

L 3 COMMUNICATIONS CORP
Form 10-Q
May 07, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 29, 2013

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission file numbers 001-14141 and 333-46983

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

(Exact names of registrants as specified in their charters)

Delaware (State or other jurisdiction of incorporation or organization)	13-3937434 and 13-3937436 (I.R.S. Employer Identification Nos.)
600 Third Avenue, New York, NY (Address of principal executive offices)	10016 (Zip Code)
(212) 697-1111	

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant, L-3 Communications Corporation, Inc., is a large accelerated filer, accelerated filer, non-accelerated filer, or smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Act). Yes No

There were 89,995,841 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on May 1, 2013.

L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION
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For the quarterly period ended March 29, 2013

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PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****L-3 COMMUNICATIONS HOLDINGS, INC.****AND L-3 COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(in millions, except share data)**

	(Unaudited) March 29, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 276	\$ 349
Billed receivables, net of allowances of \$30 in 2013 and \$33 in 2012	1,108	968
Contracts in process	2,748	2,652
Inventories	347	363
Deferred income taxes	85	95
Other current assets	126	144
Total current assets	4,690	4,571
Property, plant and equipment, net	998	1,017
Goodwill	7,720	7,744
Identifiable intangible assets	304	314
Deferred debt issue costs	28	29
Other assets	140	151
Total assets	\$ 13,880	\$ 13,826
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable, trade	\$ 595	\$ 494
Accrued employment costs	568	551
Accrued expenses	417	462
Advance payments and billings in excess of costs incurred	579	671
Income taxes	10	21
Other current liabilities	398	398
Total current liabilities	2,567	2,597
Pension and postretirement benefits	1,367	1,360
Deferred income taxes	371	328
Other liabilities	358	373
Long-term debt	3,629	3,629
Total liabilities	8,292	8,287
Commitments and contingencies (see Note 17)		
Equity:		
L-3 shareholders' equity:		

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L-3 Communications Holdings, Inc. s common stock: \$.01 par value; 300,000,000 shares authorized, 90,210,105 shares outstanding at March 29, 2013 and 90,433,743 shares outstanding at December 31, 2012 (L-3 Communications Corporation s common stock: \$.01 par value, 100 shares authorized, issued and outstanding)	5,367	5,314
L-3 Communications Holdings, Inc. s treasury stock (at cost), 58,990,317 shares at March 29, 2013 and 57,418,645 shares at December 31, 2012	(4,610)	(4,488)
Retained earnings	5,334	5,191
Accumulated other comprehensive loss	(578)	(554)
Total L-3 shareholders equity	5,513	5,463
Noncontrolling interests	75	76
Total equity	5,588	5,539
Total liabilities and equity	\$ 13,880	\$ 13,826

See notes to unaudited condensed consolidated financial statements

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	First Quarter Ended	
	March 29, 2013	March 30, 2012
Net sales:		
Products	\$ 1,813	\$ 1,746
Services	1,372	1,414
Total net sales	3,185	3,160
Cost of sales:		
Products	1,620	1,546
Services	1,252	1,289
Total cost of sales	2,872	2,835
Operating income	313	325
Interest expense	(43)	(45)
Interest and other income, net	3	3
Income from continuing operations before income taxes	273	283
Provision for income taxes	79	96
Income from continuing operations	194	187
Income from discontinued operations, net of income tax		16
Net income	\$ 194	\$ 203
Less: Net income attributable to noncontrolling interests	1	2
Net income attributable to L-3	\$ 193	\$ 201
Basic earnings per share attributable to L-3 Holdings common shareholders:		
Continuing operations	\$ 2.14	\$ 1.88
Discontinued operations		0.15
Basic earnings per share	\$ 2.14	\$ 2.03
Diluted earnings per share attributable to L-3 Holdings common shareholders:		
Continuing operations	\$ 2.11	\$ 1.86
Discontinued operations		0.15
Diluted earnings per share	\$ 2.11	\$ 2.01
Cash dividends paid per common share	\$ 0.55	\$ 0.50
L-3 Holdings weighted average common shares outstanding:		
Basic	90.3	99.0

