

ROCKWELL COLLINS INC
Form 10-K
November 15, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

R ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2016

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

Commission file number 001-16445

Rockwell Collins, Inc.
(Exact name of registrant as specified in its charter)
Delaware 52-2314475
(State or other jurisdiction (I.R.S. Employer
of incorporation or organization) Identification No.)

400 Collins Road NE
Cedar Rapids, Iowa 52498
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (319) 295-1000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.01 per share	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes R No £

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes £ No R

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 R 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 Regulations S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes R No £

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

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

Large accelerated filer R

Accelerated filer £

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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 R

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant on April 1, 2016 was approximately \$12.07 billion. For purposes of this calculation, the registrant has assumed that its directors and executive officers are affiliates.

130,256,671 shares of the registrant's Common Stock were outstanding on October 31, 2016.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information contained in the Proxy Statement for the Annual Meeting of Shareowners of the registrant to be held on February 2, 2017 is incorporated by reference into Part III.

ROCKWELL COLLINS, INC.

Annual Report on Form 10-K

Table of contents

	Page No.
<u>PART I</u>	
<u>Item 1. Business</u>	<u>1</u>
<u>Item 1A. Risk Factors</u>	<u>9</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>15</u>
<u>Item 2. Properties</u>	<u>15</u>
<u>Item 3. Legal Proceedings</u>	<u>16</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>17</u>
<u>Item 4A. Executive Officers of the Company</u>	<u>17</u>
<u>PART II</u>	
<u>Item 5. Market for the Company's Common Equity, Related Stockholder Matters and Company Purchases of Equity Securities</u>	<u>18</u>
<u>Item 6. Selected Financial Data</u>	<u>19</u>
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>47</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>49</u>
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>99</u>
<u>Item 9A. Controls and Procedures</u>	<u>99</u>
<u>Item 9B. Other Information</u>	<u>101</u>
<u>PART III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>101</u>
<u>Item 11. Executive Compensation</u>	<u>101</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>101</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>102</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>102</u>
<u>PART IV</u>	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	<u>103</u>

SIGNATURES
EXHIBIT INDEX

S-1
S-2

i

PART I

Item 1. Business.

General

Rockwell Collins, Inc. designs, produces and supports communications and aviation systems for commercial and military customers and provides information management services through voice and data communication networks and solutions worldwide. The integrated system solutions and products we provide to our served markets are oriented around a set of core competencies: communications, navigation, automated flight control, displays/surveillance, simulation and training, integrated electronics and information management systems. We also provide a wide range of services and support to our customers through a worldwide network of service centers, including equipment repair and overhaul, service parts, field service engineering, training, technical information services and aftermarket used equipment sales. The structure of our business allows us to leverage these core competencies across markets and applications to bring high value solutions to customers. We operate in multiple countries and are headquartered in Cedar Rapids, Iowa.

We entered into an agreement on October 23, 2016 to acquire B/E Aerospace for \$8.3 billion in total consideration, which is expected to close in the spring of 2017 subject to various closing conditions. B/E Aerospace is a leading manufacturer of aircraft cabin interior products. We believe this transformative transaction will accelerate growth and strengthen our position as a leading supplier of cockpit and cabin solutions, as well as diversify and balance our portfolio across aircraft manufacturers, airlines and aftermarket. See Note 23 of the Notes to Consolidated Financial Statements in Item 8 below for additional discussion.

Our Company's heritage is rooted in the Collins Radio Company, established in 1933. Rockwell Collins, Inc., the parent company, is incorporated in Delaware. As used herein, the terms "we", "us", "our", "Rockwell Collins" or the "Company" include subsidiaries and predecessors unless the context indicates otherwise.

Whenever reference is made in any Item of this Annual Report on Form 10-K to information in our Proxy Statement for the Annual Meeting of Shareowners to be held on February 2, 2017 (2017 Proxy Statement), such information shall be deemed to be incorporated herein by such reference.

All date references contained herein relate to our fiscal year ending on the Friday closest to September 30 unless otherwise stated. For ease of presentation, September 30 is utilized consistently throughout this report to represent the fiscal year end date. Fiscal year 2016 and 2015 were 52-week fiscal years, while 2014 was a 53-week fiscal year.

Financial Information About Our Operating Segments

Financial information with respect to our operating segments, including product line disclosures, revenues, operating earnings and total assets, is contained under the caption Segment Financial Results in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below and in Note 21 of the Notes to Consolidated Financial Statements in Item 8 below.

Access to the Company's Reports and Governance Information

We maintain an internet website at www.rockwellcollins.com. Our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on this site as soon as reasonably practicable after the reports are filed with or furnished to the Securities and Exchange Commission

(SEC). All reports we file with the SEC are also available free of charge via EDGAR through the SEC website at www.sec.gov. We also post corporate governance information (including our corporate governance guidelines and Board committee charters) and other information related to our Company on our internet website where it is available free of charge. We will provide, without charge, upon written request, copies of our SEC reports and corporate governance information. Our internet website and the information contained therein or connected thereto are not incorporated into this Annual Report on Form 10-K.

Description of Business by Segment

We serve a worldwide customer base through our Commercial Systems, Government Systems and Information Management Services operating segments. These three segments are described in detail below.

Commercial Systems

Our Commercial Systems segment supplies aviation electronics systems, products and services to customers located throughout the world. The customer base is comprised of original equipment manufacturers (OEMs) of commercial air transport, business and regional aircraft, commercial airlines and business aircraft operators. Our systems and products are used in both OEM applications as well as in retrofit and upgrade applications designed to increase the efficiency and enhance the value of existing aircraft.

Our commercial aviation electronics systems, products and services include:

- integrated avionics systems, such as Pro Line Fusion®, which provide advanced avionics capabilities to meet the challenges of operating in the next generation global airspace. Pro Line Fusion® capabilities include; touch control primary flight displays, advanced flight and performance management, flight guidance and information management
- integrated cabin electronics solutions, including cabin management systems with touch-screen controls, wireless connectivity, high definition video and audio, and entertainment and information content such as Airshow moving maps
- communications systems and products, such as data link, high frequency (HF), very high frequency (VHF) and satellite communications systems
- navigation systems and products, including landing sensors to enable fully automatic landings, radio navigation and geophysical sensors, as well as flight management systems
- situational awareness and surveillance systems and products, such as synthetic and enhanced vision systems, surface surveillance and guidance solutions, head-up guidance systems, weather radar and collision avoidance systems
- integrated flight controls including fly-by-wire, advanced flight guidance with auto-land capability, pilot controls, and primary and secondary electro-mechanical actuation
- simulation and training systems, including full-flight simulators for crew training, visual system products, training systems and engineering services
- maintenance, repair, parts, after-sales support services and aftermarket used equipment

Commercial Systems sales are categorized into air transport aviation electronics and business and regional aviation electronics. Product category sales are delineated based upon the difference in the underlying customer base, size of aircraft and markets served.

Air transport aviation electronics include avionics, cabin systems and flight control systems for large commercial transport aircraft platforms. We design these items as sub-systems and work with OEMs to integrate with other suppliers' products into the flight deck and broader aircraft systems. Our products offered for OEM applications in the air transport category are marketed directly to aircraft OEMs and airline operators, while our products offered for aftermarket applications are primarily marketed to the airline operators.

Business and regional aviation electronics include integrated avionics, cabin management and flight control systems for application on regional and business aircraft platforms. We develop integrated avionics, cabin and flight control solutions for business and regional aircraft OEMs and support them with integration into other aircraft systems.

Products offered for OEM applications in the business and regional aircraft category are marketed directly to the aircraft OEMs. Products offered for aftermarket applications are primarily marketed through distributors for business aviation and directly to regional airline operators.

Government Systems

Our Government Systems segment provides a broad range of electronic products, systems and services to customers including the U.S. Department of Defense, various ministries of defense, other government agencies and defense contractors around the world. Our defense electronic solutions are designed to meet a wide range of customer requirements, but tend to share certain characteristics including design for rugged environments and use in size, weight and power constrained applications. These applications also typically have stringent product integrity and certification requirements with a high degree of customer oversight. These products, systems and services support airborne, precision weapon, ground and maritime applications on new equipment as well as in retrofit and upgrade applications designed to extend the service life and enhance the capability of existing aircraft, vehicle and weapon platforms.

Our defense-related systems, products and services include:

- communications systems and products designed to enable the transmission of information across the communications spectrum

- navigation products and systems, including radio navigation products, global positioning system (GPS) equipment and multi-mode receivers

- avionics systems for aircraft flight decks, including cockpit display products (multipurpose flat panel head-down displays, wide field of view head-up and helmet-mounted displays), flight controls, information/data processing and communications, navigation, safety and surveillance systems

- precision targeting, electronic warfare and range and training systems

- simulation and training systems, including visual system products, training systems and services

- space wheels for satellite stabilization

- maintenance, repair, parts, after-sales support services and aftermarket used equipment

Beginning in 2016, product category sales for Government Systems have been consolidated as a result of an internal reorganization and are delineated based upon underlying product technologies. The previously reported sales categories of Communication products, Surface solutions and Navigation products are now primarily consolidated into Communication and navigation.

Avionics consists of electronic solutions for a broad range of airborne platforms including fixed wing aircraft and military and civil rotary wing aircraft, unmanned aerial systems (UASs) and the associated aircrew and maintenance training devices and services. We provide complete avionics solutions, including cockpit avionics, mission system applications and system integration, and also provide individual avionics products to platform integrators. We serve various roles within these markets including system and sub-systems integrator as well as provider of various electronic products. For the UAS market we provide cost effective, high performance integrated flight control, navigation, communication and sensor capabilities. Simulation and training solutions are provided for both fixed and rotary wing aircraft.

Communication and navigation products include full spectrum communication solutions for voice and data connectivity for government and military use in the air, on the ground and at sea. These communication products support military user requirements for high availability, highly secure, jam resistant wireless communication. Products

include radio communication, data links, electronic warfare and networked communication systems. The navigation products are primarily comprised of global positioning system based products used for precision navigation and targeting applications. These applications include airborne, vehicular, maritime, soldier navigation devices, precision targeting subsystems, precision-guided weapons products, range and training systems and a variety of embedded GPS applications.

Information Management Services

Our Information Management Services segment was formed with the December 2013 acquisition of ARINC Incorporated (ARINC) and provides communications services, systems integration and security solutions across the aviation, airport, rail and nuclear security markets to customers located around the world. The customer base includes commercial airlines, business aircraft operators, the U.S. Federal Aviation Administration (FAA), airport and critical infrastructure operators and major passenger and freight railroads.

Our information management services include:

- voice and data communication services, such as air-to-ground GLOBALinkSM and ground-to-ground AviNet[®] services, which enable satellite, VHF and HF transmissions between the cockpit, air traffic control, airline operation centers, reservation systems and other third parties ensuring safety and efficiency for commercial airlines and other related entities in the aviation ecosystem
- around the clock global flight support services for business aircraft operators, under the ARINC DirectSM brand, including flight planning and datalink, international trip support, cabin connectivity solutions and flight operations management software
- airport communications and information systems designed to ease congestion and improve airport efficiency via airline agent and self-service check-in, airport operations, baggage management, boarding and access control solutions
- train dispatching and information systems including solutions to support positive train control as mandated by the 2008 Railroad Safety Improvement Act
- mission critical security command and control systems for nuclear power facilities with functions such as intrusion detection, access control, video and credential management and vehicle identification
- global, high throughput cabin connectivity solutions enabling airlines to provide an enhanced experience for their passengers and improved operational efficiency for crews

Customers, Sales and Marketing

We serve a broad range of customers worldwide, including the U.S. Department of Defense, U.S. Coast Guard, civil agencies, airports, defense contractors, foreign ministries of defense, manufacturers of commercial helicopters, manufacturers of commercial air transport, business and regional aircraft, commercial airlines, fractional and other business jet operators, the FAA, critical infrastructure operators and major passenger and freight railroads. We market our systems, products and services directly to our customers through an internal marketing and sales force. In addition, we utilize a worldwide dealer network to distribute our products and international sales representatives to assist with international sales and marketing. In 2016, various branches of the U.S. Government, both directly and indirectly through subcontracts, accounted for 33 percent of our total sales.

Our largest customers have substantial bargaining power with respect to price and other commercial terms. Although we believe that we generally enjoy good relations with our customers, the loss of all or a substantial portion of our sales to any of our large volume customers for any reason, including the loss of contracts, bankruptcy, reduced or delayed customer requirements, strikes or other work stoppages affecting production by these customers, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Competition

We operate in a highly competitive environment. Principal competitive factors include total cost of ownership, product and system performance, network coverage, quality, service, warranty and indemnification terms, technology, design engineering capabilities, new product innovation and timely delivery. We compete worldwide with a number of U.S. and non-U.S. companies in each of our businesses. Many of these competitors are also our suppliers or customers on our programs. Some of our principal competitors include Honeywell International, Inc.; Thales S.A.; Panasonic; Raytheon Co.; Harris Corp.; BAE Systems Aerospace, Inc.; General Dynamics Corporation; L3 Communications, Inc.; The Boeing Company; Northrop Grumman Corp.; CAE Inc.; General Electric Co., Garmin International Inc.; SITA; Esterline Technologies Corp.; Elbit Systems Ltd., Satcom Direct, Inc. and FlightSafety International. Several of our competitors are significantly larger than we are in terms of resources and market share, and can offer a broader range of products. We believe that our systems, products and services are well positioned to compete in our served markets.

Industry consolidation has from time to time had a major impact on the competitive environment in which we operate. Our competitors periodically undertake mergers, alliances and realignments that contribute to a dynamic competitive landscape. We have contributed to this changing landscape in the past three years by completing a significant acquisition (ARINC), three smaller acquisitions and several strategic alliances to improve our competitive position and expand our market reach. In addition, on October 23, 2016 we entered into an agreement to acquire B/E Aerospace, which is expected to close in the spring of 2017 subject to various closing conditions. Additional information related to this acquisition is contained in Note 23 of the Notes to Consolidated Financial Statements in Item 8 below.

Raw Materials, Supplies and Working Capital

We believe we have adequate sources for the supply of raw materials and components for our manufacturing and service needs with suppliers located around the world. Electronic components and other raw materials used in the manufacturing of our products are generally available from several suppliers. We continue to work with our supply base for raw materials and components to ensure an adequate source of supply, utilizing strategic alliances, dual sourcing, identification of substitute or alternate parts that meet performance requirements and life-time buys. These life-time buys involve purchases of multiple years of supply in order to meet production and service requirements over the life span of a product. Although historically we have not experienced any significant difficulties in obtaining an adequate supply of raw materials and components necessary for our manufacturing operations or service needs, the loss of a significant supplier or the inability of a supplier to meet performance and quality specifications or delivery schedules could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our investment in inventory is a significant part of our working capital, and historically we have maintained sufficient inventory to meet our customers' requirements on a timely basis. This investment includes production stock, work-in-process, pre-production engineering costs, finished goods, spare parts and goods on consignment. Our accounts receivable also constitute a significant part of our working capital. Accounts receivable includes unbilled receivables which are primarily related to sales recorded under the percentage-of-completion method of accounting in accordance with applicable contract terms that have not been billed to customers. The critical accounting policies involving pre-production engineering costs, inventory valuation reserves and long-term contracts are discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below. Additional information relating to accounts receivable and inventory is contained in Notes 2, 5 and 6 of the Notes to Consolidated Financial Statements in Item 8 below.

Backlog

The following table summarizes our backlog:

	September 30	
(in billions)	2016	2015
Commercial Systems	\$ 2.2	\$ 2.1
Government Systems:		
Funded orders	2.5	2.5
Unfunded orders	0.7	0.5
Information Management Services	0.3	0.3
Total backlog	\$ 5.7	\$ 5.4

Our backlog represents the aggregate of the sales price of orders received from customers, but not recognized as revenue, and excludes unexercised options. Although we believe that the orders included in backlog are firm, most of our backlog orders can be modified or terminated by the customer. Our backlog at September 30, 2016 includes approximately \$2.9 billion of orders that are expected to be filled after 2017.

Joint Ventures

Joint ventures, strategic alliances, strategic investments and other cooperative arrangements are part of our business strategies to broaden the market for our products and develop new technologies.

We have a 50 percent ownership interest in each of the following:

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ACCEL (Tianjin) Flight Simulation Co., Ltd, a joint venture with Haite Group, for the joint development and production of commercial flight simulators in China

ADARI Aviation Technology Limited, a joint venture with Aviation Data Communication Corporation Co., LTD, operates remote ground stations around China and develops certain content delivery management software

AVIC Leihua Rockwell Collins Avionics Company, a joint venture with China Leihua Electronic Technology Research Institute, a subsidiary of the Aviation Industry Corporation of China (AVIC), which provides integrated surveillance system products for the C919 aircraft in China

5

Data Link Solutions LLC, a joint venture with BAE Systems, plc, for joint pursuit of the worldwide military data link market

ESA Vision Systems LLC, a joint venture with Elbit Systems, Ltd., for joint pursuit of helmet-mounted cueing systems for the worldwide military fixed wing aircraft market

Integrated Guidance Systems LLC, a joint venture with Honeywell International, Inc., for joint pursuit of the development of weapons guidance and navigation solutions

Quest Flight Training Limited, a joint venture with Quadrant Group, plc, which provides aircrew training services primarily for the United Kingdom Ministry of Defence

Rockwell Collins CETC Avionics Co., Ltd. a joint venture with CETC Avionics Co., Ltd. to develop and deliver products for the C919 program

Acquisitions and Dispositions

We regularly consider various business opportunities, including strategic acquisitions and alliances, licenses and marketing arrangements. We review the prospects of our existing businesses to determine whether any of them should be modified, sold or otherwise discontinued.

We completed four acquisitions in the past three years to augment our growth plans. These acquisitions were:

in February 2016, we acquired the Matrix series projector product line from Christie Digital Systems, a global visual, audio and collaboration solutions company

in August 2015, we acquired International Communications Group, Inc. (ICG), which provides satellite-based global voice and data communication products and services for the aviation industry

in March 2015, we acquired Pacific Avionics Pty. Limited (Pacific Avionics), which provides technologies used for wireless information distribution

in December 2013, we acquired ARINC, which provides communication services, systems integration and security solutions across the aviation, airport, rail, transit and nuclear security markets

We completed three divestitures in the past three years as part of our strategy to reshape our business and focus on opportunities in addressed markets for our core products and solutions. These divestitures were:

in March 2015, we divested ARINC's Aerospace Systems Engineering and Support business (ASES), which provided military aircraft integration and modifications, maintenance, logistics and support

in July 2014, we divested our satellite communication systems business formerly known as Datapath, Inc. (Datapath), which designed, manufactured and provided services for ground-based satellite communication systems (primarily for military applications)

in November 2013, we divested our Kaiser Optical Systems, Inc. (KOSI) subsidiary, which supplied spectrographic instrumentation and applied holographic technology

Additional information relating to our acquisitions, dispositions and joint ventures is contained in Notes 3, 4 and 8 of the Notes to Consolidated Financial Statements in Item 8 below.

In addition, on October 23, 2016 we entered into an agreement to acquire B/E Aerospace, which is expected to close in the spring of 2017 subject to various closing conditions. Additional information related to this acquisition is contained in Note 23 of the Notes to Consolidated Financial Statements in Item 8 below.

Research and Development

We have significant research, development, engineering and product design capabilities. At September 30, 2016, we employed approximately 6,300 engineers.

Our research and development (R&D) investment is as follows:

(in millions)	2016	2015	2014
Customer-funded ⁽¹⁾	\$621	\$578	504
Company-funded	224	272	268
Total research and development expense	845	850	772
Increase in pre-production engineering costs, net	128	136	162
Total research and development investment ⁽²⁾	\$973	\$986	\$934

⁽¹⁾ Customer-funded R&D includes activities relating to the development of new products and the improvement of existing products for which we are reimbursed by our customers. Customer-funded R&D also includes amortization of pre-production engineering costs as disclosed in Note 6 of the Notes to Consolidated Financial Statements in Item 8 below.

⁽²⁾ Total research and development investment consists of company- and customer-funded research and development expenditures as well as the net increase in pre-production engineering costs capitalized within inventory. As disclosed in Note 6 of the Notes to Consolidated Financial Statements in Item 8 below, pre-production engineering costs capitalized within inventory were \$1.140 billion and \$1.012 billion at September 30, 2016 and 2015, respectively. A description of the critical accounting policies involving pre-production engineering is included under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below.

Intellectual Property

Our intellectual property rights include valuable patents, trademarks, copyrights, trade secrets, inventions and other proprietary rights. We own numerous U.S. and foreign patents and have numerous pending patent applications, including patents and patent applications purchased in our acquisitions. We also license certain patents relating to our manufacturing and other activities. While in the aggregate we consider our patents and licenses important to the operation of our business, we do not consider any individual patent or license to be of such importance that the loss or termination of any one patent or license would materially affect us.

Rockwell Automation, Inc. (Rockwell) owns the "Rockwell" name. In connection with our spin-off from Rockwell in 2001, we were granted the exclusive right to continue to use the Rockwell Collins name for use in our business other than in connection with the Rockwell Automation business or industrial automation products. This exclusive right would terminate following certain change of control events applicable to us as described in our distribution agreement with Rockwell.

Employees

As of September 30, 2016, we had approximately 19,000 employees and approximately 80 percent of them were located in the U.S. Approximately 12 percent of our employees in the U.S. are covered by collective bargaining agreements. The collective bargaining agreements for most of our U.S. bargaining unit employees were renewed without disruption in 2013 and are set to expire in 2018. A collective bargaining agreement covering approximately 140 employees represented by the International Brotherhood of Teamsters expires in September 2017. In certain of our non-U.S. subsidiaries, many of our employees are represented by workers' councils or statutory labor unions. In general, we believe we have good employee relations.

Cyclicality and Seasonality

The avionics and communications markets in which we sell our products are, to varying degrees, cyclical and have experienced periodic upswings and downturns. For example, markets for our commercial aviation electronic products have experienced downturns during periods of slowdowns in the commercial airline industry and during periods of weak conditions in the economy in general, as demand for new aircraft generally declines during these periods. We believe that we are currently benefiting from robust backlogs in commercial air transportation and increasing content as next generation aircraft enter into service. While we believe our Government Systems business is well positioned, it is also subject to some cyclical, primarily as a result of U.S. Government defense budget cycles. Additional information related to the defense budget environment can be found under the caption Risk Factors in Item 1A below.

Our business tends to be seasonal with our fourth quarter usually producing relatively higher sales and cash flow and our first quarter usually producing relatively lower sales and cash flow. A large part of this seasonality variance is attributable to our Government Systems business and relates to the U.S. Government procurement cycle.

7

Regulatory Matters

As a defense contractor, our contract costs are audited and reviewed on a continual basis by the Defense Contract Management Agency and the Defense Contract Audit Agency. Audits and investigations are conducted from time to time to determine if our performance and administration of our U.S. Government contracts are compliant with applicable contractual requirements and procurement regulations and other applicable federal statutes and regulations. Under present U.S. Government procurement regulations, if indicted or adjudged in violation of procurement or other federal civil laws, a contractor, such as us, could be subject to fines, penalties, repayments or other damages. U.S. Government regulations also provide that certain findings against a contractor may lead to suspension or debarment from eligibility for awards of new U.S. Government contracts for up to three years. In addition, we are subject to various non-U.S. governmental contracting requirements.

The sale, installation and operation of our products in commercial aviation applications is subject to continued compliance with applicable regulatory requirements and future changes to those requirements. In the U.S., our commercial aviation products are required to comply with FAA regulations governing production and quality systems, airworthiness and installation approvals, repair procedures and continuing operational safety. Some of our products, such as radio frequency transmitters and receivers, must also comply with Federal Communications Commission (FCC) regulations governing authorization and operational approval of telecommunications equipment. Our communication services offered in the Information Management Services business are also subject to certain FCC regulations.

