulative catch-up basis. Alternatively, in instances where the performance obligations in the modifications are deemed distinct, contract modifications are accounted for prospectively.

The amount of revenue recognized as the Company satisfies performance obligations associated with contracts with customers is based upon the determination of transaction price. Transaction price reflects the amount of consideration to which the Company expects to be entitled for performance under the terms and conditions of the relevant contract and may reflect fixed and variable components, including shareline incentive fees whereby the value of the contract is variable based upon the amount of costs incurred, as well as other incentive fees based upon achievement of contractual schedule commitments or other specified criteria in the contract. Shareline incentive fees are determined based upon the formula under the relevant contract using the Company’s estimated cost to complete each period. The Company generally utilizes a most likely amount approach to estimate variable consideration. In all such instances, the estimated revenues represent those amounts for which the Company believes a significant reversal of revenue is not probable.

Contract Estimates - In estimating contract costs, the Company utilizes a profit-booking rate based upon performance expectations that takes into consideration a number of assumptions and estimates regarding risks related to technical requirements, feasibility, schedule, and contract costs. Management performs periodic reviews of the contracts to evaluate the underlying risks, which may increase the profit-booking rate as the Company is able to mitigate and retire such risks. Conversely, if the Company is not able to retire these risks, cost estimates may increase, resulting in a lower profit-booking rate.

The cost estimation process requires significant judgment and is based upon the professional knowledge and experience of the Company’s engineers, program managers, and financial professionals. Factors considered in estimating the work to be completed and ultimate contract recovery include the availability, productivity, and cost of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any performance delays, the availability and timing of funding from the customer, and the recoverability of any claims included in the estimates to complete.

Changes in estimates of sales, costs, and profits on a performance obligation are recognized using the cumulative catch-up method of accounting, which recognizes in the current period the cumulative effect of the changes in current and prior periods. A significant change in an estimate on one or more contracts in a period could have a material effect on the Company's unaudited condensed consolidated financial position or results of operations for that period.

When estimates of total costs to be incurred exceed estimates of total revenue to be earned on a performance obligation related to a complex, construction-type contract, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined.

Accounts Receivable - Accounts receivable include amounts related to any unconditional Company right to receive consideration and are presented as receivables in the unaudited condensed consolidated statement of financial position, separate from other contract balances. Accounts receivable are comprised of amounts billed and currently due from customers. The Company reports accounts receivable net of an allowance for doubtful accounts. Because the Company's accounts receivable are primarily with the U.S. Government or with companies acting as a contractor to the U.S. Government, the Company does not have material exposure to accounts receivable credit risk.

Contract Assets - Contract assets primarily relate to the Company’s rights to consideration for work completed but not billed as of the reporting date when the right to payment is not just subject to the passage of time, including retention amounts. Contract assets are classified as current assets and, in accordance with industry practice, include amounts that may be billed and collected beyond one year due to the long term nature of many of the Company's contracts. Contract assets are transferred to accounts receivable when the right to consideration becomes unconditional.

Contract Liabilities - Contract liabilities are comprised of advance payments, billings in excess of revenues, and deferred revenue amounts. Such advances are generally not considered a significant financing component, because they are utilized to pay for contract costs within a one year period. Contract liability amounts are recognized as revenue once the requisite performance progress has occurred.

Inventoried Costs - Inventoried costs primarily relate to company owned raw materials, which are stated at the lower of cost or net realizable value, generally using the average cost method, and costs capitalized pursuant to applicable provisions of the Federal Acquisition Regulation ("FAR") and Cost Accounting Standards ("CAS"). Under the Company's U.S. Government contracts, the customer asserts title to, or a security interest in, inventories related to such contracts as a result of contract advances, performance-based payments, and progress payments. In accordance with industry practice, inventoried costs are classified as current assets and include amounts related to contracts having production cycles longer than one year.

Warranty Costs - Certain of the Company’s contracts contain assurance-type warranty provisions, which generally promise that the service or vessel will comply with agreed upon specifications. In such instances, the Company accrues the estimated loss by a charge to income in the relevant period. In limited circumstances,the Company's complex construction type contracts may provide the customer with an option to purchase a warranty or provide an extended assurance service coupled with the primary assurance warranty. In such cases, the Company accounts for the warranty as a separate performance obligation to the extent it is material within the context of the contract. Warranty liabilities are reported within other current liabilities and are not material.

Government Grants - The Company recognizes incentive grants, inclusive of transfers of depreciable assets, from federal, state, and local governments at fair value upon compliance with the conditions of their receipt and reasonable assurance that the grants will be received or the depreciable assets will be transferred. Grants in recognition of specific expenses are recognized in the same period as an offset to those related expenses. Grants related to depreciable assets are recognized over the periods and in the proportions in which depreciation expense on those assets is recognized.

For the six months ended June 30, 2018, the Company recognized cash grant benefits of approximately $19 million in other long-term liabilities in the unaudited condensed consolidated statements of financial position. For the six months ended June 30, 2017, the Company recognized no grant benefits.

Fair Value of Financial Instruments - Except for the Company's long-term debt, the carrying amounts of the Company's financial instruments recorded at historical cost approximate fair value due to the short-term nature of the instruments and low credit risk associated with the respective counterparties.

The Company maintains multiple grantor trusts established to fund certain non-qualified pension plans. These trusts were valued at $104 million and $94 million as of June 30, 2018, and December 31, 2017, respectively, and are presented within miscellaneous other assets within the unaudited condensed consolidated statements of financial position. These trusts consist primarily of available-for-sale investments in marketable securities, which are held at fair value within Level 1 of the fair value hierarchy.

Related Party Transactions - On March 29, 2011, HII entered into a Separation and Distribution Agreement (the "Separation Agreement") with its former parent company, Northrop Grumman Corporation ("Northrop Grumman"), and Northrop Grumman's subsidiaries (Northrop Grumman Shipbuilding, Inc. and Northrop Grumman Systems Corporation), pursuant to which HII was legally and structurally separated from Northrop Grumman. As of December 31, 2017, the Company was due $8 million from Northrop Grumman under spin-off related agreements. For the six months ended June 30, 2018, the Company received $8 million from Northrup Grumman under spin-off related agreements. As of each of June 30, 2018, and December 31, 2017, the Company had $84 million outstanding under Industrial Revenue Bonds issued by the Mississippi Business Finance Corporation. Prior to the spin-off, repayment of principal and interest was guaranteed by Northrop Grumman Systems Corporation. The guaranty remains in effect, and the Company has agreed to indemnify Northrop Grumman Systems Corporation for any losses related to the guaranty.

3. ACCOUNTING STANDARDS UPDATES

Effective January 1, 2018, the Company adopted the requirements of ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," and related amendments, which provide a single revenue recognition model under which the Company should recognize revenue to portray the transfer of promised goods or service in a manner reflective of the consideration the Company is entitled to receive in exchange for those goods or services. The Company used the modified retrospective method and related practical expedient in its application of the new standard to those contracts that were not completed as of January 1, 2018, and reflected the cumulative effect of changes in the opening balance of retained earnings. Results for reporting periods beginning after January 1, 2018, were presented under Topic 606, while prior period amounts were not adjusted and were reported in accordance with the Company's historic accounting practices under Topic 605.

The adoption of Topic 606 did not have a significant impact on the Company's unaudited condensed consolidated financial statements, contracting and accounting processes, internal controls, or information technology systems. For the consolidated statements of operations and comprehensive income (loss), the new standard supports the recognition of revenue over time under the cost-to-cost input method, which is consistent with the Company’s previous revenue recognition model for a substantial majority of its contracts. The most significant impact of the new standard was the modification and expansion of the Company’s disclosures as they relate to revenues and contract balances. Pre-contract fulfillment costs requiring capitalization are not material.

On the Company’s unaudited condensed consolidated statements of financial position, contract assets and liabilities are reported in a net position on a contract-by-contract basis at the end of each reporting period. The

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application of the new standard is materially consistent with the Company’s previous accounting policies related to contract balances. In accordance with the new standard, unbilled accounts receivable were reclassified as contract assets and advance payments and billings in excess of revenue were reclassified as contract liabilities as of June 30, 2018, and December 31, 2017, none of which resulted in a change to total current assets or total current liabilities. As part of the transition, the Company also classified in contract assets approximately $64 million of retention amounts arising from contractual provisions, since the right to collect is based on certain conditions other than the passage of time. These retention amounts were previously reported within billed accounts receivable. Under Topic 605, the Company included warranty costs specified in a contract as contract costs. Under Topic 606, assurance-type warranty costs are not deemed to be part of a performance obligation and, therefore, are included within warranty liabilities, which are not material.

The adoption of Topic 606 resulted in a cumulative increase to retained earnings of $5 million, net of $1 million tax expense, as of January 1, 2018, driven by changes in contract assets and warranty liabilities. For the three months ended June 30, 2018, product sales, operating income, and net earnings increased by less than $1 million and diluted earnings per share increased by $0.01, due to the adoption of Topic 606. For the six months ended June 30, 2018, product sales, operating income, and net earnings increased by $1 million and diluted earnings per share increased by $0.01, due to the adoption of Topic 606.

In January 2016, the FASB issued ASU 2016 01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," relating to the recognition and measurement of financial assets and liabilities, with further clarifications made in February 2018 with the issuance of ASU 2018-03. The amended guidance requires certain equity investments that are not consolidated and not accounted for under the equity method to be measured at fair value, with changes in fair value recognized in net income rather than as a component of accumulated other comprehensive income (loss). The Company adopted this amended guidance on January 1, 2018, using a prospective transition approach, which did not have a significant impact on the Company's unaudited condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which establishes a right-of-use model that requires a lessee to record the right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Additional qualitative and quantitative disclosures will be required. ASU 2016-02 will be effective for the Company beginning with the first quarter of 2019 and currently requires the use of a modified retrospective adoption approach. In March 2018, the FASB tentatively approved an optional transition method, which the Company plans to elect, that would instead allow companies to use a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.

The Company has established a cross-functional implementation team to evaluate the impact of ASU 2016-02 on the Company’s financial position, results of operations and cash flows. The Company is in the process of executing its implementation plan and performing an assessment of its leasing arrangements and service contracts, as well as evaluating the impact of applying the practical expedients and accounting policy elections. The Company is implementing software that will assist in the recognition of additional assets and liabilities related to leases currently classified as operating leases with durations greater than 12 months, with certain allowable exceptions, to be included on the consolidated statement of financial position. The Company is also in the process of identifying changes to its business processes and controls to support the adoption of the new standard.

The Company anticipates the adoption of this new standard will result in an increase in lease-related assets and liabilities on the Company’s consolidated statements of financial position, but does not anticipate any material changes to operating results as a result of recording right-of-use assets and corresponding lease liabilities.

In January 2018, the FASB issued ASU 2018-01 Leases, “Land Easement Practical Expedient,” which permits entities to forgo the evaluation of existing land easement arrangements to determine if they contain a lease as part of the adoption of ASU 2016-02 issued in February 2016. Accordingly, the Company’s accounting treatment of any existing land easement arrangements will not change. The Company will adopt this standard update concurrently with ASU

2016-02.

In March 2017, the FASB issued ASU 2017-07, "Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." The update requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. The other components of net benefit cost, including interest cost, expected return on plan assets, amortization of prior service cost/credit and actuarial gain/loss, and settlement and curtailment effects, are presented outside of any subtotal of operating income. Employers

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are required to disclose the line(s) used to present the other components of net periodic benefit cost, if the components are not presented separately in the income statement. ASU 2017-07 became effective for fiscal years and interim periods beginning after December 15, 2017.

The Company adopted ASU 2017-07 on January 1, 2018, using the retrospective method, which changed the FAS/CAS Adjustment within operating income, offset by a corresponding change in other income (expense), as a result of reclassifying interest cost, expected return on plan assets, amortization of prior service cost/credit and actuarial gain/loss, and settlement and curtailment effects of net periodic benefit expense. Additionally, the remaining FAS/CAS Adjustment within operating income was reclassified from general and administrative expenses to cost of product sales and service revenues. The adoption of ASU 2017-07 did not have a material impact on the Company's unaudited condensed consolidated statements of financial position, cash flows, accounting processes, or internal controls.

The following table is a schedule of the impact of adoption of ASU 2017-07 for the three and six months ended June 30, 2017. The Company has reclassified the following line items on its previously issued consolidated financial statements to conform to the current year presentation.

	As Previously Reported		As Presented	
(in millions, except per share amounts)	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Cost of product sales	$1,104	$2,174	$1,061	$2,088
Cost of service revenues	$385	$748	$375	$728
General and administrative expenses	$133	$262	$182	$360
Operating income (loss)	$237	$401	$241	$409
Non-operating retirement expense	$—	$—	$(4)	$(8)

In May 2017, the FASB issued ASU 2017-10, "Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services," which addresses how an operating entity should determine the customer for operations under a service concession arrangement. The update clarifies that the grantor is the customer of the operation services in all cases for these arrangements. This standard is effective for annual reporting periods beginning after December 15, 2017. The FASB permitted companies to adopt the new standard early, but not before the original effective date of annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact of ASU 2017-10 on its consolidated financial statements and disclosures, accounting processes, or internal controls.

In February 2018, the FASB issued ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," which provides for the reclassification from accumulated other comprehensive income to retained earnings of stranded tax effects resulting from the Tax Cuts and Jobs Act (the "Tax Act"). This update is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. Effective January 1, 2018, the Company early adopted the amendments in this update prospectively and, accordingly, reclassified the income tax effects of the Tax Act from accumulated other comprehensive income to retained earnings. See Note 12: Income Taxes, for further disclosure.

In June 2018, the FASB issued ASU 2018-08, “Not-For-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made,” which assists entities to evaluate the nature and accounting treatment of contributions received. The update applies to business entities that receive contributions of cash or other assets, but does not apply to transfers of assets from government entities to business entities. This standard is effective for annual reporting periods beginning after December 15, 2018. The update should be applied on a modified prospective basis. The Company is currently evaluating the impact of ASU 2018-08 on its consolidated financial statements and disclosures, accounting processes, or internal controls related to periodic government grants received as reimbursements of costs or related to depreciable assets.

Other accounting pronouncements issued but not effective until after December 31, 2018, are not expected to have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

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4. AVONDALE

In 2010, plans were announced to consolidate the Company's Ingalls shipbuilding operations by winding down shipbuilding at the Avondale, Louisiana facility in 2013 after completion of LPD-class ships that were under construction at this facility. In October 2014, the Company ceased shipbuilding construction operations at the Avondale facility.

