RAYTHEON CO/
Form 10-Q
October 25, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2012

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

For the transition period from to

Commission File Number 1-13699

RAYTHEON COMPANY
(Exact name of registrant as specified in its charter)

Delaware	95-1778500
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

870 Winter Street, Waltham, Massachusetts 02451
(Address of principal executive offices) (Zip Code)
(781) 522-3000
(Registrant's telephone number, including area code)

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

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

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.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No S

Number of shares of common stock outstanding as of October 22, 2012 was 329,867,000.

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Cautionary Note Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of federal securities laws, including information regarding our financial outlook, future plans, objectives, business prospects, trends and anticipated financial performance including with respect to our liquidity and capital resources, our cash tax payments, our pension expense and funding, the impact of new accounting pronouncements, our unrecognized tax benefits and the outcome of legal and administrative proceedings, claims, investigations, and commitments and contingencies. You can identify these statements by the fact that they include words such as “will,” “believe,” “anticipate,” “expect,” “estimate,” “intend,” “pla variations of these words or similar expressions. These forward-looking statements are not statements of historical facts and represent only our current expectations regarding such matters. These statements inherently involve a wide range of known and unknown uncertainties. Our actual actions and results could differ materially from what is expressed or implied by these statements. Specific factors that could cause such a difference include, but are not limited to, those set forth under Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011 and other important factors disclosed previously and from time to time in our other filings with the Securities and Exchange Commission (SEC). Given these factors, as well as other variables that may affect our operating results, you should not rely on forward-looking statements, assume that past financial performance will be a reliable indicator of future performance nor use historical trends to anticipate results or trends in future periods. We expressly disclaim any obligation or intention to provide updates to the forward-looking statements and the estimates and assumptions associated with them.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
RAYTHEON COMPANY
CONSOLIDATED BALANCE SHEETS

(In millions, except per share amounts)	(Unaudited) Sep 30, 2012	Dec 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$3,032	$4,000
Short-term investments	614	—
Contracts in process, net	4,789	4,526
Inventories	482	336
Deferred taxes	83	221
Prepaid expenses and other current assets	260	226
Total current assets	9,260	9,309
Property, plant and equipment, net	1,929	2,006
Deferred taxes	720	657
Goodwill	12,546	12,544
Other assets, net	1,242	1,338
Total assets	$25,697	$25,854
LIABILITIES AND EQUITY		
Current liabilities		
Advance payments and billings in excess of costs incurred	$2,169	$2,542
Accounts payable	1,190	1,507
Accrued employee compensation	1,130	941
Other accrued expenses	1,179	1,140
Total current liabilities	5,668	6,130
Accrued retiree benefits and other long-term liabilities	6,192	6,774
Deferred taxes	3	5
Long-term debt	4,609	4,605
Commitments and contingencies (Note 9)		
Equity		
Raytheon Company stockholders' equity		
Common stock, par value, $0.01 per share, 1,450 shares authorized, 330 and 339 shares outstanding at September 30, 2012 and December 31, 2011, respectively, after deducting 178 and 163 treasury shares at September 30, 2012 and December 31, 2011, respectively.	3	3
Additional paid-in capital	11,900	11,676
Accumulated other comprehensive loss	(6,506)	(7,001)
Treasury stock, at cost	(8,913)	(8,153)
Retained earnings	12,578	11,656
Total Raytheon Company stockholders' equity	9,062	8,181
Noncontrolling interests in subsidiaries	163	159
Total equity	9,225	8,340
Total liabilities and equity	$25,697	$25,854

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended		Nine Months Ended	
(In millions, except per share amounts)	Sep 30, 2012	Oct 2, 2011	Sep 30, 2012	Oct 2, 2011
Net sales				
Products	$5,065	$5,115	$14,937	$15,399
Services	980	1,001	3,038	2,970
Total net sales	6,045	6,116	17,975	18,369
Operating expenses				
Cost of sales—products	3,848	3,971	11,438	12,163
Cost of sales—services	841	844	2,562	2,483
Administrative and selling expenses	389	426	1,198	1,288
Research and development expenses	181	153	543	454
Total operating expenses	5,259	5,394	15,741	16,388
Operating income	786	722	2,234	1,981
Non-operating (income) expense				
Interest expense	49	41	149	127
Interest income	(3)	(5)	(6)	(12)
Other (income) expense	(5)	14	(10)	15
Total non-operating (income) expense, net	41	50	133	130
Income from continuing operations before taxes	745	672	2,101	1,851
Federal and foreign income taxes	237	165	668	521
Income from continuing operations	508	507	1,433	1,330
Income (loss) from discontinued operations, net of tax	(1)	3	(4)	14
Net income	507	510	1,429	1,344
Less: Net income (loss) attributable to noncontrolling interests in subsidiaries	7	9	10	21
Net income attributable to Raytheon Company	$500	$501	$1,419	$1,323
Basic earnings (loss) per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$1.51	$1.42	$4.26	$3.70
Income (loss) from discontinued operations, net of tax	—	0.01	(0.01)	0.04
Net income	1.51	1.43	4.25	3.73
Diluted earnings (loss) per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$1.51	$1.42	$4.24	$3.68
Income (loss) from discontinued operations, net of tax	—	0.01	(0.01)	0.04
Net income	1.50	1.43	4.23	3.71
Amounts attributable to Raytheon Company common stockholders:				
Income from continuing operations	$501	$498	$1,423	$1,309
Income (loss) from discontinued operations, net of tax	(1)	3	(4)	14