Internationally, similar requirements exist for communication services, airworthiness, installation and operational approvals. These requirements are administered by the national aviation authorities of each country and, in the case of Europe, coordinated by the European Joint Aviation Authorities. Many countries also impose specific telecommunications equipment requirements, administered through their national aviation authorities or telecommunications authorities. In Europe, approval to import products also requires compliance with European Commission directives, such as those associated with electrical safety, electro-magnetic compatibility, use of metric units of measurement and restrictions on the use of lead.

Products already in service may also become subject to mandatory changes for continued regulatory compliance as a result of any identified safety issue, which can arise from an aircraft accident, incident or service difficulty report.

Our products and technical data are controlled for export and import under various regulatory agencies. Audits and investigations by these agencies are a regular occurrence to ensure compliance with applicable federal statutes and regulations. Violations, including as a successor to an acquired business, can result in fines and penalties assessed against the Company as well as individuals, and the most egregious acts may result in a complete loss of export privileges.

Various anti-bribery and anti-corruption laws, as well as data privacy laws, are applicable to our business operations throughout the world.

Although we do not have any significant regulatory action pending against us, any such action could have a material adverse impact on our business, financial condition, results of operations and cash flows.

Environmental Matters

Federal, state and local requirements relating to the discharge of substances into the environment, the disposal of hazardous wastes and other activities affecting the environment have had and will continue to have an impact on our

manufacturing operations. To date, compliance with environmental requirements and resolution of environmental claims have been accomplished without material effect on our liquidity and capital resources, competitive position or financial condition. We believe that our expenditures for environmental capital investment and remediation necessary to comply with present regulations governing environmental protection and other expenditures for the resolution of environmental claims will not have a material adverse effect on our business or financial condition. Additional information on environmental matters is contained in Note 18 of the Notes to Consolidated Financial Statements in Item 8 below.

Geographic Information

Our principal markets outside the U.S. are in France, Canada, China, the United Kingdom, Germany, Brazil, Japan, Italy, South Korea, Singapore, United Arab Emirates, Australia, Hong Kong, Ireland and Spain. In addition to normal business risks, operations outside the U.S. are subject to other risks, including political, economic and social environments, governmental laws and regulations and currency revaluations and fluctuations.

Selected financial information by major geographic area for each of the three years in the period ended September 30, 2016 is contained in Note 21 of the Notes to Consolidated Financial Statements in Item 8 below.

Item 1A. Risk Factors.

Risks Related to Our Business/Industry:

Reduction in U.S. Government spending adversely impacts Government Systems sales and profitability.

In 2016, 33 percent of our sales were derived from U.S. Government contracts, both directly and indirectly through subcontracts. Defense funding by the U.S. Government is expected to continue to be under pressure due to the overall economic environment, budget deficits and competing budget priorities. Cost cutting, efficiency initiatives, reprioritization and other affordability analysis by the U.S. Government on defense spending could present some additional opportunities for us, but continued pressure on U.S. Government spending on defense could also adversely impact our Government Systems sales and profitability.

The U.S. Government has implemented various initiatives to address its fiscal challenges. In August 2011, Congress enacted the Budget Control Act (BCA) of 2011 which imposed spending caps and certain reductions in security spending over a ten-year period through 2021. These spending caps and reductions, referred to as sequestration, went into effect in March 2013. In December 2013, the Murray-Ryan Bipartisan Budget Act (BBA) of 2013 was enacted, raising government discretionary spending limits temporarily for 2014 and 2015.

More recently, the Bipartisan Budget Act of 2015 again raised the government discretionary spending limits temporarily for 2016 and 2017, after which the BCA will again be in force. The continued uncertainty surrounding the defense budget could have a material adverse effect on the Company and the defense industry in general.

Furthermore, in years when the U.S. Government does not complete its annual budget and appropriations process prior to the beginning of its fiscal year (October 1), government operations are typically funded through a continuing resolution that authorizes agencies of the U.S. Government to continue to operate in the new year, but generally does not authorize new spending initiatives. During periods covered by continuing resolutions (or until the regular appropriation bills are passed), we may experience delays by the government in procurement of new or existing products and services which can adversely impact our results of operations and cause variability in the timing of revenue between periods. The government began operations in fiscal years 2016 and 2017 under a continuing resolution.

We offer a diverse range of defense products and services. We believe that this makes it less likely that cuts in any specific contract or program will have a long-term effect on our business; however, delays or termination of multiple or large programs or contracts could adversely affect our business and future financial performance. Potential changes in funding priorities may afford new or additional opportunities for our businesses in terms of existing, follow-on or replacement programs. While we would expect to compete and be well positioned as the incumbent on existing programs, we may not be successful, and any replacement programs may be funded at lower levels.

We depend to a significant degree on U.S. Government contracts, which are subject to unique risks.

In addition to normal business risks, our supply of systems and products to the U.S. Government is subject to unique risks which are largely beyond our control. These risks include:

- dependence on Congressional appropriations and administrative allotment of funds

the ability of the U.S. Government to terminate, without prior notice, partially completed government programs and contracts that were previously authorized (although we may recover certain costs if terminated for convenience)

changes in governmental procurement legislation and regulations and other policies which may reflect military and political developments, including recent U.S. Government initiatives to gain increased access to intellectual property and to limit reimbursement of internal research and development as well as bid and proposal costs

significant changes in contract scheduling or program structure, which generally result in delays or reductions in deliveries

- intense competition for available U.S. Government business necessitating increases in time and investment for design and development

- difficulty of forecasting costs and schedules when bidding on developmental and highly sophisticated technical work

- changes over the life of U.S. Government contracts, particularly development contracts, which generally result in adjustments of contract prices

- claims based on U.S. Government work and violation of associated compliance and other requirements, which may result in fines, the cancellation or suspension of payments or suspension or debarment proceedings affecting potential further business with the U.S. Government

We are subject to risks arising from changes in the competitive environment in which we operate.

We operate in a highly competitive environment. Many of our competitors are also our suppliers or customers on our programs and may be significantly larger than us. Among others, risks in the competitive environment include:

- original equipment manufacturers' efforts to vertically integrate

- customers seeking more rights in intellectual property developed in connection with their program, price concessions, extensive liability protections and other customer favorable contract terms

- competitors offering lower prices and new solutions, developing new technologies or otherwise capturing more market share

International conflicts and terrorism may adversely affect our business.

International conflicts and political turmoil in the Middle East and elsewhere and the possibility of future terrorist attacks cause significant uncertainty with respect to business and financial markets and may adversely affect our business. These international conflicts also affect the price of oil, which has a significant impact on the financial health of our commercial customers. Although our Government Systems business may experience greater demand for its products as a result of increased government defense spending, factors arising (directly or indirectly) from international conflicts or terrorism which may adversely affect our commercial business include reduced aircraft build rates, upgrades, maintenance and spending on discretionary products such as in-flight entertainment, as well as increases in the cost of property and aviation products insurance and increased restrictions placed on our insurance policies.

Our business is heavily concentrated in the aviation industry.

As a provider of products and services to the aviation industry, we are significantly affected by the overall economic condition of that industry. The aviation industry is historically cyclical.

Our business, financial condition, results of operations and cash flows may be adversely impacted, among other things, by the following:

- reductions in demand for aircraft (for example, softness in demand for business jets) and delayed aircraft delivery schedules

- bankruptcy or other significant financial difficulties of our existing and potential customers

• reductions in the need for, or the deferral of, aircraft maintenance and repair services and spare parts support

• retirement or storage of older generation aircraft, resulting in fewer retrofits and less demand for services for those aircraft, as well as the increased availability of used or recycled equipment on the market

• limited availability of financing for airlines or aircraft

• impact on the aviation industry due to the volatility of fuel prices

• disruptions to commercial air travel demand

10

A global or regional recession may adversely affect us.

If a recession emerges that impacts where we do business, risks may include:

- declines in revenues, profitability and cash flows from reduced orders, payment delays or other factors caused by the economic problems of our customers

- adverse impacts on our access to short-term commercial paper borrowings or other credit sources

- supply problems associated with any financial constraints faced by our suppliers

We derive a significant portion of our revenues from international sales and are subject to the risks of doing business outside the U.S.

In 2016, 41 percent of our total revenues were from sales of our products and services internationally, including foreign military sales. We expect that international sales will continue to account for a significant portion of our total sales. As a result, we are subject to risks of doing business internationally, including:

- laws, regulations and policies of non-U.S. governments relating to investments and operations, as well as U.S. laws affecting the activities of U.S. companies abroad

- regulatory requirements and potential changes, including imposition of tariffs or embargoes, export controls and other trade restrictions, anti-bribery, antitrust and data privacy requirements

- changes in government spending on defense programs, including spending declines in European countries

- uncertainties and restrictions concerning the availability of funding, credit or guarantees

- requirements of certain customers which obligate us to specified levels of in-country purchases, manufacturing or investments, known as offsets, and penalties in the event we fail to perform in accordance with the offset requirements

- impacts associated with foreign currency volatility

- uncertainties as to local laws and enforcement of contract and intellectual property rights

- rapid changes in government, economic and political policies, political or civil unrest or the threat of international boycotts or U.S. anti-boycott legislation

We have made, and expect to continue to make, strategic acquisitions and partnerships that involve risks and uncertainties.

We completed the following acquisitions in the past three fiscal years:

- in February 2016, we acquired the Matrix series projector product line from Christie Digital Systems

- in August 2015, we acquired ICG

- in March 2015, we acquired Pacific Avionics

In December 2013, we acquired ARINC

We also completed several joint ventures and strategic alliances (partnerships) in the past few years.

We intend to make acquisitions and partnerships in the future in an effort to enhance shareowner value. Acquisitions and partnerships involve certain risks and uncertainties, such as:

difficulty in integrating newly-acquired businesses and commencing partnership operations in an efficient and cost-effective manner and the risk that we encounter significant unanticipated costs or other problems associated with integration or commencement

11

challenges in achieving strategic objectives, cost and revenue synergies and other expected benefits

risk that our markets do not evolve as anticipated and the targeted technologies do not prove to be those needed to be successful in those markets

risk that we assume significant liabilities that exceed the limitations of any applicable indemnification provisions or the financial resources of any indemnifying parties

loss of key employees of the acquired businesses or joint venture

risk of diverting the attention of senior management from our existing operations

risk of litigation associated with an acquisition

On October 23, 2016 we entered into an agreement to acquire B/E Aerospace, which is expected to close in the spring of 2017 subject to various closing conditions. Additional information related to this acquisition is contained in Note 23 of the Notes to Consolidated Financial Statements in Item 8 below.

We enter into fixed-price contracts that could subject us to losses in the event that we have cost overruns.

During 2016, approximately 93 percent of our total sales were, and a significant portion of our anticipated future sales will be, from fixed-price contracts. This allows us to benefit from cost savings, but it carries the burden of potential cost overruns since we assume all of the cost risk. If our initial cost estimates are incorrect, we can incur losses on these contracts. These fixed-price contracts can expose us to potentially large losses because the customer may compel us to complete a project or, in the event of a termination for default, pay the entire incremental cost of its replacement by another provider regardless of the size of any cost overruns that occur over the life of the contract. Because many of these projects involve new technologies and applications and can last for years, unforeseen events such as technological difficulties, fluctuations in the price of raw materials, problems with subcontractors and cost overruns can result in the contractual price becoming less favorable or even unprofitable to us over time. Furthermore, if we do not meet project deadlines or specifications, we may need to renegotiate contracts on less favorable terms, be forced to pay penalties or liquidated damages or suffer major losses if the customer exercises its right to terminate. In addition, some of our contracts have provisions relating to cost controls and audit rights, and if we fail to meet the terms specified in those contracts we may not realize their full benefits. Our results of operations are dependent on our ability to maximize earnings from our contracts. Lower earnings caused by cost overruns could have an adverse impact on our financial condition, results of operations and cash flows.

Costs of certain employee and retiree benefits may rise.

Although we have taken action seeking to contain volatility in the costs related to medical and pension benefits, there are risks that our costs for these benefits will increase as a result of:

continued increases in medical costs related to current employees due to increased usage of medical benefits, medical inflation and the impact of U.S. Government health care legislation

continued increases in the average life span of retirees

material changes in legislation or market dynamics impacting medical or pension matters

the effect declines in the stock and bond markets have on our pension plan assets

reductions in the discount rate used to determine the present value of our retirement benefit obligations

Tax changes could affect our effective tax rate and future profitability.

Our future results could be adversely affected by changes in the effective tax rate as a result of changes in our overall profitability and changes in the mix of earnings in countries with differing statutory tax rates, changes in tax legislation, the results of audits and examination of previously filed tax returns and continuing assessment of our tax exposures.

We depend on critical suppliers and subcontractors.

We do not always have alternate sources of supply readily available for certain goods or services, such as liquid crystal displays. The loss of a significant supplier or subcontractor or their inability to meet performance, quality or delivery requirements due to natural disaster, financial stress, capacity constraints, military conflicts or other causes could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We depend on specialized test equipment.

Some of our specialized test equipment that supports the reliability of our products and systems is the result of significant investment. Back-up test equipment may not be readily available. Damage to our specialized test equipment may result in protracted production recovery and may adversely impact our ability to service our products.

A cybersecurity incident, network failure or other business disruption could have negative impacts.

We face cyber threats, threats to the physical security of our facilities, as well as the potential for business disruptions associated information technology (IT) failures. Possible areas of significant exposure to cyber threats or other disruptions include our enterprise information technology resources, our information management network that provides communication services to customers and our flight deck communication products and solutions. Any of these threats or disruptions may result in a material adverse effect on our business, financial condition, results of operations and cash flows. Risks may include:

- adverse effects to future results due to the theft, destruction, loss, corruption or release of personal data, confidential information or intellectual property

- operational or business disruptions resulting from the failure of IT or other systems and subsequent mitigation activities

- negative publicity resulting in reputation or brand damage with our customers, suppliers, employees, shareowners and others

Risks Related to Our B/E Aerospace Transaction:

The proposed acquisition of B/E Aerospace is subject to conditions, some or all of which may not be satisfied, or completed on a timely basis, if at all. Failure to complete the proposed transaction could have material adverse effects on us.

The completion of the proposed acquisition of B/E Aerospace is subject to a number of conditions, including, among others, the approval by our shareowners of the issuance of the shares of our common stock in the proposed transaction, the approval by B/E Aerospace stockholders and the receipt of certain regulatory approvals, which make the completion and timing of the completion of the proposed transaction uncertain. Also, either we or B/E Aerospace may generally terminate the transaction if it has not been consummated by October 21, 2017.

If the proposed transaction is not completed, our businesses may be materially adversely affected and, without realizing any of the benefits of having completed the proposed transaction, we will be subject to a number of risks, including the following:

- the market price of our common stock could decline

- we could owe substantial termination fees to B/E Aerospace under certain circumstances

- if the transaction is abandoned, our shareowners cannot be certain that we could find a party willing to enter into a transaction on terms equivalent to or more attractive than the terms of the proposed B/E Aerospace acquisition

time and resources committed by our management to matters relating to the proposed transaction could otherwise have been devoted to pursuing other beneficial opportunities

we may experience negative reactions from the financial markets or from our customers, suppliers or employees. In addition, if the proposed transaction is not completed, we could be subject to litigation related to any failure to complete the proposed transaction.

13

The materialization of any of these risks could adversely impact our ongoing businesses.

Similarly, delays in the completion of the proposed transaction could, among other things, result in additional transaction costs, loss of revenue or other negative effects associated with uncertainty about completion of the proposed transaction.

Our agreement to acquire B/E Aerospace contains provisions that limit our ability to pursue alternatives to the proposed acquisition, could discourage a potential acquiror of us from making a favorable alternative transaction proposal and, in specified circumstances, could require us to pay substantial termination fees to B/E Aerospace. Our agreement to acquire B/E Aerospace contains certain provisions that restrict our ability to initiate, seek, solicit, knowingly encourage, knowingly induce or engage in negotiations or discussions with respect to, or approve or recommend, any third-party proposal for certain alternative transactions. Further, even if our board of directors withdraws or qualifies its recommendation with respect to the issuance of the shares of our common stock in connection with the proposed transaction, unless the agreement has been terminated in accordance with its terms, we will still be required to submit our acquisition-related proposals to a vote at a special meeting of our shareowners. In some circumstances, upon termination of the agreement, we could be required to pay a termination fee of \$300 million to B/E Aerospace. In addition, if the agreement is terminated due to a failure to obtain our shareowner approval, we may still have to reimburse B/E Aerospace up to \$56 million for their fees and expenses incurred in connection with the proposed transaction.

These provisions could discourage a potential third-party acquiror or merger partner that might have an interest in acquiring all or a significant portion of us or pursuing an alternative transaction from considering or proposing such a transaction. In particular, a termination fee, if applicable, may be substantial, and could result in a potential third-party acquiror or merger partner proposing to pay a lower price to our shareowners than it might otherwise have proposed to pay absent such a fee.

The proposed acquisition of B/E Aerospace is subject to the expiration or termination of applicable waiting periods and the receipt of approvals, consents or clearances from regulatory authorities that could prevent or delay the completion of the proposed acquisition.

Before the proposed acquisition of B/E Aerospace may be completed, any waiting period under applicable U.S. antitrust laws must have expired or been terminated and any authorizations or consents under certain other competition laws of foreign jurisdictions required with respect to the proposed transaction must have been obtained. Regulators may impose conditions, terms, obligations or restrictions in connection with their authorization of or consent to the proposed transaction, and such conditions, terms, obligations or restrictions may delay completion of the proposed transaction or impose additional material costs on or materially limit the revenues of the combined company following the completion of the transaction. There can be no assurance that regulators will choose not to impose such conditions, terms, obligations or restrictions, and, if imposed, such conditions, terms, obligations or restrictions may delay or lead to the abandonment of the proposed transaction.

We are subject to business uncertainties while the proposed acquisition of B/E Aerospace is pending, which could adversely affect our business and operations.

In connection with the pendency of the proposed acquisition of B/E Aerospace, it is possible that some customers, suppliers and other persons with whom we have a business relationship may delay or defer certain business decisions or might decide to seek to terminate, change or renegotiate their relationships with us as a result of the proposed transaction, which could negatively affect our revenues, earnings and cash flows, as well as the market price of our common stock, regardless of whether the proposed transaction is completed.

Each of the risks described above may be exacerbated by delays or other adverse developments with respect to the completion of the proposed transaction.

Uncertainties associated with the proposed acquisition of B/E Aerospace may cause a loss of management personnel and other key employees which could adversely affect our business and operations.

We are dependent on the experience and industry knowledge of our officers and other key employees to execute our business plan. Prior to completion of the proposed acquisition of B/E Aerospace, our current and prospective employees may experience uncertainty about their roles within the combined company following the completion of the proposed transaction, which may have an adverse effect on our ability to attract or retain key management and

other key personnel.

14

If the proposed acquisition of B/E Aerospace is not completed, we will have incurred substantial costs that may adversely affect our financial results.

We have incurred and will continue to incur substantial costs in connection with the proposed acquisition of B/E Aerospace. These costs are primarily associated with financing for the proposed transaction and the fees of financial advisors, consultants, accountants and attorneys.

Cautionary Statement

This Annual Report on Form 10-K, and documents that are incorporated by reference in this Annual Report on Form 10-K, contain statements, including certain projections and business trends, that are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected as a result of certain risks and uncertainties, including but not limited to, those disclosed in Risk Factors in Item 1A above, as well as other risks and uncertainties, including but not limited to those detailed herein and from time to time in our Securities and Exchange Commission filings. These forward-looking statements are made only as of the date hereof.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As of September 30, 2016, we operated various manufacturing and engineering facilities, sales offices, warehouses and service locations throughout the U.S. and around the world. These facilities have aggregate floor space of approximately 6.8 million square feet. Of this floor space, 55 percent is owned and 45 percent is leased. There are no major encumbrances on any of our plants or equipment. In the opinion of management, our properties have been well maintained, are in sound operating condition and contain all equipment and facilities necessary to operate at present levels. A summary of floor space of these facilities at September 30, 2016 is as follows:

Location (in thousands of square feet)	Owned Facilities	Leased Facilities	Total
Commercial and Government Systems			
U.S.	3,350	1,866	5,216
Europe / Africa / Middle East	330	233	563
Asia-Pacific	—	248	248
Americas, excluding U.S.	—	148	148
Total	3,680	2,495	6,175
Information Management Services			
U.S.	39	549	588
Europe / Africa / Middle East	—	31	31
Asia-Pacific	—	25	25
Americas, excluding U.S.	—	1	1
Total	39	606	645
Combined Total	3,719	3,101	6,820
Type of Facility (in thousands of square feet)			
Commercial and Government Systems			
Manufacturing and service	1,274	986	2,260
Sales, engineering and general office space	2,406	1,509	3,915
Information Management Services			
Manufacturing and service	39	—	39
Sales, engineering and general office space	—	606	606
Combined Total	3,719	3,101	6,820

We have facilities with a total of at least 100,000 square feet (in rounded thousands) in the following cities: Cedar Rapids, Iowa (2,990,000 square feet), Melbourne, Florida (390,000 square feet), Annapolis, Maryland (360,000 square feet), Richardson, Texas (280,000 square feet), Heidelberg, Germany (240,000 square feet), Irvine, California (210,000 square feet), Coralville, Iowa (200,000 square feet), Sterling, Virginia (180,000 square feet), Wilsonville, Oregon (170,000 square feet), Toulouse, France (160,000 square feet), Salt Lake City, Utah (120,000 square feet), Hyderabad, India (110,000 square feet) and Mexicali, Mexico (110,000 square feet). Most of our facilities for our Commercial Systems and Government Systems businesses are shared and have therefore been presented together in the tables above. We have excluded from the tables above hundreds of leased locations wherein our Information Management Services business has radio frequency equipment in various locations throughout the world.

We purchase property insurance covering physical damage to our facilities and resulting business interruption from perils including fire, windstorm, flood and earthquake. This insurance generally provides replacement cost coverage subject to a \$10 million deductible with certain exceptions. For example, certain of our facilities, including those located in California and Mexico, are located near major earthquake fault lines. For those facilities we maintain earthquake insurance with limits that may be less than full replacement cost. These exceptions are largely driven by the availability and cost of catastrophe coverage from the insurance markets.

Item 3. Legal Proceedings.

Various lawsuits, claims and proceedings have been or may be instituted or asserted against us relating to the conduct of our business, including those pertaining to product liability, intellectual property, environmental, safety and health, exporting or importing, contract, employment and regulatory matters. Although the outcome of litigation cannot be

predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to us, management believes there are no material pending legal proceedings.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 4A. Executive Officers of the Company.