In connection with and as a result of the decision to wind down shipbuilding at the Avondale facility, the Company began incurring and paying related costs, including, but not limited to, severance expense, relocation expense, and asset write-downs related to the Avondale facilities. Pursuant to applicable provisions of the FAR and Cost Accounting Standards for the treatment of restructuring and shutdown related costs, the Company began amortizing the deferred costs over a five year period in 2014, when the Company ceased shipbuilding construction operations at the Avondale facility.

The Company engaged in communications and negotiations with the U.S. Government beginning in 2010 regarding the amount and recovery of the Company's restructuring and shutdown costs. On November 16, 2017, the U.S. Government and the Company reached a settlement of the Company’s claim for restructuring costs. Under the terms of the settlement, $251 million is being treated as allowable costs. Any future gain or loss associated with disposition of the land, facilities, and capital assets located at Avondale was excluded from the settlement and will be recorded by the Company at the time of disposition. The settlement was consistent with management’s cost recovery expectations and did not have a material effect on the Company's consolidated financial position or results of operations. The Company anticipates that a majority of these restructuring and shutdown related costs will be billed to the U.S. Government and collected by the end of 2018.

In 2017, the Company and a potential buyer of the Avondale facility entered into a Purchase and Sale Agreement, which is subject to certain closing conditions. As of June 30, 2018, Avondale assets held for sale totaled $41 million and are presented within prepaid expenses and other current assets in the unaudited condensed consolidated statements of financial position.

5. GULFPORT

In September 2013, the Company announced the closure of its Gulfport Composite Center of Excellence in Gulfport, Mississippi, part of the Ingalls reportable segment, which it completed in August 2014. In connection with this closure, the Company incurred total costs of $54 million, consisting of $52 million in accelerated depreciation of fixed assets and $2 million in personnel, facility shutdown, and other related costs. In March 2015, the Company sold the Gulfport Composite Center of Excellence to the Mississippi State Port Authority for $32 million, resulting in a gain on disposition of $9 million, recorded as a reduction to contract costs in accordance with the terms of the Company’s contracts with the U.S. Government.

The Company has received communications from the Supervisor of Shipbuilding questioning the Company's treatment and proposed allocation of the Gulfport closure costs. The Company has responded to such communications with the position that its proposed accounting and allocation of the closure costs complies with applicable law, and the Company and the U.S. Government remain in discussions about the proper accounting and allocation of such costs. While the Company anticipates a resolution that is substantially in accordance with management's cost recovery expectations, any inability to recover such costs substantially in accordance with the Company's cost recovery expectations could result in a material effect on the Company’s consolidated financial position, results of operations, or cash flows.

6. STOCKHOLDERS' EQUITY

Treasury Stock - On November 7, 2017, the Company's board of directors authorized an increase in the Company's stock repurchase program from $1.2 billion to $2.2 billion and an extension of the term of the program to October 31, 2022. Repurchases are made from time to time at management's discretion in accordance with applicable federal securities laws. For the six months ended June 30, 2018, the Company repurchased 1,805,667 shares at an aggregate cost of $413 million, of which approximately $7 million was not yet settled for cash as of June 30, 2018. For the six months ended June 30, 2018, the Company also settled for cash $2 million of shares repurchased in the prior year. For the six months ended June 30, 2017, the Company repurchased 1,065,737 shares at an aggregate cost of $210 million, of which approximately $3 million was not yet settled for cash as of June 30, 2017. The cost of purchased shares is recorded as treasury stock in the unaudited condensed

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consolidated statements of financial position and the unaudited condensed consolidated statements of changes in equity.

Dividends - The Company declared cash dividends per share of $0.72 and $0.60 for the three months ended June 30, 2018 and 2017, respectively. The Company declared cash dividends per share of $1.44 and $1.20 for the six months ended June 30, 2018 and 2017, respectively. The Company paid cash dividends totaling $64 million and $55 million for the six months ended June 30, 2018 and 2017, respectively.

Accumulated Other Comprehensive Income (Loss) - Other comprehensive income (loss) refers to gains and losses recorded as an element of stockholders' equity but excluded from net earnings (loss). The accumulated other comprehensive loss as of June 30, 2018, was comprised of unamortized benefit plan costs of $1,080 million and other comprehensive loss items of $5 million. The accumulated other comprehensive loss as of December 31, 2017, was comprised of unamortized benefit plan costs of $906 million and other comprehensive income items of $6 million. The changes in accumulated other comprehensive income (loss) by component for the three and six months ended June 30, 2018 and 2017, were as follows:

($ in millions)	Benefit Plans	Other	Total
Balance as of March 31, 2017	$(935)	$ —	$(935)
Other comprehensive income (loss) before reclassifications	—	3	3
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of net actuarial loss (gain)[1]	23	—	23
Tax benefit (expense) for items of other comprehensive income	(9)	(1)	(10)
Net current period other comprehensive income (loss)	14	2	16
Balance as of June 30, 2017	(921)	2	(919)
Balance as of March 31, 2018	(1,095)	(3)	(1,098)
Other comprehensive income (loss) before reclassifications	—	(2)	(2)
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of net actuarial loss (gain)[1]	21	—	21
Tax benefit (expense) for items of other comprehensive income	(6)	—	(6)
Net current period other comprehensive income (loss)	15	(2)	13
Balance as of June 30, 2018	$(1,080)	$ (5)	$(1,085)

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($ in millions)	Benefit Plans	Other	Total
Balance as of December 31, 2016	$(948)	$(3)	$(951)
Other comprehensive income (loss) before reclassifications	—	7	7
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of prior service cost (credit)[1]	(1)	—	(1)
Amortization of net actuarial loss (gain)[1]	46	—	46
Tax benefit (expense) for items of other comprehensive income	(18)	(2)	(20)
Net current period other comprehensive income (loss)	27	5	32
Balance as of June 30, 2017	(921)	2	(919)
Balance as of December 31, 2017	(906)	6	(900)
Other comprehensive income (loss) before reclassifications	—	(2)	(2)
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of prior service cost (credit)[1]	1	—	1
Amortization of net actuarial loss (gain)[1]	40	—	40
Tax benefit (expense) for items of other comprehensive income	(11)	—	(11)
Net current period other comprehensive income (loss)	30	(2)	28
Effect of Accounting Standards Update 2016-01[2]	—	(11)	(11)
Effect of Accounting Standards Update 2018-02[3]	(204)	2	(202)
Balance as of June 30, 2018	$(1,080)	$(5)	$(1,085)

[1] These accumulated comprehensive income (loss) components are included in the computation of net periodic benefit cost. See Note 16: Employee Pension and Other Postretirement Benefits. The tax benefit associated with amounts reclassified from accumulated other comprehensive income (loss) for the three months ended June 30, 2018 and 2017, was $6 million and $9 million, respectively. The tax benefit associated with amounts reclassified from accumulated other comprehensive income (loss) for the six months ended June 30, 2018 and 2017, was $11 million and $18 million, respectively.

[2] The Company adopted ASU 2016-01 as of January 1, 2018. Accordingly, accumulated other comprehensive income of $11 million related to available-for-sale securities, net of $4 million tax expense, was reclassified to retained earnings.

[3] The Company adopted ASU 2018-02 as of January 1, 2018. Accordingly, stranded tax effects of $202 million related to the Tax Act were reclassified to retained earnings.

7. EARNINGS PER SHARE

Basic and diluted earnings per common share were calculated as follows:

	Three Months Ended June 30		Six Months Ended June 30	
(in millions, except per share amounts)	2018	2017	2018	2017
Net earnings (loss)	$239	$147	$395	$266
Weighted-average common shares outstanding	44.2	45.7	44.5	46.0
Net dilutive effect of stock options and awards	0.1	0.1	0.1	0.1
Dilutive weighted-average common shares outstanding	44.3	45.8	44.6	46.1
Earnings (loss) per share - basic	$5.41	$3.22	$8.88	$5.78
Earnings (loss) per share - diluted	$5.40	$3.21	$8.86	$5.77

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Under the treasury stock method, the Company has excluded from the diluted share amounts presented above the effects of 0.3 million Restricted Performance Stock Rights ("RPSRs") for the three and six months ended June 30, 2018. The Company has excluded from diluted share amounts presented above the effects of 0.3 million and 0.4 million RPSRs for the three and six months ended June 30, 2017, respectively.

8. REVENUE

The following is a description of principal activities from which the Company generates its revenues. For more detailed information regarding reportable segments, see Note 9: Segment Information. For more detailed information regarding the Company's significant accounting policy for revenue, see Note 2: Basis of Presentation.

U.S. Government Contracts

The Ingalls and Newport News segments generate revenue primarily from performance under multi-year contracts with the U.S. Government, generally the U.S. Navy and U.S. Coast Guard, or prime contractors to contracts with the U.S. Government, relating to the advance planning, design, construction, repair, maintenance, refueling, overhaul, or inactivation of nuclear-powered ships and non-nuclear ships. The period over which the Company performs may extend past five years. The Technical Solutions segment also generates the majority of its revenue from contracts with the U.S. Government, including U.S. Government agencies. The Company generally invoices and receives related payments based upon performance progress no less frequently than monthly.

Shipbuilding - For most of the Company's shipbuilding contracts, the customer contracts with the Company to provide a comprehensive service of designing, procuring long-lead-time materials, manufacturing, and integrating complex equipment and technologies into a single ship or project, often resulting in a single performance obligation. Contract modifications to account for changes in specifications and requirements are recognized when approved by the customer. In the majority of circumstances, modifications do not result in additional performance obligations that are distinct from the existing performance obligations in the contract and the effects of the modifications are recognized as an adjustment to revenue on a cumulative catch-up basis. Alternatively, in instances where the performance obligations in the modifications are deemed distinct, contract modifications are accounted for prospectively.

The Company considers incentive and award fees to be variable consideration and includes in the transaction price at inception the consideration to which the Company expects to be entitled under the terms and conditions of the contract, generally estimated using a most likely amount approach. Transaction price is limited to the extent of funding allotted by the customer and available for performance, and estimated revenues represent those amounts for which the Company believes a significant reversal of revenue is not probable.

The Company recognizes revenues related to shipbuilding contracts as it satisfies the related performance obligations over time using a cost-to-cost input method to measure performance progress, which best reflects the transfer of control to the customer.

Services - The Technical Solutions segment primarily generates revenue under U.S. Government contracts from the provision of fleet support and integrated mission solutions services. Contracts generally are structured using either an Indefinite Delivery/Indefinite Quantity ("IDIQ") vehicle, under which orders are issued, or a standalone contract. Contracts may be fixed-price or cost-type, include variable consideration such as incentives and awards, and structured as task orders under an IDIQ contract vehicle or requirements contract vehicle. In either case, the Company generally performs over the course of a short-duration period and may continue to perform upon exercise of related period of performance options that are also short in duration, generally one year. The Company’s performance obligations vary in nature and may be stand-ready, in which case the Company responds to the customer’s needs on the basis of its demand, a recurring service, in the case of recurring maintenance services, or a single performance obligation that does not comprise a series of distinct services.

In determining transaction price, the Company considers incentives and other contingencies to be variable consideration and includes in the initial transaction price the consideration to which the Company expects to be entitled under the terms and conditions of the contract, generally estimated using a most likely amount approach. Transaction price is limited to the extent of funding allotted by the customer and available for performance, and estimated revenues represent those amounts for which the Company believes a significant reversal of revenue is not probable. Where a series of distinct services has been identified, the Company generally allocates variable

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consideration to distinct time increments of service.

The Company generally recognizes revenue as it satisfies the related performance obligations over time using a cost-to-cost input method to measure performance progress, because, even where the Company has identified a series of services, its cost incurrence pattern generally is not ratable given the complex nature of the services the Company provides. Invoices are issued and related payments are received, on the basis of performance progress, no less frequently than monthly. In addition, many of the Company's U.S. Government services contracts are time and material arrangements. As a result, the Company often utilizes the practical expedient allowing the recognition of revenue in the amount the Company invoices, which corresponds with the value provided to the customer and to which the Company is entitled to payment for performance to date.

Non-U.S. Government Contracts

Revenues generated under commercial and state and local government agency contracts are primarily derived from the provision of nuclear and environmental and oil and gas services. Non-U.S. Government contracts typically are one or two years in duration.

In determining transaction price, the Company considers incentives and other contingencies to be variable consideration and includes in the initial transaction price the consideration to which the Company expects to be entitled under the terms and conditions of the contract, generally estimated using a most likely amount approach. In the context of variable consideration, the Company limits the transaction price to amounts for which the Company believes a significant reversal of revenue is not probable. Such amounts may relate to transaction price in excess of funding, a lack of history with the customer, a lack of history with the goods or services being provided, or other items.

Revenue generally is recognized over time given the terms and conditions of the related contracts. The Company generally utilizes a cost-to-cost input method to measure performance progress, which best depicts the transfer of control to the customer. The Company’s non-U.S. Government contract portfolio is comprised of a large number of time and material arrangements. As a result, the Company often utilizes the practical expedient allowing the recognition of revenue in the amount the Company invoices, which corresponds with the value provided to the customer and to which the Company is entitled to payment for performance to date.

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Disaggregation of Revenue

The following tables present revenues on a disaggregated basis, in a manner that reconciles with the Company's reportable segment disclosures, for the following categories: product versus service type, customer type, contract type, and major program. See Note 9: Segment Information. The Company believes that this level of disaggregation provides investors with information to evaluate the Company’s financial performance and provides the Company with information to make capital allocation decisions in the most appropriate manner.