Diluted

91.5

100.2

See notes to unaudited condensed consolidated financial statements

L-3 COMMUNICATIONS HOLDINGS, INC.**AND L-3 COMMUNICATIONS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(in millions)**

	First Quarter Ended	
	March 29, 2013	March 30, 2012
Net income	\$ 194	\$ 203
Other comprehensive (loss) income:		
Foreign currency translation adjustments	(34)	29
Unrealized (losses) gains on hedging instruments ⁽¹⁾	(3)	3
Pension and postretirement benefit plans:		
Amortization of net loss and prior service cost previously recognized ⁽²⁾	13	11
Total other comprehensive (loss) income:	(24)	43
Comprehensive income	170	246
Less: Comprehensive income attributable to noncontrolling interests	1	2
Comprehensive income attributable to L-3	\$ 169	\$ 244

⁽¹⁾ Amounts are net of an income tax benefit of \$2 million and income taxes of \$2 million for the quarterly periods ended March 29, 2013 and March 30, 2012, respectively.

⁽²⁾ Amounts are net of income taxes of \$9 million and \$6 million for the quarterly periods ended March 29, 2013 and March 30, 2012, respectively.

See notes to unaudited condensed consolidated financial statements

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(in millions, except per share data)

	L-3 Holdings Common Stock		Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Noncontrolling Interests	Total Equity
	Shares Outstanding	Par Value						
For the Quarter ended March 29, 2013:								
Balance at December 31, 2012	90.4	\$ 1	\$ 5,313	\$ (4,488)	\$ 5,191	\$ (554)	\$ 76	\$ 5,539
Net income					193		1	194
Other comprehensive loss						(24)		(24)
Distributions to noncontrolling interests							(2)	(2)
Cash dividends paid on common stock (\$0.55 per share)					(50)			(50)
Shares issued:								
Employee savings plans	0.5		37					37
Exercise of stock options	0.3		16					16
Employee stock purchase plan	0.3							
Stock-based compensation expense			14					14
Treasury stock purchased	(1.6)			(122)				(122)
Other	0.3		(14)					(14)
Balance at March 29, 2013	90.2	\$ 1	\$ 5,366	\$ (4,610)	\$ 5,334	\$ (578)	\$ 75	\$ 5,588
For the Quarter ended March 30, 2012:								
Balance at December 31, 2011	99.0	\$ 1	\$ 5,063	\$ (3,616)	\$ 5,641	\$ (454)	\$ 89	\$ 6,724
Net income					201		2	203
Other comprehensive income						43		43
Distributions to noncontrolling interests							(3)	(3)
Cash dividends paid on common stock (\$0.50 per share)					(49)			(49)
Shares issued:								
Employee savings plans	0.6		38					38
Exercise of stock options	0.1		6					6
Employee stock purchase plan	0.4							
Stock-based compensation expense			14					14
Treasury stock purchased	(2.0)			(138)				(138)
Other	0.1				(1)			(1)
Balance at March 30, 2012	98.2	\$ 1	\$ 5,121	\$ (3,754)	\$ 5,792	\$ (411)	\$ 88	\$ 6,837

