L 3 COMMUNICATIONS CORP
Form 10-K
February 26, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2008

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

For the transition period from to

Commission file numbers 001-14141 and 333-46983
L-3 COMMUNICATIONS HOLDINGS, INC.
L-3 COMMUNICATIONS CORPORATION
(Exact names of registrants as specified in their charters)

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

(212) 697-1111
(Telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered:**
L-3 Communications Holdings, Inc. common stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrants are well-known seasoned issuers, as defined in Rule 405 of the Securities Act.

x Yes o No

Indicate by check mark if the registrants are not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

o Yes x No

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrants knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Act).

o Yes x No

The aggregate market value of the L-3 Communications Holdings, Inc. voting stock held by non-affiliates of the registrants as of June 27, 2008 was approximately $11.0 billion. For purposes of this calculation, the Registrants have assumed that their directors and executive officers are affiliates.

There were 118,585,242 shares of L-3 Communications Holdings, Inc. common stock with a par value of $0.01 outstanding as of the close of business on February 23, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed with Securities and Exchange Commission (SEC) pursuant to Regulation 14A relating to the Registrants Annual Meeting of Shareholders, to be held on April 28, 2009, will be incorporated by reference in this Form 10-K in response to Items 10, 11, 12, 13 and 14 of Part III. Such proxy statement will be filed with the SEC not later than 120 days after the registrant s fiscal year ended December 31, 2008.

L-3 COMMUNICATIONS HOLDINGS, INC.
L-3 COMMUNICATIONS CORPORATION

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For the Year Ended December 31, 2008

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PART I

For convenience purposes in this filing on Form 10-K, L-3 Holdings refers to L-3 Communications Holdings, Inc., and L-3 Communications refers to L-3 Communications Corporation, a wholly-owned operating subsidiary of L-3 Holdings. L-3 , we , us and our refer to L-3 Holdings and its subsidiaries, including L-3 Communications.

Item 1. Business

Overview

L-3 Holdings, a Delaware corporation organized in April 1997, derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications. L-3 Communications, a Delaware corporation, was organized in April 1997. L-3 is a prime system contractor in aircraft modernization and maintenance, Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR) systems, and government services. L-3 is also a leading provider of high technology products, subsystems and systems. Our customers include the U.S. Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), U.S. Department of Justice (DoJ), allied foreign governments, domestic and international commercial customers and select other U.S. federal, state and local government agencies.

For the year ended December 31, 2008, we generated sales of $14.9 billion, operating income of $1,685 million and net cash from operating activities of $1,387 million. The table below presents a summary of our 2008 sales by major category of end customer. For a more detailed presentation of our sales by end customer, see Major Customers on page 12.

	2008 Sales (in millions)	% of Total Sales
DoD	$ 11,059	74%
Other U.S. Government	1,067	7
Total U.S. Government	$ 12,126	81%
International	2,086	14
Commercial domestic	689	5
Total sales	$ 14,901	100%

We have the following four reportable segments: (1) C^3ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Specialized Products. Financial information for our reportable segments, including financial information about geographic areas, is included in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 21 to our audited consolidated financial statements.

Business Strategy

Our business strategy is customer-focused and aims to increase shareholder value by providing products and services to our customers that create value for them with responsive, high-quality and affordable solutions. Financially, our emphasis is on sustainably growing earnings per share and cash flow. Our strategy involves a flexible and balanced combination of organic growth, cost reductions, select business acquisitions and divestitures, dividends and share repurchases, enabling us to grow the company and return cash to our shareholders. We intend to maintain and expand our position as a leading supplier of products, subsystems, systems and services to the DoD, other U.S. Government agencies, allied foreign governments and commercial customers, both domestic and international. Our strategy includes the objectives discussed below.

Expand Prime Contractor and Supplier Positions. We intend to expand our prime system contractor roles in select business areas where we have domain expertise, including C^3ISR, aircraft modernization and maintenance and government technical services. We also intend to enter into teaming arrangements with

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other prime system contractors and platform original equipment manufacturers to compete for select new business opportunities. As an independent supplier of a broad range of products, subsystems and systems in several key business areas, our growth will partially be driven by expanding our share on existing programs and participating on new programs. We also expect to identify opportunities to use our customer relationships and leverage the capabilities of our various businesses, including proprietary technologies, to expand the scope of our products and services to existing and new customers. We also intend to continue to supplement our growth by participating on and competing for new programs internationally, particularly in Canada, the United Kingdom and Australia.

Grow Sales Organically and Selectively Acquire Businesses. We intend to use our existing prime contractor and supplier positions and internal investments to grow our sales organically. We expect to benefit from our positions as a supplier to multiple bidders on select prime contract bids. We plan to maintain our diversified and broad business mix with its limited reliance on any single contract and significant follow-on and new business opportunities. We also expect to continue to supplement our organic sales growth by selectively acquiring businesses that add new products, services, technologies, programs or customers to our existing businesses, and provide attractive returns on investment.

Favorably Perform on Contracts. We believe that favorable performance on our existing contracts is the foundation for successfully meeting our objectives of expanding L-3 s prime contractor and supplier positions and growing sales organically. We believe that a prerequisite for growing and winning new business is to retain our existing business with successful contract performance, including schedule, cost, technical and other performance criteria. Therefore, we will continue to focus on delivering superior contract performance to our customers to maintain our reputation as an agile and responsive contractor and to differentiate L-3 from its competitors.

Continuously Improve our Cost Structure. We intend to continue to aggressively improve and reduce our direct contract costs and overhead costs, including general and administrative costs. Effective management of labor, material, subcontractor and other direct costs is a primary element of favorable contract performance. We also intend to grow sales at a faster rate than overhead costs. We believe continuous cost improvement will enable us to increase our cost competitiveness, expand operating margin and selectively invest in new product development, bids and proposals and other business development activities to organically grow sales.

Align Research & Development, and Capital Expenditures. We intend to continue to align our internal investments in research and development, business development and capital expenditures to proactively address customer requirements and priorities with our products, services and solutions. We also intend to grow our sales through the introduction of new products and services and continued increased collaboration between our businesses to offer the best quality and competitive solutions and services to our customers.

Selected Recent Business Acquisitions and Business and Product Line Dispositions

During the year ended December 31, 2008, we used cash of $283 million for business acquisitions and generated cash of $63 million from business and product line dispositions. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Business Acquisitions and Business and Product Line Dispositions on page 36 for additional details about our 2008 business acquisitions, including their aggregate purchase prices, and our 2008 business and product line dispositions.

Products and Services

Our four reportable segments provide a wide range of products and services to various customers and are described below.

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C^3ISR Reportable Segment

In 2008, C^3ISR net sales of $2,567 million represented 17% of our total net sales. The businesses in this segment provide products and services for the global ISR market, specializing in signals intelligence (SIGINT) and communications intelligence (COMINT) systems. These products and services provide to the warfighter in real-time, the unique ability to collect and analyze unknown electronic signals from command centers, communication nodes and air defense systems for real-time situational awareness and response. The businesses in this reportable segment also provide C^3 systems, networked communications systems and secure communications products for military and other U.S. Government and foreign government intelligence, reconnaissance and surveillance applications. We believe that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Major products and services for this reportable segment include:

- highly specialized fleet management sustainment and support, including procurement, systems integration, sensor development, modifications and periodic depot maintenance for SIGINT and ISR special mission aircraft and airborne surveillance systems;
- strategic and tactical SIGINT systems that detect, collect, identify, analyze and disseminate information;
- secure data links that enable real-time information collection and dissemination to users of networked communications for airborne, satellite, ground and sea-based remote platforms, both manned and unmanned;
- secure terminal and communication network equipment and encryption management; and
- communication systems for surface and undersea vessels and manned space flights.

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The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our C^3ISR reportable segment.

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
ISR Systems		
Prime mission systems integration, sensor development and operations and support	Signal processing, airborne SIGINT applications, antenna technology, real-time process control and software development	U.S. Air Force (USAF), United Kingdom (U.K.) Ministry of Defence (MoD) and other allied foreign militaries ISR aircraft platforms
Fleet management of special mission aircraft, including avionics and mission system upgrades and logistics support	Measurement collection and signal intelligence, special missions	DoD and special customers within the U.S. Government
ISR operations and support	Data link support and services, special applications, classified projects, spares and repairs	USAF and U.S. Army ISR aircraft platforms
Networked Communications		
Airborne, space and surface data link terminals, ground stations, and transportable tactical SATCOM (satellite communications) systems	High performance, wideband secure communication links for relaying of intelligence and reconnaissance information	Manned aircraft, unmanned aerial vehicles (UAVs), naval ships, ground vehicles and satellites for the DoD
Multi-band Manpack Receivers	Portable, ruggedized terminals used for receiving reconnaissance video and sensor data from multiple airborne platforms	U.S. Special Operations Command (USSOCOM), USAF and other DoD customers
Satellite command and control sustainment and support	Software integration, test and maintenance support, satellite control network and engineering support for satellite launch systems	USAF Space Command (AFSC), USAF Satellite Control Network and launch ranges
Secure Communications Products		
Secure communication terminals and equipment, and secure network encryption products	Secure and non-secure voice, data and video communication for office, battlefield and secure internet protocol (IP) network applications	DoD and U.S. Government intelligence agencies
Ground-based satellite communication terminals and payloads	Interoperable, transportable ground terminals	DoD and U.S. Government intelligence agencies
Satellite communication and tracking systems	On-board satellite external communications, video systems, solid state recorders and ground support equipment	International Space Station, Space Shuttle and various satellites for National Aeronautics and Space Administration (NASA)
Shipboard communications systems	Internal and external communications (radio rooms)	U.S. Navy (USN), U.S. Coast Guard and allied foreign navies

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Government Services Reportable Segment

In 2008, Government Services net sales of $4,303 million represented 29% of our total net sales. The businesses in this segment provide a full range of engineering, technical, information technology (IT), advisory, training and support services to the DoD, DoS, DoJ and U.S. Government intelligence agencies and allied foreign governments. Major services for this reportable segment include:

- communication software support, information technology services and a wide range of engineering development services and integration support;
- high-end engineering and information systems support services used for command, control, communications and ISR architectures, as well as for air warfare modeling and simulation tools for applications used by the DoD, DHS and U.S. Government intelligence agencies, including missile and space systems, UAVs and manned military aircraft;
- developing and managing extensive programs in the United States and internationally that focus on teaching, training and education, logistics, strategic planning, organizational design, democracy transition and leadership development;
- human intelligence support and other services, including linguist and translation services and related management to support contingency operations and current intelligence-gathering requirements;
- Command & Control Systems and Software services in support of maritime and expeditionary warfare;
- intelligence solutions support to the DoD, including the U.S. Armed Services combatant commands and the U.S. Government intelligence agencies, including those within the U.S. Armed Services;
- technical and management services, which provide support of intelligence, logistics, C^3 and combatant commands; and
- conventional high-end enterprise IT support, systems and other services to the DoD and other U.S. federal agencies.

The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our Government Services reportable segment.

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Training and Operational Support		
Training systems, courseware and doctrine development	Training, leadership development and education services for U.S. and allied foreign armed forces, counterintelligence and law enforcement personnel	U.S. Army, U.S. Marine Corps (USMC), DoS, DoJ and allied foreign governments
Acquisition management and staff augmentation	Rapid fielding support for combatants and physical location management	U.S. Army

Weapons Training Systems	Laser marksmanship training systems and advanced integrated technologies for security products and services	DoD and law enforcement agencies

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Specialized management, policy and training in energy, environmental and natural resource management	Water and Coastal resource management, sustainable agriculture and food security, climate change mitigation strategies, emergency preparedness, response and reconstruction, power sector restructuring and energy economics and finance	U.S. Agency for International Development, foreign governments, World bank and Non-Governmental Organizations
Enterprise IT Solutions		
Network and enterprise administration and management	Systems engineering, assurance and risk management, network and systems administration, management, software development and life cycle support and systems integration	U.S. Army, U.S. Joint Chiefs of Staff, USAF, USSOCOM, Federal Aviation Administration (FAA) and NASA
Systems acquisition and advisory support and comprehensive operational support services	Requirements definition, program management, planning and analysis, systems engineering, integration and development, intelligence analysis and managing and network engineering	U.S. Army, USAF, USN and DHS
Intelligence Solutions and Support		
System support and concept operations (CONOPS)	C^3ISR, modeling and simulation	DoD, U.S. Missile Defense Agency (MDA), U.S. Government intelligence agencies, and NASA
IT services	IT infrastructure modernization and operations	U.S. Government intelligence agencies and U.K. MoD
Information management and IT systems support and software design, development and systems integration	Intelligence and operations support, C^3 systems, network centric operations and information operations	DoD and U.S. Government intelligence agencies
Linguistic, interpretation, translation and analyst services	Counterintelligence, threat protection and counter terrorism	U.S. Army

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Command & Control Systems and Software		
Software engineering/software sustainment, operations analysis, research, technical analysis and test and evaluation	Systems engineering and operational analysis of every aircraft and vessels in the USN fleet, C^3 and Computers (C^4) systems acquisitions, logistics and administrative support, as well as systems life cycle support	U.S. Army, USN and USMC
Communication systems and software engineering services	Value-added, critical software support for C^3ISR systems, electronic warfare and fire support systems	U.S. Army Communications Electronics Command (CECOM)
Acquisition Support	Support defense acquisition programs, develop acquisition roadmaps, capability assessments and develop requirements	U.S. Army, USN and USMC
Systems Engineering and Integration Support	System design and development, platform simulations, systems testing, prototype development and deployment and hardware and software integration	USMC, U.S. Army and, USSOCOM
Global Security & Engineering Solutions		
Surveillance systems and products, including installation and logistics support	Remote surveillance for U.S. borders	DHS
Security Solutions	Border security systems, area surveillance and access control, critical infrastructure protection, continuity planning and emergency management	DHS, USMC and Customs and Border Patrol
Engineering and technical solutions	Systems engineering and design, analysis and integration, technical support and test & evaluation, Weapons of Mass Destruction (WMD) effects analysis and Improvised Explosive Device (IED) counter measures	DoD and U.S. Government agencies
Program management and operational support	Command center operations, systems acquisitions, emergency management training, continuity of operations and government planning	Federal Emergency Management Agency, FAA, Joint Task Force Civil Support

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Aircraft Modernization and Maintenance (AM&M) Reportable Segment

In 2008, AM&M net sales of $2,657 million represented 18% of our total net sales. The businesses in this segment provide modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. We sell these services primarily to the DoD, the Canadian Department of National Defense (DND) and other allied foreign governments. Major products and services for this reportable segment include:

- engineering, modification, maintenance, logistics and upgrades for aircraft, vehicles and personnel equipment;
- turnkey aviation life cycle management services that integrate custom developed and commercial off-the-shelf products for various military fixed and rotary wing aircraft, including heavy maintenance and structural modifications and interior modifications and construction; and
- aerospace and other technical services related to large fleet support, such as aircraft and vehicle modernization, maintenance, repair and overhaul, logistics, support and supply chain management, primarily for military training, tactical, cargo and utility aircraft, anti-missile defense systems and tanks.

The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our AM&M reportable segment.

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Aircraft and Base Support Services		
Logistics support, maintenance and refurbishment	Aircraft maintenance repair and overhaul, flight operations support for training, cargo and special mission aircraft	U.S. Army, USAF, USN, USSOCOM, Canadian DND and other allied foreign militaries
Contract Field Teams (CFT)	Deployment of highly mobile, quick response field teams to customer locations to supplement the customer s resources for various ground vehicles and aircraft	U.S. Army, USAF, USN and USMC
Contractor operated and managed base supply (COMBS)	Inventory management activities relating to flight support and maintenance, including procurement and field distribution	Military training and cargo aircraft
Aircraft Modernization		
Modernization and life extension maintenance upgrades and support	Aircraft structural modifications and inspections, installation of mission equipment, navigation and avionics products	USN, USAF, USSOCOM, Canadian DND, Royal Australian Air Force, other allied foreign governments, various military, fixed and rotary wing aircraft and Head of State aircraft

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Specialized Products Reportable Segment

In 2008, Specialized Products net sales of $5,374 million represented 36% of our total net sales. The businesses in this reportable segment provide a broad range of products, including components, products, subsystems, systems and related services to military and commercial customers in several niche markets. The table below provides a summary of the segment s business areas and the percentage that each contributed to Specialized Products net sales in 2008.

Business Area	**% of 2008 Segment Sales**
Power & Control Systems	17%
Electro-Optic/Infrared (EO/IR)	14
Microwave	14
Avionics & Displays	11
Simulation & Training	11
Precision Engagement	9
Security & Detection	6
Propulsion Systems	6
Telemetry & Advanced Technology	5
Undersea Warfare	4
Marine Services	3
Total Specialized Products	100%

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The table below provides additional information for the systems and products, selected applications and selected platforms or end users of our Specialized Products reportable segment.

Systems/Products	Selected Applications	Selected Platforms/End Users
Power & Control Systems		
Shipboard electrical power packages, electric drives and propulsion, automation, navigation and communication systems	Surface ships ranging from shipping vessels, container carriers, environmental and research ships, ferries and cruise liners	Commercial shipbuilders and allied foreign navies
Naval power delivery, conversion and switching products	Switching, distribution and protection, as well as frequency and voltage conversion	Naval submarines, surface ships and aircraft carriers
EO/IR		
Targeted stabilized camera systems with integrated sensors and wireless communication systems	Intelligence Data Collection, Surveillance and Reconnaissance	DoD, intelligence and security agencies, law enforcement, manned/unmanned platforms
Airborne and ground based high energy laser beam directors and high tracking rate telescopes	Directed energy systems, space surveillance, satellite laser ranging and laser communications	USAF and NASA
Night Vision (NV) technology and electro-optical systems and products	Free-standing or mounted image intensified NV goggles, weapon sights, and driver viewers for special forces, pilots and aircrews, soldiers, Marines, sailors and law enforcement personnel	U.S. Army, USN, USMC, DHS, allied foreign militaries and law enforcement agencies
Microwave		
Passive components, switches and wireless assemblies	Radio transmission, switching and conditioning, antenna and base station testing and monitoring	DoD, wireless communications service providers and original equipment manufacturers
Satellite and wireless components (channel amplifiers, transceivers, converters, filters and multiplexers)	Satellite transponder control, channel and frequency separation	SATCOM and wireless communications equipment for DoD and various government agencies
Traveling wave tubes, power modules, klystrons and digital broadcast	Microwave vacuum electron devices and power modules	DoD and allied foreign military manned/unmanned platforms, various missile programs and commercial broadcast
Quick-deploy flyaway very small aperture terminals (VSAT) and vehicular satellite systems	Satellite communication systems	U.S. Army, USAF and various DoD customers
Ultra-wide frequency and advanced radar antennas and radomes	Surveillance and radar detection	Military fixed and rotary winged aircraft, SATCOM
Avionics & Displays		
Solid state crash protected cockpit voice and flight data recorders	Aircraft voice and flight data recorders that continuously record	Commercial transport, business, regional and military aircraft

	voice and sounds from cockpit and aircraft intercommunications	
Airborne traffic and collision avoidance systems, terrain awareness warning systems	Reduce the potential for midair aircraft collisions and crashes into terrain by providing visual and audible warnings and maneuvering instructions to pilots	Commercial transport, business, regional and military aircraft
Advanced cockpit avionics	Pilot safety, navigation and situation awareness products	Commercial transport, business, regional and military aircraft
Cockpit and mission displays	High performance, ruggedized flat panel and cathode ray tube displays and processors	Various military aircraft
Simulation & Training		
Military aircraft flight simulators, reconfigurable training devices, distributed mission training (DMT) suites	Advanced simulation technologies and training for pilots, navigators, flight engineers, gunners and operators	Fixed and rotary winged aircraft and ground vehicles for USAF, USN, U.S. Army, Canadian DND and allied foreign militaries

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Systems/Products	Selected Applications	Selected Platforms/End Users
Precision Engagement		
Global Positioning System (GPS) receivers	Location tracking	Guided projectiles and precision munitions
Navigation systems and positioning navigation units	Satellite launch and orbiting navigation and navigation for ground vehicles and fire control systems	USAF, U.S. Army, USMC and NASA
Premium fuzing products	Munitions and electronic and electromechanical safety arming devices (ESADs)	Various DoD and allied foreign military customers
Security & Detection		
Explosives detection systems and airport security systems	Rapid scanning of passenger checked baggage and carry-on luggage, scanning of large cargo containers	DHS, including the U.S. Transportation and Security Administration (TSA), domestic and international airports and state and local governments
Non-invasive security systems and portals, and sophisticated sensors with threat detection capabilities	Aviation, rail and border crossing security	TSA, U.S. Customs agency, various regulatory authorities and private security companies
Propulsion Systems		
Heavy fuel engines, cross drive variable transmissions, turret drive systems, vehicle suspension, advanced drive systems and auxiliary power generators	Power trains and suspension systems for military vehicles, power and energy management for military hybrid electric vehicles, non portable and under armor auxiliary power units, and heavy fueled engines for unmanned systems	U.S. Army, USMC and allied foreign ministries of defense, manned/unmanned military platforms
Telemetry & Advanced Technology		
Telemetry and instrumentation systems	Real-time data acquisition, measurement, processing, simulation, distribution, display and storage for flight tracking, testing and termination	Aircraft, missiles and satellites
High power microwave sources, systems & effects, pulse power systems and electromagnetics hardened construction	Forensic analysis of weapons of mass destruction, active detection of special nuclear material and irradiation systems for decontamination and industrial applications	U.K. MoD, U.S. Defense Threat Reduction Agency, U.S. Army and USAF
Undersea Warfare		
Airborne dipping sonars, submarine and surface ship towed arrays	Submarine and surface ship detection and localization	USN and allied foreign navies
Marine Services		

Shipboard electronics racks, rugged computers, rugged displays and communication terminals	Ruggedized displays, computers and electronic systems	Naval vessels and other DoD applications
Service life extensions	Landing craft air cushion amphibious vehicles	USN

Backlog and Orders

We define funded backlog as the value of funded orders received from customers, less the cumulative amount of sales recognized on such orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. A table that presents our funded backlog, percent of December 31, 2008 funded backlog expected to be recorded as sales in 2009 and funded orders for each of our reportable segments is located in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Backlog and Orders beginning on page 58.