The name, age, office and position held with us, and principal occupations and employment during the past five years of each of our executive officers as of November 15, 2016 are as follows:

Name, Office and Position, and Principal Occupations and Employment	Age
Robert K. Ortberg—Chairman of the Board of Directors since November 2015; Chief Executive Officer and a Director since August 2013; President since September 2012; Executive Vice President and Chief Operating Officer, Government Systems prior thereto	56
Patrick E. Allen—Senior Vice President and Chief Financial Officer since January 2005	52
Tatum J. Buse—Vice President, Finance and Corporate Controller since September 2013; Vice President Cost Optimization from September 2012 to September 2013; Vice President and Controller of International and Service Solutions prior thereto	42
Philip J. Jasper—Executive Vice President and Chief Operating Officer, Government Systems since September 2012; Vice President, Business Development, Government Systems prior thereto	48
Bruce M. King—Senior Vice President, Operations since May 2011	55
Jeffrey D. MacLauchlan—Senior Vice President, Corporate Development since September 2014; Vice President, Corporate Development of Lockheed Martin Corporation prior thereto	57
Colin R. Mahoney—Senior Vice President, International and Service Solutions since February 2013; Vice President of Commercial Systems Sales, Marketing and Customer Support prior thereto	51
Nan Mattai—Senior Vice President, Engineering and Information Technology since August 2015; Senior Vice President, Engineering and Technology prior thereto	64
David J. Nieuwsma—Senior Vice President, Information Management Services since April 2016; Vice President, Strategy and Business Development from December 2012 to April 2016; Vice President and General Manager of Airborne Solutions prior thereto	52
Robert J. Perna—Senior Vice President, General Counsel and Secretary since February 2014; Senior Vice President, General Counsel from January 2014 to February 2014; Vice President, General Counsel and Secretary for AM Castle & Co. prior thereto	52
Jeffrey A. Standerski—Senior Vice President, Human Resources since April 2016; Senior Vice President, Information Management Services from December 2013 to April 2016; Vice President and General Manager, Business and Regional Systems from July 2013 to December 2013; Vice President and General Manager, Air Transport Systems prior thereto	50
Kent L. Statler—Executive Vice President and Chief Operating Officer, Commercial Systems since February 2010	51
Douglas E. Stenske—Vice President, Treasurer and Risk Management since September 2013; Vice President, Treasurer and Financial Planning prior thereto	50
Robert A. Sturgell—Senior Vice President, Washington Operations since April 2009	57

There are no family relationships, as defined, between any of the above executive officers and any other executive officer or any director. No officer was selected pursuant to any arrangement or understanding between the officer and any person other than us. All executive officers are elected annually.

PART II

Item 5. Market for the Company's Common Equity, Related Stockholder Matters and Company Purchases of Equity Securities.

Market Information

Our common stock, par value \$.01 per share, is listed on the New York Stock Exchange and trades under the symbol COL. On October 31, 2016, there were 16,340 shareowners of record of our common stock.

The following table sets forth the high and low sales price of our common stock on the New York Stock Exchange—Composite Transactions reporting system during each quarter of our years ended September 30, 2016 and 2015:

Fiscal Quarters	2016		2015	
	High	Low	High	Low
First	\$95.11	\$82.26	\$86.60	\$72.35
Second	93.20	76.03	97.49	83.00
Third	94.98	81.04	99.37	92.22
Fourth	87.11	80.92	93.89	78.15

Dividends

The following table sets forth the cash dividends per share paid by us during each quarter of our years ended September 30, 2016 and 2015:

Fiscal Quarters	2016	2015
First	\$0.33	\$0.30
Second	0.33	0.30
Third	0.33	0.33
Fourth	0.33	0.33

Based on our current dividend policy, we have been paying quarterly cash dividends which, on an annual basis, equal \$1.32 per share. The declaration and payment of dividends, however, will be at the sole discretion of our Board of Directors and there can be no assurance that we will continue to pay dividends at our current levels.

Repurchases

Our Board of Directors has authorized certain repurchases of our common stock. During 2016, we repurchased approximately 2.9 million shares of our common stock at a total cost of \$255 million, at a weighted average cost of \$87.30 per share. During 2015, we repurchased approximately 3.8 million shares of our common stock at a total cost of \$325 million, at a weighted average cost of \$85.32 per share.

The following table provides information with respect to purchases made by or on behalf of us or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934) of shares of our common stock during the three months ended September 30, 2016:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased	Maximum Number (or Approximate
			as	

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			Part of Publicly Announced Plans or Programs	Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
July 1, 2016 through July 31, 2016	—	\$	—	\$ 125 million
August 1, 2016 through August 31, 2016	—	—	—	125 million
September 1, 2016 through September 30, 2016	—	—	—	125 million
Total/Average	—	—	—	

⁽¹⁾ On September 19, 2014 we announced that our Board authorized the repurchase of an additional \$500 million of our common stock, the balance of which is reflected in the table above. This authorization has no stated expiration.

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 below. The Statement of Operations, Statement of Financial Position and other data has been derived from our audited financial statements. The Company operates on a 52/53 week fiscal year ending on the Friday closest to September 30. Fiscal year 2016, 2015, 2013 and 2012 were 52-week fiscal years while fiscal year 2014 was a 53-week fiscal year. Certain prior data has been reclassified to conform to the current year presentation and to reflect the adoption of new guidance requiring all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet (see Note 2).

(dollars in millions, except per share amounts)	Years Ended September 30				
	2016(a)	2015(b)	2014(c)	2013(d)	2012(e)
Statement of Operations Data:					
Sales	\$5,259	\$5,244	\$4,979	\$4,474	\$4,531
Cost of sales	3,642	3,630	3,469	3,103	3,168
Selling, general and administrative expenses	638	606	594	495	530
Income from continuing operations	727	694	618	630	589
Income (loss) from discontinued operations, net of taxes	1	(8)	(14)	2	20
Net income	728	686	604	632	609
Net income as a percent of sales	13.8	% 13.1	% 12.1	% 14.1	% 13.4
Diluted earnings per share from continuing operations	5.50	5.19	4.52	4.56	4.01
Statement of Financial Position Data:					
Working capital(f)	\$1,144	\$1,164	\$1,054	\$1,096	\$1,292
Property	1,035	964	919	773	773
Goodwill and intangible assets	2,586	2,607	2,551	1,067	1,071
Total assets	7,707	7,304	7,005	5,397	5,310
Short-term debt	740	448	504	436	—
Long-term debt, net	1,382	1,680	1,663	563	779
Shareowners' equity	2,078	1,875	1,884	1,618	1,259
Other Data:					
Capital expenditures	\$193	\$210	\$163	\$120	\$138
Depreciation and amortization	253	252	225	177	170
Dividends per share	1.32	1.26	1.20	1.20	1.08
Stock Price:					
High	\$95.11	\$99.37	\$84.06	\$75.25	\$61.46
Low	76.03	72.35	65.76	52.24	46.37

(a) Income from continuing operations includes a \$24 million income tax benefit from the retroactive reinstatement of the previously expired Federal Research and Development Tax Credit and a \$41 million income tax benefit due to the release of a valuation allowance for a U.S. capital loss carryforward. In addition, income from continuing operations includes \$31 million of restructuring and asset impairment charges (\$45 million before income taxes) primarily related to employee severance costs. Approximately \$33 million of the pre-tax expense was recorded within cost of sales and \$12 million was included within selling, general and administrative expenses.

(b) Income from continuing operations includes a \$22 million income tax benefit from the retroactive reinstatement of the previously expired Federal Research and Development Tax Credit and a \$16 million income tax benefit related to the remeasurement of certain prior year tax positions.

(c) Income from continuing operations includes \$18 million of restructuring, pension settlement and ARINC transaction costs (\$25 million before income taxes). Approximately \$18 million of the pre-tax expense was recorded in selling, general and administrative expenses, \$4 million was included within cost of sales, and \$3 million was classified as interest expense. Income from continuing operations also includes a \$9 million gain (\$10 million before income taxes) resulting from the sale of the KOSI business. On December 23, 2013, we acquired ARINC for \$1.405 billion. This acquisition was funded through a combination of new long-term debt and

short-term commercial paper borrowings.

- (d) Net income includes a \$19 million income tax benefit related to the retroactive reinstatement of the previously expired Federal Research and Development Tax Credit. Short-term debt includes commercial paper borrowings incurred to fund a portion of our share repurchase program and also includes \$200 million related to debt that matured in December 2013.

(e) Net income includes \$38 million of net restructuring and asset impairment charges (\$58 million before income taxes), primarily related to employee severance costs and certain customer bankruptcy charges. Approximately \$38 million of the

pre-tax charge was recorded in cost of sales, \$25 million was included within selling, general and administrative expenses and \$5 million was classified as a gain within Other income. Net income also includes a \$19 million income tax benefit related to the favorable resolution of certain tax matters in 2012.

(f) Working capital consists of all current assets and liabilities, including cash and short-term debt.

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

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto in Item 8 below. The following discussion and analysis contains forward-looking statements and estimates that involve risks and uncertainties. Actual results could differ materially from these estimates. Factors that could cause or contribute to differences from estimates include those discussed under Cautionary Statement and Risk Factors contained in Item 1A above.

We operate on a 52/53 week fiscal year ending on the Friday closest to September 30. For ease of presentation, September 30 is utilized consistently throughout Management's Discussion and Analysis of Financial Condition and Results of Operations to represent the fiscal year end date. Fiscal year 2016 and 2015 were 52-week fiscal years while 2014 was a 53-week fiscal year. All date references contained herein relate to our fiscal year unless otherwise stated.

As discussed in Note 23 of the Notes to Consolidated Financial Statements in Item 8 below, on October 23, 2016, subsequent to our 2016 fiscal year end, the Company reached a definitive agreement to acquire B/E Aerospace for approximately \$6.4 billion in cash and stock, plus the assumption of \$1.9 billion in net debt. Except as otherwise explicitly noted, the anticipated acquisition is excluded from the following discussion and analysis of financial condition and results of operations.

As discussed in Note 4 of the Notes to Consolidated Financial Statements in Item 8 below, on March 10, 2015 the Company divested the ASES business, which was acquired as part of the ARINC transaction. On July 25, 2014 the Company divested its satellite communication systems business, formerly known as Datapath, Inc. (Datapath). As a result of the divestitures, the operating results of ASES and Datapath have been accounted for as discontinued operations for all periods presented.

OVERVIEW AND OUTLOOK

We have a diversified and balanced business, serving both commercial and government markets. Our Commercial Systems business supplies aviation electronics systems, products and services to customers located throughout the world. The Commercial Systems customer base is comprised of commercial air transport and business and regional aircraft OEMs, commercial airlines and business aircraft operators. The Government Systems business provides communication and navigation products and avionics to the U.S. Department of Defense, state and local governments, other government agencies, civil agencies, defense contractors and foreign ministries of defense around the world. These systems, products and services support airborne (fixed and rotary wing), ground and shipboard applications. Our Information Management Services business enables mission-critical data and voice communications throughout the world to customers including the U.S. Federal Aviation Administration, commercial airlines, business aircraft operators, airport and critical infrastructure operators and major passenger and freight railroads. These communications are enabled by our high-performance, high-quality and high-assurance proprietary radio and terrestrial networks, enhancing customer efficiency, safety and connectivity.

On December 23, 2013, we completed our acquisition of ARINC for \$1.405 billion. The acquisition of ARINC was funded through a combination of new long-term debt issuances and commercial paper borrowings. In connection with this acquisition, the Information Management Services operating segment was formed. This segment combines

ARINC with the Company's legacy flight services business, which had previously been included in the Commercial Systems segment.

Total revenues were about flat in 2016 compared to 2015, as 6 percent higher revenues in Information Management Services and 1 percent growth in Government Systems were mostly offset by a 2 percent revenue reduction within Commercial Systems. Total segment operating margins⁽¹⁾ improved 10 basis points to 21.2 percent. Income from continuing operations improved 5 percent to \$727 million due primarily to lower income tax expense and higher pre-tax earnings, partially offset by a \$45 million restructuring charge recorded in the first quarter of 2016. The restructuring charge was initiated as a result of certain challenging market conditions, particularly in business aviation.

⁽¹⁾ Total segment operating margins is a non-GAAP measure and is reconciled to the related GAAP measure, Income from continuing operations before income taxes, in Note 21 of the Notes to Consolidated Financial Statements. Total segment operating margins is calculated as total segment operating earnings divided by total sales. The non-GAAP total segment operating margin information included in this disclosure is believed to be useful to investors in comparing our operating performance from period to period by isolating the effects of some items that vary from period to period without any correlation to core operating performance.

Our effective tax rate was favorably impacted by the below items in 2016:

On December 18, 2015, the Protecting Americans from Tax Hikes Act was enacted, which permanently reinstated the Federal Research and Development Tax Credit (Federal R&D Tax Credit) retroactive to January 1, 2015. This tax credit had previously expired on December 31, 2014.

We released a \$41 million valuation allowance for a U.S. capital loss carryforward as a result of the creation of a tax planning strategy.

We generated operating cash flows of \$723 million during 2016, representing a 3 percent decline from 2015. We generated free cash flow⁽¹⁾ of \$530 million in 2016, representing a 2 percent decline from 2015. We continued to deploy cash for the benefit of our shareowners by paying aggregate dividends of \$172 million and repurchasing 2.9 million shares of common stock for \$255 million.

Fiscal year 2016 results are as follows:

	FY16 Results
Total sales	\$5.26 billion
Diluted earnings per share from continuing operations	\$5.50
Operating cash flow from continuing operations	\$723 million
Capital expenditures	\$193 million
Total research and development investment ⁽²⁾	\$973 million

Performance in 2016 was negatively impacted by business jet production rate declines and muted air transport aftermarket conditions as a result of used aircraft parts recycling. We anticipated challenging market conditions at the beginning of 2016 and initiated a restructuring plan aimed at adjusting our cost structure to these market dynamics. This restructuring plan was effective in maintaining our operating margin performance as we endured these challenging market conditions.

As we plan for 2017, many air transport and regional jet aircraft production rates continue to increase and we expect to see the Boeing 737MAX enter into service. We see improved sentiment around defense spending and Government Systems is well positioned to accelerate its growth during the year. The connectivity offerings in our IMS business are driving innovation to facilitate aviation's new information age. Most important, 2017 is the year we expect to accelerate our free cash flow performance as development costs wind-down and new aircraft production rates increase. Our management team is focused on delivering this improvement in free cash flow and our annual and long-term incentive plans were adjusted in 2016 to include free cash flow as a key metric used in computing the payout percentages for both plans. Despite depressed business jet OEM production rates and a challenging air transport aftermarket, we believe the fundamentals of the marketplace and longer-term trends continue to position Rockwell Collins for growth.

⁽¹⁾ Free cash flow is a non-GAAP measure and is reconciled to the related GAAP measure, Cash Provided by Operating Activities from Continuing Operations below. The non-GAAP free cash flow information included in this disclosure is believed to be useful to investors' understanding of cash generated from operations that is available for investment opportunities, such as acquisitions, dividend payments, debt repayment and share repurchases.

(dollars in millions)	Year Ended		
	September 30		
	2016	2015	2014
Cash Provided by Operating Activities from Continuing Operations	\$723	\$749	\$660
Less: Property Additions	(193)	(210)	(163)
Free Cash Flow	\$530	\$539	\$497

(2) Total research and development (R&D) investment is comprised of company and customer-funded R&D expenditures and the net increase in pre-production engineering costs capitalized within Inventory.

Our long-term strategies are focused on the following:

- accelerate sales growth
- expand operating margins and improve cash flow conversion
- deploy capital with priorities on growth and shareowner return

Accelerate sales growth

Accelerating our business growth is a fundamental objective of our management team. For the past decade we have been in a period of significant investment in research and development for our company to support market share gains throughout our businesses. Our record of success in migrating technologies across the enterprise is a core strength and enables us to realize the benefits of investment even if market conditions change. We are now beginning to realize the benefits of completing investments in these programs as new platforms enter service. Our focus on developing solutions aimed at making Rockwell Collins the supplier of choice is evidenced by our significant investment in research and development. Over the past 5 years, we invested approximately \$4.8 billion in research and development, which has allowed us to develop new systems, products and software solutions for our customers and capture strategically important positions on a variety of air transport, business aviation and military aircraft.

Highlights of our strategy to accelerate top-line sales growth are as follows:

Strong positions will fuel growth

Within Commercial Systems, we were recognized as a top supplier in 2016 by many of our largest customers and achieved numerous milestones on aircraft development programs throughout the year. During 2016, a number of ProLine Fusion equipped aircraft entered into service including the Textron King Air, the Legacy 450 at Embraer, and the Challenger 650 and CSeries at Bombardier. We also supported the certification of the COMAC ARJ-21 and the first flights of the Mitsubishi regional jet and the Boeing 737MAX. In 2016 we supported rate increases on the Boeing 787, Airbus A350 and narrow body aircraft. Looking forward, the Boeing 737MAX is scheduled to enter service in 2017 and is expected to ultimately be the largest Commercial Systems aircraft program at our company with content that is 50 percent greater than the 737NG. We recently announced we will provide touchscreen flight displays on the 777X, which is an industry first on an air transport aircraft. We believe these accomplishments have positioned us to continue to grow our market share.

Within Government Systems, we built our backlog by \$170 million during 2016. Sentiment around defense spending has improved not only in the United States, but also throughout the world. During 2016 we were announced as a key supplier to Northrup Grumman on the Long Range Strike Bomber, which has been named the B-21 Raider. We were also down selected to one of three companies on the HMS Manpack program, which has the potential to be a large Government Systems program. At Embraer our development performance on the avionics for the KC-390 helped in securing the cargo handling and aerial delivery control systems. We also supported the Boeing KC-46A's first aerial refueling with the Rockwell Collins Remote Vision System. In the second quarter of 2016, we completed the acquisition of the Matrix series projector line, which will increase our simulation and training product suite. We also signed a landmark agreement with the Defense Contract Management Agency that establishes an improved process for procurement of commercial items for military application.

We are capitalizing on aviation's information age

In today's information-enabled world, the industry continues to trend away from hardware-based solutions to more software-based applications and the needs for connectivity are increasing for airlines, airports and passengers. Through organic innovations and acquisitions, our Information Management Services portfolio positions us as a leader in aviation information management, delivering efficiency and safety to our customers and their passengers.

As traffic on our air-to-ground networks increases, we're taking steps to enhance their capacity and usefulness. This year we increased our investment to build out our network capacity and global footprint, strengthening our position in Europe, the Middle East and Africa. We are also developing new applications that will improve the operations of our customers. For example, we rolled out our ARINC MultiLinkSM flight tracking service, offering a comprehensive and cost-effective global flight tracking solution for the world's airlines. We are also looking for ways to make better use of our high fidelity networks. This year we launched ARINC RailwayNet, a hosted network and messaging platform for passenger and freight railroads. The new solution is designed to increase safety and reliability in the railroad industry and to help railroads meet the Positive Train Control (PTC) requirements mandated by the Rail Safety Improvement Act of 2008.

We expect that connectivity capabilities will evolve and we plan to be a leader within the next generation aviation information management ecosystem. Connectivity solutions for business aviation and air transport aircraft are growing. For example, Inmarsat's new high-speed Ka-band network will dramatically change the customer experience and offer broadband type connectivity speeds in the cabin of the aircraft. We are a value added reseller of this service and have already secured customers in both air transport aircraft and business jets.

We are growing globally

Market opportunities outside the United States continue to evolve, driven in part by expanding populations and emerging economies. Security needs are on the rise in places around the globe, as countries seek to establish indigenous capabilities to protect their borders, infrastructure and resources. At the same time, global commercial air travel is expected to increase as we see a growing middle class in developing countries, generating higher traffic and increased demand for new aircraft. We believe we are positioned to grow by capturing new programs at emerging international OEMs, strategically positioning service centers around the globe, and by launching joint ventures.

Expand operating margins and improve cash flow conversion

Operational excellence is a fundamental objective at our Company. We have extended Lean concepts beyond the factory floor to virtually every aspect of our business. We focus on streamlining processes, reducing costs and increasing quality while enhancing our ability to respond quickly to customer needs. In addition, our shared service model uses an organizational structure to leverage resources across the business. This is evidenced by our product and technology centers of excellence, through which we apply our core competencies to solutions in both Government Systems and Commercial Systems. By applying common tools and systems across our businesses, we can better manage our cost structure and maximize our R&D investments.

We believe our Company has a proven ability to both react quickly to changing business conditions and to execute its business plans. For example, as we plan for challenging conditions in business aviation in fiscal 2017, we have taken actions to manage our cost structure, while focusing on our customers, continuing our commitment to operational excellence and maintaining our balanced business model. We will also distinguish ourselves through strong customer relationships, high returns on invested capital and continued investment in market differentiating technologies and programs. As we grow our company and complete major program investments, our goal is to generate long-term double-digit cash flow growth.

Deploy capital with priorities on growth and shareowner return

We plan to allocate capital across our company in a way that prioritizes growth through investments in R&D and capital expenditures. On October 23, 2016, the Company reached a definitive agreement to acquire B/E Aerospace for approximately \$6.4 billion in cash and stock, plus the assumption of \$1.9 billion in net debt. The transaction combines our capabilities in flight deck avionics, cabin electronics, mission communications, simulation and training, and information management systems with B/E Aerospace's range of cabin interior products, which include seating, food and beverage preparation and storage equipment, lighting and oxygen systems, and modular galley and lavatory systems for commercial airliners and business jets. The acquisition significantly increases our scale and diversifies our product portfolio, customer mix and geographic presence. We will provide updated financial guidance to reflect the acquisition for fiscal year 2017 closer to the expected transaction close date. Additional information related to this acquisition is contained in Note 23 of the Notes to Consolidated Financial Statements in Item 8 below. As a result of the pending acquisition, paying down debt will become a capital deployment priority. We also expect to continue to target a 25 percent dividend to net income payout ratio.

See the following sections for further discussion of our results of operations and anticipated 2017 results of operations. For additional disclosure on segment operating earnings see Note 21 of the Notes to Consolidated Financial Statements in Item 8 below. Please also see our Risk Factors and Cautionary Statement in Item 1A of this Form 10-K.

RESULTS OF OPERATIONS

The following management discussion and analysis of results of operations is based on reported financial results for 2014 through 2016 and should be read in conjunction with our consolidated financial statements and the notes thereto in Item 8 below.

23

Consolidated Financial Results

Sales

(in millions)	2016	2015	2014
U.S. ^{(1) (2)}	\$3,292	\$3,174	\$2,993
Non-U.S. ⁽¹⁾	1,967	2,070	1,986
Total	\$5,259	\$5,244	\$4,979
Percent increase —	% 5	%	

⁽¹⁾ Sales are attributed to geographic region based on the location of our customers.

⁽²⁾ For the years ended September 30, 2016, 2015 and 2014, U.S. sales include revenue from foreign military sales of \$171 million, \$171 million and \$176 million, respectively.

Sales for 2016 compared to 2015

Total sales increased \$15 million primarily due to a \$35 million increase in Information Management Services sales and a \$19 million increase in Government Systems, partially offset by a \$39 million reduction in Commercial Systems. Refer to the Commercial Systems, Government Systems and Information Management Services sections of the Segment Financial Results below for a detailed discussion of sales by segment in 2016 and 2015.

U.S. sales increased \$118 million, or 4 percent, with Government Systems contributing \$76 million of the increase driven primarily by higher sales to the U.S. Government. Commercial Systems sales contributed \$44 million of the increase driven by higher Boeing 787 production rates, higher flight deck retrofit and mandate activity, as well as inorganic sales growth from the acquisition of International Communications Group (ICG).

Non-U.S. sales decreased \$103 million, or 5 percent, with Commercial Systems sales decreasing \$83 million driven primarily by lower business aircraft OEM production rates. Additionally, non-U.S. sales for Government Systems decreased \$57 million due to lower international deliveries of targeting systems and the wind-down of an international electronic warfare program. Information Management Services increased \$37 million primarily due to higher international aviation-related sales.

Sales for 2015 compared to 2014

Total sales increased \$265 million, or 5 percent. ARINC, which was acquired on December 23, 2013, contributed \$131 million of inorganic revenue growth. The remaining net increase of \$134 million was primarily driven by a \$135 million increase in Commercial Systems sales and an organic sales increase of \$21 million in Information Management Services, partially offset by a \$22 million reduction in Government Systems sales. Refer to the Commercial Systems, Government Systems and Information Management Services sections of the Segment Financial Results below for a detailed discussion of sales by segment in 2015 and 2014.