	Three Months Ended June 30, 2018				
($ in millions)	Ingalls	Newport News	Technical Solutions	Intersegment Eliminations	Total
Revenue Type					
Product sales	$577	$ 903	$ 19	$ —	$1,499
Service revenues	52	277	192	—	521
Intersegment	—	3	32	(35)	—
Sales and service revenues	$629	$ 1,183	$ 243	$ (35)	$2,020
Customer Type					
Federal	$629	$ 1,180	$ 141	$ —	$1,950
Commercial	—	—	69	—	69
State and local government agencies	—	—	1	—	1
Intersegment	—	3	32	(35)	—
Sales and service revenues	$629	$ 1,183	$ 243	$ (35)	$2,020
Contract Type					
Firm fixed-price	$18	$ 1	$ 41	$ —	$60
Fixed-price incentive	528	480	—	—	1,008
Cost-type	83	699	92	—	874
Time and materials	—	—	78	—	78
Intersegment	—	3	32	(35)	—
Sales and service revenues	$629	$ 1,183	$ 243	$ (35)	$2,020

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	Six Months Ended June 30, 2018				
($ in millions)	Ingalls	Newport News	Technical Solutions	Intersegment Eliminations	Total
Revenue Type					
Product sales	$1,111	$1,725	$ 33	$ —	$2,869
Service revenues	103	537	385	—	1,025
Intersegment	—	3	58	(61)	—
Sales and service revenues	$1,214	$2,265	$ 476	$ (61)	$3,894
Customer Type					
Federal	$1,214	$2,262	$ 292	$ —	$3,768
Commercial	—	—	125	—	125
State and local government agencies	—	—	1	—	1
Intersegment	—	3	58	(61)	—
Sales and service revenues	$1,214	$2,265	$ 476	$ (61)	$3,894
Contract Type					
Firm fixed-price	$42	$4	$ 81	$ —	$127
Fixed-price incentive	1,014	897	1	—	1,912
Cost-type	158	1,361	185	—	1,704
Time and materials	—	—	151	—	151
Intersegment	—	3	58	(61)	—
Sales and service revenues	$1,214	$2,265	$ 476	$ (61)	$3,894

($ in millions)	Three Months Ended June 30 2018	Six Months Ended June 30 2018
Major Programs		
Amphibious assault ships	$327	$615
Surface combatants and coast guard cutters	302	598
Other	—	1
Total Ingalls	629	1,214
Aircraft carriers	654	1,241
Submarines	386	745
Other	143	279
Total Newport News	1,183	2,265
Government and energy services	201	395
Oil and gas services	42	81
Total Technical Solutions	243	476
Intersegment eliminations	(35)	(61)
Sales and service revenues	$2,020	$3,894

As of June 30, 2018, the Company had $21.2 billion of remaining performance obligations. The Company expects to recognize approximately 50% of its remaining performance obligations as revenue through 2019, an additional 35% through 2021, and the balance thereafter.

Cumulative Catch-up Adjustments

For the three months ended June 30, 2018 and 2017, net cumulative catch-up adjustments increased operating income by $37 million and $60 million, respectively, and increased diluted earnings per share by $0.66 and $0.85, respectively. For the six months ended June 30, 2018 and 2017, net cumulative catch-up adjustments increased

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operating income by $65 million and $86 million, respectively, and increased diluted earnings per share by $1.15 and $1.21, respectively. No individual adjustment was material to the Company's unaudited condensed consolidated statements of operations and comprehensive income for the three and six months ended June 30, 2018. Cumulative catch-up adjustments for the three and six months ended June 30, 2017, included favorable adjustments of $30 million on a contract at the Ingalls segment, which increased diluted earnings per share by $0.42 in both periods.

Contract Balances

Contract balances include accounts receivable, contract assets, and contract liabilities from contracts with customers. Accounts receivable represent an unconditional right to consideration and include amounts billed and currently due from customers. Contract assets primarily relate to the Company's rights to consideration for work completed but not billed as of the reporting date when the right to payment is not just subject to the passage of time. Fixed-price contracts are generally billed to the customer using either progress payments, whereby amounts are billed monthly as costs are incurred or work is completed, or performance based payments, which are based upon the achievement of specific, measurable events or accomplishments defined and valued at contract inception. Cost-type contracts are typically billed to the customer on a monthly or semi-monthly basis. Contract liabilities relate to advance payments, billings in excess of revenues, and deferred revenue amounts.

The Company reports contract balances in a net contract asset or contract liability position on a contract-by-contract basis at the end of each reporting period. The Company’s net contract assets increased $255 million from December 31, 2017 to June 30, 2018, primarily due to an increase in contract assets as a result of revenue on certain U.S. Navy contracts. For the three and six months ended June 30, 2018, the Company recognized revenue of $1 million and $87 million, respectively, related to its contract liabilities as of December 31, 2017.

9. SEGMENT INFORMATION

The Company is organized into three reportable segments: Ingalls, Newport News, and Technical Solutions, consistent with how management makes operating decisions and assesses performance.

The following table presents segment results for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30		Six Months Ended June 30	
($ in millions)	2018	2017	2018	2017
Sales and Service Revenues				
Ingalls	$629	$639	$1,214	$1,189
Newport News	1,183	1,001	2,265	1,972
Technical Solutions	243	244	476	469
Intersegment eliminations	(35)	(26)	(61)	(48)
Sales and service revenues	$2,020	$1,858	$3,894	$3,582
Operating Income (Loss)				
Ingalls	$83	$98	$147	$164
Newport News	91	80	142	152
Technical Solutions	7	9	9	(9)
Segment operating income (loss)	181	187	298	307
Non-segment factors affecting operating income (loss)				
Operating FAS/CAS Adjustment	73	53	145	106
Non-current state income taxes	3	1	5	(4)
Operating income (loss)	$257	$241	$448	$409

Operating FAS/CAS Adjustment - The Operating FAS/CAS Adjustment represents the difference between the service cost component of our pension and other postretirement expense determined in accordance with GAAP ("FAS") and our pension and other postretirement expense under U.S. Cost Accounting Standards ("CAS").

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The following table presents the Company's assets by segment.

($ in millions)	June 30 2018	December 31 2017
Assets		
Ingalls	$ 1,474	$ 1,385
Newport News	3,571	3,350
Technical Solutions	671	642
Corporate	659	997
Total assets	$ 6,375	$ 6,374

10. INVENTORIED COSTS, NET

Inventoried costs were comprised of the following:

($ in millions)	June 30 2018	December 31 2017
Production costs of contracts in process[1]	$ 75	$ 90
Raw material inventory	99	93
Total inventoried costs, net	$ 174	$ 183

[1] Includes amounts capitalized pursuant to applicable provisions of the FAR and Cost Accounting Standards.

11. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

HII performs impairment tests for goodwill as of November 30 of each year and between annual impairment tests if an event occurs or circumstances change that would more likely than not reduce the fair values of the Company's reporting units below their carrying values.

Accumulated goodwill impairment losses as of each of June 30, 2018, and December 31, 2017, were $2,877 million. The accumulated goodwill impairment losses for Ingalls as of each of June 30, 2018, and December 31, 2017, were $1,568 million. The accumulated goodwill impairment losses for Newport News as of each of June 30, 2018, and December 31, 2017, were $1,187 million. The accumulated goodwill impairment losses for Technical Solutions as of each of June 30, 2018, and December 31, 2017, were $122 million.

Other Intangible Assets

The Company's purchased intangible assets are being amortized on a straight-line basis or a method based on the pattern of benefits over their estimated useful lives. Net intangible assets consist principally of amounts pertaining to nuclear-powered aircraft carrier and submarine program intangible assets, with an aggregate weighted-average useful life of 40 years based on the long life cycle of the related programs. Aggregate amortization expense was $9 million for each of the three months ended June 30, 2018 and 2017, and $18 million and $20 million for the six months ended June 30, 2018 and 2017, respectively.

The Company expects amortization expense for purchased intangible assets of approximately $36 million in 2018, $32 million in 2019, $28 million in 2020, $26 million in 2021, and $24 million in 2022.

12. INCOME TAXES

The Company's earnings are primarily domestic, and its effective tax rates on earnings from operations for the three months ended June 30, 2018 and 2017, were 8.8% and 32.6%, respectively. For the six months ended June 30, 2018 and 2017, the Company's effective tax rates on earnings from operations were 13.6% and 27.1%, respectively. The lower effective tax rate for the three months ended June 30, 2018, was primarily attributable to a claim for higher research and development tax credits for the post-spin-off 2011 through 2015 tax years and the reduction in the federal corporate income tax rate, partially offset by an increase in unrecognized tax benefits and the repeal of the domestic manufacturing deduction effective January 1, 2018. The lower effective tax rate for the six months ended June 30, 2018, was primarily attributable to the reduction in the federal corporate income tax rate and a claim for higher research and development tax credits for the post-spin-off 2011 through 2015 tax years, partially offset by a reduction in the income tax benefits resulting from stock award settlement activity and an increase in unrecognized tax benefits. The reduction in the federal corporate income tax rate from 35% to 21% and the repeal of the domestic manufacturing deduction are provisions of the Tax Act.

For the three and six months ended June 30, 2018, the Company's effective tax rates differed from the federal statutory rates primarily as a result of a claim for higher research and development tax credits for the post-spin-off 2011 through 2015 tax years. For the three and six months ended June 30, 2017, the Company's effective tax rates differed from the federal statutory rates primarily as a result of the income tax benefits resulting from stock award settlement activity and the domestic manufacturing deduction.

Tax Reform - The Tax Act, signed into law on December 22, 2017, provides for significant changes to U.S. federal income tax law, including a provision that allows for full expensing of certain qualified property, reduction of the federal corporate income tax rate from 35% to 21%, repeal of the domestic manufacturing deduction, and further limitations on the deductibility of certain executive compensation. The SEC staff issued Staff Accounting Bulletin 118, which provides guidance on accounting for the tax effects of the Tax Act in the reporting period of enactment, including a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under Accounting Standards Codification 740, Income Taxes.

The Company's accounting for the Tax Act is incomplete. As disclosed in the Company's Annual Report on Form 10-K for 2017, the Company was able to reasonably estimate certain effects and, for the reduction in the U.S. federal corporate income tax rate, the Company recorded provisional decreases in its deferred tax assets and deferred tax liabilities of $252 million and $196 million, respectively, with a corresponding net adjustment to deferred income tax expense of $56 million, for the year ended December 31, 2017. The Company has not made any additional measurement period adjustments for the reduction in the corporate income tax rate, which may be affected by other analyses related to the Tax Act, including, but not limited to, accounting method changes for tax purposes that could result in adjustments to temporary federal tax differences. For the acceleration of depreciation for assets qualifying for immediate expensing, the Company recorded a provisional benefit of $8 million for the year ended December 31, 2017, based on the Company’s intent to fully expense all qualifying expenditures. This resulted in a decrease of approximately $8 million to the Company's current income taxes payable and a corresponding decrease in its net deferred tax assets, excluding the effect of the reduction in the U.S. federal corporate income tax rate, for the year ended December 31, 2017. The Company has not yet completed its determination of which assets qualify for immediate expensing, and no additional measurement period adjustment was recorded for this item.

As disclosed in the Company's Annual Report on Form 10-K for 2017, the Company was not able to reasonably estimate the effect of the Tax Act changes to the deductibility of executive compensation, and, therefore, no provisional adjustment was recorded. These changes included repeal of the performance-based compensation exception to the $1 million deduction limitation of Internal Revenue Code Section 162(m) and revision of the employees subject to the $1 million deduction limitation. The only exception to this rule is compensation paid pursuant to a binding contract in effect on November 2, 2017 that would have otherwise been deductible under prior Section 162(m) rules. Accordingly, any compensation paid in the future pursuant to compensation arrangements entered into after November 2, 2017, even if performance-based, will count toward the $1 million annual deduction limit if paid to an executive subject to Section 162(m). The Company has not yet completed an analysis of the binding contract requirement on its various compensation plans to determine the impact of the change in law. Accordingly, no additional measurement period adjustment was recorded.

Adoption of ASU 2018-02 - The Company early adopted ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive

Income," which provides for the reclassification from accumulated other comprehensive income to retained earnings of stranded tax effects resulting from the Tax Act. In accordance with the provisions of the ASU, $202 million of stranded tax effects related to the Tax Act were reclassified from accumulated other comprehensive income to retained earnings in the first quarter of 2018. This reclassification includes the impact of the change in the federal corporate income tax rate and the related federal benefit of state taxes.

The Company’s accounting policy with respect to releasing income tax effects from accumulated other comprehensive income is to apply an aggregate approach whereby the tax effects are measured based on the change in the unrealized gains or losses reflected in other comprehensive income.

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The Company's unrecognized tax benefits increased $15 million during the three and six months ended June 30, 2018, for a tax position claimed during the quarter ended June 30, 2018, related to prior years. Assuming a sustainment of these positions, the reversal of the $15 million accrued would favorably impact the Company’s effective federal income tax rates in future periods.

The Company recognizes interest and penalties related to unrecognized tax benefits as income tax expense. As a result of the unrecognized tax benefits noted above, there was an increase in income tax expense of $1 million for interest for the three and six months ended June 30, 2018.

Non-current state income taxes include deferred state income taxes, which reflect the change in deferred state tax assets and liabilities, and the tax expense or benefit associated with changes in state uncertain tax positions in the relevant period. These amounts are recorded within operating income. Current period state income tax expense is charged to contract costs and included in cost of sales and service revenues in segment operating income.

13. DEBT

Long-term debt consisted of the following:

($ in millions)	June 30 2018	December 31 2017
Senior notes due November 15, 2025, 5.000%	600	600
Senior notes due December 1, 2027, 3.483%	600	600
Mississippi economic development revenue bonds due May 1, 2024, 7.81%	84	84
Gulf opportunity zone industrial development revenue bonds due December 1, 2028, 4.55%	21	21
Less unamortized debt issuance costs	(24)	(26)
Total long-term debt	$1,281	$ 1,279

Credit Facility - In November 2017, the Company terminated its Second Amended and Restated Credit Agreement and entered into a new Credit Agreement (the "Credit Facility") with third-party lenders. The Credit Facility includes a revolving credit facility of $1,250 million, which may be drawn upon during a period of five years from November 22, 2017. The revolving credit facility includes a letter of credit subfacility of $500 million. The revolving credit facility has a variable interest rate on outstanding borrowings based on the London Interbank Offered Rate ("LIBOR") plus a spread based upon the Company's credit ratings, which may vary between 1.125% and 1.500%. The revolving credit facility also has a commitment fee rate on the unutilized balance based on the Company’s credit ratings. The commitment fee rate as of June 30, 2018, was 0.25% and may vary between 0.20% and 0.30%.

The Credit Facility contains customary affirmative and negative covenants, as well as a financial covenant based on a maximum total leverage ratio. Each of the Company's existing and future material wholly owned domestic subsidiaries, except those that are specifically designated as unrestricted subsidiaries, are and will be guarantors under the Credit Facility.

As of June 30, 2018, approximately $17 million in letters of credit were issued but undrawn, and the remaining $1,233 million of the revolving credit facility was unutilized. The Company had unamortized debt issuance costs associated with its credit facilities of $9 million and $11 million as of June 30, 2018, and December 31, 2017, respectively.

Senior Notes - In December 2017, the Company issued $600 million aggregate principal amount of 3.483% senior notes with registration rights due December 2027, the net proceeds of which were used to repurchase the Company's 5.000% senior notes due in 2021. Pursuant to the terms of the registration rights agreement entered into in connection with the issuance of these senior notes, the Company completed in June 2018, an exchange of $600 million aggregate principal amount of registered 3.483% senior notes due December 2027 for all of the then outstanding unregistered senior notes due December 2027. The Company also has outstanding $600 million aggregate principal amount of unregistered 5.000% senior notes due November 2025. Interest on the Company's senior notes is payable semi-annually.