Major Customers

The table below presents a summary of our 2008 sales by end customer and the percent contributed by each to our total 2008 sales. For additional information regarding domestic and foreign sales, see Note 21 to our audited consolidated financial statements.

	2008 Sales (in millions)	% of Total Sales
Army	$ 4,180	28%
Air Force	2,944	20
Navy/Marines	2,295	15
Other Defense	1,640	11
Total DoD	$ 11,059	74%
Other U.S. Government	1,067	7
Total U.S. Government	$ 12,126	81%
Foreign governments	1,099	7
Commercial foreign	987	7
Commercial domestic	689	5
Total sales	$ 14,901	100%

Approximately 73% of our DoD sales for 2008 were direct to the customer, and approximately 27% were indirect through other prime system contractors and subcontractors of the DoD.

Our sales are predominantly derived from contracts with agencies of, and prime system contractors to, the U.S. Government. Various U.S. Government agencies and contracting entities exercise independent and individual purchasing decisions, subject to annual appropriations by the U.S. Congress. For the year ended December 31, 2008, our five largest contracts generated 12% of our consolidated sales. For the year ended December 31, 2008, our largest contract, the U.S. Air Force (USAF) Contract Field Teams (CFT) contract, generated 3% of our sales. CFT is a multi-sourced contract, which provides worldwide quick reaction maintenance of deployed aircraft and ground vehicles for the U.S. military.

Research and Development

We conduct research and development activities that consist of projects involving applied research, new product development and select concept studies. We employ scientific, engineering and other personnel to improve our existing product-lines and develop new products and technologies. As of December 31, 2008, we employed approximately 11,000 engineers, a substantial portion of whom hold advanced degrees, and work on company sponsored research and development efforts and customer funded research and development contracts.

Company-sponsored (Independent) research and development costs for our businesses that are U.S. Government contractors are allocated to U.S. Government contracts and are charged to cost of sales when the related sales are recognized as revenue. Research and development costs for our commercial businesses are expensed as incurred. The table below presents company-sponsored (Independent) research and development expenses incurred for the years ended December 31, 2008, 2007 and 2006 for our U.S. Government businesses and our commercial businesses.

	Year Ended December 31,		
	2008	2007	2006
	(In millions)		
Company-Sponsored Research and Development Costs:			
U.S. Government Contractor Businesses	$ 287	$ 263	$ 243
Commercial Businesses	86	93	77
Total	$ 373	$ 356	$ 320

Customer-funded research and development costs pursuant to contracts (revenue arrangements) are direct contract costs and are expensed when the corresponding revenue is recognized. See Note 2 to our audited consolidated financial statements for additional information regarding research and development.

Competition

Our businesses generally encounter intense competition. We believe that we are a major provider for many of the products and services we offer to our DoD, government and commercial customers.

Our ability to compete for existing and new business depends on a variety of factors, including,

- the effectiveness and innovation of our technologies and research and development programs;
- our ability to offer better program performance than our competitors at a lower cost;
- historical technical and schedule performance;
- us maintaining an effective supplier and vendor base;
- our ability to retain our employees and hire new ones, particularly those who have U.S. Government security clearances; and
- the capabilities of our facilities, equipment and personnel to undertake the business for which we compete.

In some instances, we are the incumbent supplier or have been the sole provider on a contract for many years, and we refer to these positions as sole-source . On our sole-source contracts, there may be other suppliers who have the capability to compete for the contracts involved, but they can only enter the market if the customer chooses to reopen the particular contract to competition. Sole-source contracts are generally re-competed every three to five years and at times more frequently. For the year ended December 31, 2008, contracts where we held sole-source positions accounted for 50% of our total sales and contracts which we had competitively won accounted for 50% of our total sales.

We believe we are the defense supplier with one of the broadest and most diverse product portfolios. We supply our products and services to other prime system contractors. However, we also compete directly with other large prime system contractors for (i) certain products and subsystems where they have vertically integrated businesses and (ii) niche areas where we are a prime system contractor. We also compete with numerous other aerospace, defense and government technical services contractors, which generally provide similar products, subsystems or services. We believe that a majority of our businesses enjoy the number one or number two competitive position in their market niches. We believe that the primary competitive factors for our businesses are technology, research and development capabilities, quality, cost, market position and past performance. However, some of these competitors are larger than we are and have more financial and other resources than we have.

In addition, our ability to compete for select contracts may require us to team with one or more of the other prime system contractors that bid and compete for major platform programs, and our ability to team with them is often dependent upon the outcome of a competition for subcontracts they award.

Patents and Licenses

Generally, we do not believe that our patents, trademarks and licenses are material to our operations. Furthermore, most of our U.S. Government contracts generally permit us to use patents owned by other U.S. Government contractors. Similar provisions in U.S. Government contracts awarded to other companies make it impossible for us to prevent the use of our patents in most DoD work performed by other companies for the U.S. Government.

Raw Materials

Generally, our businesses engage in limited manufacturing activities. In manufacturing our products, we use our own production capabilities as well as a diverse base of third party suppliers and subcontractors. Although aspects of certain of our businesses require relatively scarce raw materials, we have not experienced difficulty in our ability to procure raw materials, components, sub-assemblies and other supplies required in our manufacturing processes.

Contracts

A significant portion of our sales are derived from sole-source contracts as discussed above. We believe that our customers award sole-source contracts to the most capable supplier in terms of quality, responsiveness, design, engineering and program management competency and cost. However, as discussed above, we are increasingly competing against other prime system contractors for major subsystems business. As a consequence of our competitive position, for the year ended December 31, 2008, we won contract awards at a rate in excess of 61% on new competitive contracts that we bid on, and at a rate in excess of 95% on the number of contracts we rebid for when we were the incumbent supplier.

Generally, the sales price arrangements for our contracts are either fixed-price, cost-reimbursable or time-and-material type. Generally, a fixed-price type contract offers higher profit margin potential than a cost-reimbursable type or time-and-material type contract, which is commensurate with the greater levels of risk we assume on a fixed-price type contract. Our operating margins (pretax operating income as a percentage of sales) on fixed-price type contracts generally range between 10% and 15%, while on cost-reimbursable type contracts they generally range between 5% and 10%, and on time-and-material type contracts they generally range between 8% and 12%.

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract. Accounting for the sales on a fixed-price type contract requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract s statement of work, and (3) the measurement of progress towards completion. Adjustments to original estimates for a contract s revenue, estimated costs at completion and estimated total profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change.

On a cost-reimbursable type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit which can be fixed or variable depending on the contract s fee arrangement up to predetermined funding levels determined by our customers. Cost-reimbursable type contracts with award and incentive fee provisions are our primary variable contract fee arrangement. Award fees provide for a fee based on actual performance relative to contractually specified performance criteria. Incentive fees provide for a fee based on the relationship which total allowable costs bear to target cost. Sales from cost-reimbursable type contracts with award fees were approximately $1.3 billion for the year ended December 31, 2008. Sales from cost-reimbursable type contracts with incentive fees were approximately $589 million for the year ended December 31, 2008.

On a time-and-material type contract (revenue arrangement), we are paid on the basis of direct labor hours expended at specified fixed-price hourly rates (that include wages, overhead, allowable general and administrative expenses and profit) and materials at cost. Therefore, on cost-reimbursable type and time-and-material type contracts we do not bear the risks of unexpected cost overruns, provided that we do not incur costs that exceed the predetermined funded amounts. Our customer satisfaction and performance record is evidenced by our receipt of performance-based award fees achieving 92% of the available award fees on average during the year ended December 31, 2008.

We believe we have a favorable balance of fixed-price, cost-reimbursable and time and material type contracts, a significant sole-source follow-on business and an attractive customer profile with limited reliance on any single contract.

The table below presents the percentage of our total sales generated from each contract-type.

	Year Ended December 31,		
Contract-Type	**2008**	**2007**	**2006**
Fixed-price	54%	51%	50%
Cost-reimbursable	27%	30%	31%
Time-and-material	19%	19%	19%
Total sales	100%	100%	100%

Substantially all of our cost-reimbursable type contracts and time-and-material type contracts are with U.S. Government customers. Substantially all of our sales to commercial customers are transacted under fixed-price sales arrangements and are included in our fixed-price contract sales.

Regulatory Environment

Most of our revenue arrangements with agencies of the U.S. Government, including the DoD, are subject to unique procurement and administrative rules. These rules are based on both laws and regulations, including the U.S. Federal Acquisition Regulation (FAR), that: (1) impose various profit and cost controls, (2) regulate the allocations of costs, both direct and indirect, to contracts and (3) provide for the non-reimbursement of unallowable costs. Unallowable costs include, but are not limited to, lobbying expenses, interest expenses and certain costs related to business acquisitions, including, for example, the incremental depreciation and amortization expenses arising from fair value increases to the historical carrying values of acquired assets. Our contract administration and cost accounting policies and practices are also subject to oversight by government inspectors, technical specialists and auditors. See Part I Item 1A Risk Factors on page 17 for a discussion of certain additional business risks specific to our government contracts.

As is common in the U.S. defense industry, we are subject to business risks, including changes in the U.S. Government s procurement policies (such as greater emphasis on competitive procurement), governmental appropriations, national defense policies or regulations, service modernization plans, and availability of funds. A reduction in expenditures by the U.S. Government for products and services of the type we manufacture and provide, lower margins resulting from increasingly competitive procurement policies, a reduction in the volume of contracts or subcontracts awarded to us or the incurrence of substantial contract cost overruns could materially adversely affect our business.

Certain of our sales are under foreign military sales (FMS) agreements directly between the U.S. Government and allied foreign governments. In such cases, because we serve only as the supplier, we do not have unilateral control over the terms of the agreements. These contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance with these laws and regulations. Investigations could result in administrative, civil, or criminal liabilities, including repayments, disallowance of certain costs, or fines and penalties. Certain of our sales are direct commercial sales to allied foreign governments. These sales are subject to U.S. Government approval and licensing under the Arms Export Control Act. Legal restrictions on sales of sensitive U.S. technology also limit the extent to which we can sell our products to allied foreign governments or private parties.

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Environmental Matters

Our operations are subject to various environmental laws and regulations relating to the discharge, storage, treatment, handling, disposal and remediation of certain materials, substances and wastes used in our operations. We continually assess our obligations and compliance with respect to these requirements.

We have also assessed the risk of environmental contamination for our various manufacturing facilities, including our acquired businesses and, where appropriate, have obtained indemnification, either from the sellers of those acquired businesses or through pollution liability insurance. We believe that our current operations are in substantial compliance with all existing applicable environmental laws and permits. We believe our current expenditures will allow us to continue to be in compliance with applicable environmental laws and regulations. While it is difficult to determine the timing and ultimate cost to be incurred in order to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which we are aware, we believe that after considering recorded liabilities, there are no environmental loss contingencies that, individually or in the aggregate, would be material to our consolidated results of operations, financial position or cash flows.

Certain Acquired Pension Plans

In connection with our acquisition of ten business units from Lockheed Martin and the formation of L-3 in 1997, we assumed certain defined benefit pension plan liabilities for present and former employees and retirees of certain of these businesses from Lockheed Martin. Lockheed Martin had previously received a letter from the Pension Benefit Guaranty Corporation (PBGC), indicating that the pension plans of two businesses were under funded using the PBGC s actuarial assumptions (Subject Plans).

With respect to the Subject Plans, Lockheed Martin entered into an agreement (Lockheed Martin Commitment) with L-3 and the PBGC dated as of April 30, 1997. The terms and conditions of the Lockheed Martin Commitment include a commitment by Lockheed Martin to the PBGC to, under certain circumstances, assume sponsorship of the Subject Plans or provide another form of financial support for the Subject Plans. The Lockheed Martin Commitment will continue until the Subject Plans are no longer under funded on a PBGC basis for two consecutive years, or immediately if we achieve investment grade credit ratings on all of our outstanding debt.

If Lockheed Martin did assume sponsorship of the Subject Plans, it would be primarily liable for the costs associated with funding the Subject Plans or any costs associated with the termination of the Subject Plans. The terms and conditions of the Lockheed Martin Commitment would require us to reimburse Lockheed Martin for these costs. Lockheed Martin has not assumed sponsorship or provided another form of financial support for the Subject Plans.

We believe we have performed our obligations under the Lockheed Martin Commitment and have not received any communications from the PBGC concerning actions that the PBGC contemplates taking in respect of the Subject Plans.

For the year ended December 31, 2008, we contributed $3 million to the Subject Plans. For subsequent years, our funding requirements will depend upon prevailing interest rates, return on pension plan assets and underlying actuarial assumptions. At December 31, 2008, the aggregate projected benefit obligation was $245 million and the aggregate plan assets were $144 million for the Subject Plans. At December 31, 2008, we have recorded a liability of $101 million for the under funded status of the Subject Plans.

Employees

As of December 31, 2008, we employed approximately 65,000 full-time and part-time employees, 84% of whom were located in the United States. Of these employees, approximately 15% are covered by 123 separate collective bargaining agreements with various labor unions. The success of our business is primarily dependent upon the knowledge of our employees and on the management, contracting, engineering and technical skills of our employees. In addition, our ability to grow our businesses, obtain additional orders for our products and services and to satisfy contractual obligations under certain of our existing revenue

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arrangements is largely dependent upon our ability to attract and retain employees who have U.S. Government security clearances, particularly those with clearances of top-secret and above. We believe that relations with our employees are positive.

L-3 Holdings Obligations

The only obligations of L-3 Holdings at December 31, 2008 were: (1) its 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued by L-3 Holdings on July 29, 2005, (2) its guarantee of borrowings under the senior credit facility of L-3 Communications and (3) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. L-3 Holdings obligations relating to the CODES have been jointly, severally, fully and unconditionally guaranteed by L-3 Communications and certain of its wholly-owned domestic subsidiaries. In order to generate the funds necessary to repurchase common stock and pay dividends declared and principal and interest on its outstanding indebtedness, if any, L-3 Holdings relies on dividends and other payments from its subsidiaries or it must raise funds in public or private equity or debt offerings.

Available Information

We are subject to the informational requirements of the Securities Exchange Act of 1934 and, in accordance therewith, file reports, including annual, quarterly and current reports, proxy statements and other information with the SEC. Such reports and other information can be inspected and copied at the Public Reference Room of the SEC located at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material can be obtained from the Public Reference Room of the SEC at prescribed rates. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Such material may also be accessed electronically by means of the SEC s home page on the Internet at http://www.sec.gov.

You may also obtain a free copy of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statement for the annual shareholders meeting, as well as any amendments to those reports as soon as reasonably practicable after electronic filing with the SEC through our website on the Internet at http://www.L-3com.com.

The Company also has a Corporate Governance webpage. You can access the Company s Corporate Governance Guidelines and charters for the audit, compensation and nominating/corporate governance committees of our Board of Directors through our Web site, http://www.L-3com.com, by clicking on the Corporate Governance link under the heading Investor Relations. The Company posts its Code of Ethics and Business Conduct on its Corporate Governance webpage under the link Code of Ethics and Business Conduct. The Company s Code of Ethics and Business Conduct applies to all directors, officers and employees, including our chairman, president and chief executive officer, our vice president and chief financial officer, and our corporate controller and principal accounting officer. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. (NYSE), on our Web site within the required periods. The information on the Company s Web site is not incorporated by reference into this report. You can request a copy of our Code of Ethics and Business Conduct or any other corporate governance document or periodic report at no cost by contacting (866) INFO-LLL (866-463-6555).

To learn more about L-3, please visit the Company s Web site at www.L-3com.com. L-3 uses its Web site as a channel of distribution of material Company information. Financial and other material information regarding L-3 is routinely posted on the Company s Web site and is readily accessible.

Item 1A. Risk Factors

You should carefully consider the following risk factors and other information contained or incorporated by reference in this Form 10-K, including Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations . Any of these risks could materially adversely affect our business and our financial condition, results of operations and cash flows, which could in turn materially adversely affect the price of our common stock.

Our contracts (revenue arrangements) with U.S. Government customers entail certain risks.

A decline in or a redirection of the U.S. defense budget could result in a material decrease in our sales, earnings and cash flows.

Our government contracts are primarily dependent upon the U.S. defense budget. We, as well as other defense contractors, have benefited from increased overall DoD spending over recent years, including supplemental appropriations for military operations in Iraq, Afghanistan and the Global War on Terror (GWOT). The President s DoD base defense budget request, for the government s fiscal year ending September 30, 2009, excluding a fiscal year 2009 GWOT supplemental request, indicates continued growth over the fiscal year 2008 period. However, future DoD budgets could be negatively affected by several factors, including events we cannot foresee, U.S. Government budget deficits, current or future economic conditions, new administration priorities, U.S. national security strategies, a change in spending priorities, the cost of sustaining U.S. military and related security operations in Iraq and Afghanistan and other locales around the world where U.S. military support may be pivotal, and other related exigencies and contingencies. While we are unable to predict the impact and outcome of these uncertainties, the effect of changes in these DoD imperatives could cause the DoD budget to remain unchanged or to decline (or even to increase). A significant decline in or redirection of U.S. military expenditures in the future could result in a decrease to our sales, earnings and cash flows. The loss or significant reduction in government funding of a large program in which we participate could also result in a decrease in our future sales, earnings and cash flows. U.S. Government contracts are also conditioned upon continuing approval by Congress of the amount of necessary spending. Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress for future fiscal years. Given the potential for uncertainty in the DoD fiscal process as we begin a new political era in the United States, and given the dangerous and volatile global condition in which the U.S. is a primary stabilizing force, our approach to future business planning will include our best assessments and judgments on how to account for change and adapt to new conditions and circumstances.

We rely predominantly on sales to U.S. Government entities, and the loss of a significant number of our contracts would have a material adverse effect on our results of operations and cash flows.

Our sales are predominantly derived from contracts (revenue arrangements) with agencies of, and prime system contractors to, the U.S. Government. The loss of all or a substantial portion of our sales to the U.S. Government would have a material adverse effect on our results of operations and cash flows. At December 31, 2008, we had approximately 2,100 contracts (revenue arrangements) with individual estimated contract values in excess of $1 million. Approximately 81%, or $12 billion, of our sales for the year ended December 31, 2008 were made directly or indirectly to U.S. Government agencies, including the DoD. For the year ended December 31, 2008, our largest contract (revenue arrangement) in terms of annual sales was the U.S. Air Force (USAF) Contract Field Teams (CFT) contract, which generated 3% of our sales. CFT is a multi-sourced contract, which provides worldwide quick reaction maintenance of deployed aircraft and ground vehicles for the U.S. military. Additionally, aggregate sales from our five largest contracts amounted to $1.8 billion, or 12% of our sales.

A substantial majority of our total sales are for products and services under contracts with various agencies and procurement offices of the DoD or with prime contractors to the DoD. Although these various agencies, procurement offices and prime contractors are subject to common budgetary pressures and other factors, our customers exercise independent purchasing decisions. Because of this concentration of contracts, if a significant number of our DoD contracts and subcontracts are simultaneously delayed or cancelled for budgetary, performance or other reasons, it would have a material adverse effect on our results of operations and cash flows.

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In addition to contract cancellations and declines in agency budgets, our backlog and future financial results may be adversely affected by:

- curtailment of the U.S. Government s use of technology or other services and products providers, including curtailment due to government budget reductions and related fiscal matters;
- developments in Iraq, Afghanistan or other geopolitical developments that affect demand for our products and services;
- our ability to hire and retain personnel to meet increasing demand for our services; and
- technological developments that impact purchasing decisions or our competitive position.

Our government contracts contain unfavorable termination provisions and are subject to audit and modification. If a termination right is exercised by the government, it could have a material adverse effect on our business, financial condition and results of operations.

Companies engaged primarily in supplying defense-related equipment and services to U.S. Government agencies are subject to certain business risks peculiar to the defense industry. These risks include the ability of the U.S. Government to unilaterally:

- suspend us from receiving new contracts pending resolution of alleged violations of procurement laws or regulations;
- terminate existing contracts;
- reduce the value of existing contracts;
- audit our contract-related costs and fees, including allocated indirect costs; and
- control and potentially prohibit the export of our products.