Net income	$500	$501	$1,419	$1,323

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

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RAYTHEON COMPANY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In millions)	Three Months Ended Sep 30, 2012	Three Months Ended Oct 2, 2011	Nine Months Ended Sep 30, 2012	Nine Months Ended Oct 2, 2011
Net income	$507	$510	$1,429	$1,344
Other comprehensive income (loss), before tax:				
Foreign exchange translation	44	(48)	43	(2)
Cash flow hedges and interest rate locks	7	(15)	7	(5)
Unrealized gain (loss) on short term investments and other	(2)	(2)	(2)	(2)
Pension and other employee benefit plans:				
Net change in initial net obligation	—	1	—	3
Prior service cost arising during period	—	—	—	45
Net loss arising during period	(21)	(113)	(21)	(120)
Amortization of prior service cost included in net periodic expense	1	—	5	2
Amortization of net actuarial loss included in net income	227	197	706	596
Defined benefit pension and other employee benefit plans, net	207	85	690	526
Other comprehensive income (loss), before tax	256	20	738	517
Income tax (expense) benefit related to items of other comprehensive income	(74)	(25)	(243)	(179)
Other comprehensive income (loss), net of tax	182	(5)	495	338
Total comprehensive income (loss)	689	505	1,924	1,682
Less: Comprehensive income (loss) attributable to noncontrolling interests in subsidiaries	7	9	10	21
Comprehensive income (loss) attributable to Raytheon Company	$682	$496	$1,914	$1,661

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)

Nine months ended September 30, 2012 and October 2, 2011 (In millions)	Common stock	Additional paid-in capital	Accumulated other comprehensive (loss)	Treasury stock	Retained earnings	Total Raytheon Company stockholders' equity	Noncontrolling interests in subsidiaries	Total equity
Balance at December 31, 2010	$4	$ 11,406	$ (5,146)	$(6,900)	$10,390	$9,754	$ 136	$9,890
Net income					1,323	1,323	21	1,344
Other comprehensive income (loss)			338			338		338
Dividends declared					(455)	(455)		(455)
Distributions and other activity related to noncontrolling interests							(5)	(5)
Common stock plans activity	(1)	111				110		110
Warrants exercised		123				123		123
Treasury stock activity				(938)		(938)		(938)
Balance at October 2, 2011	$3	$ 11,640	$ (4,808)	$(7,838)	$11,258	$10,255	$ 152	$10,407
Balance at December 31, 2011	$3	$ 11,676	$ (7,001)	$(8,153)	$11,656	$8,181	$ 159	$8,340
Net income					1,419	1,419	10	1,429
Other comprehensive income (loss)			495			495		495
Dividends declared					(497)	(497)		(497)
Distributions and other activity related to noncontrolling interests							(6)	(6)
Common stock plans activity		224				224		224
Treasury stock activity				(760)		(760)		(760)
Balance at September 30, 2012	$3	$ 11,900	$ (6,506)	$(8,913)	$12,578	$9,062	$ 163	$9,225

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended	
(In millions)	Sep 30, 2012	Oct 2, 2011
Cash flows from operating activities		
Net income	$1,429	$1,344
(Income) loss from discontinued operations, net of tax	4	(14)
Income from continuing operations	1,433	1,330
Adjustments to reconcile to net cash provided by (used in) operating activities from continuing operations, net of the effect of acquisitions and divestitures		
Depreciation and amortization	341	328
Stock-based compensation	84	72
Deferred income taxes	7	84
Tax benefit from stock-based awards	(14)	(14)
Changes in assets and liabilities		
Contracts in process, net and advance payments and billings in excess of costs incurred	(622)	(667)
Inventories	(145)	(52)
Prepaid expenses and other current assets	37	(4)
Accounts payable	(314)	(198)
Income taxes receivable/payable	(90)	74
Accrued employee compensation	191	162
Other accrued expenses	(22)	(82)
Other long-term liabilities	(38)	(55)
Pension and other postretirement benefit plans	120	(260)
Other, net	(5)	98
Net cash provided by (used in) operating activities from continuing operations	963	816
Net cash provided by (used in) operating activities from discontinued operations	6	(27)
Net cash provided by (used in) operating activities	969	789
Cash flows from investing activities		
Additions to property, plant and equipment	(204)	(197)
Proceeds from sales of property, plant and equipment	46	1
Additions to capitalized internal-use software	(60)	(74)
Purchases of short-term investments	(831)	—
Sales of short-term investments	150	—
Maturities of short-term investments	75	—
Payments for purchases of acquired companies, net of cash received	(7)	(551)
Change in other assets	(2)	—
Net cash provided by (used in) investing activities from continuing operations	(833)	(821)
Net cash provided by (used in) investing activities from discontinued operations	—	26
Net cash provided by (used in) investing activities	(833)	(795)
Cash flows from financing activities		
Dividends paid	(478)	(440)
Repurchases of common stock	(725)	(937)
Proceeds from warrants exercised	—	123
Activity under common stock plans	90	20
Tax benefit from stock-based awards	14	14
Other	(5)	(7)
Net cash provided by (used in) financing activities	(1,104)	(1,227)