U.S. sales increased \$181 million, or 6 percent. Information Management Services sales contributed \$109 million of the increase, primarily due to the acquisition of ARINC, with the remaining increase primarily attributable to higher U.S. OEM production rates and higher customer funding for U.S. development programs within Commercial Systems.

Non-U.S. sales increased \$84 million, or 4 percent, with Commercial Systems sales contributing \$52 million of the increase driven primarily by higher customer funding for development efforts on international programs. Additionally, non-U.S. sales for Information Management Services increased \$43 million primarily due to the acquisition of ARINC. Non-U.S. sales for Government Systems decreased \$11 million as higher product deliveries to non-U.S. customers of \$28 million were more than offset by a reduction to revenue of \$39 million due to unfavorable foreign currency exchange rates.

Cost of Sales

(in millions)	2016	2015	2014
Total cost of sales	\$3,642	\$3,630	\$3,469
Percent of total sales	69.3 %	69.2 %	69.7 %

Cost of sales consists of all costs incurred to design and manufacture our products and provide our services and includes R&D, raw material, labor, facility, product warranty, depreciation, amortization, service and support and other related expenses.

Cost of sales for 2016 compared to 2015

Total cost of sales increased \$12 million primarily due to the following:

• \$45 million increase from higher sales volume, which was negatively impacted by less favorable program sales mix

• \$33 million of asset and restructuring charges recorded in 2016

partially offset by a \$48 million reduction in company-funded R&D expense, as detailed in the Research and Development Expense section below

• in addition, pension costs decreased \$16 million

Cost of sales for 2015 compared to 2014

Total cost of sales increased \$161 million, or 5 percent, primarily due to the following:

• \$91 million from inorganic sales growth attributable to ARINC

• \$18 million from higher employee incentive compensation costs

the remaining net increase of \$52 million was driven primarily by higher organic sales volume within Commercial Systems and Information Management Services, partially offset by a corporate-level charge for employee severance recorded in 2014

Research and Development Expense

R&D expense is included as a component of cost of sales and is summarized as follows:

(in millions)	2016	2015	2014
Customer-funded:			
Commercial Systems	\$231	\$187	\$143
Government Systems	381	382	353
Information Management Services	9	9	8
Total customer-funded	621	578	504
Company-funded:			
Commercial Systems	143	182	193
Government Systems	79	88	74
Information Management Services ⁽¹⁾	2	2	1
Total company-funded	224	272	268
Total research and development expense	\$845	\$850	\$772
Percent of total sales	16.1 %	16.2 %	15.5 %

⁽¹⁾ R&D expenses for the Information Management Services segment do not include costs of internally developed software and other costs associated with the expansion and construction of network-related assets. These costs are capitalized as Property on the Consolidated Statement of Financial Position.

We make significant investments in research and development to allow our customers to benefit from the latest technological advancements. Total R&D expense is comprised of both company-funded and customer-funded expenditures. In addition to the R&D expenditures shown in the table above, we capitalize in inventory the cost of certain pre-production engineering effort incurred during the development phase of programs when the customer has provided us a long-term supply arrangement and a contractual guarantee for reimbursement. Pre-production

engineering costs are then amortized over their useful lives. This amortization cost is included within customer-funded R&D expense and totaled \$49 million, \$47 million and \$36 million for 2016, 2015 and 2014, respectively. Refer to the Research and Development section found in Item 1 and the Critical Accounting Policies section found in Item 7 below for further discussion of our incremental investments in pre-production engineering effort.

Customer-funded R&D expenditures are incurred pursuant to contractual arrangements and are typically accounted for as contract costs within cost of sales, with the reimbursement accounted for as a sale in accordance with the percentage-of-completion method of accounting.

Company-funded R&D expenditures relate to the development of new products and the improvement of existing products and are expensed as incurred and included in cost of sales, as disclosed in Note 2 of the Notes to Consolidated Financial Statements. Company-funded R&D expense consists primarily of payroll-related expenses of employees engaged in R&D activities, engineering-related product materials and equipment and subcontracting costs.

Total R&D expense decreased \$5 million from 2015 to 2016. The customer-funded portion of R&D increased \$43 million from 2015 to 2016, primarily due to development expenditures in Commercial Systems for international regional jet programs. Company-funded R&D expenditures decreased \$48 million from 2015 to 2016 primarily due to lower business jet development costs in Commercial Systems as well as lower development costs for software-defined radio programs in Government Systems.

Total R&D expense increased \$78 million from 2014 to 2015. The customer-funded portion of R&D increased \$74 million from 2014 to 2015. Commercial Systems accounted for \$44 million of the increase due to higher development expenditures for various international programs, as well as higher amortization of pre-production engineering costs. In addition, customer-funded expenditures for Government Systems increased \$29 million, primarily due to higher development expenditures for various data link programs, as well as higher amortization of pre-production engineering costs. Company-funded R&D expenditures increased \$4 million from 2014 to 2015 primarily due to an increase in R&D efforts associated with positioning our Government Systems business for new growth offset by lower expenditures for the Airbus A350 program in Commercial Systems.

In addition to the R&D expenses above, development expenditures incurred on the Boeing 737 MAX platform, the Bombardier CSeries and Global 7000/8000 programs and certain military transport programs in 2016 resulted in a net \$128 million increase to our investments in pre-production engineering programs capitalized within inventory. The net increase of \$128 million for 2016 was \$8 million less than the \$136 million net increase in pre-production engineering costs capitalized within inventory during 2015, primarily due to lower costs incurred for the Bombardier CSeries program, partially offset by higher costs incurred for certain military transport programs in Government Systems and the Bombardier Global 7000/8000 program.

Development expenditures incurred on the Boeing 737 MAX platform and Bombardier CSeries and Global 7000/8000 programs in 2015 resulted in a net \$136 million increase to our investments in pre-production engineering programs capitalized within inventory. The net increase of \$136 million for 2015 was \$26 million less than the \$162 million net increase in pre-production engineering costs capitalized within inventory during 2014, primarily due to lower development expenditures for the Airbus A350 program.

Refer to Note 6 of the Notes to Consolidated Financial Statements for further discussion of our incremental investments in pre-production engineering effort.

Selling, General and Administrative Expenses

(in millions)	2016	2015	2014
Selling, general and administrative expenses	\$638	\$606	\$594
Percent of total sales	12.1 %	11.6 %	11.9 %

Selling, general and administrative (SG&A) expenses consist primarily of personnel, facility and other expenses related to employees not directly engaged in manufacturing or R&D activities. These activities include marketing and business development, finance, legal, information technology and other administrative and management functions.

Total SG&A expenses increased \$32 million, or 5 percent, in 2016 compared to 2015, primarily due to the following:

\$12 million of restructuring and asset impairment charges recorded in 2016

higher costs from further expansion in international emerging markets

incremental costs associated with the acquisitions of ICG and Pacific Avionics

26

Total SG&A expenses increased \$12 million, or 2 percent, in 2015 compared to 2014, primarily due to the following:

\$19 million of inorganic SG&A cost growth from the acquired ARINC business

higher international business development and bid and proposal costs

partially offset by the absence of \$13 million of transaction costs for legal, accounting and advisory fees resulting from the ARINC acquisition, as well as the absence of a pension settlement charge in 2014

Interest Expense

(in millions) 2016 2015 2014

Interest expense \$ 64 \$ 61 \$ 59

Interest expense increased by \$3 million in 2016 compared to 2015, primarily due to higher interest rates on commercial paper borrowings in 2016.

Interest expense increased by \$2 million in 2015 compared to 2014, primarily due to incremental interest for a full year of outstanding long-term debt issued to fund the ARINC acquisition.

See Note 9 of the Notes to Consolidated Financial Statements in Item 8 below for more detail regarding outstanding debt.

Other Income, Net

(in millions) 2016 2015 2014

Other income, net \$ 20 \$ 15 \$ 25

Other income, net increased by \$5 million in 2016 compared to 2015, primarily due to lower pension costs in 2016.

Other income, net decreased by \$10 million in 2015 compared to 2014, primarily due to a \$10 million pre-tax gain that occurred in 2014 when we divested the KOSI business. For additional information regarding the sale of the KOSI business, refer to Note 4 of the Notes to Consolidated Financial Statements in Item 8 below.

Income Tax Expense from Continuing Operations

(in millions) 2016 2015 2014

Income tax expense \$208 \$268 \$264

Effective income tax rate 22.2 % 27.9 % 29.9 %

The difference between our effective income tax rate in 2016 and the statutory tax rate is primarily due to the benefit derived from the Federal Research and Development Tax Credit (Federal R&D Tax Credit), which provides a tax benefit on certain incremental R&D expenditures, the release of a valuation allowance related to a U.S. capital loss carryforward and the Domestic Manufacturing Deduction under Section 199 (DMD), which provides a tax benefit on U.S. - based manufacturing.

The effective income tax rate in 2016 decreased from 2015 primarily due to the permanent extension of the Federal R&D Tax Credit and the release of a \$41 million valuation allowance related to a U.S. capital loss carryforward. The valuation allowance release resulted from the creation of a tax planning strategy in the third quarter of 2016. These tax benefits were partially offset by favorable adjustments in the prior year related to the remeasurement of certain tax positions.

The effective income tax rate in 2015 decreased from 2014 primarily due to the retroactive extension of the Federal R&D Tax Credit, which had previously expired on December 31, 2013, and favorable remeasurement of certain prior year tax positions. These favorable adjustments were partially offset by the absence of the recognition of a tax benefit related to the Extraterritorial Income Exclusion claimed in prior years.

Net Income and Diluted Earnings Per Share (in millions, except per share amounts)			
	2016	2015	2014
Income from continuing operations	\$727	\$694	\$618
Percent of sales	13.8 %	13.2 %	12.4 %
Income (loss) from discontinued operations, net of taxes	1	(8)	(14)
Net income	\$728	\$686	\$604
Diluted earnings per share from continuing operations	\$5.50	\$5.19	\$4.52
Diluted earnings (loss) per share from discontinued operations	0.01	(0.06)	(0.10)
Diluted earnings per share	\$5.51	\$5.13	\$4.42
Weighted average diluted common shares	132.1	133.7	136.7

Income from continuing operations, net of taxes, for 2016 was \$727 million, up 5 percent, or \$33 million, from the \$694 million in income from continuing operations, net of taxes, reported for 2015. Diluted earnings per share from continuing operations increased 6 percent to \$5.50 during this same time period. The rate of increase in diluted earnings per share from continuing operations was more than the rate of increase in income from continuing operations, net of taxes, because of the favorable impacts from our share repurchase program.

Income from continuing operations, net of taxes, and diluted earnings per share from continuing operations in 2016 increased primarily due to:

- a \$60 million decrease in income tax expense primarily due to the release of a valuation allowance for a U.S. capital loss carryforward, the retroactive reinstatement of the Federal R&D Tax Credit and lower pre-tax income from continuing operations

- a total segment operating earnings increase of \$9 million as operating earnings increased \$20 million in Government Systems and \$12 million in Information Management Services, partially offset by a \$23 million decrease in Commercial Systems

- partially offset by \$45 million of pre-tax restructuring and asset impairment charges recorded in 2016

Income from continuing operations, net of taxes, for 2015 was \$694 million, up 12 percent, or \$76 million, from the \$618 million in income from continuing operations, net of taxes, reported for 2014. Diluted earnings per share from continuing operations increased 15 percent to \$5.19 during this same time period. The rate of increase in diluted earnings per share from continuing operations was more than the rate of increase in income from continuing operations, net of taxes, because of the favorable impacts from our share repurchase program.

Income from continuing operations, net of taxes, and diluted earnings per share from continuing operations in 2015 increased primarily due to:

- a \$45 million segment operating earnings increase in Commercial Systems and a \$33 million segment operating earnings increase in Information Management Services

- the absence of \$16 million of transaction costs incurred in connection with the ARINC acquisition

- partially offset by lower operating earnings of \$8 million in Government Systems and the absence of a \$10 million gain realized on the divestiture of KOSI in 2014

Segment Financial Results

One of the key metrics we use to describe year-over-year changes in operating income for each segment is the incremental (or reduced) earnings derived from higher (or lower) sales volumes. Similarly, the gross margin derived from these incremental (or reduced) earnings is often used to describe changes in segment operating margins. The incremental (or reduced) margin realized on the sales volume change tends to be disproportionately higher than the overall operating margin reported for the segment. This is because the overall operating margin for the segment contemplates more elements of our cost structure, such as company-funded R&D expense, depreciation, amortization and selling, general and administrative expenses.

Commercial Systems

Overview and Outlook

Our Commercial Systems business supplies aviation electronics systems, products and services to customers located throughout the world. The customer base is comprised of OEMs of commercial air transport, business and regional aircraft, commercial airlines and business aircraft operators. The near and long-term performance of our Commercial Systems business is impacted by general worldwide economic health, commercial airline flight hours, corporate profits and the financial condition of airlines worldwide.

Commercial Systems sales are expected to be about flat in 2017 compared to 2016.

For risks to the Commercial Systems segment, see Risk Factors in Item 1A above. For additional disclosure on Commercial Systems segment results see Note 21 of the Notes to Consolidated Financial Statements in Item 8 below.

Commercial Systems Sales

The following table presents Commercial Systems sales by product category:

(in millions)	2016	2015	2014
Air transport aviation electronics:			
Original equipment	\$850	\$806	\$703
Aftermarket	542	522	512
Wide-body in-flight entertainment	38	57	70
Total air transport aviation electronics	1,430	1,385	1,285
Business and regional aviation electronics:			
Original equipment	534	640	618
Aftermarket	431	409	396
Total business and regional aviation electronics	965	1,049	1,014
Total	\$2,395	\$2,434	\$2,299
Percent (decrease) increase	(2)%	6%	

Commercial Systems Sales for 2016 compared to 2015

Total air transport aviation electronics sales increased \$45 million, or 3 percent, primarily due to the following:

original equipment sales increased \$44 million, or 5 percent, primarily due to higher Airbus A350 and Boeing 787 production rates, and higher customer-funded development program revenues, partially offset by lower Airbus A330 production rates and unfavorable customer timing for airline selectable equipment

aftermarket sales increased \$20 million, or 4 percent, primarily due to inorganic sales growth from ICG and Pacific Avionics, partially offset by lower service and support activity and the absence of a large used aircraft equipment sale that occurred in the prior year

wide-body IFE sales decreased \$19 million, or 33 percent, as airlines decommissioned their legacy IFE systems

Total business and regional aviation electronics sales decreased \$84 million, or 8 percent, primarily due to the following:

- original equipment sales decreased \$106 million, or 17 percent, primarily due to certain lower business aircraft OEM production rates, partially offset by higher product deliveries for the Bombardier CSeries and Embraer Legacy business jet programs and higher customer-funded development program revenues

- aftermarket sales increased \$22 million, or 5 percent, primarily due to higher regulatory mandate upgrade and flight deck retrofit activity, as well as higher simulation hardware deliveries, partially offset by lower cabin retrofit activity

Commercial Systems Sales for 2015 compared to 2014

Total air transport aviation electronics sales increased \$100 million, or 8 percent, primarily due to the following:

- original equipment sales increased \$103 million, or 15 percent, primarily due to higher OEM production rates, improved share of airline selectable equipment and higher customer-funded development program sales

- aftermarket sales increased \$10 million, or 2 percent, primarily driven by higher sales of used aircraft parts and higher customer-funded development program sales, partially offset by lower spares provisioning for the Boeing 787 program

- wide-body IFE sales decreased \$13 million, or 19 percent, as airlines decommissioned their legacy IFE systems

Total business and regional aviation electronics sales increased \$35 million, or 3 percent, primarily due to the following:

- original equipment sales increased \$22 million, or 4 percent, primarily due to higher customer-funded development program revenues and higher product deliveries for the Embraer Legacy 500 in support of entry into service

- aftermarket sales increased \$13 million, or 3 percent, driven by higher cabin retrofit activity and higher regulatory mandate upgrades partially offset by lower spares provisioning

Commercial Systems Segment Operating Earnings

(in millions)	2016	2015	2014
Segment operating earnings	\$531	\$554	\$509
Percent of sales	22.2 %	22.8 %	22.1 %

Commercial Systems Operating Earnings for 2016 compared to 2015

Commercial Systems operating earnings decreased \$23 million, or 4 percent, primarily due to the following:

- operating earnings were negatively impacted by a \$39 million decrease in sales and sales mix, as lower margin customer-funded development revenues increased and higher margin business jet OEM sales decreased in 2016

- \$15 million increase in the amortization of pre-production engineering costs and intangible assets

- \$10 million increase in SG&A costs primarily due to the acquisition and integration of Pacific Avionics and ICG

-

partially offset by a \$39 million decrease in company-funded R&D expense and the favorable impact of benefits from cost savings initiatives from previously announced restructuring plans

The decrease in Commercial Systems operating earnings as a percent of sales was primarily due to lower sales volume and unfavorable sales mix, partially offset by lower company-funded R&D expense.

Commercial Systems Operating Earnings for 2015 compared to 2014

Commercial Systems operating earnings increased \$45 million, or 9 percent, primarily due to the following:

the \$135 million increase in sales discussed in the Commercial Systems sales section above, which resulted in an \$83 million increase in cost and incremental earnings of \$52 million, or 39 percent of the higher sales volume. The margin from incremental sales benefited from favorable customer-funded development program adjustments

partially offset by \$7 million of other net decreases to operating earnings, including higher employee incentive compensation costs of \$8 million

The increase in Commercial Systems operating earnings as a percent of sales was primarily due to earnings from the higher sales volume, partially offset by higher employee incentive compensation costs.

Government Systems

Overview and Outlook

The Government Systems business provides communication and navigation products and avionics to the U.S. Department of Defense, state and local governments, other government agencies, civil agencies, defense contractors and foreign ministries of defense around the world. These systems, products and services support airborne (fixed and rotary wing), ground and shipboard applications. The short and long-term performance of our Government Systems business is affected by a number of factors, including the amount and prioritization of defense spending by the U.S. and non-U.S. governments, which is generally based on the security environment and underlying political landscape.

The U.S. Government has implemented various initiatives to address its fiscal challenges. In August 2011, Congress enacted the Budget Control Act of 2011 which imposed spending caps and certain reductions in security spending over a ten-year period through 2021. These spending caps and reductions, referred to as sequestration, went into effect in March 2013. In December 2013, Congress enacted the Murray-Ryan Bipartisan Budget Act of 2013, raising government discretionary spending limits temporarily for 2014 and 2015. More recently, the Bipartisan Budget Act of 2015 again raised the government discretionary spending limits temporarily for 2016 and 2017, after which the BCA will again be in force. The continued uncertainty surrounding the U.S. defense budget could have a material adverse effect on the Company and the defense industry in general.

In years when the U.S. Government does not complete its annual budget and appropriations process prior to the beginning of its fiscal year (October 1), government operations are typically funded through a continuing resolution that authorizes agencies of the U.S. Government to continue to operate in the new year, but generally does not authorize new spending initiatives. During periods covered by continuing resolutions (or until the regular appropriation bills are passed), we may experience delays by the government in procurement of new or existing products and services which can adversely impact our results of operations and cause variability in the timing of revenue between periods. The government began operations in fiscal year 2017 under a continuing resolution that is set to expire in December 2016. We remain confident that our product offerings are well positioned to meet the needs of our government customers in this uncertain environment and we continue to enhance our international strategies and make proactive adjustments to our cost structure as necessary.

Government Systems fiscal year 2017 revenue is expected to be up low to mid-single digits when compared to 2016.

Beginning in 2016, product category sales for Government Systems have been consolidated as a result of an internal reorganization and are delineated based upon underlying product technologies. The previously reported sales

categories of Communication products, Surface solutions and Navigation products are now primarily consolidated into Communication and navigation. Government Systems sales have been reclassified to conform to the current year presentation.

For risks to the Government Systems segment, see Risk Factors in Item 1A above. For additional disclosure on Government Systems segment results see Note 21 of the Notes to Consolidated Financial Statements in Item 8 below.

Government Systems Sales

The following table presents Government Systems sales by product category:

(in millions)	2016	2015	2014	
Avionics	\$1,483	\$1,436	\$1,409	
Communication and navigation	723	751	800	
Total	\$2,206	\$2,187	\$2,209	
Percent increase (decrease)	1	% (1)%	

Government Systems Sales for 2016 compared to 2015

Avionics sales increased \$47 million, or 3 percent, primarily due to the following:

- an \$80 million increase from higher deliveries and service revenue on various fixed wing platforms
- an \$8 million increase from higher simulation and training sales

partially offset by \$41 million in other net decreases to revenue, including lower deliveries on various rotary wing platforms

Communication and navigation sales decreased \$28 million, or 4 percent, primarily due to the following:

- a \$32 million decrease due to lower international deliveries of targeting systems
- a \$28 million decrease due to the wind-down of an international electronic warfare program

partially offset by \$32 million in other net increases to revenue, including increases in data link and ARC-210 radio sales

Government Systems Sales for 2015 compared to 2014

Avionics sales increased \$27 million, or 2 percent, primarily due to the following:

- \$81 million increase from higher deliveries on various tanker transport and rotary wing platforms

partially offset by \$54 million in other net decreases to revenue, including lower fighter aircraft and simulation and training sales

Communication and navigation product sales decreased \$49 million, or 6 percent, primarily due to the following:

- \$93 million decrease from lower deliveries of Joint Tactical Radio System Manpack radios

• \$39 million in other decreases from lower deliveries of Firestorm targeting systems and lower development sales for the Common Range Integrated Instrumentation System program

partially offset by \$83 million in other net increases to revenue, including increases in data link development sales, higher Radio Navigation and ARC-210 radio sales, and higher international electronic intelligence program sales

Changes in foreign currency exchange rates, primarily the strengthening of the U.S. dollar, resulted in a \$39 million reduction to Government Systems sales for 2015 when compared to 2014. This \$39 million reduction is included within the Government Systems sales categories above.

Government Systems Segment Operating Earnings			
(in millions)	2016	2015	2014
Segment operating earnings	\$477	\$457	\$465
Percent of sales	21.6 %	20.9 %	21.1 %

Government Systems Operating Earnings for 2016 compared to 2015

Government Systems operating earnings increased \$20 million, or 4 percent, primarily due to the following:

- the \$19 million increase in sales volume discussed in the Government Systems sales section above, which resulted in a \$9 million increase in cost and incremental earnings of \$10 million, or 53 percent of the higher sales volume. The margins on the sales increase were favorably impacted by benefits from cost savings initiatives from previously announced restructuring plans and unfavorably impacted by the absence of certain favorable development program adjustments that occurred in the prior year
- a \$9 million decrease in company-funded R&D expense
- an \$8 million decrease in pension costs
- partially offset by a \$6 million unfavorable warranty adjustment

The increase in Government Systems operating earnings as a percent of sales was primarily driven by earnings from the higher sales volume including the favorable impact of cost savings initiatives, decreased company-funded R&D expense and lower pension costs, partially offset by an unfavorable warranty adjustment and the absence of certain favorable development program adjustments that occurred in the prior year.

Government Systems Operating Earnings for 2015 compared to 2014

Government Systems operating earnings decreased \$8 million, or 2 percent, primarily due to the following:

- a \$14 million increase in company-funded R&D expense
- an \$8 million increase in employee incentive compensation costs
- the \$22 million reduction in sales volume, which resulted in a \$20 million reduction in cost, and lower earnings of \$2 million, favorably impacted by benefits from cost savings initiatives
- partially offset by favorable development program adjustments

The decrease in Government Systems operating earnings as a percent of sales was primarily driven by the increase in company-funded R&D expense and higher employee incentive compensation costs, partially offset by favorable development program adjustments.