All of our U.S. Government contracts can be terminated by the U.S. Government either for its convenience or if we default by failing to perform under the contract. Termination for convenience provisions provide only for our recovery of costs incurred or committed settlement expenses and profit on the work completed prior to termination. Termination for default provisions provide for the contractor to be liable for excess costs incurred by the U.S. Government in procuring undelivered items from another source. Our contracts with foreign governments generally contain similar provisions relating to termination at the convenience of the customer.

U.S. Government agencies, including the Defense Contract Audit Agency and various agency Inspectors General routinely audit and investigate our costs and performance on contracts, as well as our accounting and general business practices. Based on the results of such audits, the U.S. Government may adjust our contract-related costs and fees, including allocated indirect costs. In addition, under U.S. Government purchasing regulations, some of our costs, including most financing costs, portions of research and development costs, and certain marketing expenses may not be reimbursable under U.S. Government contracts.

We may not be able to win competitively awarded contracts or receive required licenses to export our products, which would have a material adverse effect on our business, financial condition, results of operations and future prospects.

Our government contracts are subject to competitive bidding. We obtain many of our U.S. Government contracts through a competitive bidding process. We may not be able to continue to win competitively awarded contracts. In addition, awarded contracts may not generate sales sufficient to result in our profitability. We are also subject to risks associated with the following:

- the frequent need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties and/or cost overruns;
- the substantial time, effort and experience required to prepare bids and proposals for competitively awarded contracts that may not be awarded to us;

design complexity and rapid technological obsolescence; and

the constant need for design improvement.

In addition to these U.S. Government contract risks, we are required to obtain licenses from U.S. Government agencies to export many of our products and systems. Additionally, we are not permitted to export some of our products. Failure to receive required licenses would eliminate our ability to sell our products outside the United States.

We are subject to government investigations, which could have a material adverse effect on our business, financial condition, results of operations and future prospects.

We are from time to time subject to governmental investigations relating to our operations. We are currently cooperating with the U.S. Government on several investigations, including but not limited to, an investigation by the Department of Justice Criminal Antitrust Division regarding information technology services performed for the Air Force. For a discussion of this matter, see the Titan Government Investigation in Note 18 to our audited consolidated financial statements.

We are subject to the risks of current and future legal proceedings, which could have a material adverse effect on our business, financial condition, results of operations and future prospects.

At any given time, we are a defendant in various material legal proceedings and litigation matters arising in the ordinary course of business, including litigation, claims and assessments that have been asserted against acquired businesses, which we have assumed. Although we maintain insurance policies, these policies may not be adequate to protect us from all material judgments and expenses related to potential future claims and these levels of insurance may not be available in the future at economical prices or at all. A significant judgment against us, arising out of any of our current or future legal proceedings and litigation, could have a material adverse effect on our business, financial condition, results of operations and future prospects. For a discussion of the material litigation to which we are currently a party, see Note 18 to our audited consolidated financial statements.

If we are unable to keep pace with rapidly evolving products and service offerings and technological change, there could be a material adverse effect on our business, financial condition, results of operations and future prospects.

The rapid change of technology is a key feature of most of the markets in which our products, services and systems oriented businesses operate. To succeed in the future, we will need to continue to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. Historically, our technology has been developed through customer-funded and internally funded research and development and through certain business acquisitions. We may not be able to continue to maintain comparable levels of research and development or successfully complete such acquisitions. In the past, we have allocated substantial funds to capital expenditures, programs and other investments. This practice will continue to be required in the future. Even so, we may not be able to successfully identify new opportunities and may not have the needed financial resources to develop new products in a timely or cost-effective manner. At the same time, products and technologies developed by others may render our products, services and systems obsolete or non-competitive.

Our business acquisition strategy involves risks, and we may not successfully implement our strategy.

We seek to selectively acquire businesses that add new products, technologies, programs or customers to our existing businesses. We may not be able to continue to identify acquisition candidates on commercially reasonable terms or at all. If we make additional acquisitions, we may not realize the benefits anticipated from these acquisitions, including cost synergies and improving margins. Furthermore, we may not be able to obtain additional financing for acquisitions, since such additional financing could be restricted or limited by the terms of our debt agreements or due to unfavorable credit market conditions.

The process of integrating the operations of acquired businesses into our existing operations may result in unforeseen difficulties and may require significant financial and managerial resources that would otherwise be

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available for the ongoing development or expansion of our existing operations. Possible future business acquisitions could result in the incurrence of additional debt and related interest expense and contingent liabilities, each of which could result in an increase to our already significant level of outstanding debt, as well as more restrictive covenants. We consider and execute strategic acquisitions on an ongoing basis and may be evaluating acquisitions or engage in acquisition negotiations at any given time. We regularly evaluate potential acquisitions and joint venture transactions, and, except as disclosed in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Business Acquisitions and Business and Product Line Dispositions beginning on page 36, we have not entered into any agreements with respect to any material transactions at this time. Furthermore, in certain of our business acquisitions we have assumed all claims against and liabilities of the acquired business, including both asserted and unasserted claims and liabilities.

Goodwill represents a significant asset on our balance sheet. We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also review goodwill annually in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The annual impairment test is based on determining the fair value of our reporting units. A decline in the estimated fair value of a reporting unit could result in a goodwill impairment, and a related non-cash impairment charge against earnings, if estimated fair value for the reporting unit is less than the carrying value of the net assets of the reporting unit, including its goodwill. A large decline in estimated fair value of a reporting unit could result in an adverse effect on our financial condition and results of operations. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies beginning on page 38.

Our results of operations and cash flows are substantially affected by our mix of fixed-price, cost-reimbursable and time-and-material type contracts.

Our sales are transacted using written revenue arrangements, or contracts, which are generally either fixed-price, cost-reimbursable or time-and-material. For a description of our revenue recognition policies, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies beginning on page 38.

The table below presents the percentage of our total sales generated from each contract-type as of December 31, 2008.

Contract-Type	% of Total Sales
Fixed-price	54%
Cost-reimbursable	27%
Time-and-material	19%
Total sales	100%

Substantially all of our cost-reimbursable and time-and-material type contracts are with the U.S. Government, primarily the DoD. Substantially all of our sales to commercial customers are transacted under fixed-price sales arrangements, and are included in our fixed-price type contract sales.

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract.

On a cost-reimbursable type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit which can be fixed or variable depending on the contract s fee arrangement up to predetermined funding levels determined by our customers. On a time-and-material type contract (revenue arrangement), we are paid on the basis of direct labor hours expended at specified fixed-price hourly rates (that include wages, overhead, allowable general and administrative expenses and profit) and materials at cost. Therefore, on cost-reimbursable type and time-and-material type contracts, we do not bear the risks of unexpected cost overruns, provided that we do not incur costs that exceed the predetermined funded amounts.

Additionally, the impact of revisions in profit or loss estimates for all types of contracts subject to percentage of completion accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. Provisions for anticipated losses on contracts are recorded in the period in which they become evident. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as reduce the valuations of receivables and inventories; and in some cases, result in liabilities to complete contracts in a loss position.

Intense competition in the industries in which our businesses operate could limit our ability to attract and retain customers.

The defense industry and the other industries in which our businesses operate and the market for defense applications is highly competitive. We expect that the DoD s increased use of commercial off-the-shelf products and components in military equipment will continue to encourage new competitors to enter the market. We also expect that competition for original equipment manufacturing business will increase due to the continued emergence of merchant suppliers. Additionally, some of our competitors are larger than we are and have more financial and other resources than we have. For more information concerning the factors that affect our ability to compete, see Part I Item 1 Business Competition beginning on page 13.

Our significant level of debt and our ability to make payments on or service our indebtedness may adversely affect our financial and operating activities or ability to incur additional debt.

In prior years we incurred substantial indebtedness to finance our business acquisitions. At December 31, 2008, we had approximately $4,550 million in aggregate principal amount of outstanding debt, which includes a $650 million term loan facility. In addition, at December 31, 2008, we had additional borrowing capacity of $940 million available to us under our revolving credit facility, after reductions of $60 million for outstanding letters of credit. In the future, we may increase our borrowings, subject to limitations imposed on us by our debt agreements. The first scheduled maturity of our existing debt is our senior credit facility, comprised of the $650 million term loan facility and the revolving credit facility, on March 9, 2010. For further discussion concerning the scheduled maturity of our senior credit facility, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Anticipated Sources of Cash Flow on page 51.

Our ability to make scheduled payments of principal and interest on our indebtedness and to refinance our existing debt, including the scheduled maturity of our senior credit facility, depends on our future financial performance as well as our ability to access the capital markets, and the relative attractiveness of available financing terms. We do not have complete control over our future financial performance because it is subject to economic, political, financial (including credit market conditions), competitive, regulatory and other factors affecting the aerospace and defense industry, as well as commercial industries in which we operate. It is possible that in the future our business may not generate sufficient cash flow from operations to allow us to service our debt and make necessary capital expenditures. If this situation occurs, we may have to reduce costs and expenses, sell assets, restructure debt or obtain additional equity capital. We may not be able to do so in a timely manner or upon acceptable terms in accordance with the restrictions contained in our debt agreements.

Our level of indebtedness has important consequences to us. These consequences may include:

requiring a substantial portion of our net cash flow from operations to be used to pay interest and principal on our debt and therefore be unavailable for other purposes, including acquisitions, capital expenditures, paying dividends to our shareholders, repurchasing shares of our common stock, research and development and other investments;

limiting our ability to obtain additional financing for acquisitions, working capital, investments or other expenditures, which, in each case, may limit our ability to carry out our acquisition strategy;

increasing interest expenses due to higher interest rates on our borrowings that have variable interest rates;

heightening our vulnerability to downturns in our business or in the general economy and restricting us from making acquisitions, introducing new technologies and products or exploiting business opportunities; and

impacting debt covenants that limit our ability to borrow additional funds, dispose of assets, pay cash dividends or repurchase shares of our common stock. Failure to comply with such covenants could result in an event of default which, if not cured or waived, could result in the acceleration of our outstanding indebtedness.

Additionally, on December 31, 2008, we had $9,556 million of contractual obligations (including outstanding indebtedness). For a detailed listing of the components of our contractual obligations, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations on page 56.

Our debt agreements restrict our ability to finance our future operations and, if we are unable to meet our financial ratios, could cause our existing debt to be accelerated.

Our debt agreements contain a number of significant covenants that, among other things, restrict our ability to:

sell assets;

incur more indebtedness;

repay certain indebtedness;

pay dividends on the common stock of L-3 Holdings;

make certain investments or business acquisitions;

repurchase or redeem capital stock;

make certain capital expenditures;

engage in business mergers or consolidations; and

engage in certain transactions with subsidiaries and affiliates.

These restrictions could impair our ability to finance our future operations or capital needs or engage in other business activities that may be in our interest. In addition, some of our debt agreements also require us to maintain compliance with certain financial ratios, including (1) total consolidated earnings before interest, taxes, depreciation and amortization to total consolidated cash interest expense and (2) total consolidated funded indebtedness less designated cash balances to total consolidated earnings before interest, taxes, depreciation and amortization. Our ability to comply with these ratios and covenants may be affected by events beyond our control. A breach of any of these agreements or our inability to comply with the required financial ratios or covenants could result in a default under those debt agreements. In the event of any such default, the lenders under those debt agreements could elect to:

declare all outstanding debt, accrued interest and fees to be due and immediately payable;

require us to apply all of our available cash to repay our outstanding senior debt; and prevent us from making debt service payments on our other debt.

For further discussion of our financial ratios, debt agreements and other payment restrictions, see Note 10 to our audited consolidated financial statements.

If we are unable to attract and retain key management and personnel, we may become unable to operate our business effectively.

Our future success depends to a significant degree upon the continued contributions of our management, and our ability to attract and retain highly qualified management and technical personnel, including employees who have U.S. Government security clearances, particularly clearances of top-secret and above.

We do not maintain any key person life insurance policies for members of our management. We face competition for management and technical personnel from other companies and organizations. Failure to attract and retain such personnel would damage our future prospects.

Environmental laws and regulations may subject us to significant liability.

Our operations are subject to various U.S. federal, state and local as well as certain foreign environmental laws and regulations within the countries in which we operate relating to the discharge, storage, treatment, handling, disposal and remediation of certain materials, substances and wastes used in our operations.

New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean-up requirements may require us to incur a significant amount of additional costs in the future and could decrease the amount of free cash flow available to us for other purposes, including capital expenditures, research and development and other investments and could have a material adverse effect on our business, financial condition, results of operations and future prospects.

Termination of our backlog of orders could negatively impact our results of operations and cash flows.

We currently have a backlog of funded orders, primarily under contracts with the U.S. Government. Our total funded backlog was $11,572 million at December 31, 2008. As described above, the U.S. Government may unilaterally modify or terminate its contracts. Accordingly, most of our backlog could be modified or terminated by the U.S. Government, which would negatively impact our results of operations and cash flows.

Our sales to certain foreign customers expose us to risks associated with operating internationally.

For the year ended December 31, 2008, sales to foreign customers, excluding our foreign sales made under foreign military sales (FMS) agreements directly between the U.S. Government and allied foreign governments, represented approximately 11% of our consolidated sales. Consequently, our businesses are subject to a variety of risks that are specific to international operations, including the following:

- export regulations that could erode profit margins or restrict exports;
- compliance with the U.S. Foreign Corrupt Practices Act (FCPA);
- the burden and cost of compliance with foreign laws, treaties and technical standards and changes in those regulations;
- contract award and funding delays;
- potential restrictions on transfers of funds;
- foreign currency fluctuations;
- import and export duties and value added taxes;
- transportation delays and interruptions;
- uncertainties arising from foreign local business practices and cultural considerations; and

potential military conflicts and political risks.

While we have and will continue to adopt measures to reduce the potential impact of losses resulting from the risks of our foreign business, we cannot ensure that such measures will be adequate.

Global economic recession, continued tightening of credit markets, and U.S. Government intervention in financial and other industries may adversely affect our results.

Domestic and foreign economies and equity and fixed income markets have recently experienced significant declines, and severely diminished liquidity and credit availability. These economic conditions are currently negatively impacting, and could continue to adversely affect, our sales to the commercial markets in which we operate, including our commercial aviation products and commercial shipbuilding products businesses. Sales to commercial customers were $1.7 billion for 2008, or 11.2% of our total sales.

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Additionally, while we are unable to predict the impact and outcome of these economic events and the U.S. Government s intervention to shore up financial and other industries, these events could also negatively affect future U.S. defense budgets and spending and, consequently, our financial condition, results of operations and cash flows. Sales to the DoD represented 74% of our total sales for 2008.

These economic conditions could also continue to adversely affect our pension plan funded status and annual pension expense. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Pension Plans on page 53 and Note 19 to our audited consolidated financial statements.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

At December 31, 2008, we operated in 536 locations consisting of manufacturing facilities, administration, research and development and other properties throughout the United States and internationally. Of these, we owned 45 locations consisting of approximately 5.5 million square feet and leased space at 491 locations consisting of approximately 17.9 million square feet.

Our reportable segments have major operations at the following locations:

C^{3}ISR Camden, New Jersey; Greenville and Waco, Texas; and Salt Lake City, Utah.

Government Services Huntsville, Alabama; Tucson, Arizona; Washington, DC; Orlando, Florida; Annapolis, Maryland; and Alexandria, Arlington, Chantilly and Reston, Virginia.

AM&M Crestview, Florida; Lexington, Kentucky; South Madison, Mississippi; Greenville and Waco, Texas; and Edmonton and Quebec, Canada.

Specialized Products Phoenix and Tempe, Arizona; Anaheim, San Carlos, San Diego, San Leandro, Santa Barbara, Simi Valley, Sylmar and Torrance, California; Orlando, Sarasota and St. Petersburg, Florida; Ayer, Massachusetts; Grand Rapids and Muskegon, Michigan; Budd Lake, New Jersey; Albuquerque, New Mexico; Binghamton and Hauppauge, New York; Cincinnati and Mason, Ohio; Tulsa, Oklahoma; Philadelphia, Pittsburgh and Williamsport, Pennsylvania; Arlington, Dallas and Garland, Texas; Norfolk, Virginia; Burlington and Toronto, Canada; and Hamburg and Elmenhorst, Germany.

Corporate and other locations New York, New York and Arlington, Virginia.

A summary of square footage by reportable segment as of December 31, 2008 is presented below.

	Leased	Owned	Total
	(Square feet in millions)		
C^{3}ISR	4.3	0.7	5.0
Government Services	3.1		3.1
AM&M	3.2	1.4	4.6

Specialized Products	7.2	3.4	10.6
Corporate	0.1		0.1
Total	17.9	5.5	23.4

Management believes all of our properties have been well maintained, are in good condition, and are adequate to meet current contractual requirements.

Item 3. Legal Proceedings

The information required with respect to this item can be found in Note 18 to our audited consolidated financial statements and is included in this Item 3 by reference.

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

None.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of L-3 Holdings is traded on the New York Stock Exchange (NYSE) under the symbol LLL . On February 23, 2009, the closing price of L-3 Holdings common stock, as reported by the NYSE, was $72.35 per share and the number of holders of L-3 Holdings common stock was approximately 75,000. The table below sets forth the high and low closing price of L-3 Holdings common stock as reported on the NYSE composite transaction tape and the amount of dividends paid per share during the past two calendar years.

	Dividends Paid		Closing Price (High-Low)			
	2008	2007	2008		2007	
Common Stock Dividends Paid and Market Prices						
First Quarter	$0.30	$0.25	$ 110.48	$101.99	$ 88.99	$80.02
Second Quarter	0.30	0.25	114.46	90.63	99.20	87.81
Third Quarter	0.30	0.25	105.88	87.57	102.68	92.11
Fourth Quarter	0.30	0.25	98.32	59.32	114.69	103.69
Year Ended December 31	$1.20	$1.00	114.46	59.32	114.69	80.02

On February 5, 2009, L-3 Holdings announced that its Board of Directors had increased L-3 Holdings regular quarterly cash dividend by 17% to $0.35 per share, payable on March 16, 2009, to shareholders of record at the close of business on February 19, 2009.

L-3 Holdings relies on dividends received from L-3 Communications to generate the funds necessary to pay dividends on L-3 Holdings common stock. See Note 10 to our audited consolidated financial statements for the financial and other restrictive covenants that limit the payment of dividends by L-3 Communications to L-3 Holdings.

Issuer Purchases of Equity Securities

The following table provides information about share repurchases made by L-3 Holdings of its common stock that are registered pursuant to Section 12 of the Exchange Act during the 2008 fourth quarter. Repurchases are made from time to time at management s discretion in accordance with applicable federal securities laws. All share repurchases of L-3 Holdings common stock have been recorded as treasury shares.

	Total number of	Maximum number (or approximate dollar value) of shares that may

	Total number of shares purchased	Average price paid per share	shares purchased as part of publicly announced plans or programs	yet be purchased under the plans or programs (in millions)
September 27 October 31, 2008[1]	1,846,332	$ 82.12	1,846,332	$
November 1 30, 2008[2]				$ 1,000
December 1 31, 2008	1,037,564	66.61	1,037,564	$ 931
Total	2,883,896	$ 76.54	2,883,896	

(1) In October 2008, L-3 Holdings completed its previously announced $750 million share repurchase program, which was approved by its Board of Directors on December 11, 2007.

(2) On November 24, 2008, L-3 Holdings Board of Directors approved a new share repurchase program that authorizes L-3 Holdings to repurchase up to an additional $1 billion of its outstanding shares of common stock through December 31, 2010.

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From January 1, 2009 through February 25, 2009, L-3 Holdings has repurchased 980,609 shares of its common stock at an average price of $76.65 per share for an aggregate amount of $75 million.

The graph below compares the cumulative total returns of our common stock with the cumulative total return of the Standard & Poor s 500 Composite Stock Index and the Standard & Poor s 1500 Aerospace & Defense Index, for the period from December 31, 2003 to December 31, 2008. These figures assume that all dividends paid over the performance period were reinvested, and that the starting value of each index and the investment in our common stock was $100 on December 31, 2003.

We are one of the companies included in the Standard & Poor s 1500 Aerospace & Defense Index and the Standard & Poor s 500 Composite Stock Index. The starting point for the measurement of our common stock cumulative total return was our stock price of $51.36 per share on December 31, 2003. The graph is not, and is not intended to be, indicative of future performance of our common stock.

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Item 6. Selected Financial Data

We derived the selected financial data presented below at December 31, 2008 and 2007 and for each of the three years in the period ended December 31, 2008 from our audited consolidated financial statements included elsewhere in this Form 10-K. We derived the selected financial data presented below at December 31, 2006, 2005 and 2004 and for the years ended December 31, 2005 and 2004 from our audited consolidated financial statements not included in this Form 10-K. The selected financial data should be read in conjunction with our Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements. Our results of operations, cash flows and financial position are affected significantly by our business acquisitions, the more significant of which are described elsewhere herein.