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The terms of the senior notes limit the Company’s ability and the ability of certain of its subsidiaries to create liens, enter into sale and leaseback transactions, sell assets, and effect consolidations or mergers. The Company had unamortized debt issuance costs associated with the senior notes of $15 million as of June 30, 2018, and December 31, 2017.

Mississippi Economic Development Revenue Bonds - As of each of June 30, 2018, and December 31, 2017, the Company had $84 million outstanding under Industrial Revenue Bonds issued by the Mississippi Business Finance Corporation. These bonds accrue interest at a fixed rate of 7.81% per annum (payable semi-annually) and mature in 2024.

Gulf Opportunity Zone Industrial Development Revenue Bonds - As of each of June 30, 2018, and December 31, 2017, the Company had $21 million outstanding under Gulf Opportunity Zone Industrial Development Revenue Bonds issued by the Mississippi Business Finance Corporation. These bonds accrue interest at a fixed rate of 4.55% per annum (payable semi-annually) and mature in 2028.

The Company's debt arrangements contain customary affirmative and negative covenants. The Company was in compliance with all debt covenants during the six months ended June 30, 2018.

The estimated fair values of the Company's total long-term debt as of June 30, 2018, and December 31, 2017, were $1,309 million and $1,361 million, respectively. The fair values of the Company's long-term debt were calculated based on either recent trades of the Company's debt instruments in inactive markets or yields available on debt with substantially similar risks, terms and maturities, which fall within Level 2 under the fair value hierarchy.

The Company does not have any principal payments due on long-term debt within the next five years.

14. INVESTIGATIONS, CLAIMS, AND LITIGATION

The Company is involved in legal proceedings before various courts and administrative agencies, and is periodically subject to government examinations, inquiries and investigations. Pursuant to FASB Accounting Standards Codification 450 Contingencies, the Company has accrued for losses associated with investigations, claims, and litigation when, and to the extent that, loss amounts related to the investigations, claims, and litigation are probable and can be reasonably estimated. The actual losses that might be incurred to resolve such investigations, claims, and litigation may be higher or lower than the amounts accrued. For matters where a material loss is probable or reasonably possible and the amount of loss cannot be reasonably estimated, but the Company is able to reasonably estimate a range of possible losses, the Company will disclose such estimated range in these notes. This estimated range is based on information currently available to the Company and involves elements of judgment and significant uncertainties. Any estimated range of possible loss does not represent the Company's maximum possible loss exposure. For matters as to which the Company is not able to reasonably estimate a possible loss or range of loss, the Company will indicate the reasons why it is unable to estimate the possible loss or range of loss. For matters not specifically described in these notes, the Company does not believe, based on information currently available to it, that it is reasonably possible that the liabilities, if any, arising from such investigations, claims, and litigation will have a material effect on its consolidated financial position, results of operations, or cash flows. The Company has, in certain cases, provided disclosure regarding certain matters for which the Company believes at this time that the likelihood of material loss is remote.

False Claims Act Complaint - In 2015, the Company received a Civil Investigative Demand from the Department of Justice ("DoJ") relating to an investigation of certain allegedly non-conforming parts the Company purchased from one of its suppliers for use in connection with U.S. Government contracts. The Company has cooperated with the DoJ in connection with its investigation. In 2016, the Company was made aware that it is a defendant in a False Claims

Act lawsuit filed under seal in the U.S. District Court for the Middle District of Florida related to the Company's purchases of the allegedly non-conforming parts from the supplier. Depending upon the outcome of this matter, the Company could be subject to civil penalties, damages, and/or suspension or debarment from future U.S. Government contracts, which could have a material adverse effect on its consolidated financial position, results of operations, or cash flows. The matter remains sealed and given the current posture of the matter, the Company is unable to estimate an amount or range of reasonably possible loss or to express an opinion regarding the ultimate outcome.

U.S. Government Investigations and Claims - Departments and agencies of the U.S. Government have the authority to investigate various transactions and operations of the Company, and the results of such investigations

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may lead to administrative, civil, or criminal proceedings, the ultimate outcome of which could be fines, penalties, repayments or compensatory, treble, or other damages. U.S. Government regulations provide that certain findings against a contractor may also lead to suspension or debarment from future U.S. Government contracts or the loss of export privileges. Any suspension or debarment would have a material effect on the Company because of its reliance on government contracts.

In January 2013, the Company disclosed to the DoD, including the U.S. Navy, and the U.S. Department of Homeland Security, including the U.S. Coast Guard, pursuant to the FAR, that it had initiated an internal investigation regarding whether certain employees at Ingalls mischarged time or misstated progress on Navy and Coast Guard contracts. The Company conducted an internal investigation, led by external counsel, and took remedial actions, including the termination of employees in instances where the Company believed grounds for termination existed. The Company provided information regarding its investigation to the relevant government agencies, and agreed with the U.S. Navy and U.S. Coast Guard that they would initially withhold $24 million in payments on existing contracts pending receipt of additional information from the Company's internal investigation. The U.S. Navy subsequently reduced its portion of the withhold from $18.2 million to $4.7 million, and the U.S. Coast Guard reduced its withhold from $5.8 million to $3.6 million. In September 2017, the U.S. Navy and the U.S. Coast Guard paid the Company the respective remaining amounts they were withholding.

In June 2015, the DoJ informed the Company that it was investigating the matters disclosed by the Company to the DoD in January 2013. In August 2017, the Company settled the matters with the DoJ. This settlement did not have a material effect on the Company’s consolidated financial position, results of operations, or cash flows.

Asbestos Related Claims - HII and its predecessors-in-interest are defendants in a longstanding series of cases that have been and continue to be filed in various jurisdictions around the country, wherein former and current employees and various third parties allege exposure to asbestos containing materials while on or associated with HII premises or while working on vessels constructed or repaired by HII. The cases allege various injuries, including those associated with pleural plaque disease, asbestosis, cancer, mesothelioma, and other alleged asbestos related conditions. In some cases, several of HII's former executive officers are also named as defendants. In some instances, partial or full insurance coverage is available to the Company for its liability and that of its former executive officers. The average cost per case to resolve cases during the six months ended June 30, 2018 and 2017, was immaterial individually and in the aggregate. The Company’s estimate of asbestos-related liabilities is subject to uncertainty because liabilities are influenced by numerous variables that are inherently difficult to predict. Key variables include the number and type of new claims, the litigation process from jurisdiction to jurisdiction and from case to case, reforms made by state and federal courts, and the passage of state or federal tort reform legislation. Although the Company believes the ultimate resolution of current cases will not have a material effect on its consolidated financial position, results of operations, or cash flows, it cannot predict what new or revised claims or litigation might be asserted or what information might come to light and can, therefore, give no assurances regarding the ultimate outcome of asbestos related litigation.

Other Litigation - The Company and its predecessor-in-interest have been in litigation with the Bolivarian Republic of Venezuela (the "Republic") since 2002 over a contract for the repair, refurbishment, and modernization at Ingalls of two foreign-built frigates. The case proceeded towards arbitration, then appeared to settle favorably, but the settlement was overturned in court and the matter returned to litigation. In March 2014, the Company filed an arbitral statement of claim asserting breaches of the contract. In July 2014, the Republic filed a statement of defense in the arbitration denying all the Company’s allegations and a counterclaim alleging late redelivery of the frigates, unfinished work, and breach of warranty. In February 2018, the arbitral tribunal awarded the Company approximately $151 million on its claims and awarded the Republic approximately $22 million on its counterclaims. The Company has filed a petition in the United States District Court for the District of Columbia asking the court to confirm or enforce the award. No assurances can be provided regarding the ultimate resolution of this matter.

The Company is party to various other claims, legal proceedings and investigations that arise in the ordinary course of business, including U.S. Government investigations that could result in administrative, civil, or criminal proceedings involving the Company. The Company is a contractor with the U.S. Government, and such proceedings could therefore include False Claims Act allegations against the Company. Although the Company believes that the resolution of these other claims, legal proceedings and investigations will not have a material effect on its consolidated financial position, results of operations, or cash flows, the Company cannot predict what new or revised claims or litigation might be asserted or what information might come to light and can, therefore, give no assurances regarding the ultimate outcome of these matters.

15. COMMITMENTS AND CONTINGENCIES

Contract Performance Contingencies - Contract profit margins may include estimates of revenues for matters on which the customer and the Company have not reached agreement, such as settlements in the process of negotiation, contract changes, claims, and requests for equitable adjustment for unanticipated contract costs. These estimates are based upon management's best assessment of the underlying causal events and circumstances and are included in contract profit margins to the extent of expected recovery based upon contractual entitlements and the probability of successful negotiation with the customer. As of June 30, 2018, recognized amounts related to claims and requests for equitable adjustment were not material individually or in the aggregate.

Guarantees of Performance Obligations - From time to time in the ordinary course of business, HII may enter into joint ventures, teaming, and other business arrangements to support the Company's products and services. The Company generally strives to limit its exposure under these arrangements to its investment or the extent of obligations under the applicable contract. In some cases, however, HII may be required to guarantee performance of the arrangement's obligations and, in such cases, generally obtains cross-indemnification from the other members of the arrangement.

In the ordinary course of business, the Company may guarantee obligations of its subsidiaries under certain contracts. Generally, the Company is liable under such an arrangement only if its subsidiary is unable to perform its obligations. Historically, the Company has not incurred any substantial liabilities resulting from these guarantees. As of June 30, 2018, the Company was not aware of any existing event of default that would require it to satisfy any of these guarantees.

Environmental Matters -The estimated cost to complete environmental remediation has been accrued when it is probable that the Company will incur such costs in the future to address environmental conditions at currently or formerly owned or leased operating facilities, or at sites where it has been named a Potentially Responsible Party ("PRP") by the Environmental Protection Agency or similarly designated by another environmental agency, and the related costs can be estimated by management. These accruals do not include any litigation costs related to environmental matters, nor do they include amounts recorded as asset retirement obligations. To assess the potential impact on the Company's consolidated financial statements, management estimates the range of reasonably possible remediation costs that could be incurred by the Company, taking into account currently available facts on each site, as well as the current state of technology and prior experience in remediating contaminated sites. These estimates are reviewed periodically and adjusted to reflect changes in facts and technical and legal circumstances. Management estimates that as of June 30, 2018, the probable future cost for environmental remediation was $1 million, which is accrued in other current liabilities. Factors that could result in changes to the Company's estimates include: modification of planned remedial actions, increases or decreases in the estimated time required to remediate, changes to the determination of legally responsible parties, discovery of more extensive contamination than anticipated, changes in laws and regulations affecting remediation requirements, and improvements in remediation technology. Should other PRPs not pay their allocable share of remediation costs, the Company may incur costs exceeding those already estimated and accrued. In addition, there are certain potential remediation sites where the costs of remediation cannot be reasonably estimated. Although management cannot predict whether new information gained as projects progress will materially affect the estimated liability accrued, management does not believe that future remediation expenditures will have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

Financial Arrangements - In the ordinary course of business, HII uses standby letters of credit issued by commercial banks and surety bonds issued by insurance companies principally to support the Company's self-insured workers' compensation plans. As of June 30, 2018, the Company had $17 million in standby letters of credit issued but undrawn, as indicated in Note 13: Debt, and $273 million of surety bonds outstanding.

U.S. Government Claims - From time to time, the U.S. Government communicates to the Company potential claims, disallowed costs, and penalties concerning prior costs incurred by the Company with which the U.S. Government disagrees. When such preliminary findings are presented, the Company and U.S. Government representatives engage in discussions, from which HII evaluates the merits of the claims and assesses the amounts being questioned. Although the Company believes that the resolution of any of these matters will not have a material effect on its consolidated financial position, results of operations, or cash flows, it cannot predict the ultimate outcome of these matters.

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In February 2018, the Company received the findings of an audit conducted by the Defense Contract Audit Agency citing significant deficiencies in the Company's Newport News segment's business system for material management. The Company submitted a response in June 2018, agreeing in part and disagreeing in part with the audit findings. In the event the U.S. Government makes a final determination that there are remaining significant deficiencies and that the Company's proposed corrective actions are inadequate, the U.S. Government may withhold up to 5% from the Company's interim billings on cost-reimbursement, labor-hour, and time and materials contracts containing the applicable contractor business systems clause, until the U.S. Government determines all significant deficiencies have been remediated, which could have a material impact on the timing of the Company's cash receipts.

Collective Bargaining Agreements - Of the Company's approximately 39,000 employees, approximately 50% are covered by a total of nine collective bargaining agreements and two site stabilization agreements. Newport News has four collective bargaining agreements covering represented employees, one of which covers approximately 50% of Newport News employees and was renewed July 2017. The remaining collective bargaining agreements at Newport News expire August 2018, December 2018, and November 2020. Newport News craft workers employed at the Kesselring Site near Saratoga Springs, New York are represented under an indefinite Department of Energy ("DoE") site agreement. Ingalls has five collective bargaining agreements covering represented employees, all of which expire in March 2022. Approximately 35 Technical Solutions craft employees at the Hanford Site near Richland, Washington are represented under an indefinite DoE site stabilization agreement. The Company believes its relationship with its employees is satisfactory.

Collective bargaining agreements generally expire after three to five years and are subject to renegotiation at that time. The Company does not expect the results of these negotiations, either individually or in the aggregate, to have a material effect on the Company's consolidated results of operations.

16. EMPLOYEE PENSION AND OTHER POSTRETIREMENT BENEFITS

The Company provides defined benefit pension plans and postretirement benefit plans, and defined contribution pension plans to eligible employees.

The costs of the Company's defined benefit pension plans and other postretirement benefit plans for the three and six months ended June 30, 2018 and 2017, were as follows:

	Three Months Ended June 30				Six Months Ended June 30			
	Pension Benefits		Other Benefits		Pension Benefits		Other Benefits	
($ in millions)	2018	2017	2018	2017	2018	2017	2018	2017
Components of Net Periodic Benefit Cost								
Service cost	$40	$36	$2	$ 2	$79	$71	$4	$ 5
Interest cost	63	66	5	6	127	133	10	12
Expected return on plan assets	(108)	(91)	—	—	(215)	(182)	—	—
Amortization of prior service cost (credit)	6	4	(6)	(4)	12	8	(11)	(9)
Amortization of net actuarial loss (gain)	21	24	—	(1)	41	48	(1)	(2)
Net periodic benefit cost	$22	$39	$1	$ 3	$44	$78	$2	$ 6

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The Company made the following contributions to its pension and other postretirement plans for the six months ended June 30, 2018 and 2017:

	Six Months Ended June 30	
($ in millions)	2018	2017
Pension plans		
Qualified minimum	$—	$—
Discretionary		
Qualified	84	91
Non-qualified	3	3
Other benefit plans	16	17
Total contributions	$103	$111

For the year ending December 31, 2018, the Company expects cash contributions to its qualified benefit pension plans to be $508 million, all of which will be discretionary.