Net increase (decrease) in cash and cash equivalents	(968)	(1,233)
Cash and cash equivalents at beginning of the year	4,000	3,638
Cash and cash equivalents at end of period	$3,032	$2,405

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

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RAYTHEON COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of Presentation

We prepared the accompanying unaudited consolidated financial statements of Raytheon Company and all wholly-owned and majority-owned domestic and otherwise controlled foreign subsidiaries on the same basis as our annual audited financial statements.

In the opinion of management, our financial statements reflect all adjustments, which are of a normal recurring nature, necessary for presentation of financial statements for interim periods in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and with the instructions to Form 10-Q in Article 10 of Securities and Exchange Commission (SEC) Regulation S-X. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates, and any such differences may be material to our financial statements. As discussed in more detail below in Note 6: "Discontinued Operations" and elsewhere in this Quarterly Report on Form 10-Q, during the three months ended April 1, 2012, we completed the disposal or abandonment of the remaining individual assets of our former turbo-prop commuter aircraft portfolio, Raytheon Airline Aviation Services LLC (RAAS), and all operations have ceased. As a result, we reclassified RAAS results as a discontinued operation for all periods presented. As used in this report, the terms “we,” “us,” “our,” “Raytheon” and the “Company” mean Raytheon Company and its subsidiaries, unless the context indicates another meaning.

In the six months ended July 1, 2012, we began investing in marketable securities in accordance with our short-term investment policy and cash management strategy. These marketable securities are classified as available-for-sale and are recorded at fair value as short-term investments in our consolidated balance sheets. Unrealized gains and losses on our available-for-sale securities are recorded in accumulated other comprehensive loss, net of tax. Realized gains and losses on sales of our available-for-sale securities are recorded in other (income) expense on the statement of operations. When determined, other than temporary declines in the value of available-for-sale securities are recorded as a loss in earnings. We make such determinations by considering, among other factors, the length of time the fair value of the investment has been less than the carrying value, future business prospects for the investee, and information regarding market and industry trends for the investee's business, if available. For purposes of computing realized gains and losses on available-for-sale securities, we determine cost on a specific identification basis. There were no securities deemed to have other than temporary declines in value for the nine months ended September 30, 2012. In the nine months ended September 30, 2012, we recorded an unrealized gain on short-term investments of less than $1 million, net of tax, in accumulated other comprehensive loss. In the nine months ended September 30, 2012, we recorded gains on sales of short-term investments of less than $1 million in other (income) expense. The amortized cost of these securities closely approximated their fair value as of September 30, 2012.

We condensed or omitted certain information and footnote disclosures normally included in our annual audited financial statements, which we prepared in accordance with GAAP. Our quarterly financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011.

We have evaluated subsequent events through the time of filing our Quarterly Report on Form 10-Q with the SEC.

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Note 2: Changes in Estimates under Percentage of Completion Contract Accounting

Raytheon has a Company-wide standard and disciplined quarterly Estimate at Completion (EAC) process in which management reviews the progress and performance of our contracts. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities, and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (for example, the number and type of milestone events), technical requirements (for example, a newly-developed product versus a mature product), and other contract requirements. Management must make assumptions regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (to estimate increases in wages and prices for materials and related support cost allocations), performance by our subcontractors, the availability and timing of funding from our customer, and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations required under certain contracts. Based on this analysis, any adjustments to net sales, costs of sales, and the related impact to operating income are recorded as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating profit during the performance of individual contracts, if we determine we will be successful in mitigating risks surrounding the technical, schedule, and cost aspects of those contracts or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating profit if we determine we will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, costs of sales, and the related impact to operating income are recognized on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a contract's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our contracts. When estimates of total costs to be incurred on a contract exceed total estimates of revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

Our operating income included net EAC adjustments resulting from changes in estimates of $157 million and $140 million for the three months ended September 30, 2012 and October 2, 2011, respectively and $472 million and $302 million for the nine months ended September 30, 2012 and October 2, 2011, respectively. These adjustments increased our earnings from continuing operations attributable to Raytheon Company common stockholders by $102 million ($0.31 per diluted share) and $89 million ($0.25 per diluted share) for the three months ended September 30, 2012 and October 2, 2011, respectively, and $307 million ($0.92 per diluted share) and $190 million ($0.53 per diluted share) for the nine months ended September 30, 2012 and October 2, 2011, respectively.