Information Management Services

Overview and Outlook

Our Information Management Services business enables mission-critical data and voice communications throughout the world to customers including the FAA, commercial airlines, business aircraft operators, airport and critical infrastructure operators and major passenger and freight railroads. These communications are enabled by our high-performance, high-quality and high-assurance proprietary radio and terrestrial networks, enhancing customer efficiency, safety and connectivity.

Information Management Services fiscal year 2017 sales are expected to grow mid to high-single digits when compared to 2016.

For risks to the Information Management Services segment, see Risk Factors in Item 1A above. For additional disclosure on Information Management Services segment results see Note 21 of the Notes to Consolidated Financial Statements in Item 8 below.

Information Management Services Sales

The following table presents Information Management Services sales:

(in millions)	2016	2015	2014
Sales	\$658	\$623	\$471
Percent increase	6 %	32 %	

Information Management Services Sales for 2016 compared to 2015

Total Information Management Services sales increased \$35 million, or 6 percent, primarily due to 6 percent growth in aviation-related sales, and 4 percent growth in non-aviation related sales for airport and rail programs. Aviation-related sales growth was offset by the absence of certain favorable adjustments recorded in 2015.

Information Management Services Sales for 2015 compared to 2014

Total Information Management Services sales increased \$152 million, or 32 percent, primarily due to a \$131 million inorganic increase from the acquisition of ARINC, which occurred on December 23, 2013.

Information Management Services Pro-forma Sales

Note 3 of the Notes to Consolidated Financial Statements in Item 8 below presents supplemental pro-forma financial data as if the acquisition of ARINC had been completed on October 1, 2012. The pro-forma data included in Note 3 combines our consolidated results with the stand-alone results of ARINC for the pre-acquisition periods. The pro-forma data excludes the results of ASES, which was divested on March 10, 2015. The supplemental pro-forma data is not necessarily indicative of results that actually would have occurred had the acquisition truly been consummated on October 1, 2012.

Sales for the Information Management Services segment were \$623 million for the twelve months ended September 30, 2015 and on a pro-forma basis were \$577 million for the twelve months ended September 30, 2014. The \$46 million, or 8 percent, increase in 2015 compared to the pro-forma sales in 2014 was primarily due to the following:

- double-digit sales growth in aviation related sales
- higher rail related sales due to the absence of certain unfavorable contract adjustments recorded in 2014
- partially offset by lower sales due to the exit of a certain non-aviation government program

Refer to Note 3 of the Notes to Consolidated Financial Statements in Item 8 below for further pro-forma disclosures.

Information Management Services Segment Operating Earnings

(in millions)	2016	2015	2014
Segment operating earnings	\$107	\$95	\$62
Percent of sales	16.3 %	15.2%	13.2%

Information Management Services Operating Earnings for 2016 compared to 2015

Information Management Services operating earnings increased \$12 million, primarily due to:

a \$35 million increase in sales volume discussed in the Information Management Services sales section above, which resulted in a \$25 million increase in cost and an increase in earnings of \$10 million, or 29 percent of the higher sales volume. The margins on the sales increase were unfavorably impacted by the increase in lower margin non-aviation related sales

operating earnings were positively impacted in 2016 by the favorable resolution of certain prior year claims associated with international business jet support services

The increase in operating earnings as a percent of sales for 2016 compared to the prior year was primarily due to higher sales volume and the above mentioned favorable resolution of prior year claims.

Information Management Services Operating Earnings for 2015 compared to 2014

Information Management Services operating earnings increased \$33 million, primarily due to a \$19 million inorganic increase from the acquisition of ARINC. The remaining \$14 million increase is primarily due to:

incremental earnings from the \$21 million organic increase in sales discussed in the Information Management Services sales section above

the absence of certain licensing costs incurred in the prior year

partially offset by higher business development costs

The increase in operating earnings as a percent of sales for 2015 compared to the prior year was primarily due to higher sales volume.

General Corporate, Net

General corporate expenses that are not allocated to our operating segments are included in General corporate, net. These costs are included within Cost of sales, SG&A and Other income, net on the Consolidated Statement of Operations. General corporate, net is summarized as follows:

(in millions)	2016	2015	2014
General corporate, net	\$ 44	\$ 59	\$ 59

General corporate, net expense decreased \$15 million during 2016 as compared to 2015, primarily due to a decrease in employee incentive compensation and pension costs.

General corporate, net expense remained flat in 2015 as compared to 2014, as higher employee incentive compensation costs were offset by lower pension costs.

Retirement Plans

Net benefit expense (income) for pension benefits and other retirement benefits are as follows:

(in millions)	2016	2015	2014
---------------	------	------	------

Pension benefits	\$(24)	\$(6)	\$ 10
Other retirement benefits	14	11	10
Net benefit (income) expense	\$(10)	\$ 5	\$ 20

Pension Benefits

In 2003, we amended our U.S. qualified and non-qualified pension plans covering all salary and hourly employees not covered by collective bargaining agreements to discontinue benefit accruals for salary increases and services rendered after September 30, 2006. Concurrently, we replaced this benefit by supplementing our existing defined contribution savings plan to include an additional Company contribution effective October 1, 2006. Our total contributions made in cash to our defined contribution savings plan were \$46 million, \$47 million and \$50 million for 2016, 2015 and 2014, respectively.

In October 2014, the Society of Actuaries published a new set of mortality tables (RP-2014) and a new mortality improvement scale (MP-2014), which update life expectancy assumptions. The tables generally reflect longer life expectancy than was projected by past tables. For our 2015 year-end pension liability valuation, we used the RP-2014 tables with an adjustment for plan experience and the MP-2014 improvement scale adjusted to reflect convergence to an ultimate annual rate of mortality improvement of 0.75 percent by 2022. These changes resulted in an unfavorable impact to 2016 pension income and pre-tax earnings of \$15 million. See additional details in the Critical Accounting Policies section below.

In 2015 and prior, we used a single-weighted average discount rate to calculate pension interest and service cost. Beginning in 2016, a "spot rate approach" is being used to calculate pension interest and service cost. The spot rate approach applies separate discount rates for each projected benefit payment in the calculation of pension interest and service cost. This calculation change is considered a change in accounting estimate and was applied prospectively beginning in 2016. The use of the spot rate approach had a favorable impact to pension income of \$35 million in 2016, relative to the estimated pension income amount had we not changed our approach. See additional details in the Critical Accounting Policies section in Item 7A below.

Defined benefit pension expense (income) for the years ended September 30, 2016, 2015 and 2014 was \$(24) million, \$(6) million and \$10 million, respectively.

The increase in pension income in 2016 compared to 2015 was primarily due to the calculation change of the discount rate for interest and service cost as discussed above, partially offset by the impact of the new mortality assumptions. The decrease in pension expense in 2015 compared to 2014 was primarily due to lower interest expense from lower discount rates and higher expected asset returns as a result of a larger beginning asset balance. There was also a \$5 million settlement charge included in 2014 defined benefit pension expense.

We expect defined benefit pension income of \$25 million in 2017, compared to \$24 million of pension income in 2016.

During 2016, the funded status of our pension plans went from a deficit of \$1.265 billion at September 30, 2015 to a deficit of \$1.453 billion at September 30, 2016. The decrease in funded status was primarily due to the unfavorable impact from a decrease in the discount rate used to measure our U.S. pension obligations from 3.96 percent at September 30, 2015 to 3.22 percent at September 30, 2016, offset by an increase in plan assets due to favorable market returns during 2016. We also contributed \$69 million to our pension plans during the year ended September 30, 2016.

Our objective with respect to the funding of our pension plans is to provide adequate assets for the payment of future benefits. Pursuant to this objective, we will fund our pension plans as required by governmental regulations and may consider discretionary contributions as conditions warrant. We believe our strong financial position continues to provide us the opportunity to make contributions to our pension funds without inhibiting our ability to pursue strategic investments.

In October 2016, subsequent to our 2016 fiscal year end, we made a \$55 million voluntary contribution to our U.S. qualified pension plan. There is no minimum statutory funding requirement for 2017 and we do not currently expect to make any additional discretionary contributions during 2017 to this plan. Any additional future contributions necessary to satisfy minimum statutory funding requirements are dependent upon actual plan asset returns, interest rates and other actuarial assumptions. Contributions to our non-U.S. plans and our U.S. non-qualified plan are expected to total \$13 million in 2017.

Other Retirement Benefits

Other retirement benefits expense for the years ended September 30, 2016, 2015 and 2014 was \$14 million, \$11 million and \$10 million, respectively.

FINANCIAL CONDITION AND LIQUIDITY

Cash Flow Summary

Our ability to generate significant cash flow from operating activities coupled with our expected ability to access the credit markets enables us to execute our growth strategies and return value to our shareowners. The timing of our cash inflows is historically heavily weighted towards the second half of our fiscal year, particularly our fourth quarter. We expect this trend to continue in the future.

Operating Activities

(in millions)	2016	2015	2014
Cash provided by operating activities from continuing operations	\$723	\$749	\$660

The \$26 million decrease in cash provided by operating activities in 2016 compared to 2015 was primarily due to the following:

cash receipts from customers decreased by \$135 million to \$5.080 billion in 2016 compared to \$5.215 billion in 2015. Cash receipts from customers decreased despite sales volume growth of \$15 million due to the timing of sales relative to advanced payments and the collection of receivables from customers

payments for employee incentive pay increased \$23 million. Incentive pay is expensed in the year incurred and then paid in the first fiscal quarter of the following year. In 2016, \$137 million was paid for employee incentive pay costs expensed during 2015. This compares to \$114 million paid in 2015 for employee incentive costs expensed during 2014

the above items were partially offset by lower payments for production inventory and other operating costs which decreased \$85 million to \$4.017 billion in 2016 compared to \$4.102 billion in 2015. Cash payments for operating costs decreased despite growth in cost of sales due to the timing of payments to suppliers

cash payments for income taxes decreased \$52 million to \$130 million in 2016, compared to \$182 million in 2015. The decrease in income tax payments was primarily from the retroactive reinstatement of the Federal R&D tax credit as a result of the Protecting Americans from Tax Hikes Act, as well as lower pre-tax income from continuing operations

The \$89 million increase in cash provided by operating activities in 2015 compared to 2014 was primarily due to the following:

- cash receipts from customers increased by \$176 million to \$5.215 billion in 2015 compared to \$5.039 billion in 2014. The increase in cash receipts from customers was less than the sales volume increase of \$265 million due to the timing of sales and collection of receivables

the above item was partially offset by higher payments for production inventory and other operating costs which increased \$85 million to \$4.102 billion in 2015 compared to \$4.017 billion in 2014. The increased payments for operating costs primarily resulted from higher sales volume, partially offset by lower payroll related costs due to the timing of payroll and employee incentive payments

Investing Activities

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(in millions)	2016	2015	2014
Cash used for investing activities from continuing operations	\$(209)	\$(294)	\$(1,537)

37

The \$85 million reduction in cash used for investing activities in 2016 compared to 2015 was primarily due to the following:

- we paid \$50 million and \$24 million in 2015 for the acquisitions of ICG and Pacific Avionics, respectively

- a \$17 million decrease in cash payments for property additions to \$193 million in 2016

- the above items were partially offset by \$17 million paid for the Matrix series projector product line acquisition in 2016

The \$1,243 million reduction in cash used for investing activities in 2015 compared to 2014 was primarily due to the following:

- we paid \$1.405 billion in 2014 for the acquisition of ARINC

- the above item was partially offset by a \$47 million increase to cash payments made for property additions to \$210 million in 2015

- in addition, we paid \$50 million and \$24 million in 2015 for the acquisitions of ICG and Pacific Avionics, respectively

- also, we received \$23 million in proceeds from the divestiture of our KOSI business in 2014

Financing Activities

(in millions)	2016	2015	2014
Cash provided by (used for) financing activities from continuing operations	\$(422)	\$(492)	\$827

The \$70 million decrease in cash used for financing activities in 2016 compared to 2015 was primarily due to the following:

- cash repurchases of common stock decreased \$69 million to \$261 million in 2016, compared to \$330 million in 2015

- net repayments of short-term commercial paper borrowings decreased \$48 million to \$8 million in 2016, compared to \$56 million in 2015

- partially offset by a decrease in proceeds received from the exercise of stock options of \$28 million

- also, cash dividend payments increased \$5 million. During 2016, \$172 million of cash dividend payments were made to shareowners, compared to \$167 million 2015. The increase was primarily due to a 10 percent increase in our quarterly cash dividend paid on common stock to \$0.33 per share, which was effective beginning with dividends paid in June 2015

The \$1,319 million increase in cash used for financing activities in 2015 compared to 2014 was primarily due to the following:

- the absence of proceeds from the December 2013 issuance of long-term debt of \$1.089 billion. A portion of these proceeds were used to finance the acquisition of ARINC and the remainder was used to refinance \$200 million of

long-term debt that matured in December 2013

net proceeds from short-term commercial paper borrowings decreased \$325 million. During 2015, net repayments of short-term commercial paper borrowings were \$56 million, compared to net proceeds of \$269 million during 2014. The incrementally higher proceeds in the prior year were used primarily to finance the acquisition of ARINC

cash repurchases of common stock increased \$119 million to \$330 million during 2015, compared to \$211 million in 2014

38

Share Repurchase Program

Cash flow from operations provided funds for repurchasing our common stock under our share repurchase program as follows:

(in millions, except per share amounts)	2016	2015	2014
Amount of share repurchases	\$255	\$325	\$206
Number of shares repurchased	2.9	3.8	2.7
Weighted average price per share	\$87.30	\$85.32	\$76.84

None of the 2016, 2015 and 2014 share repurchases reflected in the table above are included within accounts payable at September 30, 2016, 2015 and 2014, respectively.

Dividends

We declared and paid cash dividends of \$172 million, \$167 million and \$162 million in 2016, 2015 and 2014, respectively. Based on our current dividend policy, we expect to pay quarterly cash dividends which, on an annual basis, will equal \$1.32 per share. We expect to fund dividends using cash generated from operations. The declaration and payment of future dividends is at the sole discretion of the Board of Directors.

Financial Condition and Liquidity

We maintain a capital structure that we believe enables us sufficient access to credit markets. When combined with our ability to generate strong levels of cash flow from our operations, this capital structure has provided the strength and flexibility necessary to pursue strategic growth opportunities and to return value to our shareowners.

A comparison of key elements of our financial condition as of September 30, 2016 and 2015 are as follows:

	September 30	
(in millions)	2016	2015
Cash and cash equivalents	\$340	\$252
Short-term debt	(740)	(448)
Long-term debt, net	(1,382)	(1,680)
Total Debt	\$(2,122)	\$(2,128)
Total equity	\$2,084	\$1,880
Debt to total capitalization ⁽¹⁾	50 %	53 %

⁽¹⁾ Calculated as Total debt divided by the sum of Total debt plus Total equity

We primarily fund our contractual obligations, capital expenditures, small to medium-sized acquisitions, dividends and share repurchases with cash generated from operating activities. As of September 30, 2016, approximately 85 percent of our cash and cash equivalents reside at non-U.S. locations and may not be readily accessible for use in the U.S., due to potential adverse income tax implications and other statutory limitations. We do not currently intend to repatriate cash and cash equivalents held at non-U.S. locations, as we anticipate utilizing this cash to fund foreign operations and international growth.

Due to the fluctuations of cash flows, we supplement our internally-generated cash flow by issuing short-term commercial paper. Under our commercial paper program, we may sell up to \$1.2 billion face amount of unsecured short-term promissory notes in the commercial paper market. The commercial paper notes have maturities of not more than 364 days from the date of issuance. At September 30, 2016, short-term commercial paper borrowings outstanding

were \$440 million, with a weighted-average interest rate and maturity period of 0.79 percent and fifteen days, respectively. At September 30, 2015, short-term commercial paper borrowings outstanding were \$448 million, with a weighted-average interest rate and maturity period of 0.52 percent and 25 days, respectively. The maximum amount of short-term commercial paper borrowings outstanding during 2016 was \$929 million.

Short-term debt includes \$300 million of senior unsecured notes that mature in December 2016. The Company plans to refinance those notes.

We have a five-year \$1 billion credit facility that expires in December 2018 and a 364-day \$200 million credit facility that was executed in February 2016 and expires in February 2017. The credit facilities include one financial covenant requiring us to maintain a consolidated debt to total capitalization ratio of not greater than 60 percent (excluding the equity impact on accumulated other comprehensive loss related to defined benefit retirement plans). The ratio was 35 percent at September 30, 2016.

In addition, alternative sources of liquidity could include funds available from the issuance of equity securities, debt securities and potential asset securitization strategies. To date, we have not raised capital through the issuance of equity securities, but have used debt financing to lower our overall cost of capital and increase our return on shareowners' equity.

Credit ratings are a significant factor in determining our ability to access short-term and long-term financing, as well as the cost of such financing. Our strong credit ratings have enabled continued access to both short- and long-term credit markets. The following is a summary of our credit ratings as of September 30, 2016:

Credit Rating Agency	Short-Term Rating	Long-Term Rating	Outlook
Fitch Ratings	F2	A-	Stable
Moody's Investors Service	P-2	A3	Stable
Standard & Poor's	A-2	A-	Stable

We were in compliance with all debt covenants at September 30, 2016 and September 30, 2015.

As discussed in Note 23 of the Notes to Consolidated Financial Statements in Item 8 below, subsequent to our 2016 fiscal year end the Company entered into a definitive agreement to acquire B/E Aerospace. Pursuant to that announcement and the Company's plans to finance the acquisition, each of the credit rating agencies have placed the Company on credit review with potential negative implications. While we expect that additional debt issued in connection with the B/E Aerospace transaction will result in a downgrade to the Company's credit ratings, we expect those credit ratings to remain at an investment grade level. We do not expect this change to our credit ratings to impact the Company's ability to access short-term or long-term debt financing, but the cost of such financing could increase.

Factoring Arrangements

We sell certain accounts receivable on a non-recourse basis to unrelated financial institutions under factoring agreements arranged by certain customers. Under the terms of the agreements, we retain no rights or interest and have no obligations with respect to the sold receivables. We account for these transactions as sales of receivables and record cash proceeds when received as cash provided by operating activities in the Consolidated Statement of Cash Flows. The beneficial impact on cash provided by operating activities from participating in these programs was \$60 million and \$12 million in 2016 and 2015, respectively. The cost of participating in these programs was immaterial to our results.

Off-balance Sheet Arrangements

As of September 30, 2016, other than operating leases, we had no material off-balance sheet arrangements, including guarantees, retained or contingent interests in assets transferred to unconsolidated entities, derivative instruments indexed to our stock and classified in shareowners' equity on our Consolidated Statement of Financial Position or variable interests in entities that provide financing, liquidity, market risk or credit risk support to our Company.

Contractual Obligations

The following table summarizes certain of our contractual obligations as of September 30, 2016, as well as when these obligations are expected to be satisfied.

40

(in millions)	Payments Due by Period				
	Total	Less than 1 Year	1 - 3 Years	4 - 5 Years	Thereafter
Long-term debt	\$1,650	\$300	\$300	\$—	\$1,050
Interest on long-term debt	731	58	116	84	473
Non-cancelable operating leases	316	63	91	49	113
Non-cancelable capital leases, including interest	76	6	11	11	48
Purchase obligations:					
Purchase orders	1,244	952	244	37	11
Purchase contracts	188	34	61	53	40
Total	\$4,205	\$1,413	\$823	\$234	\$1,735

Interest payments under long-term debt obligations exclude the potential effects of the related interest rate swap contracts. See Note 9 of the Notes to Consolidated Financial Statements in Item 8 below.

We lease certain office and manufacturing facilities as well as certain machinery and equipment under various lease contracts. Our commitments under operating leases, in the form of non-cancelable future lease payments, are not reflected as a liability on our Consolidated Statement of Financial Position. The principal portion of capital lease obligations is reflected within Other Liabilities on our Consolidated Statement of Financial Position.

Purchase obligations include purchase orders and purchase contracts. Purchase orders are executed in the normal course of business and may or may not be cancelable. Purchase contracts include agreements with suppliers under which there is a commitment to buy a minimum amount of products or pay a specified amount regardless of actual need. Generally, items represented in purchase obligations are not reflected as liabilities on our Consolidated Statement of Financial Position.

The table excludes obligations with respect to pension and other post-retirement benefit plans (see Note 10 of the Notes to Consolidated Financial Statements in Item 8 below). In October 2016, subsequent to our fiscal year end, we made a voluntary contribution of \$55 million to our U.S. qualified pension plan. For years beyond 2017, the actual amounts required to be contributed to our U.S. qualified pension plan are dependent upon, among other things, interest rates and underlying asset returns. With the exception of certain bargaining unit plans, payments due under other post-retirement benefit plans are funded as the expenses are incurred.

In addition, the table excludes liabilities for unrecognized tax benefits, which totaled \$45 million at September 30, 2016, as we cannot reasonably estimate the ultimate timing of cash settlements to the respective taxing authorities (see Note 13 of the Notes to Consolidated Financial Statements in Item 8 below).

The following table reflects certain of our commercial commitments as of September 30, 2016:

(in millions)	Amount of Commitment Expiration by Period				
	Total Amount Committed Year	Less than 1 Year	1 - 3 Years	4 - 5 Years	Thereafter
Letters of credit ⁽¹⁾	\$239	\$185	\$52	\$—	\$2

⁽¹⁾ See Note 16 of the Notes to Consolidated Financial Statements in Item 8 below for a discussion of letters of credit. In addition to the obligations disclosed above, we occasionally enter into offset agreements, required by certain customers in some non-U.S. countries, as a condition to obtaining contract awards for our products and services.

These agreements, which generally extend over several years, are customary in our industry and are designed to enhance the social and economic environment of the country in which our customers operate. These commitments may be satisfied through activities that do not require us to use cash, including transfer of technology, providing manufacturing and other consulting support to in-country projects, strategic alliances and transactions conducted by third parties (e.g., our vendors). These agreements may also be satisfied through our use of cash for activities such as placement of direct work or vendor orders for supplies and/or services, building or leasing facilities for in-country operations, in-country employment of a non-U.S. country's citizens and other forms of assistance in the applicable country. The offset rules and regulations, as well as the underlying contracts, may differ from one country to another.

We typically do not commit to offset agreements until contract awards for our products or services are definitive. Should we be unable to meet the offset obligations we may be subject to contractual penalties, and our chances of receiving additional business from the applicable customers could be reduced or, in certain cases, eliminated. We historically have not been required to pay material penalties related to offset obligations and are currently in compliance with our offset commitments.

At September 30, 2016, we had outstanding offset obligations totaling approximately \$499 million that extend through 2036. The amounts ultimately applied against our offset requirements are based on negotiations with the customer and the cost to fulfill the obligation is typically only a fraction of the original obligation.

RECENTLY ISSUED ACCOUNTING STANDARDS

For information related to recently issued accounting standards, see Note 2 of the Notes to Consolidated Financial Statements in Item 8 below.

ENVIRONMENTAL

For information related to environmental claims, remediation efforts and related matters, see Note 18 of the Notes to Consolidated Financial Statements in Item 8 below.

CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates, judgments and assumptions that affect our financial condition and results of operations that are reported in the accompanying consolidated financial statements as well as the related disclosure of assets and liabilities contingent upon future events.

Understanding the critical accounting policies discussed below and related risks is important in evaluating our financial condition and results of operations. We believe the following accounting policies used in the preparation of the consolidated financial statements are critical to our financial condition and results of operations as they involve a significant use of management judgment on matters that are inherently uncertain. If actual results differ significantly from management's estimates, there could be a material effect on our financial condition, results of operations and cash flows. Management regularly discusses the identification and development of these critical accounting policies with the Audit Committee of the Board of Directors.