See notes to unaudited condensed consolidated financial statements

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	First Quarter Ended	
	March 29, 2013	March 30, 2012
Operating activities:		
Net income	\$ 194	\$ 203
Less: Income from discontinued operations, net of tax		16
Income from continuing operations	194	187
Depreciation of property, plant and equipment	42	42
Amortization of intangibles and other assets	12	13
Deferred income tax provision	19	20
Stock-based employee compensation expense	14	13
Contributions to employee savings plans in L-3 Holdings common stock	32	34
Amortization of pension and postretirement benefit plans net loss and prior service cost	22	17
Amortization of bond discounts and deferred debt issue costs (included in interest expense)	2	2
Other non-cash items	3	(1)
Changes in operating assets and liabilities, excluding amounts from acquisitions, divestitures and discontinued operations:		
Billed receivables	(146)	(4)
Contracts in process	(106)	(131)
Inventories	13	(39)
Accounts payable, trade	105	97
Accrued employment costs	13	(17)
Accrued expenses	(35)	(120)
Advance payments and billings in excess of costs incurred	(85)	19
Income taxes	51	62
Excess income tax benefits related to share-based payment arrangements	(2)	(1)
Other current liabilities	1	(8)
Pension and postretirement benefits	4	(30)
All other operating activities	(7)	(35)
Net cash from operating activities from continuing operations	146	120
Investing activities:		
Business acquisitions, net of cash acquired		(205)
Capital expenditures	(49)	(27)
Dispositions of property, plant and equipment	1	
Other investing activities	(6)	(2)
Net cash used in investing activities from continuing operations	(54)	(234)
Financing activities:		
Borrowings under revolving credit facility	477	16
Repayment of borrowings under revolving credit facility	(477)	(16)
Common stock repurchased	(122)	(138)
Dividends paid on L-3 Holdings common stock	(52)	(49)
Proceeds from exercises of stock options	18	6
Proceeds from employee stock purchase plan	9	12
Debt issue costs		(6)
Excess income tax benefits related to share-based payment arrangements	2	1
Other financing activities	(13)	(5)
Net cash used in financing activities from continuing operations	(158)	(179)

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Effect of foreign currency exchange rate changes on cash and cash equivalents	(7)	5
Cash from discontinued operations:		
Operating activities		17
Cash from discontinued operations		17
Net decrease in cash and cash equivalents	(73)	(271)
Cash and cash equivalents, beginning of the period	349	764
Cash and cash equivalents, end of the period	\$ 276	\$ 493

See notes to unaudited condensed consolidated financial statements

L-3 COMMUNICATIONS HOLDINGS, INC.

AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

1. Description of Business

L-3 Communications Holdings, Inc. derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, Command, Control, Communications (C³) systems, platform and logistics solutions for aircrafts, maritime vessels and ground vehicles, and national security solutions. L-3 is also a leading provider of a broad range of electronic systems used on military and commercial platforms. The Company's customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), allied international governments, and domestic and international commercial customers.

The Company has the following four reportable segments: (1) C³ISR, (2) Electronic Systems, (3) Platform & Logistics Solutions (P&LS) (formerly Aircraft Modernization and Maintenance) and (4) National Security Solutions (NSS). Financial information with respect to each of the Company's segments is included in Note 21. ISR provides products and services for the global ISR market, C³ systems, networked communication systems and secure communications products. The Company believes 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. Electronic Systems provides a broad range of products and services, including components, products, subsystems and systems and related services to military and commercial customers in several niche markets across several business areas. These business areas include microwave, power & control systems, marine systems international, sensor systems, simulation & training, aviation products, precision engagement, warrior systems, security & detection, space & propulsion, undersea warfare and marine services. P&LS provides modernization, upgrades and sustainment, maintenance and logistics support solutions for military and various government aircraft and other platforms. The Company sells these services primarily to the DoD, the Canadian Department of National Defence and other allied international governments. NSS provides a full range of cyber security, intelligence, enterprise information technology (IT) and security solutions services to the DoD, U.S. Government intelligence agencies, federal civilian agencies and allied international governments.

2. Basis of Presentation

These unaudited condensed consolidated financial statements for the quarterly period ended March 29, 2013 should be read in conjunction with the audited consolidated financial statements of L-3 Holdings and L-3 Communications included in their Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Principles of Consolidation and Reporting

The accompanying financial statements comprise the consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings only asset is its investment in the common stock of L-3 Communications, its wholly-owned subsidiary, and its only obligations are: (1) the 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 Amended and Restated Revolving 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. Accordingly, such debt has been reflected as debt of L-3 Communications in its consolidated financial statements in accordance with the accounting standards for

L-3 COMMUNICATIONS HOLDINGS, INC.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

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

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. The December 31, 2012 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year.