Note 3: Inventories

Inventories consisted of the following at:

(In millions)	Sep 30, 2012	Dec 31, 2011
Materials and purchased parts	$93	$60
Work in process	373	264
Finished goods	16	12
Total	$482	$336

We capitalize costs incurred in advance of contract award or funding in inventories if we determine that contract award or funding is probable. To the extent these are precontract costs, start-up costs have been excluded. We included capitalized precontract costs and other deferred costs of $146 million and $121 million in inventories as work in process at September 30, 2012 and December 31, 2011, respectively.

Note 4: Accounting Standards

New accounting pronouncements issued but not effective until after September 30, 2012 are not expected to have a material impact on our financial position, results of operations or liquidity.

Note 5: Acquisitions

In pursuing our business strategies, we acquire and invest in certain businesses that meet strategic and financial criteria.
In the nine months ended October 2, 2011, we acquired Applied Signal Technology, Inc., subsequently renamed Raytheon Applied Signal Technology, Inc. (RAST), and substantially all the assets of Ktech Corporation (Ktech) for a combined $551

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million in cash, net of $25 million of cash and cash equivalents acquired, and exclusive of retention and management incentive payments. The acquisition of RAST is part of our strategy to extend and enhance our Space and Airborne Systems (SAS) offerings related to certain classified and Department of Defense markets, while the acquisition of Ktech is part of our strategy to extend and enhance our Missile Systems (MS) offerings. In connection with these acquisitions, in the nine months ended October 2, 2011, we recorded a combined $422 million of goodwill related to expected synergies from combining operations and the value of the existing workforce, and a combined $97 million of intangible assets, primarily related to contractual relationships, license agreements and trade names, with a weighted average life of seven years.

A rollforward of our goodwill by segment is as follows:

(In millions)	Integrated Defense Systems	Intelligence and Information Systems	Missile Systems	Network Centric Systems	Space and Airborne Systems	Technical Services	Total
Balance at December 31, 2011	$765	$1,775	$3,467	$2,616	$3,050	$871	$12,544
Acquisitions	2	(1)	—	—	—	—	1
Effect of foreign exchange rates and other	—	—	—	—	—	1	1
Balance at September 30, 2012	$767	$1,774	$3,467	$2,616	$3,050	$872	$12,546

Note 6: Discontinued Operations

In pursuing our business strategies, we have divested certain non-core businesses, investments, and assets when appropriate. All residual activity relating to our previously disposed businesses appears in discontinued operations. During the three months ended April 1, 2012, we completed the disposal or abandonment of the remaining individual assets of our former turbo-prop commuter aircraft portfolio, RAAS, and all operations have ceased. As a result, we have reported the results of RAAS as a discontinued operation for all periods presented. The sale of the remaining operating assets in the nine months ended September 30, 2012, resulted in a gain of less than $1 million.

Income from discontinued operations included the following results of RAAS:

	Three Months Ended		Nine Months Ended	
(In millions)	Sep 30, 2012	Oct 2, 2011	Sep 30, 2012	Oct 2, 2011
Pretax	$—	$3	$—	$18
After-tax	—	2	—	12

No interest expense relating to RAAS was allocated to discontinued operations for the three or nine months ended September 30, 2012 and October 2, 2011 because there was no debt specifically attributable to discontinued operations.

We retain certain assets and liabilities of our previously disposed businesses. At September 30, 2012 and December 31, 2011, we had $8 million and $19 million, respectively, of assets primarily related to our retained interest in general aviation finance receivables from the previously sold Raytheon Aircraft Company (Raytheon Aircraft). At September 30, 2012 and December 31, 2011, we had $42 million and $44 million, respectively, of liabilities primarily related to non-income tax obligations, certain environmental and product liabilities, various contract obligations and aircraft lease obligations. We also retained certain pension assets and obligations, which we include in our pension disclosures.

Note 7: Fair Value Measurements

The estimated fair value of certain financial instruments, including cash and cash equivalents, approximates the carrying value due to their short maturities. The estimated fair value of notes receivable approximates the carrying value based principally on their underlying interest rates and terms, maturities, collateral and credit status of the receivables. The carrying value of long-term debt of $4,609 million and $4,605 million at September 30, 2012 and

December 31, 2011, respectively, was recorded at amortized cost. The estimated fair value of long-term debt of $5,460 million and $5,121 million at September 30, 2012 and December 31, 2011, respectively, was determined based on quoted prices in inactive markets, which falls within Level 2 of the fair value measurement hierarchy.

At September 30, 2012, we had short-term investments of $614 million consisting of highly rated bank certificates of deposit with a minimum long-term debt rating of A or A2 and a minimum short-term debt rating of A-1 and P-1.

We did not have any significant nonfinancial assets or nonfinancial liabilities that would be recognized or disclosed at fair

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value on a recurring basis as of September 30, 2012 and December 31, 2011. We did not have any transfers of assets or liabilities between levels of the fair value hierarchy during the nine months ended September 30, 2012 or the year ended December 31, 2011.