	Year Ended December 31,				
	2008[1]	2007	2006[2]	2005	2004
	(in millions, except per share data)				
Statement of Operations Data:					
Net sales	$ 14,901	$ 13,961	$ 12,477	$ 9,445	$ 6,897
Cost of sales	13,342	12,513	11,198	8,448	6,148
Litigation gain (charge)[3]	126		(129)		
Stock-based charge[4]			(39)		
Operating income	1,685	1,448	1,111	997	749
Interest and other income, net	28	31	20	6	7
Interest expense[3]	271	296	296	204	145
Minority interests in net income of consolidated subsidiaries	11	9	10	10	9
Loss on retirement of debt					5
Income from continuing operations before income taxes	1,431	1,174	825	789	597
Provision for income taxes	502	418	299	280	215
Income from continuing operations	$ 929	$ 756	$ 526	$ 509	$ 382
Net income[5]	$ 949	$ 756	$ 526	$ 509	$ 382
L-3 Holdings earnings per common share:					
Basic:					
Income from continuing operations	$ 7.66	$ 6.05	$ 4.27	$ 4.28	$ 3.54
Net income	$ 7.83	$ 6.05	$ 4.27	$ 4.28	$ 3.54
Diluted:					
Income from continuing operations	$ 7.56	$ 5.98	$ 4.22	$ 4.20	$ 3.33
Net income	$ 7.72	$ 5.98	$ 4.22	$ 4.20	$ 3.33

L-3 Holdings weighted average common shares outstanding:					
Basic	121.2	124.9	123.1	118.8	107.8
Diluted	122.9	126.5	124.8	121.2	117.4
Cash dividends declared per share on L-3 Holdings common stock	$ 1.20	$ 1.00	$ 0.75	$ 0.50	$ 0.40

(1) The year ended December 31, 2008 includes: (1) a gain of $12 million ($7 million after income taxes, or $0.06 per share) from the sale of a product line (the Product Line Divestiture Gain), and (2) a non-cash impairment charge of $28 million ($17 million after income taxes,

or $0.14 per share) related to a write-down of capitalized software development costs for a general aviation product (the Impairment Charge).

(2) Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment* (SFAS 123(R)), which reduced 2006 operating income by $42 million, net income by $29 million and diluted earnings per share by $0.23.

(3) The year ended December 31, 2008 includes a pre-tax gain of $133 million ($81 million after income taxes, or $0.66 per diluted share) recorded in the second quarter of 2008, comprised of a $126 million reversal of a current liability for pending and threatened litigation (the Litigation Gain) and $7 million for related accrued interest as a result of a June 27, 2008 decision by the U.S. Court of Appeals which vacated an adverse 2006 jury verdict. For the year ended December 31, 2006, the Company recorded $129 million ($78 million after income taxes, or $0.63 per diluted share) related to this adverse jury verdict, which was rendered on May 24, 2006.

(4) The Stock-Based Charge of $39 million ($25 million after income taxes, or $0.20 per diluted share) was recorded in the second quarter of 2006 in connection with L-3 s voluntary review of its past stock option granting practices and the related accounting.

(5) Net Income includes an after-tax gain of $20 million or $0.16 per diluted share for the sale of our 85% ownership interest in Medical Education Technologies, Inc. (METI) on October 8, 2008. The gain is excluded from income from continuing operations for the year ended December 31, 2008.

	Year Ended December 31, (in millions)				
	2008	**2007**	**2006**	**2005**	**2004**
Balance Sheet Data (at year end):					
Working capital	$ 2,254	$ 2,181	$ 1,553	$ 1,789	$ 1,633
Total assets	14,485	14,391	13,287	11,909	7,781
Long-term debt	4,538	4,537	4,535	4,634	2,190
Minority interests	83	87	84	81	78
Shareholders equity	5,831	5,989	5,306	4,491	3,800
Cash Flow Data:					
Net cash from operating activities	$ 1,387	$ 1,270	$ 1,074	$ 847	$ 621
Net cash used in investing activities	(432)	(388)	(1,091)	(3,547)	(556)
Net cash (used in) from financing activities	(840)	(464)	(29)	2,441	453

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Financial Section Roadmap

Management s discussion and analysis (MD&A) can be found on pages 30 to 61, the report related to the financial statements and internal control over financial reporting can be found on page 62 and the financial statements and related notes can be found on pages F-1 to F-64. The following table is designed to assist in your review of MD&A.

Overview and Outlook

L-3 s Business

L-3 is a prime system contractor in aircraft modernization and maintenance, Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR) systems, and government services. L-3 is also a leading provider of high technology products, subsystems and systems. Our customers include the U.S. Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS) and U.S. Department of Justice (DoJ), allied foreign governments, domestic and international commercial customers and select other U.S. federal, state and local government agencies.

We have the following four reportable segments: (1) C^3ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Specialized Products. Financial information for our reportable segments is included in Note 21 to our audited consolidated financial statements. C^3ISR provides products and services for the global ISR market, networked communications systems and secure communications products. We believe that these products and services are critical elements for a substantial number of major command, control, communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Government Services provides training and operational support services, enterprise information technology solutions, intelligence solutions and support, command & control systems and software services and global security & engineering solutions services. AM&M provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. Specialized Products provides a broad range of products and related services

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across several business areas that include power & control systems, electro-optic/infrared (EO/IR), microwave, avionics & displays, simulation & training, precision engagement, security & detection systems, propulsion systems, telemetry & advanced technology, undersea warfare, and marine services.

For the year ended December 31, 2008, we generated sales of $14,901 million. Our primary customer was the DoD. The table below presents a summary of our 2008 sales by end customer and the percent contributed by each to our total 2008 sales.

	2008 Sales (in millions)	% of Total Sales
Army	$ 4,180	28%
Air Force	2,944	20
Navy/Marines	2,295	15
Other Defense	1,640	11
Total DoD	$ 11,059	74%
Other U.S. Government	1,067	7
Total U.S. Government	$ 12,126	81%
Foreign governments	1,099	7
Commercial foreign	987	7
Commercial domestic	689	5
Total sales	$ 14,901	100%

Most of our contracts (revenue arrangements) with the U.S. Government are subject to U.S. Defense Contract Audit Agency audits and various cost and pricing regulations, and include standard provisions for termination for the convenience of the U.S. Government. Multiyear U.S. Government contracts and related orders are subject to cancellation if funds for contract performance for any subsequent year become unavailable. Foreign government contracts generally include comparable provisions relating to termination for the convenience of the relevant foreign government.

Business Strategy

Our business strategy is customer-focused and aims to increase shareholder value by providing products and services to our customers that create value for them with responsive, high-quality and affordable solutions. Financially, our emphasis is on sustainably growing earnings per share and cash flow. Our strategy involves a flexible and balanced combination of organic growth, cost reductions, select business acquisitions and divestitures, dividends and share repurchases, enabling us to grow the company and return cash to our shareholders. We intend to maintain and expand our position as a leading supplier of products, subsystems, systems and services to the DoD, other U.S. Government agencies, allied foreign governments and commercial customers, both domestic and international. Our strategy includes the objectives discussed below.

We intend to expand our prime system contractor roles in select business areas where we have domain expertise, including C^3ISR, aircraft modernization and maintenance and government technical services. We also intend to enter into teaming arrangements with other prime system contractors and platform original equipment manufacturers to compete for select new business opportunities. As an independent supplier of a broad range of products, subsystems and systems in several key business areas, our growth will partially be driven by expanding our share on existing programs and participating on new programs. We also expect to identify opportunities to use our customer relationships and leverage the capabilities of our various businesses, including proprietary technologies, to expand the scope of our products and services to existing and new customers. We also intend to continue to supplement our growth by participating on and competing for new programs internationally, particularly in Canada, the United Kingdom and Australia.

We intend to use our existing prime contractor and supplier positions and internal investments to grow our sales organically. We expect to benefit from our positions as a supplier to multiple bidders on select prime contract bids. We plan to maintain our diversified and broad business mix with its limited reliance on any single contract and significant follow-on and new business opportunities. We also expect to continue to supplement our organic sales growth by selectively acquiring businesses that add new products, services, technologies, programs or customers to our existing businesses, and provide attractive returns on investment.

We believe that favorable performance on our existing contracts is the foundation for successfully meeting our objectives of expanding L-3 s prime contractor and supplier positions and growing sales organically. We believe that a prerequisite for growing and winning new business is to retain our existing business with successful contract performance, including schedule, cost, technical and other performance criteria. Therefore, we will continue to focus on delivering superior contract performance to our customers to maintain our reputation as an agile and responsive contractor and to differentiate L-3 from its competitors.

We intend to continue to aggressively improve and reduce our direct contract costs and overhead costs, including general and administrative costs. Effective management of labor, material, subcontractor and other direct costs is a primary element of favorable contract performance. We also intend to grow sales at a faster rate than overhead costs. We believe continuous cost improvement will enable us to increase our cost competitiveness, expand operating margin and selectively invest in new product development, bids and proposals and other business development activities to organically grow sales.

We intend to continue to align our internal investments in research and development, business development and capital expenditures to proactively address customer requirements and priorities with our products, services and solutions. We also intend to grow our sales through the introduction of new products and services and continued increased collaboration between our businesses to offer the best quality and competitive solutions and services to our customers.

Industry Considerations

In recent years, a variety of changing conditions have significantly affected the markets for defense systems, products and services. There has been a fundamental shift in focus from a traditional threat-based model to one that emphasizes a broad range of capabilities needed to respond to all contingencies and to defeat all adversaries (all hazards, all threats). This expanded scope has transformed the U.S. defense posture to a capabilities-based orientation that can be tailored and structured to meet the demands of contemporary and future national and homeland security requirements. This new approach involves creating a more flexible response with appropriate capability, agility and force while highlighting changing technologies and operational approaches applied to the challenges we face at every level of warfare and in conditions short of war. The entire set of capabilities resident in the DoD inventory will be examined for change, with special attention given to improved strategic defense systems, interoperable and brilliant networked information and communications systems, precise weapons and survivable delivery platforms, improved and enhanced intelligence, reconnaissance, surveillance and target acquisition (IRSTA) systems, and security systems in general. This transformation also includes the application of military capabilities for homeland defense and selected emergency response efforts.

We anticipate that the 2010 U.S. Quadrennial Defense Review (QDR) will incorporate lessons learned from U.S. military operations in Iraq, Afghanistan, the Balkans, and from other conflicts and security-related events around the world. We anticipate the promotion of enhanced special operations and irregular warfare capabilities, improved intelligence gathering and application, greater language and cultural capabilities, more effective communications and information sharing, and enhanced security cooperation with partner nations. We also anticipate increased attention to selected strategic capabilities to maintain a strong deterrent posture against future challenges to our security.

In recent years DoD budgets have reflected increased focus on C^5ISR (command, control, communications, computers, collaboration and intelligence, surveillance and reconnaissance), precision-guided weapons, UAVs and other electro-mechanical robotic capabilities, networked information technologies, special operations forces, and missile defense. In addition, the DoD has focused on a transformation strategy that seeks to balance modernization and recapitalization (or upgrading existing platforms and capabilities) while enhancing readiness and joint operations all while engaging in demanding on-going military operations.

As a result, defense budget program allocations continue to favor immediate war-fighting improvements and concurrent limited investment in future programs. DoD s emphasis on systems interoperability, force multipliers, advances in intelligence gathering, and the provision of real-time relevant data to battle commanders often referred to as the common operating picture (COP), have increased the electronic content of nearly all major military procurement and research programs. Therefore, it is expected that the DoD budget for information technologies and defense electronics will grow. We believe L-3 is well positioned to benefit from the expected focus in those areas.

While the DoD budget could be affected by several factors, including current and future economic conditions and the new administration priorities, we are unable to predict the impact and outcome of these uncertainties. However, the current outlook is one of more precise application of DoD spending, which will continue to support L-3 s future orders and sales, operating results and cash flows. Conversely, a decline in the DoD budget would generally have a negative effect on future orders, sales, operating profits, and cash flows of defense contractors, including L-3, depending on the platforms and programs affected by such budget reductions.

With regard to U.S. homeland defense and security, increased emphasis in these important endeavors may increase the demand for our capabilities in areas such as security systems, information assurance and cyber security, crisis management, preparedness and prevention services, and non-DoD security operations.

On balance, L-3 is one of the key U.S. providers of product, capability and support and services in both defense and homeland security. Anticipated business in these key critical areas favors a vital and rewarding future for our company.

Key Performance Measures

The primary financial performance measures that L-3 uses to manage its businesses and monitor results of operations are sales growth and operating income growth. Management believes that these financial performance measures are the primary growth drivers for L-3 s earnings per share and net cash from operating activities. L-3 s business strategy is focused on increasing sales from organic growth and select business acquisitions that add new products, services, technologies, programs or customers in areas that complement L-3 s existing businesses. We define organic sales growth as the increase or decrease in sales for the current period compared to the prior period, excluding sales in the (1) current period from business and product line acquisitions that have been included in L-3 s actual results of operations for less than twelve months, and (2) prior period from business and product line divestitures that are included in L-3 s actual results of operations for the twelve-month period prior to the divestiture date. The two main determinants of our operating income growth are sales growth and improvements in operating margin. We define operating margin as operating income as a percentage of sales.

Sales Growth. Our average annual sales growth for the five years ended December 31, 2008, was 25%, with average annual organic sales growth of approximately 10% and average annual sales growth from business acquisitions of approximately 15%. Sales growth for the year ended December 31, 2008 was 7%, comprised of organic sales growth of 5%, and sales growth from business acquisitions, net of divestitures, of 2%.

For the year ended December 31, 2008, our largest contract (revenue arrangement) in terms of annual sales was the USAF CFT contract, which generated 3% of our sales. CFT is a multi-sourced contract, which provides worldwide quick reaction maintenance of deployed aircraft and ground vehicles for the U.S. military. The USAF recently selected L-3 as one of the winning contractors for the next CFT indefinite delivery/indefinite quantity contract that began on October 1, 2008. There will be more contractors competing for task orders on the new CFT contract compared to the existing contract, and therefore, we may not be able to maintain our annual sales on the new contract.

For the year ended December 31, 2007, our largest contract (revenue arrangement) in terms of annual sales was the World Wide Linguist Support Services contract (Linguist Contract), which generated 5% of 2007 consolidated sales. On February 15, 2008, the U.S. Army Intelligence and Security Command

(INSCOM) announced that it did not select our proposal for the Translation and Interpretation Management Services (TIMS) contract. The TIMS contract is the successor contract to the portion of the Linguist Contract that provides translators and linguists in support of the U.S. military operations in Iraq. On June 9, 2008, we transitioned from our prime contract to a subcontract with Global Linguist Solutions (GLS) to supply translation and interpretation services in Iraq under the TIMS contract.

We, as most U.S. defense contractors, have benefited from the upward trend in DoD budget authorization and spending outlays over recent years, including supplemental appropriations for military operations in Iraq, Afghanistan and the Global War on Terror (GWOT). We believe that our businesses should be able to generate organic sales growth for the foreseeable future because we anticipate the defense budget will continue its focus on areas that match certain of the core competencies of L-3: communications and persistent ISR, sensors, precision engagement, Special Operations Forces, wartime support services and simulation & training. The increased DoD spending during recent years has included supplemental appropriations for military operations in Iraq and Afghanistan. These appropriations have enabled the DoD to proceed with its recapitalization and reconstitution programs that are directly related to the U.S. military operations in Iraq and Afghanistan, which allowed for the focus of base budget resources on transformational modernization programs.

The current and future DoD budgets and level of future Congressional supplemental appropriations for U.S. military operations in Iraq and Afghanistan could remain unchanged or decline because of several factors, including but not limited to, changes in U.S. procurement policies, budget considerations, current and future economic conditions, new administration priorities, changing national security and defense requirements, and geo-political developments, which are beyond our control. Any of these factors could result in a significant decline in or redirection of current and future DoD budgets and impact L-3 s future results of operations, including our organic sales growth rate. Additionally, L-3 s future results of operations and sales growth are affected by our ability to retain our existing business and to successfully compete for new business, which largely depend on: (1) our successful performance on existing contracts, (2) the effectiveness and innovation of our technologies and research and development activities, (3) our ability to offer better program performance than our competitors at a lower cost, and (4) our ability to retain our employees and hire new ones, particularly those employees who have U.S. Government security clearances.

Operating Income Growth. For the year ended December 31, 2008, our consolidated operating income was $1,685 million and our consolidated operating margin was 11.3%. Our operating income and operating margins for the year ended December 31, 2008, were impacted by certain items which occurred during the 2008 second quarter, as further discussed below. Excluding these same items, our consolidated operating income was $1,575 million for the year ended December 31, 2008, an increase of 9% from $1,448 million for the year ended December 31, 2007, and our consolidated operating margin was 10.6% for the year ended December 31, 2008, an increase of 20 basis points from 10.4% for the year ended December 31, 2007.

Excluding an increase in our 2009 pension expense because of a 28% decline in pension plan asset returns as a result of declines in equity and fixed income financial markets during 2008, we expect to continue to generate modest annual increases in operating margin as we expect to increase sales, grow sales at a faster rate than indirect costs and improve our overall contract performance. However, we may not be able to expand our operating margin on an annual basis. Additionally, in the future, select business acquisitions and select new business could reduce our operating margins, if the margins are lower than L-3 s existing operating margin. In addition, any further decline in pension plan asset returns during 2009 could reduce our operating margins in 2010. Our business objectives include growing earnings per share and cash flow. Improving operating margins is one method for achieving this growth, but it is not the only one.

Other 2008 Events

Our 2008 results were affected by three matters, which increased consolidated operating income by $110 million, income before income taxes by $117 million, net income by $71 million and diluted earnings per share (EPS) by $0.58, which are collectively referred to as the Q2 2008 Items:

A gain of $133 million ($81 million after income taxes, or $0.66 per share) for the reversal of a $126 million current liability for pending and threatening litigation as a result of a June 27, 2008

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decision by the U.S. Court of Appeals that vacated an adverse 2006 jury verdict and $7 million of related accrued interest, which is recorded in interest expense and other items (the Litigation Gain);

A gain of $12 million ($7 million after income taxes, or $0.06 per share) from the sale of a product line (the Product Line Divestiture Gain); and

A non-cash impairment charge of $28 million ($17 million after income taxes, or $0.14 per share) relating to a write-down of capitalized software development costs for a general aviation product (the Impairment Charge).

Also, on October 8, 2008, we divested our 85% ownership interest in METI and recorded a gain in the year ended December 31, 2008 of $33 million ($20 million after income taxes, or $0.16 per diluted share). The gain is excluded from income from continuing operations for the year ended December 31, 2008.

Liquidity

Our primary source of liquidity is cash flow generated from operations. We generated $1,387 million of cash from operating activities during the year ended December 31, 2008. We also had cash and cash equivalents of $867 million at December 31, 2008. Notwithstanding the recent declines in equity and fixed income financial markets and diminished liquidity and credit availability, we currently believe that our liquidity is adequate to meet our anticipated requirements. Our first scheduled maturity of outstanding debt is our $650 million term loan facility, which matures on March 9, 2010. Our intention is to refinance all or a portion of the $650 million term loan facility borrowings, if we are able to do so on terms that are acceptable to us. If such terms are not available to us, we intend to repay the term loan facility with cash on hand. Our revolving credit facility also matures on March 9, 2010. We intend to enter into a new revolving credit facility at or before that time. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources on page 51.

Business Acquisitions and Business and Product Line Dispositions

As discussed above, a portion of our growth strategy is to selectively acquire businesses that add new products, services, technologies, programs or customers to our existing businesses. We intend to continue acquiring select businesses for reasonable valuations that will provide attractive returns to L-3. Our business acquisitions, depending on their business-type, contract-type, sales mix or other factors, could reduce L-3 s consolidated operating margin while still increasing L-3 s operating income, earnings per share, and net cash from operating activities.

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Business Acquisitions and Divestitures

Acquisitions. The table below summarizes the acquisitions that we have completed during the years ended December 31, 2006, 2007 and 2008, referred to herein as business acquisitions. See Note 4 to our audited consolidated financial statements for further information regarding our business acquisitions. During the year ended December 31, 2008, we used $283 million in the aggregate for business acquisitions, including earnout payments and remaining contractual purchase prices.

Business Acquisitions	**Date Acquired**		**Purchase Price[1] (in millions)**
2006			
SAM Electronics GmbH	January 31, 2006	$	189
SafeView, Inc. (SafeView) and CyTerra Corporation	March 2006		190(2)
METI	April 4, 2006		11(3)
SSG Precision Optronics, Inc.	June 1, 2006		68
Nautronix Defence Group (Nautronix)	June 1, 2006		71(4)
Crestview Aerospace Corporation	June 29, 2006		153
TRL Electronics plc	July 12, 2006		171
Nova Engineering (Nova)	October 25, 2006		47(5)
Advanced Systems Architecture Ltd., TCS Design and Management Services, Incorporated, Magnet-Motor GmbH, gForce Technologies, Inc. and TACNET	Various		72(6)
Total 2006		$	972
2007			
Geneva Aerospace, Inc. (Geneva)	January 31, 2007	$	16(7)
Global Communication Solutions, Inc.	May 4, 2007		152
APSS S.r.l.	August 31, 2007		12
MKI Systems, Inc.	December 3, 2007		45
Total 2007		$	225
2008			
HSA Systems Pty. Ltd.	March 14, 2008	$	16
METI	April 4, 2008		3(3)
Electro-Optical Systems	April 21, 2008		178
G.A. International Electronics and subsidiaries (GAI)	July 25, 2008		4(8)
International Resources Group Ltd.	December 3, 2008		58(9)
Total 2008		$	259

(1) The purchase price represents the contractual consideration for the acquired business, excluding adjustments for net cash acquired and acquisition transaction costs.