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

Accounting Estimates

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

Sales and profits on contracts that are covered by accounting standards for construction-type and production-type contracts and federal government contractors are recognized using percentage-of-completion (POC) methods of accounting. Approximately 48% of the Company's net sales in 2012 were accounted for under contract accounting standards, of which, approximately 39% were fixed-price type contracts and approximately 9% were cost-plus type contracts. For contracts accounted for under contract accounting standards, sales and profits are recognized based on: (1) a POC method of accounting (fixed-price contracts), (2) allowable costs incurred plus the estimated profit on those costs (cost-plus contracts), or (3) direct labor hours expended multiplied by the contractual fixed rate per hour plus incurred costs for material (time-and-material contracts). Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the units-of-delivery method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to total estimated costs at

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

completion of the contract multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the cost-to-cost method). Under both POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

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

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

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

Revisions or adjustments to estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained, as facts and circumstances change and as new information is obtained, even though the scope of work required under the contract may not change. Revisions or adjustments may also be required if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to POC accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. The revisions in contract estimates, if significant, can materially affect the Company's results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates increased consolidated operating income by \$10 million, or 3%, for the quarterly period ended March 29, 2013 and \$19 million, or 6%, for the quarterly period ended March 30, 2012.

For a more complete discussion of these estimates and assumptions, see the Annual Report of L-3 Holdings and L-3 Communications on Form 10-K for the fiscal year ended December 31, 2012.

3. New Accounting Standards

Effective January 1, 2013, the Company adopted a new accounting standard issued by the Financial Accounting Standards Board (FASB), which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income (loss) (AOCI). This standard requires entities to disclose additional information about reclassification adjustments, including: (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI. The adoption of this standard resulted in additional disclosures of items reclassified out of AOCI and did not impact the Company's financial position, results of operations or cash flows. See Note 11 for these additional disclosures.

L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

4. Dispositions and Acquisitions**2012 Spin-off of Engility**

The Company completed the spin-off of its subsidiary, Engility Holdings, Inc. (Engility), to its shareholders on July 17, 2012. L-3 incurred transaction expenses in connection with the spin-off of \$6 million (\$5 million after income taxes) for the quarterly period ended March 30, 2012, which have been included in discontinued operations. In addition, L-3 allocated interest expense for debt not directly attributable or related to L-3's other operations of \$6 million to discontinued operations for the quarterly period ended March 30, 2012. Interest expense was allocated in accordance with the accounting standards for discontinued operations and was based on the ratio of Engility net assets to the sum of: (1) total L-3 consolidated net assets and (2) L-3 consolidated total debt.

Statement of operations data classified as discontinued operations related to Engility is provided in the table below:

	First Quarter Ended March 30, 2012 (in millions)
Product and service revenues	\$ 428
Operating income from discontinued operations before income taxes	32
Interest expense allocated to discontinued operations	(6)
Income from discontinued operations before income taxes	\$ 26
Income tax expense	10
Income from discontinued operations, net of income tax	\$ 16
Less: Net income from discontinued operations attributable to noncontrolling interests	1
Net income from discontinued operations attributable to L-3	\$ 15

2012 Business Acquisitions

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

During the year ended December 31, 2012, in separate transactions, the Company acquired: (1) the Kollmorgen Electro-Optical (L-3 KEO) business, (2) the assets and liabilities of MAVCO, Inc. (MAVCO), and (3) the commercial aircraft simulation business of Thales Group which was renamed by L-3, Link Simulation & Training U.K. Limited (Link U.K.), for an aggregate purchase price of \$349 million. All business acquisitions were financed with cash on hand. Based on the purchase price allocations, the aggregate goodwill recognized for these acquired businesses was \$250 million, of which \$149 million is expected to be deductible for income tax purposes. The goodwill recognized for these three acquired businesses was assigned to the Electronic Systems segment.

The purchase price and purchase price allocation for MAVCO was finalized as of December 31, 2012, with no significant changes from the preliminary amounts. The purchase price and final purchase price allocation for L-3 KEO is subject to adjustment based on the closing date net working capital and is expected to be completed in the second quarter of 2013. The final purchase price and price allocation for Link U.K. is expected to be completed by the second quarter of 2013. The final purchase price and price allocation for the Link U.K. acquisition is subject to adjustment based on the closing date net working capital, final appraisals and other analysis of fair values of acquired assets and liabilities. The

Company does not expect that differences between

L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

the preliminary and final purchase price allocations for the L-3 KEO and Link U.K. acquisitions will have a material impact on its results of operations or financial position.