Assets and liabilities measured at fair value on a recurring basis consisted of the following:

(In millions)	Level 1	Level 2 (A)	Level 3	Balances at September 30, 2012
Assets				
Marketable securities held in trust	$394	$—	$—	$394
Short-term investments	—	614	—	614
Foreign currency forward contracts	17	—	—	17
Liabilities				
Deferred compensation	241	—	—	241
Foreign currency forward contracts	16	—	—	16

(In millions)	Level 1	Level 2	Level 3	Balances at Dec 31, 2011
Assets				
Marketable securities held in trust	$363	$—	$—	$363
Foreign currency forward contracts	12	—	—	12
Liabilities				
Deferred compensation	223	—	—	223
Foreign currency forward contracts	22	—	—	22

(A) Fair value of Level 2 assets are determined by pricing vendors under a market approach using valuation models that utilize observable inputs, including maturity date, issue date, settlement date, current commercial paper rate, current certificate of deposit rate and coupon rates.

Note 8: Derivative Financial Instruments

Our primary market exposures are to interest rates and foreign exchange rates and we use certain derivative financial instruments to help manage these exposures. We execute these instruments with financial institutions that we judge to be credit-worthy, and the majority of our foreign currency forward contracts are denominated in currencies of major industrial countries. We do not hold or issue derivative financial instruments for trading or speculative purposes.

The fair value amounts of asset derivatives included in other assets, net and liability derivatives included in other accrued expenses in our consolidated balance sheets related to foreign currency forward contracts were as follows:

	Asset Derivatives		Liability Derivatives	
(In millions)	Sep 30, 2012	Dec 31, 2011	Sep 30, 2012	Dec 31, 2011
Derivatives designated as hedging instruments	$11	$11	$12	$17
Derivatives not designated as hedging instruments	6	1	4	5
Total	$17	$12	$16	$22

We recognized the following pretax gains (losses) related to foreign currency forward contracts designated as cash flow hedges:

	Three Months Ended		Nine Months Ended	
(In millions)	Sep 30, 2012	Oct 2, 2011	Sep 30, 2012	Oct 2, 2011
Effective portion				
Gain (loss) recognized in accumulated other comprehensive loss (AOCL)	$6	$(12)	$4	$(1)
Gain (loss) reclassified from AOCL to net sales	(1)	—	—	1

Gain (loss) reclassified from AOCL to cost of sales	—	4	(1)	10
Amount excluded from effectiveness assessment and ineffective portion				
Gain (loss) recognized in cost of sales	—	—	—	—

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We recognized the following pre-tax gains (losses) related to foreign currency forward contracts not designated as cash flow hedges:

	Three Months Ended		Nine Months Ended	
(In millions)	Sep 30, 2012	Oct 2, 2011	Sep 30, 2012	Oct 2, 2011
Gain (loss) recognized in net sales	$—	$—	$(5)	$—
Gain (loss) recognized in cost of sales	(4)	(4)	—	3

There were no interest rate swaps outstanding at September 30, 2012 or December 31, 2011.

We use foreign currency forward contracts to fix the functional currency value of specific commitments, payments and receipts. The aggregate notional amount of the outstanding foreign currency forward contracts was $822 million and $941 million at September 30, 2012 and December 31, 2011, respectively.

Our foreign currency forward contracts contain off-set or netting provisions to mitigate credit risk in the event of counterparty default, including payment default and cross default. At September 30, 2012 and December 31, 2011, the fair value of our counterparty default exposure was less than $1 million and spread across numerous highly rated counterparties.

Note 9: Commitments and Contingencies

Environmental Matters—We are involved in various stages of investigation and cleanup related to remediation of various environmental sites. Our estimate of the liability of total environmental remediation costs includes the use of a discount rate and takes into account that a portion of these costs is eligible for future recovery through the pricing of our products and services to the U.S. Government. We consider such recovery probable based on government contracting regulations and our long history of receiving reimbursement for such costs and accordingly have recorded the estimated future recovery of these costs from the U.S. Government within contracts in process. Our estimates regarding remediation costs to be incurred were as follows:

(In millions, except percentages)	Sep 30, 2012	Dec 31, 2011
Total remediation costs—undiscounted	$209	$227
Weighted average risk-free rate	5.6%	5.6%
Total remediation costs—discounted	$140	$152
Recoverable portion	94	105

We also lease certain government-owned properties and generally are not liable for remediation of preexisting environmental contamination at these sites; as a result, we generally do not reflect the provision for these costs in our consolidated financial statements.

Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage, and the unresolved extent of our responsibility, it is difficult to determine the ultimate outcome of environmental matters; however, we do not expect any additional liability to have a material adverse effect on our financial position, results of operations or liquidity.