Accounting for Long-Term Contracts

A substantial portion of our sales to government customers and certain of our sales to commercial customers are made pursuant to long-term contracts requiring development and delivery of products over several years and often contain fixed-price purchase options for additional products. Certain of these contracts are accounted for under the percentage-of-completion method of accounting. Sales and earnings under the percentage-of-completion method are recorded either as products are shipped under the units-of-delivery method (for production effort), or based on the ratio of actual costs incurred to total estimated costs expected to be incurred related to the contract under the cost-to-cost method (for development effort). Approximately 16 percent of our sales are accounted for under the percentage-of-completion method of accounting.

The percentage-of-completion method of accounting requires management to estimate the profit margin for each individual contract and to apply that profit margin on a uniform basis as sales are recorded under the contract. The estimation of profit margins requires management to make projections of the total sales to be generated and the total

costs that will be incurred under a contract. These projections require management to make numerous assumptions and estimates relating to items such as the complexity of design and related development costs, performance of subcontractors, availability and cost of materials, labor productivity and cost, overhead and capital costs and manufacturing efficiency. These contracts often include purchase options for additional quantities and customer change orders for additional or revised product functionality. Sales and costs related to profitable purchase options are included in our estimates only when the options are exercised while sales and costs related to unprofitable purchase options are included in our estimates when exercise is determined to be probable. Sales related to change orders are included in profit estimates only if they can be reliably estimated and collectability is reasonably assured. Purchase options and change orders are accounted for either as an integral part of the original contract or separately, depending upon the

nature and value of the item. Anticipated losses on contracts are recognized in full in the period in which losses become probable and estimable.

Estimates of profit margins for contracts are typically reviewed by management on a quarterly basis. Assuming the initial estimates of sales and costs under a contract are accurate, the percentage-of-completion method results in the profit margin being recorded evenly as revenue is recognized under the contract. Changes in these underlying estimates due to revisions in sales and cost estimates, the combining of contracts or the exercise of contract options may result in profit margins being recognized unevenly over a contract as such changes are accounted for on a cumulative basis in the period estimates are revised. Cumulative catch-up adjustments resulting from changes in estimates did not have a material effect on our results of operations during the years ended September 30, 2016, 2015 or 2014.

Program Investments

We defer certain pre-production engineering costs in Inventories, net and record up-front sales incentives in Intangible Assets (collectively referred to as Program Investments). These Program Investments are amortized over their estimated useful lives, up to a maximum of 15 years. Estimated useful lives are limited to the amount of time we are virtually assured to earn revenues through a contractually enforceable right included in long-term supply arrangements with our customers. This provides the best matching of expense over the related period of benefit. The following provides an overview of the Program Investments:

	September 30	
(in millions)	2016	2015
Pre-production engineering costs	\$1,140	\$1,012
Up-front sales incentives	233	239
Total Program Investments	\$1,373	\$1,251

We defer the cost of certain pre-production engineering costs incurred during the development phase of a program in connection with long-term supply arrangements that contain contractual guarantees for reimbursement from customers. These customer guarantees generally take the form of a minimum order quantity with quantified reimbursement amounts if the minimum order quantity is not taken by the customer. These costs are deferred in inventory to the extent of the contractual guarantees and are amortized over their estimated useful lives using a units-of-delivery method, up to 15 years. This amortization expense is included in customer funded R&D as a component of cost of sales. Amortization is based on our expectation of delivery rates on a program-by-program basis and begins when we start recognizing revenue as we deliver equipment for the program. Pre-production engineering costs in excess of the contractual guarantee, and costs incurred pursuant to supply arrangements that do not contain customer guarantees for reimbursement, are expensed as incurred.

We also provide up-front sales incentives prior to delivering products or performing services to certain commercial customers in connection with sales contracts. Up-front sales incentives are recorded as a customer relationship intangible asset and are amortized using a units-of-delivery method over the period we have received a contractually enforceable right related to the incentives, up to 15 years after entry into service. Amortization is based on our expectation of delivery rates on a program-by-program basis. Amortization begins when we start recognizing revenue as we deliver equipment for the program. Up-front sales incentives consisting of cash payments or customer account credits are amortized as a reduction of sales, whereas incentives consisting of free products are amortized as cost of sales.

Risks inherent in recovering the value of our Program Investments include, but are not limited to, the following:

-

changes in market conditions may affect product sales under a program. In particular, the commercial aerospace market has been historically cyclical and subject to downturns during periods of weak economic conditions, which could be prompted or exacerbated by political or other U.S. or international events

• bankruptcy or other significant financial difficulties of our customers

• our ability to produce products could be impacted by the performance of subcontractors, the availability of specialized materials and other production risks

We evaluate the carrying amount of Program Investments for recovery at least annually or when potential indicators of impairment exist, such as a change in the estimated number of products to be delivered under a program. No significant impairment charges related to Program Investments were recorded in 2016, 2015 or 2014. While we believe our Program Investments are recoverable over time, the cancellation of a program by a customer coupled with bankruptcy or other financial

difficulties, would represent the most significant impairment factor related to Program Investments. We also evaluate our amortization of Program Investments quarterly based on our expectation of delivery rates on a program-by-program basis. The impact of changes in expected delivery rates on the Program Investments' amortization is adjusted as needed on a prospective basis.

Amortization expense for pre-production engineering costs and up-front sales incentives for 2016, 2015 and 2014 was as follows:

(in millions)	2016	2015	2014
Amortization of pre-production engineering	\$ 49	\$ 47	\$ 36
Amortization of up-front sales incentives	18	15	12
Total amortization of Program Investments	\$ 67	\$ 62	\$ 48

As disclosed in Note 6 of the Notes to Consolidated Financial Statements, the weighted-average amortization period for pre-production engineering costs is approximately 10 years. As disclosed in Note 3 of the Notes to Consolidated Financial Statements, the weighted-average amortization period for up-front sales incentives is approximately 10 years. Anticipated amortization expense for the Program Investments at September 30, 2016, for 2017 and beyond is summarized below:

(in millions)	2017	2018	2019	2020	2021	Thereafter
Anticipated amortization expense for pre-production engineering costs ⁽¹⁾	\$ 60	\$ 102	\$ 137	\$ 154	\$ 139	\$ 521
Anticipated amortization expense for up-front sales incentives	16	19	24	26	26	122
Total anticipated amortization for Program Investments	\$ 76	\$ 121	\$ 161	\$ 180	\$ 165	\$ 643

⁽¹⁾ On October 29, 2015, Bombardier announced the cancellation of the Learjet 85 program. Pre-production engineering costs associated with the Learjet 85 program have been excluded from anticipated amortization expense, as these costs are expected to be recovered through consideration received from Bombardier pursuant to contractual guarantees and not amortized against future hardware deliveries.

Pre-production engineering costs comprise 59 percent of our total Inventory balance at September 30, 2016, compared to 55 percent at September 30, 2015. Pre-production engineering costs increased \$128 million from September 30, 2015 to September 30, 2016. The majority of this increase was attributable to increased spending on programs with Boeing and Bombardier and increased investment on certain Government Systems military transport programs. Additionally, up-front sales incentives to Commercial Systems customers decreased \$6 million from September 30, 2015 to September 30, 2016.

Growth in our Program Investments continues to be driven by the expanded market share our Company successfully captured over the past several years. Commercial Systems has secured positions on several key platforms in the air transport market, including the Boeing 737 MAX and Airbus A350. In the business and regional jet market, our Pro Line Fusion avionics system has been selected by customers around the globe, including Bombardier, Embraer and Gulfstream.

We believe our Program Investments are recoverable based upon our contractually enforceable rights under long-term supply arrangements and the expected revenues and profits associated with our positions on these aircraft platforms.

Income Taxes

At the end of each quarterly reporting period, we estimate an effective income tax rate that is expected to be applicable for the full fiscal year. The estimate of our effective income tax rate involves significant judgments resulting from uncertainties in the application of complex tax laws and regulations across many jurisdictions, implementation of tax planning strategies and estimates as to the jurisdictions where income is expected to be earned. These estimates may be further complicated by new laws, new interpretations of existing laws and rulings by taxing

authorities. Due to the subjectivity and complex nature of these underlying issues, our actual effective income tax rate and related tax liabilities may differ from our initial estimates. Differences between our estimated and actual effective income tax rates and related liabilities are recorded in the period they become known or as our estimates are revised based on additional information. The resulting adjustment to our income tax expense could have a material effect on our results of operations in the period the adjustment is recorded. A one percentage point change in our effective income tax rate would change our annual income from continuing operations by approximately \$9 million.

Deferred tax assets and liabilities are recorded for tax carryforwards and the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. The future realization of our deferred tax assets ultimately depends on our ability to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law and our ability to execute successful tax planning strategies. Management believes it is more likely than not that the long-term deferred tax assets will be realized through the reduction of future taxable income. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement tax planning strategies, could affect our ability to realize the future tax deductions underlying our net deferred tax assets, and require us to record a valuation allowance against our net deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

As part of the determination of our tax liability, management exercises considerable judgment in evaluating tax positions taken by us in determining the income tax provision and establishes reserves for tax contingencies in accordance with the Income Taxes topic of the FASB Accounting Standards Codification. See Note 13 of the Notes to Consolidated Financial Statements in Item 8 below for further detail regarding unrecognized tax benefits, deferred taxes and the factors considered in evaluating deferred tax asset realization.

Goodwill

As of September 30, 2016, we had \$1.919 billion of goodwill related to various business acquisitions. We perform goodwill impairment tests on an annual basis during the second quarter of each fiscal year, or on an interim basis if events or circumstances indicate that it is more likely than not that impairment has occurred.

Goodwill is potentially impaired if the carrying value of the reporting unit that contains the goodwill exceeds its estimated fair value. The fair values of our reporting units are generally determined using a combination of an income approach, which estimates fair value based upon future discounted cash flows, and a market approach, which estimates fair value using market multiples, ratios and valuations of a set of comparable public companies within our industry. We completed our annual goodwill impairment test in the second quarter of 2016 and concluded no impairment of goodwill exists, as all goodwill reporting units had a calculated fair value in excess of carrying value of greater than 22 percent. Although goodwill is not currently impaired, there can be no assurance that future impairments will not occur. Significant negative industry or economic trends, disruptions to our business, failure to achieve the revenue and cost synergies expected from our ARINC acquisition, or other unexpected significant changes in the use of certain assets could all have a negative effect on fair values in the future.

Warranty

Accrued liabilities are recorded on our Consolidated Statement of Financial Position to reflect our contractual obligations relating to warranty commitments to our customers. We provide warranty coverage of various lengths and terms to our customers depending on standard offerings and negotiated contractual agreements. We record an estimate for warranty expense at the time of sale based on historical warranty return rates and repair costs. We believe our primary source of warranty cost uncertainty relates to warranty terms with longer duration.

As shown in Note 16 of the Notes to Consolidated Financial Statements in Item 8 below, the carrying amount of accrued product warranty costs has decreased \$34 million from a balance of \$121 million at September 30, 2013, to a balance of \$87 million at September 30, 2016.

Approximately \$31 million of the decrease in our accrued warranty balance from 2013 to 2016 is attributable to favorable adjustments recorded in 2016, 2015 and 2014 to reduce warranty reserves for changes in estimates, as

shown in Note 16 of the Notes to Consolidated Financial Statements in Item 8 below. These reductions were principally driven by the completion of certain Government Systems programs that no longer require a warranty and a favorable impact from lower than anticipated repair costs across various product areas.

Should future warranty experience differ materially from our historical experience, we may be required to record additional warranty liabilities which could have a material adverse effect on our results of operations and cash flows in the period in which these additional liabilities are required.

Pension Benefits

In 2003, we amended our U.S. qualified and non-qualified pension plans covering all salary and hourly employees not covered by collective bargaining agreements to close the plans to new participants and to discontinue benefit accruals for salary increases and services rendered after September 30, 2006. In addition, ARINC froze the majority of its pension plans for employees not covered by bargaining unit agreements in 2006, prior to being acquired by us. Accounting standards require these plans to be measured on an actuarial basis. These accounting standards will generally reduce, but not eliminate, the volatility of pension expense as actuarial gains and losses resulting from both normal year-to-year changes in valuation assumptions and the differences from actual experience are deferred and amortized. The application of these accounting standards requires management to make numerous assumptions and judgments that can significantly affect these measurements. Critical assumptions made by management in performing these actuarial valuations include the selection of discount rates and expectations on the future rate of return on pension plan assets.

In October 2014, the Society of Actuaries published a new set of mortality tables (RP-2014) and a new mortality improvement scale (MP-2014), which update life expectancy assumptions. While accounting standards do not prescribe the use of a specific set of mortality tables in the measurement of pension obligations, mortality is a key assumption in developing actuarial estimates. The tables generally reflect longer life expectancy than was projected by past tables. For our 2015 year-end pension liability valuation, we used the RP-2014 tables with an adjustment for plan experience and the MP-2014 improvement scale adjusted to reflect convergence to an ultimate annual rate of mortality improvement of 0.75 percent by 2022. Upon adoption, these changes resulted in an increase to the 2015 projected pension benefit obligation of \$310 million and unfavorably impacted 2016 pension income by \$15 million. No pension contribution requirements are expected until at least 2018.

Discount rates are used to determine the present value of our pension obligations and also affect the amount of pension expense recorded in any given period. We estimate the discount rate based on the rates of return of high quality, fixed-income investments with maturity dates that reflect the expected time horizon over which benefits will be paid (see Note 10 of the Notes to Consolidated Financial Statements in Item 8 below). Changes to the discount rate could have a material effect on our reported pension obligations and would also impact the related pension expense.

In 2015 and prior, the weighted-average discount rate was used in the calculation of service and interest costs, both of which are components of pension expense. Beginning in 2016, we utilized a "spot rate approach" in the calculation of pension interest and service cost. The spot rate approach applies separate discount rates for each projected benefit payment in the calculation of pension interest and service cost. This calculation change is considered a change in accounting estimate and was applied prospectively in 2016. The use of the spot rate approach resulted in a favorable impact to pension income of \$35 million in 2016, relative to the estimated pension income amount had we not changed our approach.

The expected rate of return is our estimate of the long-term earnings rate on our pension plan assets and is based upon both historical long-term actual and expected future investment returns considering the current investment mix of plan assets. Differences between the actual and expected rate of return on plan assets can impact our expense for pension benefits.

Holding all other factors constant, the estimated impact on 2016 pension expense and pension benefit obligation for our U.S. plans caused by hypothetical changes to key assumptions is as follows:

	Change in Assumption (in millions)	
Assumption	25 Basis Point Increase	25 Basis Point Decrease
Pension obligation discount rate	\$121 pension projected benefit obligation decrease	\$124 pension projected benefit obligation increase

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Pension obligation discount rate	\$1 pension expense increase	\$1 pension expense decrease
Expected long-term rate of return on plan assets	\$7 pension expense decrease	\$7 pension expense increase

Inventory Valuation Reserves

Inventory valuation reserves are recorded in order to report inventories at the lower of cost or market value on our Consolidated Statement of Financial Position. The determination of inventory valuation reserves requires management to make estimates and judgments on the future salability of inventories. Valuation reserves for excess, obsolete and slow-moving inventory are estimated by comparing the inventory levels of individual parts to both future sales forecasts or production requirements and historical usage rates in order to identify inventory that is unlikely to be sold above cost. Other factors that management considers in determining these reserves include overall market conditions and other inventory management initiatives. Management can generally react to reduce the likelihood of severe excess and slow-moving inventory issues by changing purchasing behavior, although abrupt changes in market conditions can limit our ability to react quickly.

Management believes its primary source of risk for excess and obsolete inventory is derived from life-time buy inventory. Life-time buy inventory consists of inventory that is typically no longer being produced by our vendors but for which we purchase multiple years of supply in order to meet production and service requirements. Total life-time buy inventory on hand at September 30, 2016 was \$110 million.

Excluding pre-production engineering costs and progress payments, we had \$895 million of gross inventory on hand at September 30, 2016 with \$95 million of inventory valuation reserves. Although management believes these reserves are adequate, any abrupt changes in market conditions may require us to record additional inventory valuation reserves which could have a material adverse effect on our results of operations in the period in which these additional reserves are required. Pre-production engineering costs are discussed in the Program Investments section of our Critical Accounting Policies above.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Interest Rate Risk

In addition to using cash provided by normal operating activities, we utilize a combination of short-term and long-term debt to finance operations. Our operating results and cash flows are exposed to changes in interest rates that could adversely affect the amount of interest expense incurred and paid on debt obligations in any given period. In addition, changes in interest rates can affect the fair value of our debt obligations. Such changes in fair value are only relevant to the extent these debt obligations are settled prior to maturity. We manage our exposure to interest rate risk by maintaining an appropriate mix of fixed and variable rate debt and may employ financial instruments in the form of interest rate swaps to help meet this objective.

At September 30, 2016, we had the following unsecured long and short-term notes outstanding:

(in millions)	Interest Rate	September 30, 2016	
		Carrying Value	Fair Value
\$400 Notes due 2043	4.80%	\$ 398	\$ 474
\$400 Notes due 2023	3.70%	399	439
\$250 Notes due 2021	3.10%	250	263
\$300 Notes due 2019	5.25%	300	332
\$300 Notes due 2016	3 month LIBOR plus 0.35%	300	300

In June 2015, we entered into interest rate swap contracts which effectively converted \$150 million of the Notes due 2019 to floating rate debt based on three-month LIBOR plus 3.56 percent.

In March 2014, we entered into interest rate swap contracts which effectively converted \$200 million of the Notes due 2023 to floating rate debt based on one-month LIBOR plus 0.94 percent.

In January 2010, we entered into interest rate swap contracts which effectively converted \$150 million of the Notes due 2019 to floating rate debt based on six-month LIBOR plus 1.235 percent.

A hypothetical 10 percent increase in average market interest rates would have decreased the fair value of our long-term fixed rate debt, exclusive of the effects of the interest rate swap contracts, by \$24 million. A hypothetical 10 percent decrease in average market interest rates would have increased the fair value of our long-term fixed rate debt, exclusive of the effects of the interest rate swap contracts, by \$25 million. The fair value of the \$500 million notional value of interest rate swap contracts was a \$35 million net asset at September 30, 2016. A hypothetical 10 percent increase in average market interest rates would

decrease the fair value of our interest rate swap contracts by \$2 million. A 10 percent decrease in average market interest rates would increase the fair value of our interest rate swap contract by \$3 million. Our results of operations are affected by changes in market interest rates related to variable rate debt. Inclusive of the effect of the interest rate swaps, a hypothetical 10 percent increase or decrease in average market interest rates would not have a material effect on our operations or cash flows. For more information related to outstanding debt obligations and derivative financial instruments, see Notes 9, 14 and 15 in the Notes to Consolidated Financial Statements.

Foreign Currency Risk

We transact business in various foreign currencies which subjects our cash flows and earnings to exposure related to changes to foreign currency exchange rates. We attempt to manage this exposure through operational strategies and the use of foreign currency forward exchange contracts (foreign currency contracts). All foreign currency contracts are executed with banks we believe to be creditworthy and are denominated in currencies of major industrial countries. The majority of our non-functional currency firm and anticipated receivables and payables are hedged using foreign currency contracts. It is our policy not to manage exposure to net investments in non-U.S. subsidiaries or enter into derivative financial instruments for speculative purposes. Notional amounts of outstanding foreign currency contracts were \$384 million and \$359 million at September 30, 2016 and 2015, respectively. Notional amounts are stated in U.S. dollar equivalents at spot exchange rates at the respective dates. Principal currencies that are hedged include the European euro, British pound sterling and Swedish krona. The duration of foreign currency contracts is generally five years or less. The net fair value of these foreign currency contracts was a \$2 million net liability at September 30, 2016 and a \$4 million net liability at September 30, 2015. A 10 percent increase in the value of the U.S. dollar against all currencies would decrease the fair value of our foreign currency contracts at September 30, 2016 by \$6 million. A 10 percent decrease in the value of the U.S. dollar against all currencies would increase the fair value of our foreign currency contracts at September 30, 2016 by \$6 million. For more information related to outstanding currency forward exchange contracts, see Notes 14 and 15 in the Notes to Consolidated Financial Statements in Item 8 below.

Item 8. Financial Statements and Supplementary Data.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Rockwell Collins' internal control over financial reporting is a process designed, under the supervision of the Chief Executive Officer and Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Rockwell Collins; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of Rockwell Collins' management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the consolidated financial statements.

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

Management assessed the effectiveness of Rockwell Collins' internal control over financial reporting as of September 30, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013). Based on this assessment, management determined that Rockwell Collins maintained effective internal control over financial reporting as of September 30, 2016.

Rockwell Collins' internal control over financial reporting as of September 30, 2016 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included within the Controls and Procedures section in Item 9A of this Form 10-K.

/s/ ROBERT K. ORTBERG /s/ PATRICK E. ALLEN

Robert K. Ortberg
Chairman, President and
Chief Executive Officer

Patrick E. Allen
Senior Vice President and
Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareowners of
Rockwell Collins, Inc.