Unaudited Pro Forma Statement of Operations Data

The following unaudited pro forma Statement of Operations data presents the combined results of the Company and its business acquisitions completed during the year ended December 31, 2012, in each case assuming that the business acquisitions completed during the year ended December 31, 2012 had occurred on January 1, 2012.

	First Quarter Ended March 30, 2012
Pro forma net sales	\$ 3,206
Pro forma income from continuing operations	\$ 187
Pro forma net income attributable to L-3	\$ 201
Pro forma diluted earnings per share from continuing operations	\$ 1.86
Pro forma diluted earnings per share	\$ 2.01

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2012.

5. Contracts in Process

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

	March 29, 2013	December 31, 2012
	(in millions)	
Unbilled contract receivables, gross	\$ 2,863	\$ 2,874
Unliquidated progress payments	(1,162)	(1,265)
Unbilled contract receivables, net	1,701	1,609
Inventoried contract costs, gross	1,110	1,111
Unliquidated progress payments	(63)	(68)
Inventoried contract costs, net	1,047	1,043
Total contracts in process	\$ 2,748	\$ 2,652

Inventoried Contract Costs. In accordance with contract accounting standards, the Company's U.S. Government contractor businesses account for the portion of their general and administrative (G&A), independent research and development (IRAD) and bids and proposal (B&P) costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on their U.S. Government contracts (revenue arrangements) as inventoried contract costs. G&A, IRAD and B&P costs are allocated to contracts for which the U.S. Government is

the end customer and are charged to costs of sales when sales on the related contracts are recognized. The Company's U.S. Government contractor businesses record the unallowable portion of their G&A, IRAD and B&P costs to expense as incurred, and do not include them in inventoried contract costs.

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

	First Quarter Ended	
	March 29, 2013	March 30, 2012
	(in millions)	
Amounts included in inventoried contract costs at beginning of the period	\$ 110	\$ 91
Add: IRAD and B&P costs	73	82
Other G&A costs	205	213
Total contract costs incurred	278	295
Less: Amounts charged to cost of sales	(275)	(286)
Amounts included in inventoried contract costs at end of the period	\$ 113	\$ 100

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

	First Quarter Ended	
	March 29, 2013	March 30, 2012
	(in millions)	
Selling, general and administrative expenses	\$ 72	\$ 70
Research and development expenses	20	21
Total	\$ 92	\$ 91

6. Inventories

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

	March 29, 2013	December 31, 2012
	(in millions)	
Raw materials, components and sub-assemblies	\$ 155	\$ 168
Work in process	124	124
Finished goods	68	71

Total	\$ 347	\$ 363
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7. Goodwill and Identifiable Intangible Assets

Goodwill. In accordance with the accounting standards for business combinations, the Company records the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). The table below presents the changes in goodwill by segment for the quarter period ended March 29, 2013.

	C ³ ISR	Electronic Systems	P&LS (in millions)	NSS	Consolidated Total
Balance at December 31, 2012	\$ 797	\$ 4,804	\$ 1,175	\$ 968	\$ 7,744
Foreign currency translation adjustments ⁽¹⁾		(18)	(5)	(1)	(24)
Balance at March 29, 2013	\$ 797	\$ 4,786	\$ 1,170	\$ 967	\$ 7,720

⁽¹⁾ The decreases in goodwill presented in the Electronic Systems, P&LS and NSS segments were primarily due to the strengthening of the U.S. dollar against the Euro, Canadian dollar and British pound during the quarter ended March 29, 2013.

Identifiable Intangible Assets. Information on the Company's identifiable intangible assets that are subject to amortization is presented in the table below.

	Weighted Average Amortization Period (in years)	March 29, 2013			December 31, 2012		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
(in millions)							
Customer contractual relationships	19	\$ 459	\$ 232	\$ 227	\$ 460	\$ 225	\$ 235
Technology	11	164	100	64	164	98	66
Other	17	27	14	13	27	14	13
Total	17	\$ 650	\$ 346	\$ 304	\$ 651	\$ 337	\$ 314

Amortization expense recorded by the Company for its identifiable intangible assets is presented in the table below.