(2) Excludes additional purchase price for SafeView, not to exceed $35 million, in the aggregate, which is contingent upon its financial performance through December 31, 2008. The remaining contractual purchase price is currently subject to an arbitration proceeding, see Note 18 to our audited consolidated financial statements.

(3) We increased our ownership interest in METI from approximately 47% to 80% in 2006 and from 80% to 85% in 2008. METI was sold on October 8, 2008, as described below.

(4) Excludes additional purchase price, not to exceed $2 million, in the aggregate, which is contingent upon certain contract awards to Nautronix through 2010.

(5) Excludes additional purchase price, not to exceed $5 million, in the aggregate, which is contingent upon the financial performance of Nova for the years ending December 31, 2009 and 2010.

(6) Excludes additional purchase price, not to exceed $1 million, in the aggregate, which is contingent upon the financial performance of TACNET for the years ending December 31, 2009 and 2010.

(7) Excludes additional purchase price, not to exceed $13 million, in the aggregate, which is contingent upon the financial performance of Geneva for the year ending December 31, 2009.

(8) Excludes additional purchase price, not to exceed $1 million, in the aggregate, which is contingent upon the financial performance of GAI through July 2011.

(9) The final purchase price is subject to adjustment based on final closing date net assets.

All of our business acquisitions are included in our consolidated results of operations from their dates of acquisition. We regularly evaluate potential business acquisitions. Additionally, on January 30, 2009, we acquired Chesapeake Sciences Corporation (CSC). CSC is a developer and manufacturer of anti-submarine warfare systems for use onboard submarines and surface ship combatants.

Divestitures. On October 8, 2008, we divested our 85% ownership interest in METI, which is within the Specialized Products segment. The sale resulted in a gain in the year ended December 31, 2008 of $33 million ($20 million after income taxes). The gain is excluded from income from continuing operations in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets.* The revenues, operating results and net assets of METI for all periods presented were not material and therefore not presented as discontinued operations. The sales price and related gain with respect to this business divestiture are subject to adjustment based on actual closing date net working capital, which is expected to be resolved during the first quarter of 2009. On May 9, 2008, we sold the Electron Technologies Passive Microwave Devices (PMD) product line within the Specialized Products segment and recognized an after-tax gain of approximately $7 million (pre-tax gain of $12 million).

Critical Accounting Policies

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and cost of sales during the reporting period. The most significant of these estimates and assumptions relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, market values for inventories reported at lower of cost or market, pension and post-retirement benefit obligations, stock-based employee compensation expense, valuation of deferred taxes, litigation reserves and environmental obligations, accrued product warranty costs and the recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Actual amounts will differ from these estimates and could differ materially. We believe that our critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are uncertain and inherently judgmental at the time of the estimate; (2) use of reasonably different assumptions could have changed our estimates, particularly with respect to estimates of contract revenues and costs, and recoverability of assets, and (3) changes in the estimate could have a material effect on our financial condition or results of operations. We believe the following critical accounting policies contain the more significant judgments and estimates used in the preparation of our financial statements.

Contract Revenue Recognition and Contract Estimates. A large portion of our revenue is generated using written contracts (revenue arrangements) that require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services according to the buyer s specifications. These revenue arrangements or contracts are generally fixed price, cost-reimbursable, or time-and-material. These contracts are covered by the American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1) and Accounting Research Bulletin No. 45, *Long-Term Construction-Type Contracts* (ARB 45). Cost-reimbursable type contracts are also specifically covered by Accounting Research Bulletin No. 43, Chapter 11, Section A, *Government Contracts, Cost-Plus-Fixed Fee Contracts* (ARB 43). Substantially all of our cost-reimbursable type and time and material type contracts are with the U.S. Government, primarily the DoD. Certain of our contracts with the

U.S. Government are multi-year contracts that are funded annually by the customer, and sales on these multi-year contracts are based on amounts appropriated (funded) by the U.S. Government.

Sales and profits on fixed-price type contracts that are covered by SOP 81-1, ARB 43 and ARB 45 are substantially recognized using percentage-of-completion (POC) methods of accounting. Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the units-of-delivery method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to total estimated costs at completion of the contract multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the cost-to-cost method). Under the POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

Accounting for the sales on these fixed-price contracts, require the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract s statement of work, and (3) the measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units-of-delivery method, sales on a fixed-price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost-to-cost method, sales on a fixed-price type contract are recorded at amounts equal to the ratio of actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (i) the total estimated contract revenue, less (ii) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to (i) the current estimated total profit margin multiplied by the cumulative sales recognized, less (ii) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenues, a loss arises, and a provision for the entire loss is recorded in the period that the loss becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded as a component of other current liabilities entitled Estimated cost in excess of estimated contract value to complete contracts in process in a loss position.

Adjustments to estimates for a contract s revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to percentage-of-completion accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position.

Sales and profits on cost-reimbursable type contracts that are within the scope of ARB 43, in addition to SOP 81-1, are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. The estimated profit on a cost-reimbursable contract is fixed or variable based on the contractual fee arrangement. Incentive and award fees are our primary variable fee contractual arrangement. Incentive and award fees on cost-reimbursable type contracts are included as an element of total estimated contract revenues and recorded to sales in accordance with SOP 81-1 when a basis exists for the reasonable prediction of performance in relation to established contractual targets and we are able to make reasonably dependable estimates for them. Sales and profits on time-and-material type contracts are recognized on the basis of direct labor hours expended multiplied by the contractual fixed rate per hour, plus the actual costs of material and other direct non-labor costs. On a time-and-material type contract, the fixed hourly rates include amounts for the cost of direct labor, indirect contract costs and profit. Cost-reimbursable type or time-and-material type contracts generally contain less estimation risks than fixed-price type contracts.

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Sales on arrangements for (1) fixed-price type contracts that require us to perform services that are not related to production of tangible assets (Fixed-Price Service Contracts), and (2) certain commercial customers are recognized in accordance with the U.S. Securities and Exchange Commission s (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB 104). Sales for our businesses whose customers are primarily commercial business enterprises are substantially generated from single element revenue arrangements. Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectibility is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on a straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are generally recognized when the units of work are completed. Sales and profit on cost-reimbursable and time and material type contracts within the scope of SAB 104 are recognized in the same manner as those within the scope of ARB 43 and SOP 81-1, except for incentive and award fees. Cost-based incentive fees are recognized when they are realizable in the amount that would be due under the contractual termination provisions as if the contract was terminated. Performance based incentive fees and award fees are recorded as sales when awarded by the customer.

Sales and profit in connection with contracts to provide services to the U.S. Government within the scope of SAB 104 that may be at risk of collection because the contracts are incrementally funded and subject to the availability of funds appropriated are deferred until the contract modification is obtained, indicating that adequate funds are available to the contract or task order.

Goodwill and Identifiable Intangible Assets. In accordance with SFAS No. 141, *Business Combinations* (SFAS 141), we allocate the cost of business acquisitions to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). As part of the purchase price allocations for our business acquisitions, identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged. However, in accordance with SFAS 141, we do not recognize any intangible assets apart from goodwill for the assembled workforces of our business acquisitions.

Generally, the largest separately identifiable intangible asset from the businesses that we acquire is the value of their assembled workforces, which includes the human capital of the management, administrative, marketing and business development, scientific, engineering and technical employees of the acquired businesses. The success of our businesses, including their ability to retain existing business (revenue arrangements) and to successfully compete for and win new business (revenue arrangements), is primarily dependent on the management, marketing and business development, contracting, engineering and technical skills and knowledge of our employees, rather than on productive capital (plant and equipment, and technology and intellectual property). Additionally, for a significant portion of our businesses, our ability to attract and retain employees who have U.S. Government security clearances, particularly those with top-secret and above clearances, is critical to our success, and is often a prerequisite for retaining existing revenue arrangements and pursuing new ones. Generally, patents, trademarks and licenses are not material for our acquired businesses. Furthermore, our U.S. Government contracts (revenue arrangements) generally permit other companies to use our patents in most domestic work performed by such other companies for the U.S. Government. Therefore, because intangible assets for assembled workforces are part of goodwill in accordance with paragraph 39 of SFAS 141, the substantial majority of the intangible assets for our acquired business acquisitions are recognized as goodwill. Additionally, the value assigned to goodwill for our business acquisitions also includes the value that we expect to realize from cost reduction measures that we implement for our acquired businesses. Goodwill equals the amount of the purchase price of the business acquired in excess of the sum of the amounts assigned to identifiable acquired assets, both tangible and intangible, less liabilities assumed. At December 31, 2008, we had goodwill of $8,029 million and identifiable intangible assets of $417 million.

The most significant identifiable intangible asset that is separately recognized in accordance with SFAS 141 for our business acquisitions is customer contractual relationships. All of our customer relationships are established through written customer contracts (revenue arrangements). The fair value for customer contractual relationships is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows from working capital) arising from the follow-on sales on contract (revenue arrangement) renewals expected from customer contractual relationships over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory assets charge, all of which is discounted to present value. If actual future after-tax cash flows are significantly lower than our estimates, we may be required to record an impairment charge to write down the identifiable intangible assets to their realizable values. All identifiable intangible assets are amortized over their estimated useful lives as the economic benefits are consumed, ranging from 4 to 30 years.

We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also review goodwill annually in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). Pursuant to our adoption of SFAS 142 on January 1, 2002, we selected a goodwill impairment measurement date of January 1 of each year; and we have determined that goodwill was not impaired as of January 1, 2008. In the fourth quarter of 2008, we changed our impairment measurement date to November 30 of each year. See Note 2 to our audited consolidated financial statements for a discussion of the change in the goodwill impairment date.

SFAS 142 requires that goodwill be tested, at a minimum, annually for each reporting unit using a two-step process. A reporting unit is an operating segment, as defined in paragraph 10 of SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, or a component of an operating segment. A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and is reviewed by operating segment management. Two or more components of an operating segment may be aggregated and deemed a single reporting unit for goodwill impairment testing purposes if the components have similar economic characteristics. The first step is to identify any potential impairment by comparing the carrying value of the reporting unit to its fair value. If a potential impairment is identified, the second step is to measure the impairment loss by comparing the implied fair value of goodwill with the carrying value of goodwill of the reporting unit. Our methodology for determining the fair value of a reporting unit is estimated using a discounted cash flow (DCF) valuation approach, and is dependent on estimates for future sales, operating income, depreciation and amortization, income tax payments, working capital changes, and capital expenditures, as well as, expected growth rates for cash flows and long-term interest rates, all of which are affected by economic conditions related to the industries in which we operate, as well as, conditions in the U.S. capital markets.

The more significant assumptions used in a DCF valuation regarding the estimated fair values of our reporting units in connection with goodwill valuation assessments are: (1) detailed five year cash flow projections for each of our reporting units, (2) a risk adjusted discount rate including the estimated risk-free rate of return, and (3) the expected long-term growth rate of our businesses, which approximates the expected long-term growth rate for the U.S. economy and the industries in which we operate. The risk adjusted discount rate represents the estimated weighted-average cost of capital (WACC) for the reporting units. It is comprised of (1) an estimated required rate of return on equity, based on publicly traded companies with business characteristics comparable to L-3 s reporting units, including a risk free rate of return and an equity risk premium, and (2) the current after-tax market rate of return on L-3 s debt, each weighted by the relative market value percentages of L-3 s equity and debt. The valuation of our reporting units performed as of November 30, 2008 in connection with our annual impairment test used a weighted average risk adjusted discount rate of approximately 9%. The table below presents the impact on the fair value of reporting units for select changes in the risk adjusted discount rate, expected long-term growth rate and cash flow projections.

Aggregate

Assumption	Increase (decrease)	Decrease in Fair Value of reporting units (In millions)		
Risk adjusted discount rate	25 bpts	$	717	4%
Expected long-term growth rate	(25) bpts	$	480	3%
Cash flow projections	(1)%	$	86	%

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A decline in the estimated fair value of a reporting unit could result in a goodwill impairment, and a related non-cash impairment charge against earnings, if estimated fair value for the reporting unit is less than the carrying value of the net assets of the reporting unit, including its goodwill. A large decline in estimated fair value of a reporting unit could result in an adverse effect on our financial condition and results of operations.

Pension Plan and Postretirement Benefit Plan Obligations. The obligations for our pension plans and postretirement benefit plans and the related annual costs of employee benefits are calculated based on several long-term assumptions, including discount rates for employee benefit liabilities, rates of return on plan assets, expected annual rates for salary increases for employee participants in the case of pension plans, and expected annual increases in the costs of medical and other health care benefits in the case of postretirement benefit obligations. These long-term assumptions are subject to revision based on changes in interest rates, financial market conditions, expected versus actual returns on plan assets, participant mortality rates and other actuarial assumptions, including future rates of salary increases, benefit formulas and levels, and rates of increase in the costs of benefits. Changes in the assumptions, if significant, can materially affect the amount of annual net periodic benefit costs recognized in our results of operations from one year to the next, the liabilities for the pension plans and postretirement benefit plans, and our annual cash requirements to fund these plans. Changes to our expected long-term assumptions for 2009 are not expected to significantly impact our 2009 pension expense compared to 2008. However, due to negative pension plan asset returns during 2008, our pension expense for 2009 is expected to increase by $76 million to $163 million from $87 million in 2008. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Pension Plans on page 53 for a further discussion of our estimated 2009 pension expense.

Discount rates are used to determine the present value of our pension obligations and also affect the amount of pension expense in any given period. The discount rate assumptions used to determine our pension and postretirement benefit obligations at December 31, 2008 and 2007 were based on a hypothetical double A yield curve represented by a series of annualized individual discount rates. Each bond issue underlying the yield curve is required to have a rating of AA or better by Moody s Investors Service, Inc. and/or Standard & Poor s. The resulting discount rate reflects the matching of plan liability cash flows to the yield curve. For a sensitivity analysis projecting the impact of a change in the discount rate on our projected benefit obligation and pension expense, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Pension Plans on page 53.

Valuation of Deferred Income Tax Assets and Liabilities. At December 31, 2008, we had net deferred tax assets of $101 million, including $15 million for loss carryforwards and $10 million for tax credit carryforwards which are subject to various limitations and will expire if unused within their respective carryforward periods. Deferred income taxes are determined separately for each of our tax-paying entities in each tax jurisdiction. The future realization of our deferred income tax assets ultimately depends on our ability to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law and, to a lesser extent, our ability to execute successful tax planning strategies. Based on our estimates of the amounts and timing of future taxable income and tax planning strategies, we believe that L-3 will be able to realize its net deferred tax assets. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement desired tax planning strategies, could affect our ability to realize the future tax deductions underlying our net deferred tax assets, and require us to provide a valuation allowance against our net deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and, if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

Liabilities for Pending and Threatened Litigation. We are subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business or assumed in connection with certain business acquisitions. In accordance with SFAS No. 5, *Accounting for Contingencies*, we accrue a charge for a loss contingency when we believe it is both probable that a liability has been incurred, and the amount of the loss can be reasonably estimated. If the loss is within a range of

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specified amounts, the most likely amount is accrued, and if no amount within the range represents a better estimate we accrue the minimum amount in the range. Generally, we record the loss contingency at the amount we expect to pay to resolve the contingency and the amount is generally not discounted to the present value. Amounts recoverable under insurance contracts are recorded as assets when recovery is deemed probable. Contingencies that might result in a gain are not recognized until realizable. Changes to the amount of the estimated loss, or resolution of one or more contingencies could have a material impact on our results of operations, financial position and cash flows.

Valuation of Long-Lived Assets. In addition to goodwill and identifiable intangible assets recognized in connection with our business acquisitions, our long-lived assets also include property, plant and equipment, capitalized software development costs for software to be sold, leased or otherwise marketed, and certain long-term investments. As of December 31, 2008, the consolidated carrying values of our property, plant and equipment were $821 million, capitalized software development costs were $47 million and certain long-term investments were $30 million. As of December 31, 2008, the carrying value of our property, plant and equipment represented 6% of total assets and the carrying value of our capitalized software development costs and certain long-term investments each represented less than 1% of total assets. We review the valuation of our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value or net realizable value expected to result from the asset s use and eventual disposition. We use a variety of factors to assess valuation, depending upon the asset. Long-lived assets are evaluated based upon the expected period the asset will be utilized, and other factors depending on the asset, including estimated future sales, profits and related cash flows, estimated product acceptance and product life cycles, changes in technology and customer demand, and the performance of invested companies and joint ventures, as well as volatility in external markets for investments. Changes in estimates and judgments on any of these factors could have a material impact on our results of operations and financial position.

Results of Operations

The following information should be read in conjunction with our audited consolidated financial statements. Our results of operations for certain periods presented are affected significantly by our business acquisitions. See Note 4 to our audited consolidated financial statements for a discussion of our business acquisitions.

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Consolidated Results of Operations

The table below provides selected financial data for L-3 for the years ended December 31, 2008, 2007 and 2006.

	Year Ended December 31,		Increase/	Year Ended December 31,		Increase/
(Dollars in millions, except per share data)	**2008[1]**	**2007**	**(decrease)**	**2007**	**2006**	**(decrease)**
Net sales	$ 14,901	$ 13,961	$ 940	$ 13,961	$ 12,477	$ 1,484
Operating income	$ 1,685	$ 1,448	$ 237	$ 1,448	$ 1,111	$ 337
Litigation Gain[2]	(126)		(126)			
Q2 2006 Charges[3]					168	(168)
Segment operating income	$ 1,559	$ 1,448	$ 111	$ 1,448	$ 1,279	$ 169
Operating margin	11.3%	10.4%	90bpts	10.4%	8.9%	150bpts
Litigation Gain[2]	(0.8)%		(80) bpts			bpts
Q2 2006 Charges[3]			bpts		1.4%	(140)bpts
Segment operating margin	10.5%	10.4%	10bpts	10.4%	10.3%	10bpts
Interest expense and other items	$ 254[2]	$ 274	$ (20)	$ 274	$ 286	$ (12)
Effective income tax rate	35.1%	35.6%	(50) bpts	35.6%	36.2%	(60)bpts
Income from continuing operations	$ 929	$ 756	$ 173	$ 756	$ 526	$ 230
Net Income	$ 949	$ 756	$ 193	$ 756	$ 526	$ 230
Diluted EPS:						
Income from continuing operations	$ 7.56	$ 5.98	$ 1.58	$ 5.98	$ 4.22	$ 1.76
Net Income	$ 7.72	$ 5.98	$ 1.74	$ 5.98	$ 4.22	$ 1.76
Diluted shares	122.9	126.5	(3.6)	126.5	124.8	1.7

(1) The year ended December 31, 2008 includes: (1) a gain of $12 million ($7 million after income taxes, or $0.06 per share) from the sale of a product line (the Product Line Divestiture Gain), and (2) a non-cash impairment charge of $28 million ($17 million after income taxes, or $0.14 per share) related to a write-down of capitalized software development costs for a general aviation product (the Impairment Charge). Together with the Litigation Gain described in Note (2), these items are referred to as the Q2 2008 Items.

(2) The Litigation Gain represents a June 27, 2008 decision by the U.S Court of Appeals to vacate an adverse 2006 jury verdict, see Note (3) below. In the second quarter of 2008, we recorded a gain of $133 million ($81 million after income taxes, or $0.66 per diluted share), comprised of a $126 million reversal of a current liability for pending and threatened litigation and $7 million for related accrued interest.

(3) Includes (1) a pre-tax charge of $129 million ($78 million after income taxes or $0.63 per diluted share) related to an adverse jury verdict on May 24, 2006 (see OSI Systems, Inc. in Note 18 to our audited consolidated financial statements), and (2) a pre-tax charge of $39 million ($25 million after income taxes or $0.20 per diluted share) in connection with our voluntary review of our past stock option granting practices (see Note 3 to our audited consolidated financial statements). These two 2006 charges are collectively referred to herein as the Q2 2006 Charges.

2008 Compared with 2007

Net sales: For the year ended December 31, 2008, consolidated net sales increased by 7% compared to the year ended December 31, 2007. Consolidated organic sales growth of 5%, or $675 million, was driven primarily by growth in all business segments except for Government Services, which decreased because of lower linguist services. The increase in consolidated net sales from acquired businesses was $265 million, or 2%. Sales from services increased by $382 million to $7,771 million, representing approximately 52% of consolidated net sales for the year ended December 31, 2008, compared to $7,389 million, or 53% of consolidated net sales for the year ended December 31, 2007. The increase in service sales was primarily due to organic sales growth in Government Services, excluding lower linguist services, and ISR systems, networked communications systems, base and aircraft support services and several areas in the Specialized Products reportable segment. Sales from products increased by $558 million to $7,130 million for the year ended December 31, 2008, compared to $6,572 million for the year ended December 31, 2007. The increase in product sales was primarily due to organic sales growth in aircraft modernization, networked communications systems, and several product areas in the Specialized Products reportable segment. See the reportable segment discussions below for more analysis of our sales growth.

Operating income and operating margin: For the year ended December 31, 2008 compared to the year ended December 31, 2007, consolidated operating income increased by $237 million, and consolidated operating margin increased to 11.3% from 10.4%. The Q2 2008 Items increased consolidated operating income by $110 million and operating margin by 70 basis points. Excluding the Q2 2008 Items, consolidated operating margin increased by 20 basis points to 10.6% for the year ended December 31, 2008 compared to 10.4% for the year ended December 31, 2007. The changes in operating margin are further explained in our reportable segment results discussed below.