Financing Arrangements and Other—We issue guarantees and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. These instruments expire on various dates through 2023. Additional guarantees of project performance for which there are no stated values also remain outstanding. The stated values outstanding at September 30, 2012 and December 31, 2011 were as follows:

(In millions)	Sep 30, 2012	Dec 31, 2011
Guarantees	$253	$256
Letters of credit	1,255	1,275
Surety bonds	241	233

Included in guarantees and letters of credit were $106 million and $220 million, respectively, at September 30, 2012, and $109 million and $240 million, respectively, at December 31, 2011, related to our joint venture in

Thales-Raytheon Systems Co. Ltd. (TRS). We provide these guarantees and letters of credit to TRS and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. Although we expect these entities to satisfy their loans, and meet their project performance and other contractual obligations, their failure to do so

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may result in a future obligation to us. We periodically evaluate the risk of TRS and other affiliates failing to satisfy their loans, or meet project performance or other contractual obligations described above. At September 30, 2012, we believe the risk that TRS and other affiliates will not be able to perform or meet their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at September 30, 2012. At September 30, 2012 and December 31, 2011, we had an estimated liability of $4 million and $6 million, respectively, related to guarantees and letters of credit.

In 1997, we provided a first loss guarantee of $133 million on $1.3 billion of U.S. Export-Import Bank loans (maturing in 2015) to the Brazilian Government related to Network Centric Systems' System for the Vigilance of the Amazon program. Loan repayments by the Brazilian Government were current at September 30, 2012.

We have entered into industrial cooperation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. At September 30, 2012, the aggregate amount of our offset agreements had an outstanding notional value of approximately $5 billion. These agreements are designed to return economic value to the foreign country by requiring the contractor to engage in activities supporting local defense or commercial industries, promoting a balance of trade, developing in-country technology capabilities, or addressing other local development priorities. Offset agreements may be satisfied through activities that do not require a direct cash payment, including transferring technology, providing manufacturing, training and other consulting support to in-country projects, and the purchase by third parties (e.g., our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for activities such as subcontracting with local partners, purchasing supplies from in-country vendors, providing financial support for in-country projects, and making investments in local ventures. Such activities may also vary country-by-country depending upon requirements as dictated by their governments. We typically do not commit to offset agreements until orders for our products or services are definitive. The amounts ultimately applied against our offset agreements are based on negotiations with the customers and typically require cash outlays that represent only a fraction of the notional value in the offset agreements. Offset programs usually extend over several or more years and may provide for penalties in the event we fail to perform in accordance with offset requirements. We have historically not been required to pay any such penalties.

As a government contractor, we are subject to many levels of audit and investigation by the U.S. Government relating to our contract performance and compliance with applicable rules and regulations. Agencies that oversee contract performance include: the Defense Contract Audit Agency, the Defense Contract Management Agency, the Inspector General of the Department of Defense and other departments and agencies, the Government Accountability Office, the Department of Justice and Congressional Committees. From time to time, these and other agencies investigate or conduct audits to determine whether our operations are being conducted in accordance with applicable requirements. Such investigations and audits could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, the suspension of government export licenses or the suspension or debarment from future U.S. Government contracting. U.S. Government investigations often take years to complete and many result in no adverse action against us. Our final allowable incurred costs for each year are also subject to audit and have from time to time resulted in disputes between us and the U.S. Government with litigation resulting at the Court of Federal Claims (COFC) or the Armed Services Board of Contract Appeals (ASBCA) or their related courts of appeals. In addition, the Department of Justice has, from time to time, convened grand juries to investigate possible irregularities by us. We also provide products and services to customers outside of the U.S. and those sales are subject to local government laws, regulations, and procurement policies and practices. Our compliance with such local government regulations or any applicable U.S. Government regulations (e.g., the Foreign Corrupt Practices Act and the International Traffic in Arms Regulations) may also be investigated or audited. Other than as specifically disclosed herein, we do not expect these audits, investigations or disputes to have a material effect on our financial position, results of operations or liquidity, either individually or in the aggregate. After the close of the quarter, the Company learned of allegations claiming the Company may have violated certain government procurement regulations and related statutes. We are reviewing the allegations, but at this time are unable reasonably to determine whether the allegations have any merit. However, we currently do not believe that this matter will have a material impact, and we are confident that we have appropriate processes, procedures and controls in place to comply with the government procurement regulations and related statutes.

We have completed a self-initiated internal review of certain of our international operations, focusing on compliance with the Foreign Corrupt Practices Act. In the course of the review, we identified possible areas of concern involving certain practices related to operations in a foreign jurisdiction where we do business. We voluntarily disclosed and shared the results of our review with the SEC and the Department of Justice. Based on the information available to date, we do not believe that the results of this review will have a material adverse effect on our financial condition, results of operations or liquidity.

On July 22, 2010, Raytheon Systems Limited (RSL) was notified by the UK Border Agency (UKBA) that it had been terminated for cause on a program. The termination notice included allegations that RSL had failed to perform on certain key milestones and other matters in addition to claiming entitlement to recovery of certain losses incurred and previous payments made to RSL. We believe that RSL performed well and delivered substantial capabilities to the UKBA under the program,