17. STOCK COMPENSATION PLANS

During the six months ended June 30, 2018 and 2017, the Company issued new stock awards as follows:

Restricted Performance Stock Rights - For the six months ended June 30, 2018, the Company granted approximately 0.1 million RPSRs at a weighted average share price of $260.69. These rights are subject to cliff vesting on December 31, 2020. For the six months ended June 30, 2017, the Company granted approximately 0.1 million RPSRs at a weighted average share price of $219.47. These rights are subject to cliff vesting on December 31, 2019. All of the RPSRs are subject to the achievement of performance-based targets at the end of the respective vesting periods and will ultimately vest between 0% and 200% of grant date value.

For the six months ended June 30, 2018 and 2017, 0.2 million and 0.4 million stock awards vested, respectively, of which approximately 0.1 million and 0.2 million, respectively, were transferred to the Company from employees in satisfaction of minimum tax withholding obligations.

The following table summarizes the status of the Company's outstanding stock awards as of June 30, 2018.

	Stock Awards (in thousands)	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (in years)
Total stock awards	403	$ 174.45	1.1

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Compensation Expense

The Company recorded stock-based compensation for the value of awards granted to Company employees and non-employee members of the board of directors for the three months ended June 30, 2018 and 2017, of $8 million and $14 million, respectively. The Company recorded stock-based compensation for the value of awards granted to Company employees and non-employee members of the board of directors for the six months ended June 30, 2018 and 2017, of $15 million and $20 million, respectively

The Company recorded tax benefits related to stock awards of $2 million and $5 million, respectively, for the three months ended June 30, 2018 and 2017. The Company recorded tax benefits related to stock awards of $3 million and $8 million for the six months ended June 30, 2018 and 2017, respectively. The Company recognized tax benefits associated with the issuance of stock in settlement of stock awards for the three months ended June 30, 2018 and 2017, of less than $1 million and $1 million, respectively. The Company recognized tax benefits associated with the issuance of stock in settlement of stock awards for the six months ended June 30, 2018 and 2017, of $7 million and $24 million, respectively.

Unrecognized Compensation Expense

As of June 30, 2018, the Company had less than $1 million of unrecognized compensation expense associated with Restricted Stock Rights granted in 2017, which will be recognized over a weighted average period of 1.3 years, and $37 million of unrecognized compensation expense associated with RPSRs granted in 2018, 2017, and 2016, which will be recognized over a weighted average period of 1.3 years.

18. SUBSIDIARY GUARANTORS

As described in Note 13, the Company issued senior notes through the consolidating parent company, HII. Performance of the Company's obligations under its senior notes outstanding as of June 30, 2018, and December 31, 2017, including any repurchase obligations resulting from a change of control, is fully and unconditionally guaranteed, jointly and severally, on an unsecured basis, by each of HII's existing and future material domestic subsidiaries ("Subsidiary Guarantors"). The Subsidiary Guarantors are 100% owned by HII. Under SEC Regulation S-X Rule 3-10, each HII subsidiary that did not provide a guarantee ("Non-Guarantors") is minor and HII, as the parent company issuer, did not have independent assets or operations. There are no significant restrictions on the ability of the parent company and the Subsidiary Guarantors to obtain funds from their respective subsidiaries by dividend or loan, except those imposed by applicable law.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Our Business

Huntington Ingalls Industries, Inc. ("HII", "we", "us", or "our") is America’s largest military shipbuilding company and a provider of professional services to partners in government and industry. For more than a century, our Ingalls segment in Mississippi and Newport News segment in Virginia have built more ships in more ship classes than any other U.S. naval shipbuilder. We also provide a range of services to the governmental, energy, and oil and gas markets through our Technical Solutions segment.

We conduct most of our business with the U.S. Government, primarily the DoD. As prime contractor, principal subcontractor, team member, or partner, we participate in many high-priority U.S. defense technology programs.

Ingalls includes our non-nuclear ship design, construction, repair, and maintenance businesses. Newport News includes all of our nuclear ship design, construction, overhaul, refueling, and repair and maintenance businesses. Our Technical Solutions segment provides a wide range of professional services, including fleet support, integrated mission solutions, nuclear and environmental, and oil and gas services.

The following discussion should be read along with the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q, as well as our Annual Report on Form 10-K for the year ended December 31, 2017.

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Business Environment

In August 2011, the Budget Control Act (the "BCA") established limits on U.S. Government discretionary spending, including a reduction of defense spending by approximately $487 billion for fiscal years 2012 through 2021. The BCA also provided that the defense budget would face “sequestration” cuts of up to an additional $500 billion during that same period, to the extent that discretionary spending limits are exceeded, and $500 billion for non-defense discretionary spending, including the U.S. Coast Guard.

The BBA 2018 provided sequestration relief for fiscal years 2018 and 2019 and raised the budget topline for defense and non-defense discretionary spending. However, sequestration remains in effect for fiscal years 2020 and 2021. Long-term uncertainty remains with respect to overall levels of defense spending across the future years defense plan, and it is likely that U.S. Government discretionary spending levels will continue to be subject to significant pressure.

While the Consolidated Appropriations Act for 2018 (the "CAA 2018"), a $1.3 trillion spending bill that funds the federal government through September 30, 2018, supports spending at BBA 2018 levels for defense and non-defense discretionary accounts, we cannot predict the impact that sequestration cuts or reprioritization of readiness and modernization investment may have on future funding for our individual programs. Long-term funding for certain programs in which we participate may be reduced, delayed, or canceled. In addition, spending cuts and/or reprioritization of defense investment could adversely affect the viability of our suppliers and subcontractors and employee base. Our contracts or subcontracts under programs in which we participate may be terminated or adjusted by the U.S. Government or the prime contractor as a result of lack of government funding or reductions or delays in government funding. Significant reductions in the number of ships procured by the U.S. Navy or significant delays in funding our ship programs would have a material effect on our financial position, results of operations, or cash flows.

The budget environment, including sequestration as currently mandated, remains a significant long-term risk. Considerable uncertainty exists regarding how future budget and program decisions will develop and what challenges budget changes will present for the defense industry. We believe continued budget pressures that result from sequestration and other budget priorities will have serious negative consequences for the security of our country, the defense industrial base, including us, and the customers, employees, suppliers, subcontractors, investors, and communities that rely on companies in the defense industrial base. Although it is difficult to determine specific impacts, we expect that over the longer term, the budget environment may result in fewer contract awards and lower revenues, profits, and cash flows from our U.S. Government contracts. Congress and the Administration continue to discuss various options to address sequestration in future budget planning, but we cannot predict the outcome of these efforts. It is likely budget and program decisions made in this environment will have long-term impacts on us and the entire defense industry.

Critical Accounting Policies, Estimates, and Judgments

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2017, we consider our policies relating to the following matters to be critical accounting policies:

- Revenue recognition;

- Purchase accounting, goodwill, and intangible assets;

- Litigation, commitments, and contingencies;

- Retirement related benefit plans; and

- Workers' compensation.

Significant changes to our critical accounting policies from the adoption of Topic 606 are discussed below:

Revenue Recognition - Most of our revenues are derived from long-term contracts for the production of goods and services provided to the U.S. Government, which are accounted for in accordance with accounting principles generally accepted in the United States of America ("GAAP"), generally recognizing revenues over time using a cost-to-cost measure of progress. We also have other types of contracts, such as services or commercial

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arrangements, for which revenues are recognized over time or at a point in time, depending upon the facts and circumstances of the related arrangement. To determine the proper revenue recognition method, we consider whether two or more contracts should be combined and accounted for as one contract and whether a single contract should be accounted for as more than one performance obligation. A contract performance obligation is a promise to transfer a distinct good or service to the customer and is the unit of account.

Many contracts contain positive and negative profit incentives based upon performance relative to predetermined targets that may occur during or subsequent to delivery of the product. These incentives take the form of potential additional fees to be earned or penalties to be incurred. We generally estimate incentives and award fees utilizing a most likely amount approach. In all such instances, the estimated revenues represent those amounts for which we believe a significant reversal of revenue is not probable.

Contracts

We generate most of our revenues from long-term U.S. Government contracts for design, production, and support activities. Government contracts typically include the following cost elements: direct material, labor and subcontracting costs, and certain indirect costs, including allowable general and administrative expenses. Unless otherwise specified in a contract, costs billed to contracts with the U.S. Government are treated as allowable and allocable costs under the Federal Acquisition Regulation ("FAR") and the U.S. Cost Accounting Standards ("CAS") regulations. Examples of costs incurred by us that are not allowable under the FAR and CAS regulations include certain legal costs, lobbying costs, charitable donations, interest expense, and advertising costs.

We monitor our policies and procedures with respect to our contracts on a regular basis to ensure consistent application under similar terms and conditions, as well as compliance with all applicable government regulations. In addition, the Defense Contract Audit Agency routinely audits the costs we incur that are allocated to contracts with the U.S. Government.

Our contracts typically fall into one of four categories: firm fixed-price, fixed-price incentive, cost-type, and time and materials. See Note 8: Revenue.

- Firm Fixed-Price Contracts - A firm fixed-price contract is a contract in which the specified scope of work is agreed to for a price that is predetermined by bid or negotiation and not generally subject to adjustment regardless of costs incurred by the contractor.

- Fixed-Price Incentive Contracts - Fixed-price incentive contracts provide for reimbursement of the contractor's allowable costs, but are subject to a cost-share limit that affects profitability. Fixed-price incentive contracts effectively become firm fixed-price contracts once the cost-share limit is reached.

- Cost-Type Contracts - Cost-type contracts provide for reimbursement of the contractor's allowable costs plus a fee that represents profit. Cost-type contracts generally require that the contractor use its reasonable efforts to accomplish the scope of the work within some specified time and some stated dollar limitation.

- Time and Materials - Time and material contracts specify a fixed hourly billing rate for each direct labor hour expended and reimbursement for allowable material costs and expenses.

Contract Fees - Negotiated contract fee structures include: fixed fee amounts, cost sharing arrangements to reward or penalize contractors for under or over cost target performance, respectively, positive award fees, and negative penalty arrangements. Profit margins may vary materially depending on the negotiated contract fee arrangements, percentage-of-completion of the contract, the achievement of performance objectives, and the stage of performance at which the right to receive fees, particularly under incentive and award fee contracts, is finally determined.

Award Fees - Certain contracts contain award fees based on performance criteria such as cost, schedule, quality, and technical performance. Award fees are determined and earned based on an evaluation by the customer of our performance against such negotiated criteria. We consider award fees to be variable consideration and generally include these fees in the transaction price using a most likely amount approach. Award fees are limited to the extent of funding alloted by the customer and available for performance and those amounts for which a significant reversal of revenue is not probable.

Program Descriptions

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For convenience, a brief description of certain programs discussed in this Quarterly Report on Form 10-Q is included in the "Glossary of Programs" in this section.

CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the following table:

	Three Months Ended				Six Months Ended			
	June 30		2018 over 2017		June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
Sales and service revenues	$2,020	$1,858	$162	9 %	$3,894	$3,582	$312	9 %
Cost of product sales and service revenues	1,568	1,436	132	9 %	3,063	2,816	247	9 %
Income (loss) from operating investments, net	2	1	1	100 %	4	3	1	33 %
Other income and gains	12	—	12	— %	14	—	14	— %
General and administrative expenses	209	182	27	15 %	401	360	41	11 %
Operating income (loss)	257	241	16	7 %	448	409	39	10 %
Other income (expense)								
Interest expense	(15)	(17)	2	12 %	(30)	(35)	5	14 %
Non-operating retirement expense	19	(4)	23	575 %	37	(8)	45	563 %
Other, net	1	(2)	3	150 %	2	(1)	3	300 %
Federal and foreign income taxes	23	71	(48)	(68)%	62	99	(37)	(37)%
Net earnings (loss)	$239	$147	$92	63 %	$395	$266	$129	48 %

Operating Performance Assessment and Reporting

We manage and assess the performance of our business based on our performance on individual contracts and programs using the financial measures referred to below, with consideration given to the Critical Accounting Policies, Estimates, and Judgments referred to in this section. Our portfolio of long-term contracts is primarily flexibly-priced. As a result, sales tend to fluctuate in concert with costs across our large portfolio of active contracts, with operating income being a critical measure of operating performance. Under FAR rules that govern our business with the U.S. Government, most types of costs are allowable, and we do not focus on individual cost groupings, such as cost of sales or general and administrative expenses, as much as we do on total contract costs, which are a key factor in determining contract operating income. As a result, in evaluating our operating performance, we look primarily at changes in sales and service revenues, as well as operating income, including the effects of significant changes in operating income as a result of changes in contract estimates and the use of the cumulative catch-up method of accounting in accordance with GAAP. This approach is consistent with the long-term life cycle of our contracts, as management assesses each contract bid based upon net sales and operating profit and monitors contract performance in a similar manner through contract completion. Consequently, our discussion of business segment performance focuses on net sales and operating profit, consistent with our approach for managing our business.

Cost of sales for both product sales and service revenues consists of materials, labor, and subcontracting costs, as well as an allocation of indirect costs for overhead. We manage the type and amount of costs at the contract level, which is the basis for estimating our total costs at completion of our contracts. Unusual fluctuations in operating performance driven by changes in a specific cost element across multiple contracts are described in our analysis.

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Sales and Service Revenues

Sales and service revenues were comprised as follows:

	Three Months Ended					Six Months Ended				
	June 30		2018 over 2017			June 30		2018 over 2017		
($ in millions)	2018	2017	Dollars	Percent		2018	2017	Dollars	Percent	
Product sales	$1,499	$1,397	$102	7	%	$2,869	$2,697	$172	6	%
Service revenues	521	461	60	13	%	1,025	885	140	16	%
Sales and service revenues	$2,020	$1,858	$162	9	%	$3,894	$3,582	$312	9	%

Product sales for the three months ended June 30, 2018, increased $102 million, or 7%, compared with the same period in 2017. Product sales for the six months ended June 30, 2018, increased $172 million, or 6%, compared with the same period in 2017. Ingalls product sales decreased $6 million for the three months ended June 30, 2018, primarily as a result of lower volumes in the Legend class NSC program and surface combatants, partially offset by higher volumes in amphibious assault ships. Ingalls product sales increased $22 million for the six months ended June 30, 2018, primarily as a result of higher volumes in amphibious assault ships, partially offset by lower volumes in the Legend class NSC program. Newport News product sales increased $109 million and $163 million for the three and six months ended June 30, 2018, respectively, primarily as a result of higher volumes in aircraft carriers. Technical Solutions product sales decreased $1 million for the three months ended June 30, 2018, primarily as a result of lower volumes in integrated mission solutions products. Technical Solutions product sales decreased $13 million for the six months ended June 30, 2018, primarily as a result of lower volumes on nuclear and environmental products.