Interest expense and other items: Interest expense and other items for the year ended December 31, 2008 decreased by $20 million, or 7%, compared to December 31, 2007 due to the reversal of $7 million of accrued interest during the 2008 second quarter in connection with the Litigation Gain. Lower interest rates on our outstanding variable rate debt also reduced interest expense for the year ended December 31, 2008 compared to the year ended December 31, 2007.

Effective income tax rate: The effective tax rate for the year ended December 31, 2008 decreased by 50 basis points compared to the same period last year. Excluding the Q2 2008 Items, the effective tax rate decreased by 90 basis points. The tax rate for the year ended December 31, 2008 included a reversal of previously accrued amounts of $18 million, or $0.15 per share, primarily related to the completion of examinations of the 2004 and 2005 U.S. Federal income tax returns, and certain state and foreign tax accruals. The reversal of previously accrued amounts during the year ended December 31, 2007 was $12 million, or $0.10 per share.

Diluted earnings per share from continuing operations and income from continuing operations: For the year ended December 31, 2008, diluted EPS from continuing operations increased to $7.56 per share compared to $5.98 per share for the year ended December 31, 2007. Income from continuing operations for the year ended December 31, 2008 increased to $929 million compared to $756 million for the year ended December 31, 2007. Excluding the Q2 2008 Items, income from continuing operations increased by $102 million, or 13%, to $858 million and EPS from continuing operations increased $1.00, or 17%, to $6.98.

Diluted earnings per share and net income: For the year ended December 31, 2008, diluted EPS increased to $7.72 per share and net income increased to $949 million, which includes a gain on the sale of METI of $33 million ($20 million after income taxes, or $0.16 per diluted share).

Diluted shares outstanding: Diluted shares outstanding for the year ended December 31, 2008 decreased by 3.6 million shares, compared to the year ended December 31, 2007. The decrease was primarily due to repurchases of our common stock in connection with our share repurchase programs authorized by our Board of Directors, partially offset by additional shares issued in connection with various stock based compensation programs and contributions to employee savings plans made in common stock.

2007 Compared with 2006

Net sales: For the year ended December 31, 2007, consolidated net sales increased by 12% compared to the year ended December 31, 2006. Consolidated organic sales growth of 10%, or $1,193 million, was driven primarily by continued strong demand for ISR systems, government services, networked communications systems, aircraft and base support services, aircraft modernization and several specialized product areas, including power & control systems, electro-optic/infrared (EO/IR), undersea warfare, simulation & training and propulsion systems. The increase in consolidated net sales from acquired businesses was $291 million, or 2%. Sales from services increased by

$845 million to $7,389 million, representing approximately 53% of consolidated net sales for the year ended December 31, 2007, compared to $6,544 million, or 52% of consolidated net sales for the year ended December 31, 2006. The increase in service sales was primarily due to organic sales growth in government services, ISR systems, aircraft and base support services and aircraft modernization. Sales from products increased by $639 million to $6,572 million for the year ended December 31, 2007, compared to $5,933 million for the year ended December 31, 2006. The increase in product sales was primarily due to organic sales growth in several product areas in the Specialized Products reportable segment. See the reportable segment discussions below for more analysis of our sales growth.

Operating income and operating margin: For the year ended December 31, 2007 compared to the year ended December 31, 2006, consolidated operating income increased by $337 million, and consolidated operating margin increased to 10.4% from 8.9%. Excluding the Q2 2006 Charges, consolidated operating income increased by $169 million, or 13%, for the year ended December 31, 2007 compared to $1,279 million for the year ended December 31, 2006, and consolidated operating margin increased by 10 basis points from 10.3% for the year ended December 31, 2006. The changes in operating margin are further explained in our reportable segment results discussed below.

Interest expense and other items: Interest expense and other items for the year ended December 31, 2007 decreased by $12 million, or 4%, compared to December 31, 2006, primarily due to interest income on higher cash balances.

Effective income tax rate: The effective income tax rate for the year ended December 31, 2007 of 35.6% included a benefit of $12 million, or $0.10 per share for the reversal of previously accrued amounts, primarily interest, related to the 2002 and 2003 U.S. Federal income tax returns, and without these benefits, the tax rate was 36.6%. Before giving effect to the Q2 2006 Charges, the tax rate for the year ended December 31, 2006 was 36.6%.

Diluted earnings per share and net income: For the year ended December 31, 2007, diluted EPS increased to $5.98 per share compared to $4.22 per share for the year ended December 31, 2006. Net income for the year ended December 31, 2007 increased to $756 million compared to $526 million for the year ended December 31, 2006. Excluding the Q2 2006 Charges, diluted EPS for the year ended December 31, 2007 increased by $0.93, or 18%, compared to $5.05 per share for the year ended December 31, 2006. Similarly, net income for the year ended December 31, 2007 increased by $126 million, or 20%, from $630 million for the year ended December 31, 2006.

Diluted shares outstanding: Diluted shares outstanding for the year ended December 31, 2007 increased by 1.7 million shares, compared to the year ended December 31, 2006. The increase was primarily due to additional shares issued in connection with various stock based compensation programs and contributions to employee savings plans made in common stock. These increases were partially offset by repurchases of our common stock in connection with our share repurchase programs.

Reportable Segment Results of Operations

The table below presents selected data by reportable segment reconciled to consolidated totals. See Note 21 to our audited consolidated financial statements for our reportable segment data.

	Year Ended December 31, 2008	2007	2006
	(dollars in millions)		
Net sales:[1]			
C^3ISR	$ 2,566.9	$ 2,310.4	$ 2,025.3
Government Services	4,303.0	4,333.5	3,834.4
AM&M	2,657.4	2,527.7	2,327.5
Specialized Products	5,373.8	4,788.9	4,289.7
Consolidated net sales	$ 14,901.1	$ 13,960.5	$ 12,476.9
Operating income:			
C^3ISR	$ 251.2	$ 231.6	$ 215.8
Government Services	421.1	403.5	342.9
AM&M	240.9	246.6	232.6
Specialized Products	645.8(2)	566.4	487.8
Segment operating income	$ 1,559.0(2)	$ 1,448.1	$ 1,279.1
Litigation Gain	125.6		
Q2 2006 Charges[3]			(168.2)
Consolidated operating income	$ 1,684.6	$ 1,448.1	$ 1,110.9
Operating margin:			
C^3ISR	9.8%	10.0%	10.7%
Government Services	9.8%	9.3%	8.9%
AM&M	9.1%	9.8%	10.0%
Specialized Products	12.0%[2]	11.8%	11.4%
Segment operating margin	10.5%[2]	10.4%	10.3%
Litigation Gain	0.8%	%	%
Q2 2006 Charges[3]	%	%	(1.4)%
Consolidated operating margin	11.3%	10.4%	8.9%

(1) Net sales are after intercompany eliminations.

(2) Segment operating income includes the Product Line Divestiture gain of $12 million and a non-cash Impairment Charge of $28 million, which is recorded in Specialized Products. The Product Line Divestiture gain and non-cash Impairment Charge reduced total segment operating margin by 10 basis points and Specialized Products operating margin by 30 basis points.

(3) See Notes 3 and 18 to our audited consolidated financial statements.

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C^{3}ISR

	Year Ended December 31, 2008	2007	Increase / (decrease)	Year Ended December 31, 2007	2006	Increase / (decrease)
	($ in millions)					
Net sales	$ 2,566.9	$ 2,310.4	$ 256.5	$ 2,310.4	$ 2,025.3	$ 285.1
Operating income	251.2	231.6	19.6	231.6	215.8	15.8
Operating margin	9.8%	10.0%	(20) bpts	10.0%	10.7%	(70) bpts

2008 Compared with 2007

For the year ended December 31, 2008, C^{3}ISR net sales increased by 11% compared to the year ended December 31, 2007 driven by higher sales volume of $257 million primarily for continued demand and new contracts from the DoD for airborne ISR and networked communications systems for manned and unmanned platforms.

C^{3}ISR operating income for the year ended December 31, 2008 increased by 8% compared to the year ended December 31, 2007. Operating margin decreased by 20 basis points. Higher costs for international airborne ISR systems reduced operating margin by 140 basis points. This decrease was partially offset by higher sales volume for airborne ISR systems and networked communications systems for the DoD and lower development costs for new secure communications products.

2007 Compared with 2006

For the year ended December 31, 2007, C^{3}ISR net sales increased by 14% compared to the year ended December 31, 2006, driven by higher sales volume of $226 million primarily for airborne surveillance and ISR systems, and continued strong demand from the DoD for networked communications systems. These increases were partially offset by $5 million for lower sales volume for Secure Terminal Equipment (STE), a product with declining demand as it continues to approach full deployment in the marketplace. The increase in net sales from acquired businesses was $64 million, or 3%.

C^{3}ISR operating income for the year ended December 31, 2007 increased by 7% compared to the year ended December 31, 2006 primarily because of higher sales volume, partially offset by a lower operating margin. Operating margin for the year ended December 31, 2007 decreased by 70 basis points of which 80 basis points were primarily due to higher development costs for new secure communications products and a decrease in higher margin STE sales. Acquired businesses reduced operating margin by 10 basis points. These decreases were partially offset by an increase of 20 basis points primarily due to higher sales volume and improved contract performance for networked communications systems.

Government Services

	Year Ended December 31, 2008	2007	(Decrease) increase/	Year Ended December 31, 2007	2006	Increase
	($ in millions)					
Net sales	$ 4,303.0	$ 4,333.5	$ (30.5)	$ 4,333.5	$ 3,834.4	$ 499.1

Operating income	421.1	403.5	17.6	403.5	342.9	60.6
Operating margin	9.8%	9.3%	50bpts	9.3%	8.9%	40bpts

2008 Compared with 2007

For the year ended December 31, 2008, Government Services net sales decreased by 1% compared to the year ended December 31, 2007. A decline in sales of $319 million for linguist services was partially offset by an increase in sales of $224 million primarily for IT and software engineering solution services, training and other support services to the DoD. Total linguist-Iraq sales for the year ended December 31, 2008 were $399 million. The increase in net sales from acquired businesses, net of divestitures, was $64 million, or 1%.

Government Services operating income for the year ended December 31, 2008 increased by 4% compared to the year ended December 31, 2007. Operating margin for the year ended December 31, 2008 increased by 50 basis points. Operating margin increased by 10 basis points because of a decline in lower margin linguist sales. Higher sales for business areas other than linguist services and lower indirect costs as a percentage of sales increased operating margin by 80 basis points. These increases were partially offset by (1) 20 basis points due to lower sale prices on certain new contracts and (2) 20 basis points due to a $4 million litigation accrual for costs to settle a claim and $4 million for severance and other costs related to business realignment and consolidation activities.

2007 Compared with 2006

For the year ended December 31, 2007, Government Services net sales increased by 13% compared to the year ended December 31, 2006, driven primarily by (1) volume increases of $327 million on existing contracts and recent new business awards for several services including linguists and translators, training and operational support for the U.S. military operations in Iraq and Afghanistan as well as broader U.S. national security objectives on a global basis and (2) higher sales of $166 million for information technology solutions to support U.S. Army communications and surveillance activities and support services for the U.S. Special Operations Command because of growth on existing contracts. The Linguist Contract generated sales of $738 million for the year ended December 31, 2007, an increase of $127 million compared with $611 million for 2006. The increase in net sales from acquired businesses was $6 million.

Government Services operating income increased by 18% compared to the year ended December 31, 2006 due to higher sales volume and higher operating margin. Operating margin for the year ended December 31, 2007 increased by 40 basis points due to higher sales volume, lower overhead costs as a percentage of sales, and improved contract performance, partially offset by higher sales volume on the Linguist Contract.

Aircraft Modernization and Maintenance (AM&M)

	Year Ended December 31, 2008	Year Ended December 31, 2007	Increase / (decrease)	Year Ended December 31, 2007	Year Ended December 31, 2006	Increase/ (decrease)
	($ in millions)					
Net sales	$ 2,657.4	$ 2,527.7	$ 129.7	$ 2,527.7	$ 2,327.5	$ 200.2
Operating income	240.9	246.6	(5.7)	246.6	232.6	14.0
Operating margin	9.1%	9.8%	(70) bpts	9.8%	10.0%	(20) bpts

2008 Compared with 2007

For the year ended December 31, 2008, AM&M net sales increased by 5% compared to the year ended December 31, 2007. The increase in sales volume was primarily driven by $115 million higher base and aircraft support services and $118 million for the Joint Cargo Aircraft (JCA) program. These increases were partially offset by lower sales volume of $44 million for the Canadian Maritime Helicopter program and lower aircraft modernization sales of $59 million for international customers and head-of-state aircraft for foreign government customers.

AM&M operating income for the year ended December 31, 2008 decreased by 2% compared to the year ended December 31, 2007. Operating margin for the year ended December 31, 2008 compared to the year ended December 31, 2007 decreased by 70 basis points. The year ended December 31, 2008 included $10 million of litigation accruals for costs to settle certain claims, which reduced operating margin by 30 basis points. Operating margin for the year ended December 31, 2008 compared to the year ended December 31, 2007 also declined by another 110 basis points due to a change in sales mix, primarily sales volume for JCA and lower international sales. These decreases were partially offset by 70 basis points because of improved contract performance.

2007 Compared with 2006

For the year ended December 31, 2007, AM&M net sales increased by 9% compared to the year ended December 31, 2006, driven by increased volume of (1) $104 million for aircraft and base support services related to continued support of U.S. military operations in Iraq and Afghanistan, partially offset by lower sales volume due to a loss of a contract in June 2006 to provide maintenance and support for U.S. Navy fixed-wing training aircraft and (2) $34 million for aircraft modernization, primarily to modify C-130 aircraft for international customers, U.S. Presidential helicopter and head-of-state aircraft for foreign government customers. The increase in net sales from acquired businesses was $62 million, or 3%.

AM&M operating income for the year ended December 31, 2007 increased by 6% compared to the year ended December 31, 2006 primarily because of higher sales volume, partially offset by lower operating margin. Operating margin decreased by 20 basis points primarily due to lower incentive fees on a contract related to a reduction in the annual contractual target costs.

Specialized Products

	Year Ended December 31, 2008	Year Ended December 31, 2007	Increase	Year Ended December 31, 2007	Year Ended December 31, 2006	Increase
	($ in millions)					
Net sales	$ 5,373.8	$ 4,788.9	$ 584.9	$ 4,788.9	$ 4,289.7	$ 499.2
Operating income	645.8	566.4	79.4	566.4	487.8	78.6
Operating margin	12.0%	11.8%	20bpts	11.8%	11.4%	40bpts

2008 Compared with 2007

For the year ended December 31, 2008, Specialized Products net sales increased by 12% compared to the year ended December 31, 2007 reflecting higher sales volume of (1) $118 million for power & control systems mostly for commercial shipbuilding, and power generation, distribution, conditioning and conversion products primarily for the U.S. Army and U.S. Navy, (2) $86 million for microwave products due to higher demand and deliveries of mobile satellite communications systems, satellite and space components, and communication services primarily to the DoD, (3) $65 million primarily for combat propulsion systems due to new and existing contracts, aviation products primarily related to spare parts for the U.S. military and data recorders for aviation and maritime markets, and acoustic undersea warfare products and ocean mapping related to new and existing contracts, (4) $56 million for precision engagement primarily related to new contracts and increased shipments on existing contracts for situational awareness systems and fuzing products, (5) $54 million for EO/IR products primarily due to increased demand and deliveries from new and existing contracts, and (6) $41 million for simulation & training primarily related to new contracts and timing of deliveries on existing contracts. These increases were partially offset by a decrease of $36 million for displays primarily due to timing of contractual deliveries and contracts completed or nearing completion. The increase in net sales from acquired businesses, net of divestitures, was $201 million, or 4%.

Specialized Products operating income for the year ended December 31, 2008 increased by 14% compared to the year ended December 31, 2007. The year ended December 31, 2008 included a gain of $12 million for the Product Line Divestiture Gain and a non-cash Impairment Charge of $28 million. Excluding these two items, operating income was $661.1 million and operating margin for the year ended December 31, 2008 compared to December 31, 2007 increased 50 basis points to 12.3%. Operating margin increased by 70 basis points due to improved contract performance and higher sales across several business areas. These increases were partially offset by 10 basis points due to a $6 million litigation accrual for costs to settle a claim and 10 basis points because of a $7 million gain in the 2007 third quarter from the settlement of a third party claim that did not recur.

2007 Compared with 2006

For the year ended December 31, 2007, Specialized Products net sales increased by 12% compared to the year ended December 31, 2006, reflecting higher sales volume of (1) $138 million for EO/IR and undersea warfare products, simulation devices and advanced mine detection systems, primarily related to new contracts, (2) $118 million for power & control systems due to recent new business awards to provide marine control systems and products to foreign allied navies, higher volume for commercial shipbuilding, power conversion and switching products, and service life extensions for landing craft air cushion amphibious vehicles, (3) $60 million primarily due to higher volumes for precision engagement, telemetry & advanced technology, and aviation products on existing contracts, and (4) $24 million for combat vehicle propulsion systems for U.S. military reset and replacement of equipment consumed in the U.S. military operations in Iraq. The increase in net sales from acquired businesses was $159 million, or 4%.

Specialized Products operating income for the year ended December 31, 2007 increased by 16% compared to the year ended December 31, 2006, due to higher sales volume and higher operating margin. Operating margin for the year ended December 31, 2007 increased by 40 basis points. Improved contract performance and higher sales in several business areas including EO/IR products, display systems and precision engagement, increased operating margin by 70 basis points. A smaller gain on a settlement of a claim of $7 million during 2007, compared to an unrelated gain from a settlement of a claim against a third party of $12 million during 2006, reduced operating margin by 10 basis points. Additionally, lower margins from acquired businesses reduced operating margin by 20 basis points.

Liquidity and Capital Resources

Anticipated Sources of Cash Flow

Our primary source of liquidity is cash flow generated from operations. We also have funds of $940 million available to use under our revolving credit facility, after reductions of $60 million for outstanding letters of credit, subject to certain conditions, as of December 31, 2008. Our revolving credit facility matures on March 9, 2010. We intend to enter into a new revolving credit facility at or before that time. Notwithstanding the current challenging credit market conditions, we currently believe that our cash from operating activities together with our cash on hand at December 31, 2008 ($867 million) will be adequate to meet our anticipated requirements for working capital, capital expenditures, defined benefit plan contributions, commitments, contingencies, research and development expenditures, contingent purchase price payments on previous business acquisitions, program and other discretionary investments, interest payments, income tax payments, L-3 Holdings dividends and share repurchase program for the foreseeable future. Our business may not continue to generate cash flow at current levels, and it is possible that currently anticipated improvements may not be achieved. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to reduce costs and expenses, sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing and we may not be able to do so on a timely basis, on satisfactory terms, or at all. Our ability to make scheduled principal payments or to pay interest on or to refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control. Our first scheduled maturity of our principal amount of outstanding debt is our $650 million term loan facility, which matures on March 9, 2010. Our intention is to refinance all or a portion of the $650 million term loan facility borrowings, if we are able to do so, on terms that are acceptable to us. If such terms are not available to us, we intend to repay the term loan facility with cash on hand. Our remaining principal amount of outstanding debt matures between June 15, 2012 and August 1, 2035. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Contractual Obligations on page 56.

Balance Sheet

Billed receivables decreased by $53 million to $1,226 million at December 31, 2008 from $1,279 million at December 31, 2007 primarily due to (1) collections primarily for ISR systems and government services, (2) the divestiture of METI on October 8, 2008, and (3) foreign currency translation adjustments. These decreases were partially offset by $34 million of acquired billed receivable balances from business acquisitions.

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Contracts in process increased by $168 million to $2,267 million at December 31, 2008, from $2,099 million at December 31, 2007. The increase included $16 million of acquired contracts-in-process balances for business acquisitions and $162 million from:

Increases of $138 million in unbilled contract receivables primarily due to sales exceeding billings for ISR systems, command and control systems and software services, aircraft modernization, training services, and intelligence solutions. These increases were partially offset by lower sales for linguist services; and

Increases of $24 million in inventoried contract costs across several business areas to support customer demand.

These increases were partially offset by a decrease of $10 million primarily due to foreign currency translation adjustments.

L-3 s receivables days sales outstanding (DSO) was 69 at December 31, 2008, compared with 72 at December 31, 2007. We calculate our DSO by dividing (1) our aggregate end of period billed receivables and net unbilled contract receivables, by (2) our trailing 12 month sales adjusted, on a pro forma basis, to include sales from business acquisitions and exclude sales from business divestitures that we completed as of the end of the period, multiplied by the number of calendar days in the trailing 12 month period (366 days at December 31, 2008 and 365 days at December 31, 2007). Our trailing 12 month pro forma sales were $14,976 million at December 31, 2008 and $14,042 million at December 31, 2007.

The increase in inventories was primarily for commercial shipbuilding customers due to timing of deliveries and to support demand.