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which began live operations in May 2009 and had been operating successfully and providing actionable information through at least April 2011 when RSL's exit obligations ended. On July 29, 2010, RSL filed a dispute notice on the grounds that the termination by the UKBA was not valid. On August 18, 2010, the UKBA initiated arbitration proceedings on this issue. On March 22, 2011, the UKBA gave notice that it had presented a demand to draw on the approximately $80 million of letters of credit provided by RSL upon the signing of the contract with the UKBA in 2007. On March 23, 2011, the UKBA submitted a detailed claim in the arbitration of approximately £350 million (approximately $565 million based on foreign exchange rates as of September 30, 2012) for damages and clawback of previous payments, plus interest and arbitration costs, excluding any credit for capability delivered or draw on the letters of credit. The UKBA also asserted that additional amounts may be detailed in the claim in the future if estimates of its damages change, and for continuing post-termination losses and any re-procurement costs, which have not been quantified. At RSL's request, on March 29, 2011, the Arbitration Tribunal issued an interim order restraining the UKBA from drawing down on the letters of credit pending a hearing on the issue. Following the hearing, the Tribunal lifted the restraint on the basis that, at this early stage of the proceedings, the Tribunal had not heard the evidence needed to decide the merits of whether the contractual conditions for a drawdown had been established. The Tribunal also concluded that any decision on the UKBA's right to call on the letters of credit is inextricably intertwined with the ultimate decision on the merits in the arbitration. The Tribunal also preserved RSL's right to claim damages should RSL later establish that the drawdown was not valid. As a result, on April 6, 2011, the UKBA drew the $80 million on the letters of credit.

As a result of the Tribunal's decision that the letters of credit are inextricably intertwined with the ultimate decision on the merits in the arbitration, we were no longer able to evaluate, independently from the overall claim, the probability of recovery of any amounts drawn on the letters of credit. We therefore recorded $80 million of costs related to the UKBA drawdown (UKBA LOC Adjustment), which was included in the operating expenses of our Intelligence and Information Systems segment in the nine months ended October 2, 2011.

In June 2011, RSL submitted in the arbitration its defenses to the UKBA claim as well as substantial counterclaims in the amount of approximately £500 million (approximately $807 million based on foreign exchange rates as of September 30, 2012) against the UKBA for the collection of receivables and damages. On October 3, 2011, the UKBA filed its reply to RSL's counterclaims, and increased its claim amount by approximately £32 million, to include additional civil service and post termination costs, and approximately £33 million for interest, raising the total gross amount of the UKBA claim for damages and clawback of previous payments to approximately £415 million (approximately $670 million based on foreign exchange rates as of September 30, 2012). On January 6, 2012, RSL filed its response to the UKBA's reply. RSL is pursuing vigorously the collection of all receivables for the program and damages in connection with the wrongful termination and is mounting a strong defense to the UKBA's alleged claims for losses and previous payments. RSL has also settled all subcontractor claims, novated all key subcontracts to the UKBA and agreed with the UKBA that RSL's exit obligations to operate the previously delivered capability ended in April 2011. Effective April 15, 2011, the UKBA took over responsibility for operating the previously delivered capability.

The receivables and other assets remaining under the program for technology and services delivered were approximately $40 million at September 30, 2012 and December 31, 2011. We believe the remaining receivables and other assets are probable of recovery in litigation or arbitration. We currently believe it is not probable that RSL is liable for losses, previous payments (which includes the $80 million related to the drawdown on the letters of credit), clawback or other claims asserted by the UKBA either in its March 2011 arbitration filing or its October 2011 reply. Due to the inherent uncertainties in litigation and arbitration and the complexity and technical nature of actual and potential claims and counterclaims, it is reasonably possible that the ultimate amount of any resolution of the termination could be less or greater than the amounts we have recorded. For the same reasons, at this time, we are unable to estimate a range of the possible loss or recovery, if any, beyond the claim and counterclaim amounts. If we are required to make payments against claims or other losses asserted by the UKBA in excess of the amounts we have recorded, it could have a material adverse effect on our financial position, results of operations or liquidity. Arbitration hearings are scheduled to commence in the fourth quarter of 2012 and we expect to have a decision in 2013.

On June 29, 2012 and July 13, 2012, we received a contracting officer’s final decision (COFD) for 2005 and 2004 incurred costs at our Space and Airborne Systems (SAS) business. The COFDs demand a total payment of $241 million for costs, interest and penalties associated with several issues, the largest of which relates to specific research and development and capital projects undertaken by SAS between 2000 and 2005. To date, no COFDs have been provided for 2000 to 2003 periods at SAS on these issues. The Government alleges that the costs incurred on the projects should have been charged directly to U.S. Government contracts rather than through indirect rates and that these costs should not be recoverable. We strongly disagree with the Government's position. We have requested a deferment of the payment and intend to litigate the issues. Due to the inherent uncertainties of litigation, we cannot estimate a range of potential loss. We believe that we appropriately charged the disputed costs based on government accounting standards and applicable precedent and properly disclosed our approach to the Government. We also believe that in many cases, the statute of limitations has run on the issues. Based upon the foregoing,

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we do not expect the results of the COFDs to have a material impact on our financial position, results of operations or liquidity.

In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against us. We do not expect any additional liability from these proceedings to have a material adverse effect on our financial position, results of operations or liquidity.

Product Warranty—We provide product warranties in conjunction with certain product sales for which we recognize revenue upon delivery.