Service revenues for the three months ended June 30, 2018, increased $60 million, or 13%, compared with the same period in 2017. Service revenues for the six months ended June 30, 2018, increased $140 million, or 16%, compared with the same period in 2017. Ingalls service revenues decreased $4 million for the three months ended June 30, 2018, primarily as a result of lower volumes in surface combatants services, partially offset by higher volumes in amphibious assault ships services. Ingalls service revenues increased $3 million for the six months ended June 30, 2018, as a result of higher volumes in amphibious assault ships services, partially offset by lower volumes in surface combatants services. Newport News service revenues increased $71 million for the three months ended June 30, 2018, primarily as a result of higher volumes in naval nuclear support services and submarines services. Newport News service revenues increased $128 million for the six months ended June 30, 2018, primarily as a result of higher volumes in naval nuclear support services and submarines services, partially offset by lower volumes in aircraft carriers services. Technical Solutions service revenues decreased $7 million for the three months ended June 30, 2018, primarily as a result of lower volumes in fleet support, integrated mission solutions, and nuclear and environmental services, partially offset by higher volumes in oil and gas services. Technical Solutions service revenues increased $9 million for the six months ended June 30, 2018, primarily as a result of higher volumes in oil and gas services, partially offset by lower volumes in integrated mission solutions and nuclear and environmental services.

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Cost of Sales and Service Revenues

Cost of product sales, cost of service revenues, income from operating investments, net, and general and administrative expenses were as follows:

	Three Months Ended					Six Months Ended				
	June 30		2018 over 2017			June 30		2018 over 2017		
($ in millions)	2018	2017	Dollars	Percent		2018	2017	Dollars	Percent	
Cost of product sales	$1,147	$1,061	$86	8	%	$2,210	$2,088	$122	6	%
% of product sales	76.5 %	75.9 %				77.0 %	77.4 %			
Cost of service revenues	421	375	46	12	%	853	728	125	17	%
% of service revenues	80.8 %	81.3 %				83.2 %	82.3 %			
Income (loss) from operating investments, net	2	1	1	100	%	4	3	1	33	%
Other income and gains	12	—	12	—	%	14	—	14	—	%
General and administrative expenses	209	182	27	15	%	401	360	41	11	%
% of sales and service revenues	10.3 %	9.8 %				10.3 %	10.1 %			
Cost of sales and service revenues	$1,763	$1,617	$146	9	%	$3,446	$3,173	$273	9	%

Cost of Product Sales

Cost of product sales for the three months ended June 30, 2018, increased $86 million, or 8%, compared with the same period in 2017. Cost of product sales for the six months ended June 30, 2018, increased $122 million, or 6%, compared with the same period in 2017. Ingalls cost of product sales increased $11 million for the three months ended June 30, 2018, primarily driven by higher volumes in amphibious assault ships, partially offset by lower volumes in surface combatants and the Legend class NSC program. Ingalls cost of product sales increased $31 million for the six months ended June 30, 2018, primarily as a result of higher volumes in amphibious assault ships, as well as one time employee bonus payments in 2018 related to the Tax Act, partially offset by lower volumes in surface combatants and the Legend class NSC program. Newport News cost of product sales increased $89 million for the three months ended June 30, 2018, primarily as a result of the volume changes described above. Newport News cost of product sales increased $154 million for the six months ended June 30, 2018, primarily as a result of the volume changes described above, as well as one time employee bonus payments in 2018 related to the Tax Act. Technical Solutions cost of product sales increased $1 million for the three months ended June 30, 2018, primarily as a result of the volume changes described above. Technical Solutions cost of product sales decreased $34 million for the six months ended June 30, 2018, primarily due to an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017 and the lower volumes described above. Cost of product sales related to the Operating FAS/CAS Adjustment decreased $15 million and $29 million for the three and six months ended June 30, 2018, respectively, as described below.

Cost of product sales as a percentage of product sales increased from 75.9% for the three months ended June 30, 2017, to 76.5% for the three months ended June 30, 2018. A favorable change in the Operating FAS/CAS Adjustment was offset by lower risk retirement on Tripoli (LHA 7) and the Legend class NSC program, as well as year-to-year variances in contract mix. Cost of product sales as a percentage of product sales decreased from 77.4% for the six months ended June 30, 2017, to 77.0% for the six months ended June 30, 2018. This decrease was primarily due to an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017, a favorable change in the Operating FAS/CAS Adjustment, and higher risk retirement on the San Antonio class (LPD 17) program, partially offset by one time employee bonus payments in 2018 related to the Tax Act, lower risk retirement on Tripoli (LHA 7) and the Legend class NSC program, and year-to-year variances in contract mix.

Cost of Service Revenues

Cost of service revenues for the three months ended June 30, 2018, increased $46 million, or 12%, compared with the same period in 2017. Cost of service revenues for the six months ended June 30, 2018, increased $125 million, or 17%, compared with the same period in 2017. Ingalls cost of service revenues decreased $5 million for the three

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months ended June 30, 2018, primarily as a result of the volume changes described above. Ingalls cost of service revenues increased $5 million for the six months ended June 30, 2018, primarily as a result of the volume changes described above and the recognition of a loss provision on a long-term design contract. Newport News cost of service revenues increased $64 million and $120 million for the three and six months ended June 30, 2018, respectively, primarily as a result of the volume changes described above. Technical Solutions cost of service revenues decreased $8 million for the three months ended June 30, 2018, primarily due to the lower volumes described above. Technical Solutions cost of service revenues increased $10 million for the six months ended June 30, 2018, primarily due to the higher volumes described above, as well as one time employee bonus payments in 2018 related to the Tax Act. Cost of service revenues related to the Operating FAS/CAS Adjustment decreased $5 million and $10 million for the three and six months ended June 30, 2018, respectively, as described below.

Cost of service revenues as a percentage of service revenues decreased from 81.3% for the three months ended June 30, 2017, to 80.8% for the three months ended June 30, 2018, primarily driven by year-to-year variances in contract mix and a favorable change in the Operating FAS/CAS Adjustment. Cost of service revenues as a percentage of service revenues increased from 82.3% for the six months ended June 30, 2017, to 83.2% for the six months ended June 30, 2018, primarily driven by one time employee bonus payments in 2018 related to the Tax Act and the recognition of a loss provision on a long-term design contract, as well as year-to-year variances in contract mix, partially offset by a favorable change in the Operating FAS/CAS Adjustment.

Income (Loss) from Operating Investments, Net

The activities of our operating investments are closely aligned with the operations of the segments holding the investments. We therefore record income related to earnings from equity method investments in our operating income.

Income from operating investments, net for the three and six months ended June 30, 2018, increased $1 million from the same respective periods in 2017.

Other Income and Gains

Other income and gains for the three and six months ended June 30, 2018, increased $12 million and $14 million, respectively, from the same periods in 2017, primarily as a result of recoveries related to a settlement agreement at our Ingalls segment.

General and Administrative Expenses

In accordance with industry practice and the regulations that govern the cost accounting requirements for government contracts, most general and administrative expenses are considered allowable and allocable costs on government contracts. These costs are allocated to contracts in progress on a systematic basis and contract performance factors include this cost component as an element of cost.

General and administrative expenses for the three months ended June 30, 2018, increased $27 million compared with the same period in 2017, primarily driven by higher overhead costs and current state income tax expense. General and administrative expenses for the six months ended June 30, 2018 increased $41 million compared with the same period in 2017, primarily driven by higher overhead costs and current state income tax expense, partially offset by deferred state income tax expense.

Operating Income

We consider operating income to be an important measure for evaluating our operating performance, and, as is typical in the industry, we define operating income as revenues less the related cost of producing the revenues and general and administrative expenses.

We internally manage our operations by reference to "segment operating income," which is defined as operating income before the Operating FAS/CAS Adjustment and non-current state income taxes, neither of which affects segment performance. Segment operating income is not a recognized measure under GAAP. When analyzing our operating performance, investors should use segment operating income in addition to, and not as an alternative for, operating income or any other performance measure presented in accordance with GAAP. It is a measure we use

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to evaluate our core operating performance. We believe segment operating income reflects an additional way of viewing aspects of our operations that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our business. We believe the measure is used by investors and is a useful indicator to measure our performance. Because not all companies use identical calculations, our presentation of segment operating income may not be comparable to similarly titled measures of other companies.

The following table reconciles segment operating income to operating income:

	Three Months Ended				Six Months Ended			
	June 30		2018 over 2017		June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
Operating income (loss)	$257	$241	$16	7 %	$448	$409	$39	10 %
Operating FAS/CAS Adjustment	(73)	(53)	(20)	(38)%	(145)	(106)	(39)	(37)%
Non-current state income taxes	(3)	(1)	(2)	(200)%	(5)	4	(9)	(225)%
Segment operating income (loss)	$181	$187	$(6)	(3)%	$298	$307	$(9)	(3)%

Segment Operating Income

Segment operating income for the three months ended June 30, 2018, was $181 million, a decrease of $6 million from the same period in 2017. The decrease was primarily due to lower risk retirement on Tripoli (LHA 7) and the Legend class NSC program, partially offset by higher risk retirement on Arleigh Burke class (DDG 51) destroyers and the San Antonio class (LPD 17) program, as well as recoveries related to a settlement agreement at our Ingalls segment. Segment operating income for the six months ended June 30, 2018, was $298 million, a decrease of $9 million from the same period in 2017. The decrease was primarily due to lower risk retirement on the Legend class NSC program, one time employee bonus payments in 2018 related to the Tax Act, and year-to-year variances in contract mix, partially offset by an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017, higher risk retirement on the San Antonio class (LPD 17) program and Arleigh Burke class (DDG 51) destroyers, and recoveries related to a settlement agreement at our Ingalls segment.

Activity within each segment is discussed in Segment Operating Results below.

FAS/CAS Adjustment and Operating FAS/CAS Adjustment

The FAS/CAS Adjustment reflects the difference between expenses for pension and other postretirement benefits determined in accordance with GAAP ("FAS") and the expenses for these items included in segment operating income in accordance with U.S. Cost Accounting Standards ("CAS"). The Operating FAS/CAS Adjustment excludes the following components of net periodic benefit costs: interest cost, expected return on plan assets, amortization of prior service cost (credit) and actuarial loss (gain), and settlement and curtailment effects.

The components of the Operating FAS/CAS Adjustment were as follows:

	Three Months Ended				Six Months Ended			
	June 30		2018 over 2017		June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
FAS expense	$(23)	$(42)	$19	45 %	$(46)	$(84)	$38	45 %

CAS cost	115	91	24	26 %	228	182	46	25 %
FAS/CAS Adjustment	92	49	43	88 %	182	98	84	86 %
Non-operating retirement expense	(19)	4	(23)	(575)%	(37)	8	(45)	(563)%
Operating FAS/CAS Adjustment	$73	$53	$20	38 %	$145	$106	$39	37 %

The Operating FAS/CAS Adjustment was a net benefit of $73 million and $53 million for the three months ended June 30, 2018 and 2017, respectively. The Operating FAS/CAS Adjustment was a net benefit of $145 million and $106 million for the six months ended June 30, 2018 and 2017, respectively. The favorable changes in the Operating FAS/CAS Adjustment of $20 million and $39 million for the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, were primarily driven by impacts of lower discount and interest rates.

Non-current State Income Taxes

Non-current state income taxes include deferred state income taxes, which reflect the change in deferred state tax assets and liabilities, and the tax expense or benefit associated with changes in state uncertain tax positions in the relevant period. These amounts are recorded within operating income. Current period state income tax expense is charged to contract costs and included in cost of sales and service revenues in segment operating income.

Non-current state income tax benefit for the three months ended June 30, 2018, was $3 million, compared to a non-current state income tax benefit of $1 million for the same period in 2017. The increase in non-current state income tax benefit was primarily attributable to changes in pension related adjustments. Non-current state income tax benefit for the six months ended June 30, 2018, was $5 million, compared to a non-current state income tax expense of $4 million for the same period in 2017. The favorable change in non-current state income taxes was primarily attributable to changes in pension related adjustments.

Interest Expense

Interest expense for the three and six months ended June 30, 2018, decreased $2 million and $5 million, respectively, compared with the same periods in 2017, primarily as a result of refinancing 5.000% senior notes due in 2021 with 3.483% senior notes due in 2027.

Non-Operating Retirement Expense

The non-operating retirement expense includes the following components of net periodic benefit costs: interest cost, expected return on plan assets, amortization of prior service cost (credit) and actuarial loss (gain), and settlement and curtailment effects. For the three and six months ended June 30, 2018, the favorable changes in the non-operating retirement expense of $23 million and $45 million, respectively, were primarily driven by favorable 2017 returns on plan assets.

Federal and Foreign Income Taxes

Our effective tax rate on earnings from operations for the three months ended June 30, 2018, was 8.8%, compared with 32.6% for the same period in 2017. Our effective tax rate on earnings from operations for the six months ended June 30, 2018, was 13.6%, compared with 27.1% for the same period in 2017. The lower effective tax rate for the three months ended June 30, 2018, was primarily attributable to a claim for higher research and development tax credits for the post-spin-off 2011 through 2015 tax years and the reduction in the federal corporate income tax rate, partially offset by an increase in unrecognized tax benefits and the repeal of the domestic manufacturing deduction effective January 1, 2018. The lower effective tax rate for the six months ended June 30, 2018, was primarily attributable to the reduction in the federal corporate income tax rate and a claim for higher research and development tax credits for the post-spin-off 2011 through 2015 tax years, partially offset by a reduction in the income tax benefits resulting from stock award settlement activity and an increase in unrecognized tax benefits. The reduction in the federal corporate income tax rate from 35% to 21% and the repeal of the domestic manufacturing deduction are provisions of the Tax Act. Our effective tax rates for the three and six months ended June 30, 2018, differed from the federal statutory rates primarily as a result of a claim for higher research and development tax credits for the post-spin-off 2011 through 2015 tax years. See Note 12: Income Taxes and Note 17: Stock Compensation Plans.

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SEGMENT OPERATING RESULTS

Basis of Presentation

We are aligned into three reportable segments: Ingalls, Newport News, and Technical Solutions.