The increase in net property, plant and equipment (PP&E) during the year ended December 31, 2008 was principally due to capital expenditures and completed business acquisitions, partially offset by depreciation expense. The percentage of depreciation expense to average gross PP&E was 10.2% for the year ended December 31, 2008 compared to 11.2% for the year ended December 31, 2007. We did not change any of the depreciation methods or assets estimated useful lives that L-3 uses to calculate its depreciation expense.

Goodwill decreased by $136 million to $8,029 million at December 31, 2008 from $8,165 million at December 31, 2007. The table below presents the changes in goodwill allocated to our reportable segments.

	C^3ISR	Government Services	AM&M	Specialized Products	Consolidated Total
			(in millions)		
Balance at December 31, 2007	$ 986	$ 2,264	$ 1,199	$ 3,716	$ 8,165
Business acquisitions	3	44	3	149	199
Completion of Internal Revenue Service (IRS) audits[(1)]	(42)	(12)	(44)	(43)	(141)
Sale of business				(11)	(11)
Foreign currency translation adjustments[(2)]	(51)		(54)	(78)	(183)
Balance at December 31, 2008	$ 896	$ 2,296	$ 1,104	$ 3,733	$ 8,029

(1) For further discussion regarding the completion of IRS audits of L-3 s U.S. Federal income tax returns for 2004 and 2005, including income tax positions taken in connection with certain business acquisitions, see Note 16 to our audited consolidated financial statements.

(2) The decrease in goodwill from foreign currency translation adjustments is due to the strengthening of the U.S. dollar during 2008 against the functional currencies of L-3 s foreign subsidiaries, primarily in Canada, Germany and the United Kingdom.

The increase of $199 million related to business acquisitions was comprised of: (1) an increase of $187 million for business acquisitions completed and an additional ownership interest acquired during the year ended December 31, 2008, (2) an increase of $10 million for earnouts related to certain business acquisitions completed prior to January 1, 2008, and (3) an increase of $5 million primarily related to final purchase price determinations for certain business acquisitions completed prior to January 1, 2008. These increases were partially offset by a decrease of $3 million related to the completion of the final estimate of the fair value of assets acquired and liabilities assumed for certain business acquisitions completed prior to January 1, 2008.

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The increases in accounts payable and accrued expenses were primarily due to increased purchases of materials, components and services required for the increase in sales during the year ended December 31, 2008, and to the timing of payments and invoices received for purchases from third-party vendors and subcontractors. The increase in accrued employment costs was due to the timing of payroll dates for salaries, wages and bonuses. The increase in advance payments and billings in excess of costs incurred was primarily due to advance payments received on contracts for ISR systems, power & control systems for commercial shipbuilding customers and government services. Other current liabilities decreased primarily due to the reversal of a current liability in connection with the Litigation Gain. Non-current deferred income tax liabilities decreased primarily due to pension plan actuarial losses experienced in 2008 that were caused by the negative actual pension plan assets return for 2008.

Pension Plans

L-3 maintains defined benefit pension plans covering employees at certain of its businesses. At December 31, 2008, L-3 s projected benefit obligation, which includes accumulated benefits plus the incremental benefits attributable to projected future salary increases for covered employees, was $1,722 million and exceeded the fair value of L-3 s pension plan assets of $1,064 million by $658 million. At the end of 2007, L-3 s projected benefit obligation was $1,688 million and exceeded the fair value of L-3 s pension plan assets of $1,407 million by $281 million. At December 31, 2008, our unfunded status increased by $377 million from $281 million at December 31, 2007. The increase was primarily due to (1) an increase of $449 million in accumulated other comprehensive loss due to net actuarial losses experienced in 2008 and (2) pension expenses of $87 million for the year ended December 31, 2008. These increases were partially offset by employer pension contributions of $162 million.

The increase of $449 million in accumulated other comprehensive loss was principally due to the actuarial loss that we experienced in 2008 as a result of a decline in the fair value of our pension plan assets. Recent declines in equity and fixed income financial markets and diminished liquidity and diminished credit availability have negatively affected the 2008 actual return on our pension plan assets. L-3 s actual return on plan assets for the year ended December 31, 2008, was a loss of $394 million, or 28%, on the fair value of plan assets at the beginning of the year. The actuarial gains and losses that our pension plans experience are not recognized in pension expense in the year incurred, but rather are recorded as a component of accumulated other comprehensive income and amortized to pension expense in future periods over the estimated average remaining service periods of the covered employees. See Note 19 to our audited consolidated financial statements.

Our pension expense for 2008 was $87 million. We currently expect pension expense for 2009 to be approximately $163 million. As discussed above, for the year ended December 31, 2008, L-3 s actual return on plan assets was a loss of $394 million, which is the primary reason that the amortization of net loss component of pension expense is expected to increase by approximately $45 million and the expected return on plan assets component of pension expense is expected to decrease by approximately $27 million for 2009. In addition, our actual pension expense for 2009 will be based upon a number of factors, including the effect of any future business acquisitions for which we assume liabilities for pension benefits, changes in headcount at our businesses that sponsor pension plans, actual pension plan contributions and changes (if any) to our pension assumptions for 2009, including the discount rate, expected long-term return on plan assets and salary increases.

Our contributions for the full year 2008 were $162 million, of which $100 million represented a pre-funding of contributions that were previously scheduled for 2009. We currently expect to contribute approximately $65 million to our pension plans in 2009. Actual 2009 pension contributions will be affected by L-3 s actual amount of net cash from operating activities for the year ending December 31, 2009, as well as the funded status of our pension plans during 2009. A substantial portion of our pension plan contributions for L-3 s businesses that are U.S. Government contractors are recoverable as allowable indirect contract costs at amounts generally equal to the annual pension contributions, except for pre-funded contributions, which are generally recoverable in the following year.

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Our projected benefit obligation and annual pension expense are significantly affected by the discount rate assumption we use. For example, an additional reduction to the discount rate of 25 basis points would have increased our projected benefit obligation at December 31, 2008 by approximately $56 million, and our estimated pension expense for 2009 by approximately $8 million. Conversely, an increase to the discount rate of 25 basis points would have decreased our projected benefit obligation at December 31, 2008 by approximately $52 million, and our estimated pension expense for 2009 by approximately $7 million.

Statement of Cash Flows

The table below provides a summary of our cash flows from operating, investing, and financing activities for the periods indicated.

	Year Ended December 31,		
	2008	**2007**	**2006**
		(in millions)	
Net cash from operating activities	$ 1,387	$ 1,270	$ 1,074
Net cash used in investing activities	(432)	(388)	(1,091)
Net cash used in financing activities	(840)	(464)	(29)

Operating Activities

2008 Compared with 2007. We generated $1,387 million of cash from operating activities during the year ended December 31, 2008, an increase of $117 million compared with $1,270 million generated during the year ended December 31, 2007. The increase was due to (1) an increase in net income of $193 million, and (2) higher non-cash expenses of $64 million, primarily due to higher deferred income taxes and the non-cash Impairment Charge, partially offset by (3) $140 million of more cash used for changes in operating assets and liabilities, primarily for other current liabilities (mainly the Litigation Gain) and income taxes. The net cash used from changes in operating assets and liabilities is further discussed above under Liquidity and Capital Resources Balance Sheet on page 51.

2007 Compared with 2006. We generated $1,270 million of cash from operating activities during the year ended December 31, 2007, an increase of $196 million compared with $1,074 million generated during the year ended December 31, 2006. The increase was primarily due to an increase in net income of $230 million, partially offset by a decrease of $41 million because of more cash used for changes in operating assets and liabilities primarily for contracts in process and other current liabilities.

Interest Payments. Our cash from operating activities includes interest payments on debt of $267 million for the year ended December 31, 2008, $280 million for the year ended December 31, 2007, and $287 million for the year ended December 31, 2006. Our interest expense also includes amortization of deferred debt issue costs and bond discounts and deferred gains on terminated interest rate swap agreements, which are non-cash items.

Investing Activities

During 2008, we used $283 million of cash in the aggregate to (1) acquire four businesses discussed under Business Acquisitions , (2) pay earnouts and the remaining contractual purchase price for certain business acquisitions completed prior to January 1, 2008, and (3) increase our ownership interest in METI by 5% from 80% to 85%. We also used $218 million of cash for capital expenditures. Investing activities for the year ended December 31, 2008 included a $63 million source of cash in the aggregate from the sale of METI on October 8, 2008 and the sale of the

PMD product line during the second quarter.

During 2007, we used $235 million of cash for business acquisitions. We paid $207 million in connection with our 2007 business acquisitions discussed under Business Acquisitions. We also paid $17 million for earnouts and $11 million primarily for the remaining contractual purchase prices, for the Crestview and TRL business acquisitions made prior to January 1, 2007. We also used $157 million for capital expenditures.

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During 2006, we used $943 million of cash for business acquisitions. We paid $900 million in connection with our 2006 business acquisitions discussed above under Business Acquisitions. We also paid $21 million for the remaining contractual purchase price for the ASIT acquisition and $11 million for an additional 10% interest in the Army Fleet Support joint venture, which increased our total ownership interest to 90%. We also paid $10 million for earnouts and $25 million primarily for adjustments to the contractual purchase prices for certain business acquisitions. We received $24 million, in the aggregate, for reductions to the contractual purchase prices for the Aircraft Integration Systems (AIS), Marine Controls division of CAE (MAPPS) and The Titan Corporation (Titan) acquired businesses.

Financing Activities

Debt

Senior Credit Facility. Our senior credit facility provides for a term loan facility and a $1 billion revolving credit facility.

At December 31, 2008, borrowings under the term loan facility were $650 million, and available borrowings under our revolving credit facility were $940 million, after reduction for outstanding letters of credit of $60 million. There were no outstanding revolving credit borrowings under our senior credit facility at December 31, 2008. The senior credit facility matures on March 9, 2010. Our remaining outstanding debt matures between June 15, 2012 and August 1, 2035. Total outstanding debt was $4,538 million at December 31, 2008, compared to $4,537 million at December 31, 2007.

Debt Issuances. During 2008, 2007 and 2006, we did not issue any debt obligations. For additional details about the terms of our debt, see Note 10 to our audited consolidated financial statements.

Credit Ratings. Our credit ratings as of February 2009 are as follows:

Rating Agency	Senior Debt	Subordinated Debt
Standard & Poor s	BBB-	BB+
Fitch Ratings	BBB-	BB+
Moody s Investors Service	Ba2	Ba3

Agency ratings are not a recommendation to buy, sell or hold any security, and they may be revised or withdrawn at any time by the rating agency. Each agency s rating should be evaluated independently of any other agency s rating. The system and the number of rating categories can vary widely from rating agency to rating agency. Customers usually focus on claims-paying ratings, while creditors focus on debt ratings. Investors use both to evaluate a company s overall financial strength. The ratings issued on L-3 or its subsidiaries by any of these agencies are announced publicly and are available from the agencies. Our ability to access the capital markets could be impacted by a downgrade in one or more of our debt ratings. If this were to occur, we could incur higher borrowing costs.

Debt Covenants and Other Provisions. The senior credit facility and senior subordinated notes agreements contain financial covenants and other restrictive covenants. See Note 10 to our audited consolidated financial statements for a description of our debt and related financial covenants, including dividend payment and share repurchase restrictions and cross default provisions, under our senior credit facility. As of December 31, 2008, we were in compliance with our financial and other restrictive covenants.

The borrowings under the senior credit facility are guaranteed by L-3 Holdings and by substantially all of the material wholly-owned domestic subsidiaries of L-3 Communications on a senior basis. The payment of principal and premium, if any, and interest on the senior subordinated notes are unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by substantially all of L-3 Communications wholly-owned domestic subsidiaries. The guarantees of the senior subordinated notes rank pari passu with one another and are junior to the guarantees of the senior credit facility. The payment of principal and premium, if any, and interest on the 3% Convertible Contingent Debt Securities CODES due 2035 are fully and unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by certain of L-3 Holdings wholly-owned domestic subsidiaries. The guarantees of the CODES rank pari passu with all of the guarantees of the senior subordinated notes and are junior to the guarantees of the senior credit facility.

Equity

During 2008 and 2007, L-3 Holdings Board of Directors authorized the following quarterly cash dividends:

Date Declared	Record Date	Cash Dividends Per Share	Date Paid	Total Dividends Paid (in millions)
2008				
February 5	February 19	$ 0.30	March 17	$ 37
April 29	May 16	$ 0.30	June 16	$ 37
July 8	August 18	$ 0.30	September 15	$ 37
October 7	November 17	$ 0.30	December 15	$ 36
2007				
February 6	February 21	$ 0.25	March 15	$ 31
April 24	May 16	$ 0.25	June 15	$ 32
July 10	August 16	$ 0.25	September 17	$ 32
October 9	November 16	$ 0.25	December 17	$ 31

On February 5, 2009, L-3 Holdings announced that its Board of Directors had increased L-3 Holdings regular quarterly cash dividend by 17% to $0.35 per share, payable on March 16, 2009, to shareholders of record at the close of business on February 19, 2009.

On February 23, 2009, the closing price of L-3 Holdings common stock, as reported by the NYSE, was $72.35 per share and the number of holders of L-3 Holdings common stock was approximately 75,000.

For the year ended December 31, 2008, L-3 repurchased $794 million of its common stock compared to $500 million for the year ended December 31, 2007.

Contractual Obligations

The table below presents our estimated total contractual obligations at December 31, 2008, including the amounts expected to be paid or settled for each of the periods indicated below.

		Payments due by period			
	Total	Less than 1 year	1-3 years (in millions)	3-5 years	More than 5 years
Contractual Obligations					
L-3 Communications long-term debt[1]	$ 3,850	$	$ 650	$ 1,150	$ 2,050
L-3 Holdings long-term debt[1][2]	700				700
Interest payments[3]	1,676	247	462	359	608

Non-cancelable operating leases(4)	843	166	283	158	236
Notes payable and capital lease obligations	11	1	1		9
Purchase obligations(5)	2,237	1,811	401	25	
Other long-term liabilities(6)	239	78(7)	61	14	86
Total(8)	$ 9,556	$ 2,303	$ 1,858	$ 1,706	$ 3,689

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(1) Represents principal amount of long-term debt and only includes scheduled principal payments.

(2) The conversion feature of the CODES may require L-3 Holdings to settle the $700 million principal amount with the holders of the CODES if L-3 Holdings common stock price is more than 120% of the then current conversion price (currently $121.36) for a specified period (see Note 10 to our audited consolidated financial statements). L-3 Holdings stock price on February 23, 2009 was $72.35.

(3) Represents expected interest payments on L-3 s long-term debt balance as of December 31, 2008 using the stated interest rate on our fixed rate debt and the variable interest rate in effect at December 31, 2008 on the outstanding borrowings under our term loan facility, assuming that current borrowings remain outstanding to the contractual maturity date.

(4) Non-cancelable operating leases are presented net of estimated sublease rental income.

(5) Represents open purchase orders at December 31, 2008 for amounts expected to be paid for goods or services that are legally binding.

(6) Other long-term liabilities primarily consist of workers compensation and deferred compensation for the years ending December 31, 2010 and thereafter and also include pension and postretirement benefit plan contributions that we expect to pay in 2009.

(7) Our pension and postretirement benefit plan funding policy is generally to contribute in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations thereon. For 2009, we expect to contribute approximately $65 million to our pension plans and approximately $13 million to our postretirement benefit plans. Due to the current uncertainty of the amounts used to compute our expected pension and postretirement benefit plan funding, we believe it is not practicable to reasonably estimate such future funding for periods in excess of one year and we may decide or be required to contribute more than we expect to our pension and postretirement plans.

(8) Excludes all income tax obligations, a portion of which represents unrecognized tax benefits in connection with uncertain tax positions taken, or expected to be taken on our income tax returns as of December 31, 2008 since we cannot determine the time period of future tax consequences. For additional information regarding income taxes, see Note 16 to our audited consolidated financial statements.

Off Balance Sheet Arrangements

The table below presents our estimated total contingent commitments and other guarantees at December 31, 2008, including the amounts expected to be paid or settled for each of the periods indicated below.

	Payments due by period				
	Total	**2009**	**2010-2011**	**2012-2013**	**2014 and thereafter**
			(in millions)		
Contingent Commitments					
Standby letters of credit under our Senior Credit Facility[1]	$ 60	$ 57	$ 3	$	$

Other standby letters of credit[1]		312		242		68		2		
Other guarantees[2]		44				41				3
Contingent commitments for earnout payments on business acquisitions[3]		64		44		20				
Total	$	480	$	343	$	132	$	2	$	3

(1) Represents outstanding letters of credit with financial institutions covering performance and financial guarantees per contractual requirements with certain customers. These letters of credit may be drawn upon in the event of L-3 s nonperformance.

(2) Represents the minimum guarantees made by L-3 or lessee (i) under the purchase option for certain operating leases in which the lease renewal is not exercised and (ii) for 50% of certain bank debt related to a joint venture arrangement (see Note 18 to our audited consolidated financial statements for a description of these guarantees).

(3) Represents potential additional contingent purchase payments for business acquisitions that are contingent upon the post-acquisition financial performance or certain other performance conditions of the acquired businesses in accordance with the contractual purchase agreement.

For a discussion of the conversion and contingent interest features of our CODES, see Note 10 to our audited consolidated financial statements.

Legal Proceedings and Contingencies

We are engaged in providing products and services under contracts with the U.S. Government and, to a lesser degree, under foreign government contracts, some of which are funded by the U.S. Government. All such contracts are subject to extensive legal and regulatory requirements, and, periodically, agencies of the

U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. Under U.S. Government procurement regulations, an indictment by a federal grand jury could result in the suspension for a period of time from eligibility for awards of new government contracts. A conviction could result in debarment from contracting with the federal government for a specified term. Additionally, in the event that U.S. Government budget and expenditures for products and services of the type we manufacture and provide are reduced, there may be a reduction in our sales volume. We are currently cooperating with the U.S. Government on several investigations, none of which we anticipate will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

We continually assess our obligations with respect to applicable environmental protection laws. While it is difficult to determine the timing and ultimate cost that we will incur to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which we are aware, we believe that even without considering potential insurance recoveries, if any, there are no environmental loss contingencies that, in the aggregate, would be material to our consolidated financial position, results of operations or cash flows. Also, we have been periodically subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business. We accrue for these contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. For a description of our legal proceedings and contingencies, see Note 18 to our audited consolidated financial statements.

Derivative Financial Instruments and Other Market Risk

Included in our derivative financial instruments are foreign currency forward contracts. All of our derivative financial instruments that are sensitive to market risk are entered into for purposes other than trading.

Interest Rate Risk. The borrowings under our senior revolving credit facility and term loan facility contain variable interest only and are sensitive to changes in interest rates. The interest rates on the senior subordinated notes and CODES are fixed-rate and are not affected by changes in interest rates.

Additional data on our debt obligations and our applicable borrowing spreads included in the interest rates we pay on borrowings under the Senior Credit Facility are provided in Note 10 to our audited consolidated financial statements.

Foreign Currency Exchange Risk. Our U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors, and certain of these contracts are denominated in currencies other than the functional currencies of our businesses. To protect the functional currency equivalent cash flows associated with certain of these contracts denominated in a foreign currency, we have entered into foreign currency forward contracts, which are accounted for as cash flow hedges. At December 31, 2008, the notional value of foreign currency forward contracts was $414 million and the fair value of these contracts was $1 million, which represented an asset. The notional values of our foreign currency forward contracts with maturities ranging through 2013 and thereafter are presented in the table below.

	Year of Maturity				
	2009	**2010**	**2011**	**2012**	**2013 and thereafter**
			(in million)		
Notional value	$ 266	$ 72	$ 35	$ 17	$ 24

Backlog and Orders

We define funded backlog as the value of funded orders received from customers, less the cumulative amount of sales recognized on such orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. The table below presents our funded backlog; percent of funded backlog at December 31, 2008 expected to be recorded as sales in 2009 and funded orders for each of our reportable segments.

	Funded Backlog at December 31, 2008 (in millions)	Funded Backlog at December 31, 2007 (in millions)	Percentage of December 31, 2008 Funded Backlog Expected to be Recorded as Sales in 2009	Funded Orders 2008 (in millions)	Funded Orders 2007 (in millions)
Reportable Segment:					
C^3ISR	$ 2,324	$ 1,935	84%	$ 2,956	$ 2,505
Government Services	2,212	1,989	94	4,495	4,412
AM&M	1,810	1,496	77	2,971	2,395
Specialized Products	5,226	4,151	69	6,110	5,429
Consolidated	$ 11,572	$ 9,571	78%	$ 16,532	$ 14,741

Our funded backlog does not include the full value of our contract awards including those pertaining to multi-year, cost-plus reimbursable contracts, which are generally funded on an annual basis. Funded backlog also excludes the sales value of unexercised priced contract options that may be exercised by customers under existing contracts and the sales value of purchase orders that we may receive under indefinite quantity contracts or basic ordering agreements.

Accounting Standards Issued and Not Yet Implemented

For a discussion of accounting standards issued and not yet implemented, see Note 2 to our audited consolidated financial statements.

Inflation

The effect of inflation on our sales and earnings has not been significant. Although a majority of our sales are made under long-term contracts (revenue arrangements), the selling prices of such contracts, established for deliveries in the future, generally reflect estimated costs to be incurred in these future periods. In addition, some of our contracts provide for price adjustments through cost escalation clauses.