We have audited the accompanying consolidated statements of financial position of Rockwell Collins, Inc. and subsidiaries (the "Company") as of September 30, 2016 and October 2, 2015, and the related consolidated statements of operations, comprehensive income, cash flows, and equity for each of the three years in the period ended September 30, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2016 and October 2, 2015, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2016, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of September 30, 2016, based on the criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 15, 2016 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Chicago, Illinois
November 15, 2016

ROCKWELL COLLINS, INC.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(in millions, except per share amounts)

	September 30	
	2016	2015
ASSETS		
Current Assets:		
Cash and cash equivalents	\$340	\$252
Receivables, net	1,094	1,038
Inventories, net	1,939	1,824
Other current assets	117	110
Total current assets	3,490	3,224
Property	1,035	964
Goodwill	1,919	1,904
Intangible Assets	667	703
Deferred Income Taxes	219	165
Other Assets	377	344
TOTAL ASSETS	\$7,707	\$7,304
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term debt	\$740	\$448
Accounts payable	527	487
Compensation and benefits	269	273
Advance payments from customers	283	365
Accrued customer incentives	246	232
Product warranty costs	87	89
Other current liabilities	194	166
Total current liabilities	2,346	2,060
Long-term Debt, Net	1,382	1,680
Retirement Benefits	1,660	1,466
Other Liabilities	235	218
Equity:		
Common stock (\$0.01 par value; shares authorized: 1,000; shares issued: September 30, 2016, 143.8; September 30, 2015, 183.8)	1	2
Additional paid-in capital	1,506	1,519
Retained earnings	3,327	5,124
Accumulated other comprehensive loss	(1,898)	(1,699)
Common stock in treasury, at cost (shares held: September 30, 2016, 13.6; September 30, 2015, 51.9)	(858)	(3,071)
Total shareowners' equity	2,078	1,875
Noncontrolling interest	6	5
Total equity	2,084	1,880
TOTAL LIABILITIES AND EQUITY	\$7,707	\$7,304

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.
CONSOLIDATED STATEMENT OF OPERATIONS
(in millions, except per share amounts)

	Year Ended September 30		
	2016	2015	2014
Sales			
Product sales	\$4,411	\$4,438	\$4,309
Service sales	848	806	670
Total sales	5,259	5,244	4,979
Costs, expenses and other:			
Product cost of sales	3,045	3,064	3,001
Service cost of sales	597	566	468
Selling, general and administrative expenses	638	606	594
Interest expense	64	61	59
Other income, net	(20)	(15)	(25)
Total costs, expenses and other	4,324	4,282	4,097
Income from continuing operations before income taxes	935	962	882
Income tax expense	208	268	264
Income from continuing operations	727	694	618
Income (loss) from discontinued operations, net of taxes	1	(8)	(14)
Net income	\$728	\$686	\$604
Earnings (loss) per share:			
Basic			
Continuing operations	\$5.57	\$5.25	\$4.57
Discontinued operations	0.01	(0.06)	(0.10)
Basic earnings per share	\$5.58	\$5.19	\$4.47
Diluted			
Continuing operations	\$5.50	\$5.19	\$4.52
Discontinued operations	0.01	(0.06)	(0.10)
Diluted earnings per share	\$5.51	\$5.13	\$4.42
Weighted average common shares:			
Basic	130.5	132.3	135.1
Diluted	132.1	133.7	136.7
Cash dividends per share	\$1.32	\$1.26	\$1.20

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in millions)

	Year Ended September 30		
	2016	2015	2014
Net income	\$728	\$686	\$604
Unrealized foreign currency translation adjustments	(20)	(41)	(27)
Pension and other retirement benefits adjustments (net of taxes: 2016, \$102; 2015, \$169; 2014, \$29)	(181)	(289)	(55)
Foreign currency cash flow hedge adjustments (net of taxes: 2016, \$1; 2015, \$(1); 2014, \$1)	2	(3)	3
Comprehensive income	\$529	\$353	\$525

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions)

	Year Ended		
	September 30		
	2016	2015	2014
Operating Activities:			
Net income	\$728	\$686	\$604
Income (loss) from discontinued operations, net of tax	1	(8)	(14)
Income from continuing operations	727	694	618
Adjustments to arrive at cash provided by operating activities:			
Non-cash restructuring charges	6	—	9
Gain on sale of business	—	—	(10)
Depreciation	144	152	141
Amortization of intangible assets and pre-production engineering costs	109	100	84
Stock-based compensation expense	27	24	24
Compensation and benefits paid in common stock	59	50	50
Excess tax benefit from stock-based compensation (see Note 2)	—	(13)	(6)
Deferred income taxes	48	50	113
Pension plan contributions	(69)	(69)	(75)
Fair value of acquisition-related contingent consideration	1	—	—
Changes in assets and liabilities, excluding effects of acquisitions and foreign currency adjustments:			
Receivables	(91)	(46)	67
Production inventory	(18)	(23)	(84)
Pre-production engineering costs	(177)	(183)	(198)
Accounts payable	38	(29)	23
Compensation and benefits	(4)	24	(60)
Advance payments from customers	(82)	16	(11)
Accrued customer incentives	14	30	18
Product warranty costs	(2)	(14)	(14)
Income taxes	25	50	(21)
Other assets and liabilities	(32)	(64)	(8)
Cash Provided by Operating Activities from Continuing Operations	723	749	660
Investing Activities:			
Property additions	(193)	(210)	(163)
Acquisition of businesses, net of cash acquired	(17)	(74)	(1,405)
Acquisition of intangible assets	—	—	(1)
Proceeds from business divestitures	—	—	24
Other investing activities	1	(10)	8
Cash (Used for) Investing Activities from Continuing Operations	(209)	(294)	(1,537)
Financing Activities:			
Purchases of treasury stock	(261)	(330)	(211)
Cash dividends	(172)	(167)	(162)
Repayment of short-term borrowings	—	—	(200)
Increase (decrease) in short-term commercial paper borrowings, net ⁽¹⁾	(8)	(56)	269
Increase in long-term borrowings	—	—	1,089
Proceeds from the exercise of stock options	21	49	37
Excess tax benefit from stock-based compensation (see Note 2)	—	13	6

Other financing activities	(2)	(1)	(1)
Cash Provided by (Used for) Financing Activities from Continuing Operations	(422)	(492)	827

(Continued on next page)

ROCKWELL COLLINS, INC.
 CONSOLIDATED STATEMENT OF CASH FLOWS, CONTINUED
 (in millions)

	Year Ended September 30		
	2016	2015	2014
Effect of exchange rate changes on cash and cash equivalents	(4)	(23)	(12)
Discontinued Operations:			
Operating activities	—	(14)	(16)
Investing activities	—	3	10
Cash (Used For) Discontinued Operations	—	(11)	(6)
Net Change in Cash and Cash Equivalents	88	(71)	(68)
Cash and Cash Equivalents at Beginning of Period	252	323	391
Cash and Cash Equivalents at End of Period	\$340	\$252	\$323

(1) Includes gross borrowings and repayments of commercial paper with maturities greater than three months as follows:

	Year Ended September 30	
	2015	2014
Gross borrowings of commercial paper with maturities greater than three months	\$—	—\$265
Gross payments of commercial paper with maturities greater than three months	—	265
Net borrowings of commercial paper with maturities greater than three months	\$—	—\$—

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.
CONSOLIDATED STATEMENT OF EQUITY
(in millions)

	Common Stock		Additional	Retained	Accumulated	Treasury	Noncontrol	Total
	Shares Outstanding	Par Value	Paid-In Capital	Earnings	Other Comprehensive Loss	Stock	Interest	Equity
Balance at September 30, 2013	135.1	\$ 2	\$ 1,469	\$ 4,163	\$ (1,287)	\$(2,729)	\$ 5	\$ 1,623
Net income	—	—	—	604	—	—	—	604
Other comprehensive income	—	—	—	—	(79)	—	—	(79)
Cash dividends	—	—	—	(162)	—	—	—	(162)
Shares issued:								
Exercise of stock options	0.8	—	(9)	—	—	46	—	37
Vesting of performance shares and restricted stock units	0.2	—	(11)	—	—	6	—	(5)
Excess tax pools	—	—	3	—	—	—	—	3
Employee stock purchase plan	0.1	—	2	—	—	8	—	10
Employee savings plan	0.5	—	11	—	—	29	—	40
Stock-based compensation	—	—	24	—	—	—	—	24
Treasury share repurchases	(2.7)	—	—	—	—	(206)	—	(206)
Balance at September 30, 2014	134.0	\$ 2	\$ 1,489	\$ 4,605	\$ (1,366)	\$(2,846)	\$ 5	\$ 1,889
Net income	—	—	—	686	—	—	—	686
Other comprehensive income	—	—	—	—	(333)	—	—	(333)
Cash dividends	—	—	—	(167)	—	—	—	(167)
Shares issued:								
Exercise of stock options	1.1	—	(13)	—	—	62	—	49
Vesting of performance shares and restricted stock units	0.1	—	(10)	—	—	5	—	(5)
Excess tax pools	—	—	12	—	—	—	—	12
Employee stock purchase plan	0.1	—	4	—	—	7	—	11
Employee savings plan	0.4	—	13	—	—	26	—	39
Stock-based compensation	—	—	24	—	—	—	—	24
Treasury share repurchases	(3.8)	—	—	—	—	(325)	—	(325)
Balance at September 30, 2015	131.9	\$ 2	\$ 1,519	\$ 5,124	\$ (1,699)	\$(3,071)	\$ 5	\$ 1,880
Net income	—	—	—	728	—	—	—	728
Other comprehensive income	—	—	—	—	(199)	—	—	(199)
Cash dividends	—	—	—	(172)	—	—	—	(172)
Shares issued:								
Exercise of stock options	0.4	—	(2)	—	—	23	—	21
Vesting of performance shares and restricted stock units	0.1	—	(10)	—	—	4	—	(6)
Excess tax pools	—	—	—	—	—	—	—	—
Employee stock purchase plan	0.1	—	2	—	—	8	—	10
Employee savings plan	0.6	—	14	—	—	35	—	49
Stock-based compensation	—	—	27	—	—	—	—	27
Treasury share repurchases	(2.9)	—	—	—	—	(255)	—	(255)

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Treasury share retirements ⁽¹⁾	—	(1)	(44)	(2,353)	—	2,398	—	—
Other	—	—	—	—	—	—	1	1
Balance at September 30, 2016	130.2	\$ 1	\$ 1,506	\$ 3,327	\$ (1,898)	\$(858)	\$ 6	\$ 2,084

⁽¹⁾ During the year ended September 30, 2016, the Company retired 40 million shares of treasury stock. These shares were retired at a weighted-average price of \$59.95 per share, resulting in a \$2.4 billion reduction in treasury stock. The retired shares were returned to the status of authorized and unissued.

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Business Description and Basis of Presentation

Rockwell Collins, Inc. (the Company or Rockwell Collins) designs, produces and supports communications and aviation systems for commercial and military customers and provides information management services through voice and data communication networks and solutions worldwide.

The Company operates on a 52/53 week fiscal year ending on the Friday closest to September 30. Fiscal year 2016 and 2015 were 52-week years while 2014 was a 53-week year. For ease of presentation, September 30 is utilized consistently throughout these financial statements and notes to represent the fiscal year end date. All date references contained herein relate to the Company's fiscal year unless otherwise stated.

As discussed in Note 4, Discontinued Operations and Divestitures, on March 10, 2015, the Company divested its Aerospace Systems Engineering and Support (ASES) business, which was acquired as part of the ARINC Incorporated (ARINC) transaction. On July 25, 2014, the Company divested its satellite communication systems business, formerly known as Datapath, Inc. (Datapath). As a result of the divestitures, the operating results of ASES and Datapath have been accounted for as discontinued operations for all periods presented. Unless otherwise noted, disclosures pertain to the Company's continuing operations.

2. Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of the Company and all majority-owned subsidiaries. The Company has one consolidated subsidiary with income attributable to a noncontrolling interest. The net income and comprehensive income attributable to the noncontrolling interest is insignificant. The Company's investments in entities it does not control but over which it has the ability to exercise significant influence are accounted for under the equity method and are included in Other Assets. All intercompany transactions are eliminated.

Foreign Currency Translation and Transactions

The functional currency for significant subsidiaries operating outside the United States is typically their respective local currency. Assets and liabilities of subsidiaries operating outside the United States with a functional currency other than the U.S. dollar are translated into U.S. dollars using the exchange rate at the balance sheet date. Sales, costs and expenses are translated at the average exchange rates in effect during the period. Foreign currency translation gains and losses are included as a component of Accumulated other comprehensive loss within the Consolidated Statements of Comprehensive Income and Equity.

Foreign exchange transaction gains and losses due to the remeasurement of account balances in foreign currencies are included within the Consolidated Statement of Operations and were not material to the Company's results of operations for 2016, 2015 and 2014.

Revenue Recognition

The Company enters into sales arrangements that may provide for multiple deliverables to a customer. The Company identifies all goods and/or services that are to be delivered separately under a sales arrangement and allocates revenue to each deliverable based on relative fair values. Fair values are generally established based on the prices charged when sold separately by the Company. In general, revenues are separated between hardware, engineering services, maintenance services and installation services. The allocated revenue for each deliverable is then recognized using

appropriate revenue recognition methods.

Sales related to long-term contracts requiring development and delivery of products over several years are generally accounted for under the percentage-of-completion method of accounting in accordance with the Construction-Type and Production-Type Contracts subtopic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification. The percentage-of-completion method is predominately used in the Government Systems segment and sales and earnings under qualifying contracts are recorded either as products are shipped under the units-of-delivery method (for production effort), or based on the ratio of actual costs incurred to total estimated costs expected to be incurred related to the contract under the cost-to-cost method (for development effort). Purchase options and change orders are accounted for either as an integral part of the original contract or separately depending upon the nature and value of the item. Sales and costs related to profitable purchase options are included in estimates only when the options are exercised whereas sales and costs related to unprofitable purchase options

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

are included in estimates when exercise is determined to be probable. Sales related to change orders are included in estimates only if they can be reliably estimated and collectability is reasonably assured. Anticipated losses on contracts are recognized in full in the period in which losses become probable and estimable. Changes in estimates of profit or loss on contracts are included in earnings on a cumulative basis in the period the estimate is changed.

Sales related to long-term separately priced product maintenance or warranty contracts are accounted for based on the terms of the underlying agreements. Certain contracts are fixed-price contracts with sales recognized ratably over the contractual life, while other contracts have a fixed hourly rate with sales recognized based on actual labor or flight hours incurred. The cost of providing these services is expensed as incurred.

The Company recognizes sales for most other products or services when all of the following criteria are met: an agreement of sale exists, product delivery and acceptance has occurred or services have been rendered, pricing is fixed or determinable and collection is reasonably assured.

Cash and Cash Equivalents

Cash and cash equivalents include time deposits, certificates of deposit with original maturity dates of three months or less and money market funds.

Allowance for Doubtful Accounts

Allowances are established in order to report receivables at net realizable value on the Company's Consolidated Statement of Financial Position. The determination of these allowances requires Company management to make estimates and judgments as to the collectability of customer account balances. The allowance for doubtful accounts reflects the Company's best estimate of probable losses inherent in the accounts receivable balance. The Company determines the allowance based on known troubled accounts, historical experience and other currently available evidence.

Inventories

Inventories are stated at the lower of cost or market using costs which approximate the first-in, first-out method, less related progress payments received. Inventoried costs include direct costs of manufacturing, certain engineering costs and allocable overhead costs. The Company regularly compares inventory quantities on hand on a part level basis to estimated forecasts of product demand and production requirements as well as historical usage. Based on these comparisons, management establishes an excess and obsolete inventory reserve as needed. Inventory valuation reserves were \$95 million and \$87 million at September 30, 2016 and 2015, respectively.

The Company defers certain pre-production engineering costs during the development phase of a program in connection with long-term supply arrangements that contain contractual guarantees for reimbursement from customers. Such customer guarantees generally take the form of a minimum order quantity with quantified reimbursement amounts if the minimum order quantity is not taken by the customer. These costs are deferred to the extent of the contractual guarantees and are amortized over their estimated useful lives using a units-of-delivery method, up to 15 years. This amortization expense is included as a component of cost of sales. Amortization is based on the Company's expectation of delivery rates on a program-by-program basis and begins when the Company starts recognizing revenue as the Company delivers equipment for the program. The estimated useful life is limited to the amount of time the Company is virtually assured to earn revenues under long-term supply arrangements with the Company's customers. Pre-production engineering costs incurred pursuant to supply arrangements that do not contain customer guarantees for reimbursement are expensed as incurred.

Progress Payments

Progress payments relate to both receivables and inventories and represent cash collected from government-related contracts whereby the governments have a legal right of offset related to the receivable or legal title to the work-in-process inventory.

Property

Property is stated at acquisition cost, net of accumulated depreciation. Depreciation of property is generally provided using straight-line methods over the following estimated useful lives: buildings and improvements, 15-40 years; machinery and equipment (including internally developed software and other costs associated with the expansion and construction of ARINC's network-related assets), 5-15 years; information systems software and hardware, 5-10 years; and furniture and fixtures, 12-15 years. Depreciation methods and lives are reviewed periodically with any changes recorded on a prospective basis.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Significant renewals and betterments are capitalized and replaced units are written off. Maintenance and repairs, as well as renewals of minor amounts, are charged to expense in the period incurred. The fair value of liabilities associated with the retirement of property is recorded when there is a legal or contractual requirement to incur such costs and the costs can be reasonably estimated. Upon the initial recognition of a contractual or legal liability for an asset retirement obligation, the Company capitalizes the asset retirement cost by increasing the carrying amount of the property by the same amount as the liability. This asset retirement cost is then depreciated over the estimated useful life of the underlying property. The Company did not have any significant asset retirement obligations at September 30, 2016 and 2015.

Goodwill and Intangible Assets

Goodwill and intangible assets generally result from business acquisitions. The purchase price of the acquisition is assigned to tangible and intangible assets and liabilities assumed based on fair value. The excess of the purchase price over the amounts assigned is recorded as goodwill. Assets acquired and liabilities assumed are allocated to the Company's reporting units based on the Company's integration plans and internal reporting structure. As of September 30, 2016 the Company had six reporting units. Purchased intangible assets with finite lives are amortized over their estimated useful lives, ranging from 4-23 years. Goodwill and intangible assets with indefinite lives are not amortized, but are reviewed at least annually for impairment.

Customer Relationship Up-Front Sales Incentives

The Company provides up-front sales incentives prior to delivering products or performing services to certain commercial customers in connection with sales contracts. Up-front sales incentives are recorded as a customer relationship intangible asset and are amortized using a units-of-delivery method over the period the Company has received a contractually enforceable right related to the incentives, up to 15 years after entry into service. Amortization is based on the Company's expectation of delivery rates on a program-by-program basis. Amortization begins when the Company starts recognizing revenue as the Company delivers equipment for the program. Up-front sales incentives consisting of cash payments or customer account credits are amortized as a reduction of sales, whereas incentives consisting of free products are amortized as cost of sales.

Accrued Customer Incentives

Incentives earned by customers based on purchases of Company products or services are recognized as a liability when the related sale is recorded. Incentives consisting of cash payments or customer account credits are recognized as a reduction of sales, while incentives consisting of free products and account credits where the customer's use is restricted to future purchases are recognized as cost of sales.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment when management plans to dispose of assets or when events or circumstances indicate that the carrying amount of a long-lived asset is more-likely-than-not unrecoverable. Assets held for disposal are reported at the lower of the carrying amount or fair value less cost to sell. Management determines fair value using a discounted future cash flow analysis or other accepted valuation techniques. Long-lived assets held for use are reviewed for impairment by comparing the carrying amount of an asset to the undiscounted future cash flows expected to be generated by the asset over its remaining useful life. If an asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value.

Goodwill and indefinite-lived intangible assets are tested annually for impairment with more frequent tests performed if indications of impairment exist. The Company's annual impairment testing date is in the second quarter of each fiscal year. Impairment for intangible assets with indefinite lives exists if the carrying value of the intangible asset exceeds its fair value. Goodwill is potentially impaired if the carrying value of a reporting unit exceeds its estimated fair value.

Advance Payments from Customers

Advance payments from customers represent cash collected from customers in advance of revenue recognition.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Capital Leases

Assets under capital lease and capital lease obligation are initially measured at the lower of estimated fair value or present value of the minimum lease payments. The present value of minimum lease payments is calculated for payments during the noncancelable lease term using the lower of the Company's estimated incremental borrowing rate or the rate implicit in the lease, if known. Capital lease obligation is recorded within Other Liabilities and the related assets are recorded in Property or Other Assets based upon their intended use. Payments are allocated between a reduction of the lease obligation and interest expense using the interest method. Assets under capital lease are depreciated over the noncancelable lease term, ranging from 5-15 years, consistent with the Company's depreciation policy.

Research and Development

The Company performs R&D activities relating to the development of new products and the improvement of existing products. Company-funded R&D programs are expensed as incurred and included in cost of sales. Company-funded R&D expenditures were \$224 million, \$272 million and \$268 million for fiscal years ended September 30, 2016, 2015 and 2014, respectively.

Environmental

Liabilities for environmental matters are recorded in the period in which it is probable that an obligation has been incurred and the cost can be reasonably estimated. At environmental sites in which more than one potentially responsible party has been identified, the Company records a liability for its estimated allocable share of costs related to its involvement with the site as well as an estimated allocable share of costs related to the involvement of insolvent or unidentified parties. At environmental sites in which the Company is the only responsible party, the Company records a liability for the total estimated costs of remediation.

Income Taxes

Current tax liabilities and assets are based upon an estimate of taxes payable or refundable in the current year for each jurisdiction in which the Company is subject to tax. As part of the determination of its tax liability, management exercises considerable judgment in evaluating tax positions taken by the Company in determining the income tax provision and establishes reserves for uncertain tax positions in accordance with the Income Taxes topic of the FASB Accounting Standards Codification. Deferred tax assets and liabilities are recorded for the estimated future tax effects attributable to temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and their respective carrying amounts for income tax purposes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Derivative Financial Instruments

The Company uses derivative financial instruments in the form of foreign currency forward exchange contracts and interest rate swap contracts for the purpose of minimizing exposure to changes in foreign currency exchange rates on business transactions and interest rates, respectively. The Company's policy is to execute such instruments with banks the Company believes to be creditworthy and not enter into derivative financial instruments for speculative purposes or to manage exposure for net investments in non-U.S. subsidiaries. These derivative financial instruments do not subject the Company to undue risk as gains and losses on these instruments generally offset gains and losses on the underlying assets, liabilities or anticipated transactions that are being hedged.

All derivative financial instruments are recorded at fair value in the Consolidated Statement of Financial Position. For a derivative that has not been designated as an accounting hedge, the change in fair value is recognized immediately through earnings. For a derivative that has been designated as an accounting hedge of an existing asset or liability (a fair value hedge), the change in the fair value of both the derivative and underlying asset or liability is recognized immediately through earnings. For a derivative designated as an accounting hedge of an anticipated transaction (a cash flow hedge), the change in the fair value is recorded on the Consolidated Statement of Financial Position in Accumulated other comprehensive loss to the extent the derivative is effective in mitigating the exposure related to the anticipated transaction. The change in the fair value related to the ineffective portion of the hedge, if any, is immediately recognized in earnings. The amount recorded within Accumulated other comprehensive loss is reclassified into earnings in the same period during which the underlying hedged transaction affects earnings. The Company does not exclude any amounts from the measure of effectiveness for both fair value and cash flow hedges.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Estimates are used in accounting for, among other items, long-term contracts, allowances for doubtful accounts, inventory obsolescence, product warranty cost liabilities, customer incentives, retirement benefits, income taxes, environmental matters, pre-production engineering costs, recoverability of long-lived assets and contingencies. Estimates and assumptions are reviewed periodically and the effects of changes, if any, are reflected in the Consolidated Statement of Operations in the period they are determined.

Concentration of Risks

The Company's products and services are concentrated within the aerospace and defense industries with customers consisting primarily of military and commercial aircraft manufacturers, commercial airlines, the U.S. Government and non-U.S. governments. As a result of this industry focus, the Company's current and future financial performance is largely dependent upon the overall economic conditions within these industries. In particular, the commercial aerospace market has been historically cyclical and subject to downturns during periods of weak economic conditions, which could be prompted or exacerbated by political or other U.S. or international events. The defense market may be affected by changes in budget appropriations, procurement policies, political developments both in the U.S. and abroad and other factors. The Company depends to a large degree on U.S. Government spending, as a significant portion of the Company's sales are derived from U.S. Government contracts, both directly and indirectly through subcontracts.

The U.S. Government has implemented various initiatives to address its fiscal challenges. In August 2011, Congress enacted the Budget Control Act of 2011 which imposed spending caps and certain reductions in security spending over a ten-year period through 2021. These spending caps and reductions, referred to as sequestration, went into effect in March 2013. In December 2013, Congress enacted the Murray-Ryan Bipartisan Budget Act of 2013, raising government discretionary spending limits temporarily for 2014 and 2015. More recently, the Bipartisan Budget Act of 2015 again raised the government discretionary spending limits temporarily for 2016 and 2017, after which the BCA will again be in force. The continued uncertainty surrounding the defense budget could have a material adverse effect on the Company and the defense industry in general.

In years when the U.S. Government does not complete its annual budget and appropriations process prior to the beginning of its fiscal year (October 1), government operations are typically funded through a continuing resolution that authorizes agencies of the U.S. Government to continue to operate in the new year, but generally does not authorize new spending initiatives. During periods covered by continuing resolutions (or until the regular appropriation bills are passed), the Company may experience delays by the government in procurement of new or existing products and services which can adversely impact our results of operations and cause variability in the timing of revenue between periods. The government began operations in fiscal year 2017 under a continuing resolution that is set to expire in December 2016. The Company remains confident that its product offerings are well positioned to meet the needs of government customers in this uncertain environment and the Company continues to enhance international strategies and make proactive adjustments to the Company's cost structure as necessary.