Segment operating results are presented in the following table:

	Three Months Ended June 30		2018 over 2017		Six Months Ended June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
Sales and Service Revenues								
Ingalls	$629	$639	$(10)	(2)%	$1,214	$1,189	$25	2 %
Newport News	1,183	1,001	182	18 %	2,265	1,972	293	15 %
Technical Solutions	243	244	(1)	— %	476	469	7	1 %
Intersegment eliminations	(35)	(26)	(9)	(35)%	(61)	(48)	(13)	(27)%
Sales and service revenues	$2,020	$1,858	$162	9 %	$3,894	$3,582	$312	9 %
Operating Income (Loss)								
Ingalls	$83	$98	$(15)	(15)%	$147	$164	$(17)	(10)%
Newport News	91	80	11	14 %	142	152	(10)	(7)%
Technical Solutions	7	9	(2)	(22)%	9	(9)	18	200 %
Segment operating income (loss)	181	187	(6)	(3)%	298	307	(9)	(3)%
Non-segment factors affecting operating income (loss)								
Operating FAS/CAS Adjustment	73	53	20	38 %	145	106	39	37 %
Non-current state income taxes	3	1	2	200 %	5	(4)	9	225 %
Operating income (loss)	$257	$241	$16	7 %	$448	$409	$39	10 %

KEY SEGMENT FINANCIAL MEASURES

Sales and Service Revenues

Period-to-period revenues reflect performance under new and ongoing contracts. Changes in sales and service revenues are typically expressed in terms of volume. Unless otherwise described, volume generally refers to increases (or decreases) in reported revenues due to varying production activity levels, delivery rates, or service levels on individual contracts. Volume changes will typically carry a corresponding income change based on the margin rate for a particular contract.

Segment Operating Income

Segment operating income reflects the aggregate performance results of contracts within a segment. Excluded from this measure are certain costs not directly associated with contract performance, including the Operating FAS/CAS Adjustment and non-current state income taxes. Changes in segment operating income are typically expressed in terms of volume, as discussed above, or performance. Performance refers to changes in contract margin rates. These changes typically relate to profit recognition associated with revisions to total estimated costs at completion ("EAC") of a contract, which reflect improved or deteriorated operating performance on that contract. Operating income changes are accounted for on a cumulative to date basis at the time an EAC change is recorded. Segment operating income may be affected by, among other things, contract performance, the effects of workforce stoppages, the effects of natural disasters such as hurricanes, resolution of disputed items with the customer, recovery of insurance proceeds, and other discrete events. At the completion of a long-term contract, any originally estimated costs not incurred or reserves not fully utilized, such as warranty reserves, could also impact contract earnings. Where such items have occurred and the effects are material, a separate description is provided.

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Cumulative Adjustments

For the three and six months ended June 30, 2018 and 2017, favorable and unfavorable cumulative catch-up adjustments were as follows:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
($ in millions)	2018	2017	2018	2017
Gross favorable adjustments	$50	$88	$102	$145
Gross unfavorable adjustments	(13)	(28)	(37)	(59)
Net adjustments	$37	$60	$65	$86

For the three months ended June 30, 2018, favorable cumulative catch-up adjustments were related to risk retirement on the San Antonio class (LPD 17) program and other individually insignificant adjustments. During the same period, none of the unfavorable cumulative catch-up adjustments were individually significant. For the six months ended June 30, 2018, favorable cumulative catch-up adjustments were related to risk retirement on the San Antonio class (LPD 17) program, as well as other individually insignificant adjustments. During the same period, none of the unfavorable cumulative catch-up adjustments were individually significant.

For the three months ended June 30, 2017, favorable cumulative catch-up adjustments were related to risk retirement on the Tripoli (LHA 7) and the Legend class NSC program, as well as other individually insignificant adjustments. During the same period, none of the unfavorable cumulative catch-up adjustments were individually significant. For the six months ended June 30, 2017, favorable cumulative catch-up adjustments were related to risk retirement on the Legend class NSC program and Tripoli (LHA 7), as well as other individually insignificant adjustments. During the same period, none of the unfavorable cumulative catch-up adjustments were individually significant.

Ingalls

	Three Months Ended				Six Months Ended			
	June 30		2018 over 2017		June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
Sales and service revenues	$629	$639	$(10)	(2)%	$1,214	$1,189	$25	2 %
Segment operating income (loss)	83	98	(15)	(15)%	147	164	(17)	(10)%
As a percentage of segment sales	13.2 %	15.3 %			12.1 %	13.8 %		

Sales and Service Revenues

Ingalls revenues for the three months ended June 30, 2018, decreased $10 million, or 2%, from the same period in 2017, primarily driven by lower revenues in the Legend class NSC program and surface combatants, partially offset by higher revenues in amphibious assault ships. Revenues on the Legend class NSC program decreased due to lower volumes on Midgett (NSC 8) and Kimball (NSC 7), partially offset by higher volume on Stone (NSC 9). Surface combatants revenues decreased due to lower volumes on the delivered USS Ralph Johnson (DDG 114) and Lenah H. Sutcliffe Higbee (DDG 123), partially offset by higher volumes on USS Fitzgerald (DDG 62) repair and restoration and Delbert D. Black (DDG 119). Amphibious assault ships revenues increased due to higher volumes on Fort Lauderdale (LPD 28), Bougainville (LHA 8), and Richard M. McCool Jr. (LPD 29), partially offset by lower volume on the delivered USS Portland (LPD 27), as well as Tripoli (LHA 7).

Ingalls revenues for the six months ended June 30, 2018, increased $25 million, or 2%, from the same period in 2017, primarily driven by higher revenues in amphibious assault ships, partially offset by lower revenues in the Legend class NSC program and surface combatants. Amphibious assault ships revenues increased due to higher volumes on Fort Lauderdale (LPD 28), Richard M. McCool Jr. (LPD 29), and Bougainville (LHA 8), partially offset by lower volumes on the delivered USS Portland (LPD 27) and Tripoli (LHA 7). Revenues on the Legend class NSC program decreased due to lower volume on Kimball (NSC 7), partially offset by higher volume on Stone (NSC 9). Surface combatants revenues decreased due to lower volumes on Lenah H. Sutcliffe Higbee (DDG 123), the delivered USS Ralph Johnson (DDG 114), and the delivered USS John Finn (DDG 113), partially offset by higher

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volumes on USS Fitzgerald (DDG 62) repair and restoration, Jack H. Lucas (DDG 125), Delbert D. Black (DDG 119), and Frank E. Petersen Jr. (DDG 121).

Segment Operating Income

Ingalls segment operating income for the three months ended June 30, 2018, was $83 million, compared with $98 million for the same period in 2017. The decrease was primarily due to lower risk retirement on Tripoli (LHA 7) and the Legend class NSC program, partially offset by higher risk retirement on Arleigh Burke class (DDG 51) destroyers and the San Antonio class (LPD 17) program, as well as recoveries related to a settlement agreement.

Ingalls segment operating income for the six months ended June 30, 2018, was $147 million, compared with $164 million for the same period in 2017. The decrease was primarily due to lower risk retirement on Tripoli (LHA 7) and the Legend class NSC program, partially offset by higher risk retirement on the San Antonio class (LPD 17) program and Arleigh Burke class (DDG 51) destroyers, as well as recoveries related to a settlement agreement.

Newport News

	Three Months Ended				Six Months Ended			
	June 30		2018 over 2017		June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
Sales and service revenues	$1,183	$1,001	$182	18 %	$2,265	$1,972	$293	15 %
Segment operating income (loss)	91	80	11	14 %	142	152	(10)	(7)%
As a percentage of segment sales	7.7 %	8.0 %			6.3 %	7.7 %		

Sales and Service Revenues

Newport News revenues for the three and six months ended June 30, 2018, increased $182 million and $293 million, or 18% and 15%, respectively, from the same periods in 2017, primarily driven by higher revenues in aircraft carriers, naval nuclear support services, and submarines. Aircraft carriers revenues increased primarily as a result of higher volumes on the execution contract for the RCOH of USS George Washington (CVN 73), the construction contract for John F. Kennedy (CVN 79), and the advance planning contract for Enterprise (CVN 80), partially offset by lower volumes on the execution contract for the RCOH of the redelivered USS Abraham Lincoln (CVN 72), the inactivation of the decommissioned aircraft carrier Enterprise (CVN 65), and the construction contract for the delivered USS Gerald R. Ford (CVN 78). Naval nuclear support services revenues increased primarily as a result of higher volumes in submarine support and facility maintenance services, partially offset by lower volumes in aircraft carriers support. Submarines revenues related to the Virginia class (SSN 774) submarine program increased due to higher volumes on Block IV and Block V boats, partially offset by lower volumes on Block III boats.

Segment Operating Income

Newport News segment operating income for the three months ended June 30, 2018, was $91 million, compared with $80 million for the same period in 2017. The increase was primarily due to the higher volumes described above.

Newport News segment operating income for the six months ended June 30, 2018, was $142 million, compared with $152 million for the same period in 2017. The decrease was primarily due to one time employee bonus payments in 2018 related to the Tax Act, as well as year-to-year variances in contract mix, partially offset by the higher volumes described above.

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Technical Solutions

	Three Months Ended				Six Months Ended			
	June 30		2018 over 2017		June 30		2018 over 2017	
($ in millions)	2018	2017	Dollars	Percent	2018	2017	Dollars	Percent
Sales and service revenues	$243	$244	$(1)	— %	$476	$469	$7	1 %
Segment operating income (loss)	7	9	(2)	(22)%	9	(9)	18	200 %
As a percentage of segment sales	2.9 %	3.7 %			1.9 %	(1.9)%		

Sales and Service Revenues

Technical Solutions revenues for the three months ended June 30, 2018, decreased $1 million from the same period in 2017, primarily due to lower integrated mission solutions, fleet support, and nuclear and environmental revenues, offset by higher revenues in oil and gas services.

Technical Solutions revenues for the six months ended June 30, 2018, increased $7 million, or 1%, from the same period in 2017, primarily due to higher revenues in oil and gas and fleet support services, partially offset by lower nuclear and environmental and integrated mission solutions revenues.

Segment Operating Income

Technical Solutions segment operating income for the three months ended June 30, 2018, was $7 million, compared with $9 million for the same period in 2017. The decrease was primarily due to lower performance in fleet support services.

Technical Solutions segment operating income for the six months ended June 30, 2018, was $9 million, compared with an operating loss of $9 million for the same period in 2017. The increase was primarily due to an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017, partially offset by one time employee bonus payments in 2018 related to the Tax Act.

BACKLOG

Total backlog as of each of June 30, 2018, and December 31, 2017, was approximately $21 billion. Total backlog includes both funded backlog (firm orders for which funding is contractually obligated by the customer) and unfunded backlog (firm orders for which funding is not currently contractually obligated by the customer). Backlog excludes unexercised contract options and unfunded IDIQ orders. For contracts having no stated contract values, backlog includes only the amounts committed by the customer.

The following table presents funded and unfunded backlog by segment as of June 30, 2018, and December 31, 2017:

	June 30, 2018			December 31, 2017		
($ in millions)	Funded	Unfunded	Total Backlog	Funded	Unfunded	Total Backlog
Ingalls	$6,564	$ 2,165	$8,729	$5,920	$ 2,071	$7,991
Newport News	8,004	3,751	11,755	6,976	5,608	12,584
Technical Solutions	405	327	732	478	314	792
Total backlog	$14,973	$ 6,243	$21,216	$13,374	$ 7,993	$21,367

Approximately 32% of the $21 billion total backlog as of December 31, 2017, is expected to be converted into sales in 2018. U.S. Government orders comprised substantially all of the total backlog as of June 30, 2018, and December 31, 2017.

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Awards

The value of new contract awards during the six months ended June 30, 2018, was approximately $3.7 billion. Significant new awards during the period included the detailed design and construction contract for Richard M. McCool Jr. (LPD 29).

LIQUIDITY AND CAPITAL RESOURCES

We endeavor to ensure the most efficient conversion of operating results into cash for deployment in operating our businesses, implementing our business strategy, and maximizing stockholder value. We use various financial measures to assist in capital deployment decision making, including net cash provided by operating activities and free cash flow. We believe these measures are useful to investors in assessing our financial performance.

The following table summarizes key components of cash flow provided by (used in) operating activities:

($ in millions)	Six Months Ended June 30 2018	2017	2018 over 2017 Dollars
Net earnings (loss)	$395	$266	$129
Depreciation and amortization	105	105	—
Provision for doubtful accounts	—	22	(22)
Stock-based compensation	15	20	(5)
Deferred income taxes	11	28	(17)
Retiree benefit funding less than (in excess of) expense	(56)	(27)	(29)
Trade working capital decrease (increase)	(111)	(130)	19
Net cash provided by (used in) operating activities	$359	$284	$75

Cash Flows

We discuss below our major operating, investing, and financing activities for the six months ended June 30, 2018 and 2017, as classified on our unaudited condensed consolidated statements of cash flows.

Operating Activities

Cash provided by operating activities for the six months ended June 30, 2018, was $359 million, compared with $284 million provided by operating activities for the same period in 2017. The favorable change in operating cash flow was primarily due to lower payments for income taxes and a change in trade working capital. The change in trade working capital was primarily driven by the timing of receipts of accounts receivable and payments of accounts payable.

For the six months ended June 30, 2018, we made discretionary contributions to our qualified defined benefit pension plans totaling $84 million, compared with $91 million of discretionary contributions for the same period in 2017. For the year ending December 31, 2018, we expect cash contributions to our qualified benefit pension plans to be $508 million, all of which will be discretionary.

We expect cash generated from operations in combination with our current cash and cash equivalents, as well as existing credit facilities, to be more than sufficient to service debt, meet contractual obligations, and finance capital expenditures for at least the next 12 months.

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Investing Activities

Cash used in investing activities for the six months ended June 30, 2018, was $165 million, compared with $133 million used in investing activities for the same period in 2017. The increase in investing cash used was driven by higher capital expenditures in 2018. For 2018, we expect our capital expenditures for maintenance and sustainment to be approximately 2% to 2.5% and our discretionary capital expenditures to be approximately 3% to 3.5% of annual revenues.

Financing Activities

Cash used in financing activities for the six months ended June 30, 2018, was $497 million, compared with $318 million used in financing activities for the same period in 2017. The increase in cash used was primarily due to an additional $201 million of common stock repurchases and an additional $9 million of cash dividend payments, partially offset by a decrease of $31 million in employee taxes on certain share-based payment arrangements.

Free Cash Flow

Free cash flow represents cash provided by (used in) operating activities less capital expenditures net of related grant proceeds. Free cash flow is not a measure recognized under GAAP. Free cash flow has limitations as an analytical tool and should not be considered in isolation from, or as a substitute for, analysis of our results as reported under GAAP. We believe free cash flow is an important measure for our investors because it provides them insight into our current and period-to-period performance and our ability to generate cash from continuing operations. We also use free cash flow as a key operating metric in assessing the performance of our business and as a key performance measure in evaluating management performance and determining incentive compensation. Free cash flow may not be comparable to similarly titled measures of other companies.