Forward-Looking Statements

Certain of the matters discussed concerning our operations, cash flows, financial position, economic performance and financial condition, including in particular, the likelihood of our success in developing and expanding our business and the realization of sales from backlog, include forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act.

Statements that are predictive in nature, that depend upon or refer to events or conditions or that include words such as expects, anticipates, intends, plans, believes, estimates and similar expressions are forward-looking statement Although we believe that these statements are based upon reasonable assumptions, including projections of total sales growth, sales growth from business acquisitions, organic sales growth, consolidated operating margins, total segment operating margins, interest expense earnings, cash flow, research and development costs, working capital, capital expenditures and other projections, they are subject to several risks and uncertainties, and therefore, it is possible that these statements may not be achieved. Such statements will also be influenced by factors which include, among other things:

- our dependence on the defense industry and the business risks peculiar to that industry, including changing priorities or reductions in the U.S. Government defense budget;
- our reliance on contracts with a limited number of agencies of, or contractors to, the U.S. Government and the possibility of termination of government contracts by unilateral government action or for failure to perform;

the extensive legal and regulatory requirements surrounding our contracts with the U.S. or foreign governments and the results of any investigation of our contracts undertaken by the U.S. or foreign governments;

our ability to retain our existing business and related contracts (revenue arrangements);

our ability to successfully compete for and win new business and related contracts (revenue arrangements) and to win re-competitions of our existing contracts;

our ability to identify and acquire additional businesses in the future with terms, including the purchase price, that are attractive to L-3 and to integrate acquired business operations;

our ability to maintain and improve our consolidated operating margin and total segment operating margin in future periods;

our ability to obtain future government contracts (revenue arrangements) on a timely basis;

uncertainties arising from a change in the presidential administration;

the availability of government funding or cost-cutting initiatives and changes in customer requirements for our products and services;

our significant amount of debt and the restrictions contained in our debt agreements;

our ability to continue to retain and train our existing employees and to recruit and hire new qualified and skilled employees, as well as our ability to retain and hire employees with U.S. Government security clearances that are a prerequisite to compete for and to perform work on classified contracts for the U.S. Government;

actual future interest rates, volatility and other assumptions used in the determination of pension, benefits and equity-based compensation, as well as the market performance of benefit plan assets;

our collective bargaining agreements, our ability to successfully negotiate contracts with labor unions and our ability to favorably resolve labor disputes should they arise;

the business, economic and political conditions in the markets in which we operate, including those for the commercial aviation, shipbuilding and communications markets;

global economic uncertainty and continued tightening of the credit markets;

events beyond our control such as acts of terrorism;

our ability to perform contracts (revenue arrangements) on schedule;

our international operations, including sales to foreign customers;

our extensive use of fixed-price type contracts as compared to cost-reimbursable type and time-and-material type contracts;

the rapid change of technology and high level of competition in the defense industry and the commercial industries in which our businesses participate;

our introduction of new products into commercial markets or our investments in civil and commercial products or companies;

the outcome of current or future litigation matters;

results of audits by U.S. Government agencies, including the Defense Contract Audit Agency, of our sell prices, costs and performance on contracts (revenue arrangements), and our accounting and general business practices;

anticipated cost savings from business acquisitions not fully realized or realized within the expected time frame;

- Titan s compliance with its plea agreement and consent to entry of judgment with the U.S. Government relating to the Foreign Corrupt Practices Act (FCPA), including Titan s ability to maintain its export licenses as well as the outcome of other FCPA matters;

- ultimate resolution of contingent matters, claims and investigations relating to acquired businesses, and the impact on the final purchase price allocations;

- significant increase in competitive pressure among companies in our industry; and

- the fair values of our assets, including identifiable intangible assets and the estimated fair value of the goodwill balances for our reporting units, which can be impaired or reduced by other factors, some of which are discussed above.

In addition, for a discussion of other risks and uncertainties that could impair our results of operations or financial condition, see Part I Item 1A Risk Factors and Note 18 to our audited consolidated financial statements.

Readers of this document are cautioned that our forward-looking statements are not guarantees of future performance and the actual results or developments may differ materially from the expectations expressed in the forward-looking statements.

As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainties of estimates, forecasts and projections and may be better or worse than projected and such differences could be material. Given these uncertainties, you should not place any reliance on these forward-looking statements. These forward-looking statements also represent our estimates and assumptions only as of the date that they were made. We expressly disclaim a duty to provide updates to these forward-looking statements, and the estimates and assumptions associated with them, after the date of this filing to reflect events or changes or circumstances or changes in expectations or the occurrence of anticipated events.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

For data regarding quantitative and qualitative disclosures related to our market risk sensitive financial instruments, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Derivative Financial Instruments and Other Market Risk on page 58 and Note 13 to our audited consolidated financial statements.

Item 8. Financial Statements and Supplementary Data

See our audited consolidated financial statements beginning on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Conclusions Regarding Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934 related to L-3 Holdings and L-3 Communications is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission s (SEC) rules and forms, and that such information is accumulated and communicated to our management, including our Chairman, President and Chief Executive Officer, and our Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, with the participation of our Chairman, President and Chief Executive Officer, and our Vice President and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2008. Based upon that evaluation and subject to the foregoing, our Chairman, President and Chief Executive Officer, and our Vice President and Chief Financial Officer concluded that, as of December 31, 2008, the design and operation of our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting

As required by the SEC rules and regulations for the implementation of Section 404 of the Sarbanes-Oxley Act, our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of L-3, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements in our consolidated financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of L-3 Holdings and L-3 Communications internal control over financial reporting as of December 31, 2008. In making these assessments, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on our assessments and those criteria, management determined that L-3 Holdings and L-3 Communications maintained effective internal control over financial reporting as of December 31, 2008.

Our independent registered public accounting firm has audited and issued their attestation report on the Company s internal control over financial reporting as of December 31, 2008. See page F-2 to our audited consolidated financial statements for their report.

Item 9B: Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The following table provides information concerning the directors and executive officers of the Registrants as of February 23, 2009.

Name	Age	Position
Michael T. Strianese	52	Chairman, President and Chief Executive Officer
Curtis Brunson	61	Executive Vice President Corporate Strategy and Development
Jimmie V. Adams	72	Senior Vice President Washington D.C. Operations
David T. Butler III	52	Senior Vice President Business Operations
Steven M. Post	56	Senior Vice President, General Counsel and Corporate Secretary
Robert W. RisCassi	73	Senior Vice President
Ralph G. D Ambrosio	41	Vice President and Chief Financial Officer
James W. Dunn	65	Senior Vice President and President of Sensors and Simulation Group
Steven Kantor	64	Senior Vice President and President of Marine and Power Systems Group
John McNellis	56	Senior Vice President and President of Integrated Systems Group
Charles J. Schafer	61	Senior Vice President and President of Products Group
Carl E. Vuono	74	Senior Vice President and President of Services Group
Dan Azmon	45	Controller and Principal Accounting Officer
Robert B. Millard(1)(3)	58	Director, Lead Independent Director of the Board of Directors and Chairman of the Executive Committee
Claude R. Canizares(2)	63	Director
Peter A. Cohen(1)(3)	62	Director, Chairman of the Compensation Committee
Thomas A. Corcoran(1)(2)	64	Director, Chairman of the Audit Committee
John M. Shalikashvili(3)(4)	72	Director
Arthur L. Simon(2)(4)	76	Director
Alan H. Washkowitz(3)(4)	68	Director, Chairman of the Nominating/Corporate Governance Committee
John P. White(4)	71	Director

(1) Member of the Executive Committee.

(2) Member of the Audit Committee.

(3) Member of the Compensation Committee.

(4) Member of the Nominating/Corporate Governance Committee.

All executive officers serve at the discretion of the Board of Directors.

The remaining information called for by Item 10 is incorporated herein by reference to the definitive proxy statement relating to the Annual Meeting of Shareholders of L-3 Holdings, to be held on April 28, 2009. L-3 Holdings will file such definitive proxy statement with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 11. Executive Compensation

The information called for by Item 11 is incorporated herein by reference to the definitive proxy statement referred to above in Item 10.

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Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information called for by Item 12 is incorporated herein by reference to the definitive proxy statement referred to above in Item 10.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information called for by Item 13 is incorporated herein by reference to the definitive proxy statement referred to above in Item 10.

Item 14. Principal Accountant Fees and Services

This information called for by Item 14 is incorporated herein by reference to the definitive proxy statement referred to above in Item 10.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Financial statements filed as part of this report:

(a)(2) Financial Statement Schedules

Financial statement schedules are omitted since the required information is either not applicable or is included in our audited consolidated financial statements.

Exhibits

Exhibits identified in parentheses below are on file with the SEC and are incorporated herein by reference to such previous filings.

Exhibit No.	Description of Exhibits
3.1	Certificate of Incorporation of L-3 Communications Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Registrants Quarterly Report on Form 10-Q for the period ended June 30, 2002).
3.2	Amended and Restated By-Laws of L-3 Communications Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Registrants Current Report on Form 8-K filed on December 17, 2007).
3.3	Certificate of Incorporation of L-3 Communications Corporation (incorporated by reference to Exhibit 3.1 to L-3 Communications Corporation s Registration Statement on Form S-4 (File No. 333-31649)).
3.4	Amended and Restated Bylaws of L-3 Communications Corporation (incorporated by reference to Exhibit 3.2 to the Registrants Current Report on Form 8-K filed on December 17, 2007).
4.1	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 to L-3 Communications Holdings Registration Statement on Form S-1 (File No. 333-46975)).
4.2	Amended and Restated Credit Agreement, dated as of July 29, 2005, among L-3 Communications Corporation, L-3 Communications Holdings, Inc. and certain subsidiaries of the Registrants from time to time party thereto as guarantors, the lenders from time to time party thereto, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.40 to the Registrants Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).
4.3	Form of L-3 Communications Corporation First Amendment to Amended and Restated Credit Agreement, dated as of October 25, 2006, among L-3 Communications Corporation, L-3 Communications Holdings, Inc. and certain subsidiaries of the Registrants from time to time party thereto as guarantors, the lenders from time to time party thereto, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.41 to the Registrants Current Report on Form 8-K dated October 25, 2006).
4.4	Indenture dated as of June 28, 2002, among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.1 of L-3 Communications Corporation s Registration Statement on Form S-4 (File No. 333-99757)).
*4.5	Supplemental Indenture dated as of February 20, 2009 among L-3 Communications Corporation, The Bank of New York, as trustee, and the guarantors named therein to the Indenture dated as of June 28, 2002 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as trustee.
4.6	Indenture dated as of May 21, 2003 among L-3 Communications Corporation, the Guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.1 to L-3 Communications Corporation s Registration Statement on Form S-4 (File No. 333-106106)).
*4.7	Supplemental Indenture dated as of February 20, 2009 among L-3 Communications Corporation, The Bank of New York, as trustee, and the guarantors named therein to the Indenture dated as of May 21, 2003 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as trustee.
4.8	Indenture dated as of December 22, 2003 among L-3 Communications Corporation, the Guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 10.33 to the Registrants Annual Report on Form 10-K for the year ended December 31, 2003).

*4.9	Supplemental Indenture dated as of February 20, 2009 among L-3 Communications Corporation, The Bank of New York, as trustee, and the guarantors named therein to the Indenture dated as of December 22, 2003 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as trustee.
4.10	Indenture dated as of November 12, 2004 among L-3 Communications Corporation, the Guarantors and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.1 to L-3 Communications Corporation s Registration Statement on Form S-4 (File No. 333-122499)).
*4.11	Supplemental Indenture dated as of February 20, 2009 among L-3 Communications Corporation, The Bank of New York, as trustee, and the guarantors named therein to the Indenture dated as of November 12, 2004 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as trustee.
4.12	Indenture dated as of July 29, 2005 (Notes Indenture) among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 10.69 to the Registrants Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).

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Exhibit No.	Description of Exhibits
*4.13	Supplemental Indenture dated as of February 20, 2009 among L-3 Communications Corporation, The Bank of New York, as trustee, and the guarantors named therein to the Notes Indenture dated as of July 29, 2005 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York, as trustee.
4.14	Indenture dated as of July 29, 2005 (CODES Indenture) among L-3 Communications Holdings, Inc., the guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 10.70 to the Registrants Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).
*4.15	Supplemental Indenture dated as of February 20, 2009 among L-3 Communications Holdings, Inc., The Bank of New York, as trustee, and the guarantors named therein to the CODES Indenture dated as of July 29, 2005 among L-3 Communications Holdings, Inc., the guarantors named therein and The Bank of New York, as trustee.
10.1	L-3 Communications Holdings, Inc. 1997 Option Plan for Key Employees (incorporated by reference to Exhibit 10.91 to L-3 Communications Holdings, Inc. s Registration Statement on Form S-1, No. 333-46975).
10.2	Form of L-3 Communications Holdings, Inc. 1997 Option Plan for Key Employees Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.9 to L-3 Communications Holdings, Inc. s Registration Statement on Form S-1 No. 333-46975).
10.3	L-3 Communications Holdings, Inc. Amended and Restated 1998 Directors Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.16 to the Registrants Annual Report on Form 10-K for the year ended December 31, 2006).
10.4	Form of L-3 Communications Holdings, Inc. 1998 Directors Stock Option Plan Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.96 of the Registrants Annual Report on Form 10-K for the year ended December 31, 2004).
10.5	Form of L-3 Communications Holdings, Inc. 1998 Directors Stock Option Plan Nonqualified Stock Option Agreement (2007 Version) (incorporated by reference to Exhibit 10.3 of the Registrants Annual Report on Form 10-K for the year ended December 31, 2008).
10.6	L-3 Communications Holdings, Inc. Amended and Restated 1999 Long Term Performance Plan (Conformed copy reflecting all amendments through February 11, 2008) (incorporated by reference to Exhibit 10.4 of the Registrants Annual Report on Form 10-K for the year ended December 31, 2008).
10.7	Form of L-3 Communications Holdings, Inc. 1999 Long Term Performance Plan Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.97 of the Registrants Quarterly Report on Form 10-Q for the period ended September 30, 2004).
10.8	Form of L-3 Communications Holdings, Inc. 1999 Long Term Performance Plan Nonqualified Stock Option Agreement (2006 Version) (incorporated by reference to Exhibit 10.64 to the Registrants Annual Report on Form 10-K for the year ended December 31, 2006).
10.9	Form of L-3 Communication Holdings, Inc. 1999 Long Term Performance Plan Restricted Stock Agreement (incorporated by reference to Exhibit 10.99 of the Registrants Annual Report on Form 10-K for the year ended December 31, 2005).
10.10	Form of L-3 Communications Holdings, Inc. 1999 Long Term Performance Plan Restricted Stock Unit Agreement (2006 Version) (incorporated by reference to Exhibit 10.63 to the Registrants Annual Report on Form 10-K for the year ended December 31, 2006).
10.11	L-3 Communications Holdings, Inc. 1999 Long Term Performance Plan Amendment No. 1 to Restricted Stock Unit Agreements (incorporated by reference to Exhibit 10.6 of the Registrants

	Quarterly Report on Form 10-Q for the period ended June 27, 2008).
10.12	Form of L-3 Communications Holdings, Inc. 1999 Long Term Performance Plan Performance Unit Agreement (incorporated by reference to Exhibit 99.1 to the Registrants Current Report on Form 8-K filed on August 7, 2007).
10.13	Form of L-3 Communications Holdings, Inc. 1999 Long Term Performance Plan Performance Unit Agreement Award Notice (incorporated by reference to Exhibit 99.2 to the Registrants Current Report on Form 8-K filed on August 7, 2007).
*10.14	L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan.
10.15	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.2 of the Registrants Quarterly Report on Form 10-Q for the period ended June 27, 2008).

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Exhibit No.	Description of Exhibits
10.16	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.3 of the Registrants Quarterly Report on Form 10-Q for the period ended June 27, 2008).
*10.17	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2009 Version).
10.18	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Performance Unit Agreement (incorporated by reference to Exhibit 10.4 of the Registrants Quarterly Report on Form 10-Q for the period ended June 27, 2008).
10.19	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Performance Unit Award Notice (2008 Version) (incorporated by reference to Exhibit 10.5 of the Registrants Quarterly Report on Form 10-Q for the period ended June 27, 2008).
*10.20	L-3 Communications Holdings, Inc. 2008 Directors Stock Incentive Plan.
*10.21	L-3 Communications Holdings, Inc. Amended and Restated Change in Control Severance Plan.
*10.22	L-3 Communications Corporation Amended and Restated Supplemental Executive Retirement Plan.
10.23	L-3 Communications Corporation Deferred Compensation Plan I (incorporated by reference to Exhibit 10.15 of the Registrants Annual Report on Form 10-K for the year ended December 31, 2008).
10.24	Amendment No. 1 to the L-3 Communications Corporation Deferred Compensation Plan I (incorporated by reference to Exhibit 10.16 of the Registrants Annual Report on Form 10-K for the year ended December 31, 2008).
*10.25	L-3 Communications Corporation Deferred Compensation Plan II.
*10.26	MPRI Long Term Deferred Incentive Plan.
**11	L-3 Communications Holdings, Inc. Computation of Basic Earnings Per Share and Diluted Earnings Per Share.
*12	Ratio of Earnings to Fixed Charges.
*18	Preferability Letter of PricewaterhouseCoopers LLP.
*21	Subsidiaries of the Registrant.
*23	Consent of PricewaterhouseCoopers LLP.
*31.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
*31.2	Certification of Vice President and Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities and Exchange Act, as amended.
*32	Section 1350 Certification.

* Filed herewith.

** The information required in this exhibit is presented in Note 15 to the audited consolidated financial statements as of December 31, 2008 in accordance with the provisions of SFAS No. 128, *Earnings Per Share*.

Represents management contract, compensatory plan or arrangement in which directors and/or executive officers are eligible to participate.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned, thereunto duly authorized, on February 26, 2009.

L-3 COMMUNICATIONS HOLDINGS, INC.
L-3 COMMUNICATIONS CORPORATION

By: /s/ Ralph G. D Ambrosio
Title: Vice President and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrants in the capacities indicated on February 26, 2009.

Signature	Title
/s/ Michael T. Strianese Michael T. Strianese	Chairman, President and Chief Executive Officer (Principal Executive Officer) and Director
/s/ Ralph G. D Ambrosio Ralph G. D Ambrosio	Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ Dan Azmon Dan Azmon	Controller and Principal Accounting Officer
/s/ Robert B. Millard Robert B. Millard	Director
/s/ Claude R. Canizares Claude R. Canizares	Director
/s/ Peter A. Cohen Peter A. Cohen	Director
/s/ Thomas A. Corcoran Thomas A. Corcoran	Director
/s/ John M. Shalikashvili	Director

John M. Shalikashvili	
/s/ Arthur L. Simon	Director
Arthur L. Simon	
/s/ Alan H. Washkowitz	Director
Alan H. Washkowitz	
/s/ John P. White	Director
John P. White	

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Financial Statements as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007 and 2006.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of L-3 Communications Holdings, Inc. and L-3 Communications Corporation:

In our opinion, the accompanying consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of L-3 Communications Holdings, Inc. and L-3 Communications Corporation and its subsidiaries (collectively, the Company) at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audits of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As indicated in Note 19 to the consolidated financial statements, in 2006 the Company adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158) and in 2007 the Company changed the measurement date of its pension and postretirement benefits plans in accordance with the provisions of SFAS 158. As indicated in Note 2 to the consolidated financial statements, in 2008 the Company changed its annual goodwill impairment measurement date.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
New York, New York
February 26, 2009

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L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	December 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 867	$ 780
Billed receivables, net of allowances of $26 in 2008 and $21 in 2007	1,226	1,279
Contracts in process	2,267	2,099
Inventories	259	249
Deferred income taxes	211	246
Other current assets	131	110
Total current assets	4,961	4,763
Property, plant and equipment, net	821	754
Goodwill	8,029	8,165
Identifiable intangible assets	417	441
Deferred debt issue costs	45	56
Other assets	212	212
Total assets	$ 14,485	$ 14,391
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable, trade	$ 602	$ 571
Accrued employment costs	700	633
Accrued expenses	479	369
Advance payments and billings in excess of costs incurred	530	463
Income taxes	45	63
Other current liabilities	351	483
Total current liabilities	2,707	2,582
Pension and postretirement benefits	802	450
Deferred income taxes	110	245
Other liabilities	414	501
Long-term debt	4,538	4,537
Total liabilities	8,571	8,315

Commitments and contingencies (see Note 18)		
Minority interests	83	87
Shareholders equity:		
L-3 Holdings common stock: $.01 par value; 300,000,000 shares authorized, 118,633,746 shares outstanding at December 31, 2008 and 124,174,825 shares outstanding at December 31, 2007 (L-3 Communications common stock: $.01 par value, 100 shares authorized, issued and outstanding)	4,072	3,753
L-3 Holdings treasury stock (at cost), 13,995,450 shares at December 31, 2008 and 5,533,159 shares at December 31, 2007	(1,319)	(525)
Retained earnings	3,410	2,608
Accumulated other comprehensive (loss) income	(332)	153
Total shareholders equity	5,831	5,989
Total liabilities and shareholders equity	$ 14,485	$ 14,391

See notes to consolidated financial statements.

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L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)