First Quarter Ended	
March 29, 2013	March 30, 2012

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Amortization Expense	\$ 9	\$ 11
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Based on gross carrying amounts at March 29, 2013, the Company's estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2013 through 2017 are presented in the table below.

	2013	Year Ending December 31, (in millions)			2017
		2014	2015	2016	
Estimated amortization expense	\$ 38	\$ 42	\$ 37	\$ 31	\$ 29

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8. Other Current Liabilities and Other Liabilities

The table below presents the components of other current liabilities.

	March 29, 2013	December 31, 2012
	(in millions)	
Other Current Liabilities:		
Accruals for pending and threatened litigation (see Note 17)	\$ 10	\$ 7
Accrued product warranty costs	73	75
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	86	92
Accrued interest	47	53
Deferred revenues	39	37
Estimated contingent purchase price payable for acquired businesses	4	4
Other	139	130
Total other current liabilities	\$ 398	\$ 398

The table below presents the components of other liabilities.

	March 29, 2013	December 31, 2012
	(in millions)	
Other Liabilities:		
Non-current income taxes payable (see Note 10)	\$ 140	\$ 137
Deferred compensation	46	43
Accrued workers' compensation	55	57
Estimated contingent purchase price payable for acquired businesses	5	5
Notes payable and capital lease obligations	22	24
Accrued product warranty costs	18	18
Other	72	89
Total other liabilities	\$ 358	\$ 373

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

	First Quarter Ended March 29, 2013	March 30, 2012
	(in millions)	
Accrued product warranty costs:⁽¹⁾		

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Balance at January 1	\$ 93	\$ 94
Acquisitions during the period		2
Accruals for product warranties issued during the period	19	16
Settlements made during the period	(20)	(17)
Foreign currency translation adjustments	(1)	1
Balance at end of period	\$ 91	\$ 96

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

9. Debt

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

	March 29, 2013	December 31, 2012
	(in millions)	
L-3 Communications:		
Borrowings under Amended and Restated Revolving Credit Facility ⁽¹⁾	\$	\$
3.95% Senior Notes due 2016	500	500
5.20% Senior Notes due 2019	1,000	1,000
4.75% Senior Notes due 2020	800	800
4.95% Senior Notes due 2021	650	650
Subtotal	2,950	2,950
L-3 Holdings:		
3% Convertible Contingent Debt Securities due 2035 ⁽²⁾	689	689
Principal amount of long-term debt	3,639	3,639
Less: Unamortized discounts	(10)	(10)
Carrying amount of long-term debt	\$ 3,629	\$ 3,629

(1) At March 29, 2013, L-3 Communications had the availability of substantially all of its \$1 billion Amended and Restated Revolving Credit Facility, which expires on February 3, 2017.

(2) Under select conditions, including if L-3 Holdings' common stock price is more than 120% (currently \$109.45) of the then current conversion price (currently \$91.21) for a specified period, the conversion feature of the CODES will require L-3 Holdings, upon conversion, to pay the holders of the CODES the principal amount in cash, and if the settlement amount exceeds the principal amount, the excess will be settled in cash or stock or a combination thereof, at the Company's option. At the current conversion price of \$91.21, the aggregate consideration to be delivered upon conversion would be determined based on 7.6 million shares of L-3 Holdings' common stock. See Note 10 to the audited consolidated financial statements for the year ended December 31, 2012, included in the Company's Annual Report on Form 10-K for additional information regarding the CODES, including conditions for conversion. L-3 Holdings' closing stock price on May 3, 2013 was \$83.42 per share. Interest expense recognized was \$5 million for both quarterly periods ended March 29, 2013 and

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March 30, 2012. A portion of this interest expense was allocated to discontinued operations for the quarterly period ended March 30, 2012 as a result of the spin-off of Engility. The carrying amount of the equity component (conversion feature) of the CODES was \$64 million at March 29, 2013 and December 31, 2012.

10. Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. As of March 29, 2013, the st