The following table reconciles net cash provided by operating activities to free cash flow:

	Six Months Ended June 30		2018 over 2017
($ in millions)	2018	2017	Dollars
Net cash provided by (used in) operating activities	$359	$284	$ 75
Less capital expenditures:			
Capital expenditure additions	(177)	(137)	(40)
Grant proceeds for capital expenditures	19	—	19
Free cash flow	$201	$147	$ 54

Free cash flow for the six months ended June 30, 2018, increased $54 million from the same period in 2017, primarily due to a change in trade working capital, partially offset by higher capital expenditures.

Governmental Regulation and Supervision

The U.S. Government has the ability, pursuant to regulations relating to contractor business systems, to decrease or withhold contract payments if it determines significant deficiencies exist in one or more such systems. As of June 30, 2018 and 2017, the cumulative amounts of payments withheld by the U.S. Government under our contracts subject to these regulations were not material to our liquidity or cash flows.

In February 2018, we received the findings of an audit conducted by the Defense Contract Audit Agency citing significant deficiencies in our Newport News segment's business system for material management. We submitted a response in June 2018, agreeing in part and disagreeing in part with the audit findings. In the event the U.S. Government makes a final determination that there are remaining significant deficiencies and that our proposed corrective actions are inadequate, the U.S. Government may withhold up to 5% from our interim billings on cost-reimbursement, labor-hour, and time and materials contracts containing the contractor business systems clause, until the U.S. Government determines all significant deficiencies have been remediated, which could have a material impact on the timing of our cash receipts.

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Off-Balance Sheet Arrangements

In the ordinary course of business, we use standby letters of credit issued by commercial banks and surety bonds issued by insurance companies principally to support our self-insured workers' compensation plans. As of June 30, 2018, we had $17 million in standby letters of credit issued but undrawn and $273 million of surety bonds outstanding.

ACCOUNTING STANDARDS UPDATES

See Note 3: Accounting Standards Updates in Part I, Item 1 for information related to accounting standards updates.

FORWARD-LOOKING STATEMENTS AND PROJECTIONS

Statements in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission ("SEC"), as well as other statements we may make from time to time, other than statements of historical fact, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed in these statements. Factors that may cause such differences include:

- Changes in government and customer priorities and requirements (including government budgetary constraints, shifts in defense spending, and changes in customer short-range and long-range plans);
- Our ability to estimate our future contract costs and perform our contracts effectively;
- Changes in procurement processes and government regulations and our ability to comply with such requirements;
- Our ability to deliver our products and services at an affordable life cycle cost and compete within our markets;
- Natural and environmental disasters and political instability;
- Our ability to execute our strategic plan, including with respect to share repurchases, dividends, capital expenditures, and strategic acquisitions;
- Adverse economic conditions in the United States and globally;
- Changes in key estimates and assumptions regarding our pension and retiree health care costs;
- Security threats, including cyber security threats, and related disruptions; and
- Other risk factors discussed herein and in our other filings with the SEC.

There may be other risks and uncertainties that we are unable to predict at this time or that we currently do not expect to have a material adverse effect on our business, and we undertake no obligation to update or revise any forward-looking statements. You should not place undue reliance on any forward looking statements that we may make.

GLOSSARY OF PROGRAMS

Included below are brief descriptions of some of the programs discussed in this Quarterly Report on Form 10-Q.

Program Name	Program Description
America class (LHA 6) amphibious assault ships	Design and build large deck amphibious assault ships that provide forward presence and power projection as an integral part of joint, interagency and multinational maritime expeditionary forces. The America class (LHA 6) ships, together with the Wasp class (LHD 1) ships, are the successors to the decommissioned Tarawa class (LHA 1) ships. The America class (LHA 6) ships optimize aviation operations and support capabilities. We delivered USS America (LHA 6) in April 2014, Tripoli (LHA 7) is currently under construction, and we were awarded a construction contract for Bougainville (LHA 8) in 2017.
Arleigh Burke class (DDG 51) destroyers	Build guided missile destroyers designed for conducting anti-air, anti-submarine, anti-surface, and strike operations. The Aegis-equipped Arleigh Burke class (DDG 51) destroyers are the U.S. Navy's primary surface combatant, and have been constructed in variants, allowing technological advances during construction. In 2016 we delivered USS John Finn (DDG 113), and in 2017 we delivered USS Ralph Johnson (DDG 114). In June 2013, we were awarded a multi-year contract for construction of five additional Arleigh Burke class (DDG 51) destroyers: Paul Ignatius (DDG 117), Delbert D. Black (DDG 119), Frank E. Petersen Jr. (DDG 121), Lenah H. Sutcliffe Higbee (DDG 123), and Jack H. Lucas (DDG 125). In 2017 we began the repair and restoration of USS Fitzgerald (DDG 62).
Carrier RCOH	Perform refueling and complex overhaul ("RCOH") of nuclear-powered aircraft carriers, which is required at the mid-point of their 50-year life cycle. USS Abraham Lincoln (CVN 72) was redelivered to the U.S. Navy in the second quarter of 2017 and USS George Washington (CVN 73) arrived at Newport News for the start of its RCOH in August 2017.
Columbia class (SSBN 826) submarines	Newport News is participating in designing the Columbia class submarine as a replacement for the current aging Ohio class nuclear ballistic missile submarines, which were first introduced into service in 1981. The Ohio class SSBN includes 14 nuclear ballistic missile submarines and four nuclear cruise missile submarines. The Columbia class program plan of record is to construct 12 new ballistic missile submarines. The U.S. Navy has initiated the design process for the new class of submarines, and, in early 2017, the DOD signed the acquisition decision memorandum approving the Columbia class program’s Milestone B, which formally authorizes the program’s entry into the engineering and manufacturing development phase. We continue to perform design work as a subcontractor to Electric Boat, and we have entered into a teaming agreement with Electric Boat to build modules for the entire Columbia class submarine program that leverages our Virginia class (SSN 774) experience. The teaming agreement is subject to the U.S. Navy's concurrence. Newport News was awarded a contract from Electric Boat in 2017 to begin integrated product and process development for the Columbia class. Construction of the first Columbia class submarine is expected to begin in 2021, with procurement of long-lead-time materials and advance construction beginning prior to that time.

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Fleet support services	Provide comprehensive life-cycle sustainment services to the U.S. Navy fleet and other DoD and commercial maritime customers. We provide services including maintenance, modernization, and repair on all ship classes; naval architecture, marine engineering, and design; integrated logistics support; technical documentation development; warehousing, asset management, and material readiness; operational and maintenance training development and delivery; software design and development; IT infrastructure support and data delivery and management; and cyber security and information assurance. We provide undersea vehicle and specialized craft development and prototyping services.
USS Gerald R. Ford class (CVN 78) aircraft carriers	Design and construction for the Ford class program, which is the aircraft carrier replacement program for the decommissioned Enterprise (CVN 65) and Nimitz class (CVN 68) aircraft carriers. USS Gerald R. Ford (CVN 78), the first ship of the Ford class, was delivered to the U.S. Navy in the second quarter of 2017. In June 2015, we were awarded a contract for the detail design and construction of John F. Kennedy (CVN 79), following several years of engineering, advance construction, and purchase of long-lead time components and material. In February 2017, we were awarded a contract for advance planning of Enterprise (CVN 80), the third Ford class aircraft carrier. This category also includes the class' non-recurring engineering. The class is expected to bring improved warfighting capability, quality of life improvements for sailors, and reduced life cycle costs.
Integrated mission solutions services	Provide services including high-end information technology and mission-based solutions to DoD, intelligence, and federal civilian customers. Services include agile software engineering, development, and integration; Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance ("C4ISR") engineering and software integration; mobile application development and network engineering; modeling, simulation, and training; force protection and emergency management training and exercises; unmanned systems development, integration, operations, and maintenance; and mission-oriented intelligence, surveillance, and reconnaissance analytics.
Legend class National Security Cutter	Design and build the U.S. Coast Guard's National Security Cutters ("NSCs"), the largest and most technically advanced class of cutter in the U.S. Coast Guard. The NSC is equipped to carry out maritime homeland security, maritime safety, protection of natural resources, maritime mobility, and national defense missions. The first six ships of the class have been delivered. Kimball (NSC 7), Midgett (NSC 8), and Stone (NSC 9) are currently under construction.
Naval nuclear support services	Provide services to and in support of the U.S. Navy, ranging from services supporting the Navy's carrier and submarine fleets to maintenance services at U.S. Navy training facilities. Naval nuclear support services include design, construction, maintenance, and disposal activities for in service U.S. Navy nuclear ships worldwide through mobile and in-house capabilities. Services include maintenance services on nuclear reactor prototypes.

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Nuclear and environmental services	Provide services in nuclear management and operations, and nuclear and non-nuclear fabrication and repair. We provide site management, nuclear and industrial facilities operations and maintenance, decontamination and decommissioning, and radiological and hazardous waste management services. We provide services, including fabrication, equipment repair, and technical engineering services. We participate in several joint ventures, including N3B, MSTS, and SRNS. N3B was awarded the Los Alamos Legacy Cleanup Contract at the DoE/National Nuclear Security Administration's Los Alamos National Laboratory. MSTS was awarded a contract for site management and operations at the Nevada National Security Site. SRNS provides site management and operations at the DoE's Savannah River Site near Aiken, South Carolina.
Oil and gas services	Deliver engineering, procurement, and construction management services to the oil and gas industry for major pipeline, production, and treatment facilities. These services include full life-cycle services for domestic and international projects, from concept identification through detail design, execution and construction, and decommissioning. Related field services include survey, inspection, commissioning and start-up, operations and maintenance, and optimization and debottlenecking.
San Antonio class (LPD 17) amphibious transport dock ships	Design and build amphibious transport dock ships, which are warships that embark, transport, and land elements of a landing force for a variety of expeditionary warfare missions, and also serve as the secondary aviation platform for Amphibious Readiness Groups. The San Antonio class (LPD 17) is the newest addition to the U.S. Navy's 21st century amphibious assault force, and these ships are a key element of the U.S. Navy's seabase transformation. In 2013, we delivered USS Somerset (LPD 25), in 2016, we delivered USS John P. Murtha (LPD 26), and, in 2017, we delivered USS Portland (LPD 27). We are currently constructing Fort Lauderdale (LPD 28) and Richard M. McCool Jr. (LPD 29).
The decommissioned Enterprise (CVN 65)	Defuel and inactivate the world's first nuclear-powered aircraft carrier, which began in 2013. The inactivation was completed in the second quarter of 2018.
Virginia class (SSN 774) fast attack submarines	Construct attack submarines as the principal subcontractor to Electric Boat. The Virginia class (SSN 774) is a post-Cold War design tailored to excel in a wide range of warfighting missions, including anti-submarine and surface ship warfare; special operation forces; strike; intelligence, surveillance, and reconnaissance; carrier and expeditionary strike group support; and mine warfare.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk, primarily related to interest rates and foreign currency exchange rates.

Interest Rates - Our financial instruments subject to interest rate risk include floating rate borrowings under our Credit Facility. Our $1,250 million revolving credit facility remained undrawn as of June 30, 2018.

Foreign Currency - We currently have, and in the future may enter into, foreign currency forward contracts to manage foreign currency exchange rate risk related to payments to suppliers denominated in foreign currencies. As of June 30, 2018, the fair values of our outstanding foreign currency forward contracts were not significant.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of June 30, 2018. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2018, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in reports the Company files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) accumulated and communicated to management to allow their timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the three months ended June 30, 2018, no change occurred in the Company's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We have provided information about legal proceedings in which we are involved in the unaudited condensed consolidated financial statements in Part I, Item 1, which is incorporated herein by reference. In addition to the matters disclosed in Part I, Item 1, we are a party to various investigations, lawsuits, claims, and other legal proceedings that arise in the ordinary course of our business. Based on information available to us, we do not believe at this time that any of such other matters will individually, or in the aggregate, have a material adverse effect on our financial condition, results of operations, or cash flows. For further information on the risks we face from existing and future investigations, lawsuits, claims, and other legal proceedings, please see "Risk Factors" in Item 1A below.

Item 1A. Risk Factors

The Company has no material changes to report from the risk factors described in "Risk Factors" in its Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On November 7, 2017, the Company's board of directors authorized an increase in the Company's stock repurchase program from $1.2 billion to $2.2 billion and an extension of the term of the program to October 31, 2022. Repurchases are made from time to time at management's discretion in accordance with applicable federal securities laws. All repurchases of HII common stock have been recorded as treasury stock. The following table summarizes information relating to purchases made by or on behalf of the Company of shares of the Company's common stock during the quarter ended June 30, 2018.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (in millions)[1]
April 1, 2018 to April 30, 2018	88,983	$256.97	88,983	$ 1,039.7
May 1, 2018 to May 31, 2018	744,716	215.61	744,716	879.1
June 1, 2018 to June 30, 2018	297,603	217.38	297,603	814.4
Total	1,131,302	$219.33	1,131,302	$ 814.4

[1] From the stock repurchase program's inception through June 30, 2018, we purchased 9,638,945 shares at an average price of $143.75 per share for a total of $1.4 billion.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

3.1	Restated Certificate of Incorporation of Huntington Ingalls Industries, Inc., filed March 30, 2011 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 4, 2011).
3.2	Certificate of Amendment to the Restated Certificate of Incorporation of Huntington Ingalls Industries, Inc., dated May 28, 2014 (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q filed on August 7, 2014).
3.3	Certificate of Amendment to the Restated Certificate of Incorporation of Huntington Ingalls Industries, Inc., dated May 21, 2015 (incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2015).
3.4	Restated Bylaws of Huntington Ingalls Industries, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on February 1, 2016).
11	Computation of Per Share Earnings (provided in Note 8 "Earnings Per Share" of the Notes to the Unaudited Condensed Consolidated Financial Statements included in this Report).
12.1	Ratio of Earnings to Fixed Charges.
31.1	Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information for the company, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations and Comprehensive Income, (ii) the Condensed Consolidated Statements of Financial Position, (iii) the Condensed Consolidated Statements of Cash Flows, (iv) the Condensed Consolidated Statements of Changes in Equity, and (v) the Notes to Condensed Consolidated Financial Statements.

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SIGNATURES

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

Date:	August 2, 2018	Huntington Ingalls Industries, Inc.	
		(Registrant)	
		By:	/s/ Nicolas Schuck
			Nicolas Schuck
			Corporate Vice President, Controller and Chief Accounting Officer
			(Duly Authorized Officer and Principal Accounting Officer)