Activity related to our product warranty accruals was as follows:

	Three Months Ended		Nine Months Ended	
(In millions)	Sep 30, 2012	Oct 2, 2011	Sep 30, 2012	Oct 2, 2011
Balance at beginning of period	$36	$43	$38	$43
Provisions for warranties	1	1	5	6
Warranty services provided	(2)	(3)	(8)	(8)
Balance at end of period	$35	$41	$35	$41

We account for warranty provision costs incurred under our long-term contracts using the cost-to-cost measure of progress as contracts costs, as the estimation of these costs is integral in determining the price of the related long-term contracts. The table above excludes these costs.

Note 10: Stockholders' Equity

Repurchases of our common stock under our share repurchase programs were as follows:

	Nine Months Ended	
(In millions)	Sep 30, 2012	Oct 2, 2011
Amount of stock repurchased	$725	$937
Shares of stock repurchased	14.1	20.1

In September 2011, our Board of Directors authorized the repurchase of up to $2.0 billion of our outstanding common stock. At September 30, 2012, we had approximately $1.4 billion available under this repurchase program. All previous programs have been completed as of September 30, 2012. Share repurchases will take place from time to time at management's discretion depending on market conditions.

In March 2012, our Board of Directors authorized a 16% increase to our annual dividend payout rate from $1.72 to $2.00 per share. Our Board of Directors also declared dividends of $1.50 per share during the nine months ended September 30, 2012, compared to dividends of $1.29 per share during the nine months ended October 2, 2011. Dividends are subject to quarterly approval by our Board of Directors.

The changes in shares of our common stock outstanding for the nine months ended September 30, 2012 were as follows:

(In millions)	Number of Shares
Balance at December 31, 2011	338.9
Stock plan activity	5.0
Treasury stock repurchases	(14.1)
Balance at September 30, 2012	329.8

On October 4, 2012, our Board of Directors authorized the retirement of all outstanding treasury shares directly held by the Company. As a result, all outstanding treasury shares directly held by the Company will be retired in the fourth quarter of 2012, with an offsetting reduction in common stock for the par value and the remaining amount offset in additional paid-in-capital. In addition, our Board of Directors authorized all future share repurchases to be retired immediately upon repurchase.

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Earnings Per Share (EPS)

We compute basic and diluted EPS using actual income from continuing operations attributable to Raytheon Company common stockholders, income (loss) from discontinued operations attributable to Raytheon Company common stockholders, net income attributable to Raytheon Company, and our actual weighted-average shares and participating securities outstanding rather than the numbers presented within our consolidated financial statements, which are rounded to the nearest million. As a result, it may not be possible to recalculate EPS as presented in our unaudited consolidated financial statements. Furthermore, it may not be possible to recalculate EPS attributable to Raytheon Company common stockholders by adjusting EPS from continuing operations by EPS from discontinued operations.

EPS from continuing operations attributable to Raytheon Company common stockholders and unvested share-based payment awards was as follows:

	Three Months Ended		Nine Months Ended	
	Sep 30, 2012	Oct 2, 2011	Sep 30, 2012	Oct 2, 2011
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.50	$0.42	$1.49	$1.28
Undistributed earnings	1.01	1.00	2.77	2.42
Total	$1.51	$1.42	$4.26	$3.70
Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.50	$0.42	$1.48	$1.28
Undistributed earnings	1.01	1.00	2.76	2.40
Total	$1.51	$1.42	$4.24	$3.68

Basic EPS from discontinued operations attributable to Raytheon Company common stockholders and unvested share-based payment awards was a loss of less than $0.01 and income of $0.01 for the three months ended September 30, 2012 and October 2, 2011, respectively and a loss of $0.01 and income of $0.04 for the nine months ended September 30, 2012 and October 2, 2011, respectively. Diluted EPS from discontinued operations attributable to Raytheon Company common stockholders and unvested share-based payment awards was a loss of less than $0.01 and income of $0.01 for the three months ended September 30, 2012 and October 2, 2011, respectively and a loss of $0.01 and income of $0.04 for the nine months ended September 30, 2012 and October 2, 2011, respectively.

The amount of income from continuing operations attributable to participating securities was $10 million and $8 million for the three months ended September 30, 2012 and October 2, 2011, respectively and $27 million and $21 million for the nine months ended September 30, 2012 and October 2, 2011, respectively. The amount of income (loss) from discontinued operations attributable to participating securities was a loss of less than $1 million and income of less than $1 million for the three months ended September 30, 2012 and October 2, 2011, respectively. The amount of income (loss) from discontinued operations attributable to participating securities was a loss of less than $1 million and income of less than $1 million for the nine months ended September 30, 2012 and October 2, 2011, respectively. The amount of net income attributable to participating securities was $10 million and $8 million for the three months ended September 30, 2012 and October 2, 2011, respectively and was $27 million and $22 million for the nine months ended September 30, 2012 and October 2, 2011, respectively.

The weighted-average shares outstanding for basic and diluted EPS were as follows:

	Three Months Ended	Nine Months Ended
(In millions)		