In addition to the overall business risks associated with the Company's concentration within the aerospace and defense industries, the Company is also exposed to a concentration of collection risk on credit extended to certain business jet aircraft manufacturers. At September 30, 2016, receivables due from these business jet aircraft manufacturers were

approximately \$162 million. The Company performs ongoing credit evaluations on the financial condition of all of its customers and maintains allowances for uncollectible accounts receivable based on expected collectability. Although management believes its allowances are adequate, the Company is not able to predict with certainty the changes in the financial stability of its customers. Any material change in the financial status of any one customer or group of customers could have a material adverse effect on the Company's results of operations, financial position or cash flows.

As of September 30, 2016, approximately 12 percent of the Company's employees in the U.S. were represented by U.S. collective bargaining agreements, most of which were renewed without disruption in May 2013 and are set to expire in 2018.

Recently Adopted Accounting Standards

In March 2016, the FASB issued a new standard simplifying certain aspects of accounting for share-based payments (see Note 12). The new standard requires that excess tax benefits and shortfalls be recorded as income tax benefit or expense in the income statement, rather than in equity, and requires excess tax benefits from stock-based compensation to be classified within

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

operating cash flow. Additionally, the new standard allows a policy election to either estimate the number of awards expected to be forfeited at the time of award issuance or record stock-based compensation for forfeitures as they occur. In order to simplify accounting for share-based payments, the Company adopted the new guidance during the second quarter of 2016, which resulted in a \$4 million benefit to tax expense and a favorable impact to operating cash flows of \$4 million in 2016. With respect to forfeitures, the Company will continue to estimate the number of awards expected to be forfeited upon award issuance.

In November 2015, the FASB issued new guidance requiring all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet instead of separating those balances into current and noncurrent amounts. In order to simplify the accounting for income taxes, the Company adopted the new guidance in the first quarter of 2016 on a retrospective basis, which resulted in the reclassification of \$9 million of current deferred tax assets and \$84 million of current deferred tax liabilities to noncurrent as of September 30, 2015.

In April 2015, the FASB issued a new standard that provides a practical expedient permitting entities with a fiscal year end that does not coincide with a month end to measure defined benefit plan assets and obligations using the month end date closest to the fiscal year end. The new standard was early adopted by the Company for each of its defined benefit plans effective for the 2015 fiscal year end with no significant impact to the Company's financial statements.

Recently Issued Accounting Standards

In June 2016, the FASB issued a new standard on the measurement of credit losses, which will impact the Company's measurement of trade receivables. The new standard replaces the current incurred loss model with a forward-looking expected loss model that is likely to result in earlier recognition of losses. The new standard also increases disclosure requirements and is effective for the Company in 2021, with early adoption permitted, but not earlier than 2020. The Company has completed an evaluation of the new standard and does not expect that adoption will have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued a comprehensive new lease accounting standard, which provides revised guidance on accounting for lease arrangements by both lessors and lessees. The central requirement of the new standard is that lessees must recognize lease-related assets and liabilities for all leases with a term longer than 12 months. The Company is evaluating the effect the standard will have on the Company's consolidated financial statements and related disclosures, but expects a material change to the balance sheet due to the recognition of right-of-use assets and lease liabilities related to the Company's portfolio of real estate leases. The new guidance is not expected to materially impact accounting for those leases the Company enters with customers. The new standard is effective for the Company in 2020, with early adoption permitted.

In May 2014, the FASB issued a comprehensive new revenue recognition standard that effectively replaces all current guidance on the topic and expands disclosures regarding revenue. Several amendments to the new standard have been issued or proposed, which are intended to resolve potential implementation challenges and drive consistent interpretation and application of the new standard. The guidance permits use of either a retrospective or cumulative effect transition method. Based upon the FASB's decision to approve a one year delay in implementation, the new standard is now effective for the Company in 2019, with early adoption permitted, but not earlier than 2018. The Company continues to evaluate the transition methods allowed under the new standard and the effect the standard will have on the Company's consolidated financial statements and related disclosures. Anticipated changes under the new standard include increased use of the percentage-of-completion method of accounting for government contracts,

elimination of the units-of-delivery method, and the elimination of Customer relationship intangible assets related to free products provided to customers as up-front sales incentives. The Company continues to monitor the work of standard setters and the interpretive efforts of other non-authoritative groups with respect to other areas of potential material change.

Other new accounting standards issued but not effective until after September 30, 2016 are not expected to have a material impact on the Company's financial statements.

3. Acquisitions, Goodwill and Intangible Assets

Acquisitions

On February 25, 2016, the Company acquired the Matrix series projector product line from Christie Digital Systems, a global visual, audio and collaboration solutions company. The product line acquisition was accounted for as a business combination,

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and the purchase price, net of cash acquired, was \$17 million. In the third quarter of 2016, the purchase price allocation was finalized, with \$6 million allocated to goodwill and \$11 million to intangible assets. The intangible assets have a weighted average life of approximately 10 years. All goodwill resulting from the acquisition is tax deductible. The excess purchase price over net assets acquired, including intangible assets, reflects the Company's view that this acquisition will enhance the Company's industry-leading offerings for military and aviation simulation and training solutions.

On August 6, 2015, the Company acquired 100 percent of the outstanding shares of Newport News, Virginia-based International Communications Group, Inc. (ICG), a leading provider of satellite-based global voice and data communication products and services for the aviation industry. The purchase price, net of cash acquired, was \$50 million. Additional post-closing consideration of up to \$14 million may be paid, contingent upon the achievement of certain milestones. The Company recorded a \$12 million liability on the acquisition date for the fair value of the contingent consideration, which is reflected as a non-cash transaction on the Company's Consolidated Statement of Cash Flows in 2015. In the fourth quarter of 2016, the purchase price allocation was finalized, with \$51 million allocated to goodwill and \$23 million to intangible assets. The intangible assets have a weighted average life of approximately 8 years. All goodwill resulting from the acquisition is tax deductible. The excess purchase price over net assets acquired, including intangible assets, reflects the Company's view that this acquisition will broaden the Company's flight deck and connectivity portfolio.

On March 20, 2015, the Company acquired 100 percent of the outstanding shares of Pacific Avionics Pty. Limited (Pacific Avionics), a Singapore-based company specializing in technologies used for wireless information distribution, including in-flight entertainment and connectivity. The purchase price, net of cash acquired, was \$24 million. In the fourth quarter of 2015, the purchase price allocation was finalized with \$10 million allocated to intangible assets and \$15 million to goodwill, none of which is deductible for tax purposes. The intangible assets have a weighted average life of approximately 7 years. The excess purchase price over net assets acquired, including intangible assets, reflects the Company's view that this acquisition will further enhance the Company's cabin products and information management services portfolios.

The ICG and Pacific Avionics acquisitions are included within the Commercial Systems segment and the Matrix product line acquisition is included in the Government Systems segment. The results of operations for all three acquisitions have been included in the Company's operating results for the periods subsequent to their respective acquisition dates. Pro-forma results of operations have not been presented for these acquisitions as the effect of the acquisitions are not material to the Company's consolidated results of operations.

On December 23, 2013, the Company acquired 100 percent of the outstanding common stock and voting interests of Radio Holdings, Inc., the holding company of ARINC, a leading global provider of air-to-ground data and voice communication services. ARINC develops and operates communications and information processing systems and provides systems engineering and integration solutions to five key industries: commercial aviation, business aviation, airports, rail and nuclear security. Combining ARINC's communication networks and services with the Company's onboard aircraft information systems strengthens the Company's ability to deliver enhanced connectivity to aircraft operators worldwide.

The ARINC purchase price was \$1.405 billion, net of cash acquired and net of \$10 million in cash received by the Company in June 2014 from the settlement of various post-closing matters, including adjustments for changes in working capital. As discussed in Note 9, the Company used proceeds from the issuance of long-term debt and

commercial paper to finance the cash purchase price. The following table summarizes the fair value of assets acquired and liabilities assumed at the acquisition date:

63

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in millions)	December 23, 2013
Restricted Cash ⁽¹⁾	\$ 61
Receivables and Other current assets	216
Building held for sale ⁽²⁾	81
Business held for sale ⁽³⁾	15
Property	49
Intangible Assets	431
Other Assets	11
Total Identifiable Assets Acquired	864
Payable to ARINC option holders ⁽¹⁾	(61)
Current Liabilities	(171)
Liability related to building held for sale ⁽²⁾	(81)
Liabilities associated with business held for sale ⁽³⁾	(12)
Long-term deferred income taxes	(182)
Retirement Benefits and Other Long-term Liabilities	(39)
Total Liabilities Assumed	(546)
Net Identifiable Assets Acquired, excluding Goodwill	318
Goodwill	1,087
Net Assets Acquired	\$ 1,405

⁽¹⁾ Option-holders of ARINC were due approximately \$61 million at the transaction closing date. This payment did not clear until December 24, 2013. Therefore the opening balance sheet, which was prepared as of December 23, 2013, includes restricted cash of \$61 million and a current liability payable to the ARINC option holders for an equal amount.

⁽²⁾ On March 28, 2014, the Company sold a building which was classified as held for sale at the acquisition date.

⁽³⁾ Assets and liabilities associated with the Business held for sale relate to ASES, which the Company divested, as detailed in Note 4.

The purchase price allocation resulted in the recognition of \$1.087 billion of goodwill and \$431 million of intangible assets with a weighted average useful life of approximately 15 years. None of the goodwill is deductible for tax purposes. All of the goodwill is included in the Company's Information Management Services segment. The goodwill is primarily a result of revenue synergy opportunities generated by the combination of the Company's aviation electronics and flight services business with ARINC's network communication solutions and cost synergies resulting from the consolidation of certain corporate and administrative functions. Goodwill also results from the workforce acquired with the business. See Note 21 for additional information relating to the Information Management Services segment.

Transaction-related Expenses

The Company incurred transaction costs related to the acquisition of \$16 million during the year ended September 30, 2014, of which \$13 million is recorded within Selling, general and administrative expenses on the Company's Consolidated Statement of Operations. The remaining \$3 million is recorded within Interest expense and relates to fees incurred in connection with the bridge credit agreement which was entered into in September 2013 to support the financing of the ARINC acquisition.

Supplemental Pro-Forma Data

The following unaudited supplemental pro-forma data presents consolidated pro-forma information as if the acquisition and related financing had been completed on October 1, 2012.

The unaudited supplemental pro-forma financial information does not reflect the potential realization of revenue synergies or cost savings, nor does it reflect other costs relating to the integration of the two companies. This pro-forma data should not be considered indicative of the results that would have actually occurred if the acquisition and related financing had been consummated on October 1, 2012, nor are they indicative of future results.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The unaudited supplemental pro-forma financial information was calculated by combining the Company's results with the stand-alone results of ARINC for the pre-acquisition periods, which were adjusted to account for certain transactions and other costs that would have been incurred during this pre-acquisition period.

(in millions, except per share amounts)	2016 (as Reported)	2015 (as Reported)	2014 (Pro-forma)
Sales	\$ 5,259	\$ 5,244	\$ 5,085
Net income attributable to common shareowners from continuing operations	\$ 727	\$ 694	\$ 624
Basic earnings per share from continuing operations	\$ 5.57	\$ 5.25	\$ 4.62
Diluted earnings per share from continuing operations	\$ 5.50	\$ 5.19	\$ 4.56

The unaudited supplemental pro-forma data above excludes the results of ASES, which the Company divested, as detailed in Note 4. The following significant adjustments were made to account for certain transactions and costs that would have occurred if the acquisition had been completed on October 1, 2012. These adjustments are net of any applicable tax impact and were included to arrive at the pro-forma results above. As the acquisition of ARINC was completed on December 23, 2013, the pro forma adjustments for the year ended September 30, 2014 in the table below include only the required adjustments through December 23, 2013.

(in millions)	2016	2015	2014
Increases / (decreases) to pro-forma net income:			
Net reduction to depreciation resulting from fixed asset purchase accounting adjustments ⁽¹⁾	\$ —	—\$	—\$ 2
Advisory, legal and accounting service fees ⁽²⁾	—	—	21
Amortization of acquired ARINC intangible assets, net ⁽³⁾	—	—	(4)

⁽¹⁾ This adjustment captures the net impact to depreciation expense resulting from various purchase accounting adjustments to fixed assets

⁽²⁾ This adjustment reflects the elimination of transaction-related fees incurred by ARINC and Rockwell Collins in connection with the acquisition and assumes all of the fees were incurred during the first quarter of 2013

⁽³⁾ This adjustment eliminates amortization of the historical ARINC intangible assets and replaces it with the new amortization for the acquired intangible assets

Goodwill

Changes in the carrying amount of goodwill are summarized as follows:

(in millions)	Commercial Systems	Government Systems	Information Management Services	Total
Balance at September 30, 2014	\$ 262	\$ 508	\$ 1,093	\$ 1,863
ICG acquisition	38	—	—	38
Pacific Avionics acquisition	15	—	—	15
ARINC acquisition adjustment	—	—	(3)	(3)
Foreign currency translation adjustments and other	(1)	(8)	—	(9)
Balance at September 30, 2015	314	500	1,090	1,904
ICG acquisition adjustment	13	—	—	13
Matrix product line acquisition	—	6	—	6
Foreign currency translation adjustments	(1)	(3)	—	(4)

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Balance at September 30, 2016	\$ 326	\$ 503	\$ 1,090	\$1,919
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ICG goodwill increased by \$13 million during 2016 primarily as a result of purchase accounting adjustments to establish liabilities for product development costs pursuant to certain contractual obligations.

Beginning in the first quarter of fiscal 2014, the Company created the Information Management Services segment. This segment combines the retained portion of the acquired ARINC business with the Company's existing flight services business,

65

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

which had previously been included in the Commercial Systems segment. As a result of the reorganization of the Company's segments, a portion of the goodwill from the Commercial Systems segment was reclassified to the Information Management Services segment using a fair value allocation method.

The Company performs an annual impairment test of goodwill and indefinite-lived intangible assets during the second quarter of each fiscal year, or at any time there is an indication goodwill or indefinite-lived intangibles are more-likely-than-not impaired, commonly referred to as triggering events. The Company's 2016, 2015 and 2014 impairment tests resulted in no impairment.

Intangible Assets

Intangible assets are summarized as follows:

(in millions)	September 30, 2016			September 30, 2015		
	Gross	Accum Amort	Net	Gross	Accum Amort	Net
Intangible assets with finite lives:						
Developed technology and patents	\$354	\$(216)	\$138	\$346	\$(195)	\$151
Backlog	6	(3)	3	5	(2)	3
Customer relationships:						
Acquired	340	(106)	234	338	(87)	251
Up-front sales incentives	313	(80)	233	301	(62)	239
License agreements	14	(10)	4	13	(9)	4
Trademarks and tradenames	15	(14)	1	15	(14)	1
Intangible assets with indefinite lives:						
Trademarks and tradenames	47	—	47	47	—	47
In process research and development	7	—	7	7	—	7
Intangible assets	\$1,096	\$(429)	\$667	\$1,072	\$(369)	\$703

Amortization expense for intangible assets for 2016, 2015 and 2014 was \$60 million, \$53 million and \$48 million, respectively. As of September 30, 2016, the weighted average amortization period remaining for up-front sales incentives was approximately 10 years.

Anticipated annual amortization expense for intangible assets is as follows:

(in millions)	2017	2018	2019	2020	2021	Thereafter
Anticipated amortization expense for up-front sales incentives	\$ 16	\$ 19	\$ 24	\$ 26	\$ 26	\$ 122
Anticipated amortization expense for all other intangible assets	40	38	37	33	32	200
Total	\$ 56	\$ 57	\$ 61	\$ 59	\$ 58	\$ 322

4. Discontinued Operations and Divestitures

On March 10, 2015, the Company sold its ASES business, which provides military aircraft integration and modifications, maintenance and logistics and support, to align with the Company's long-term primary business strategies. The sale price was \$3 million, and additional post-closing consideration of up to \$2 million may be received. The Company recognized a pre-tax loss of \$5 million (\$3 million after-tax) related to the ASES divestiture. The operating results of ASES have been included in discontinued operations in the Company's Consolidated

Statement of Operations for all periods presented. During 2016, the Company recorded \$2 million of income from discontinued operations (\$1 million after-tax), primarily due to the favorable settlement of a contractual matter with a customer of the ASES business.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On July 25, 2014, the Company sold its satellite communication systems business formerly known as Datapath. The sales price, which was subject to post-closing adjustments for working capital and other adjustments, was \$10 million. The Company recognized a pre-tax loss of \$12 million (\$2 million after-tax) related to the divestiture of the Datapath business. The high effective tax rate is primarily attributable to differences in the treatment of goodwill for income tax and financial reporting purposes. The operating results of Datapath, including the loss realized on the disposition, have been included in discontinued operations in the Company's Consolidated Statement of Operations for all periods presented. The Datapath business was formerly included in the Government Systems segment. The divestiture of this business is part of the Company's strategy to reshape the Government Systems segment to align with the changing dynamics of the defense environment and focus on opportunities in addressed markets for the Company's core products and solutions.

Results of discontinued operations are as follows:

(in millions)	Year Ended	
	September 30, 2015	September 30, 2014
Sales	\$18	\$94
Income (loss) from discontinued operations before income taxes	2 (13)	(29)
Income tax benefit (expense) from discontinued operations	(1) 5	15

During the first quarter of 2014, the Company sold its subsidiary, Kaiser Optical Systems, Inc. (KOSI), a supplier of spectrographic instrumentation and applied holographic technology, to Endress+Hauser. The sale price, after post-closing adjustments for changes in working capital, was \$23 million. This resulted in a pretax gain of \$10 million, which was included in Other income, net. The divestiture of this business is part of the Company's strategy to reshape the Government Systems segment to align with the changing dynamics of the defense environment and focus on opportunities in addressed markets for the Company's core products and solutions. As part of the divestiture agreement, the Company entered into a long-term supply agreement with the buyer that allows the Company to continue purchasing certain products from KOSI after completion of the sale. As a result of this continuing involvement, the KOSI divestiture did not qualify for classification as a discontinued operation.

In April 2014, the FASB issued guidance that modifies the definition of a discontinued operation and provides new disclosure requirements for divestitures. This guidance is effective for the Company in 2016, and any divestiture in 2016 or after will be subject to the new guidance. The ASES, Datapath and KOSI divestitures occurred in 2015, 2014 and 2014, respectively, and are reported based upon the previous guidance for discontinued operations.

5. Receivables, Net

Receivables, net are summarized as follows:

(in millions)	September 30, 2016	September 30, 2015
	Billed	\$ 748
Unbilled	439	403
Less progress payments	(87)	(110)
Total	1,100	1,045
Less allowance for doubtful accounts	(6)	(7)
Receivables, net	\$ 1,094	\$ 1,038

Receivables expected to be collected beyond the next twelve months are classified as long-term and are included in Other Assets. Total receivables due from the U.S. Government including the Department of Defense and other government agencies, both directly and indirectly through subcontracts, were \$306 million and \$286 million at September 30, 2016 and 2015, respectively. U.S. Government unbilled receivables, net of progress payments, were \$99 million and \$91 million at September 30, 2016 and 2015, respectively. Receivables, net due from equity affiliates were \$68 million at September 30, 2016.

Unbilled receivables principally represent sales recorded under the percentage-of-completion method of accounting that have not been billed to customers in accordance with applicable contract terms.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company sells certain accounts receivable on a non-recourse basis to unrelated financial institutions under factoring agreements arranged by certain customers. Under the terms of the agreements, the Company retains no rights or interest and has no obligations with respect to the sold receivables. The Company accounts for these transactions as sales of receivables and records cash proceeds when received as cash provided by operating activities in the Consolidated Statement of Cash Flows. The beneficial impact on cash provided by operating activities from participating in these programs was \$60 million and \$12 million in 2016 and 2015, respectively. The cost of participating in these programs was immaterial to our results.

6. Inventories, Net

Inventories, net are summarized as follows:

(in millions)	September 30, 2016	September 30, 2015
Finished goods	\$ 210	\$ 216
Work in process	236	250
Raw materials, parts and supplies	354	353
Less progress payments	(1)	(7)
Total	799	812
Pre-production engineering costs	1,140	1,012
Inventories, net	\$ 1,939	\$ 1,824

As of September 30, 2016, pre-production engineering costs related to programs with Bombardier, Boeing and Airbus were \$414 million, \$253 million, and \$249 million, respectively.

Amortization expense for pre-production engineering costs for 2016, 2015 and 2014 was \$49 million, \$47 million and \$36 million, respectively. As of September 30, 2016, the weighted average amortization period remaining for pre-production engineering costs included in Inventories, net was approximately 10 years.

Anticipated annual amortization expense for pre-production engineering costs is as follows:

(in millions)	2017	2018	2019	2020	2021	Thereafter
Anticipated amortization expense for pre-production engineering costs ⁽¹⁾	\$ 60	\$ 102	\$ 137	\$ 154	\$ 139	\$ 521

⁽¹⁾ On October 29, 2015, Bombardier announced the cancellation of the Learjet 85 program. Pre-production engineering costs associated with the Learjet 85 program have been excluded from anticipated amortization expense, as these costs are expected to be recovered through consideration received from Bombardier pursuant to contractual guarantees and not amortized against future hardware deliveries.

In accordance with industry practice, inventories include amounts which are not expected to be realized within one year. These amounts primarily relate to pre-production engineering costs and life-time-buy inventory not expected to be realized within one year of \$1.130 billion and \$1.006 billion at September 30, 2016 and 2015, respectively. Life-time-buy inventory is inventory that is typically no longer produced by the Company's vendors but for which multiple years of supply are purchased in order to meet production and service requirements over the life span of a product.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Property

Property is summarized as follows:

(in millions)	September 30, 2016	September 30, 2015
Land	\$ 15	\$ 15
Buildings and improvements	468	429
Machinery and equipment	1,218	1,164
Information systems software and hardware	435	406
Furniture and fixtures	74	66
Capital leases	58	58
Construction in progress	183	180
Total	2,451	2,318
Less accumulated depreciation	(1,416)	(1,354)
Property	\$ 1,035	\$ 964

Property additions acquired by incurring accounts payable, which are reflected as a non-cash transaction in the Company's Consolidated Statement of Cash Flows, were \$20 million, \$19 million and \$37 million at September 30, 2016, 2015 and 2014, respectively.

Property additions acquired by incurring capital leases, which are reflected as non-cash transactions in the Company's Consolidated Statement of Cash Flows were \$0 million, \$0 million and \$56 million at September 30, 2016, 2015 and 2014, respectively.

A portion of the Company's operations are conducted in leased real estate facilities, including both operating and, to a lesser extent, capital leases. Accumulated depreciation relating to assets under capital lease totals \$10 million and \$6 million as of September 30, 2016 and 2015, respectively. Amortization of assets under capital lease is recorded as depreciation expense. As of September 30, 2016, remaining minimum lease payments for Property under capital leases total \$76 million, including \$22 million of interest.

8. Other Assets

Other assets are summarized as follows:

(in millions)	September 30, 2016	September 30, 2015
Long-term receivables	\$ 146	\$ 109
Investments in equity affiliates	10	13
Exchange and rental assets (net of accumulated depreciation of \$101 at September 30, 2016 and \$97 at September 30, 2015)	68	66
Other	153	156
Other assets	\$ 377	\$ 344

Long-term receivables

Long-term receivables expected to be collected beyond the next twelve months are principally comprised of unbilled accounts receivable pursuant to sales recorded under the percentage-of-completion method of accounting that have not

yet been billed to customers in accordance with applicable contract terms.

Investments in Equity Affiliates

Investments in equity affiliates primarily consist of eight joint ventures:

69

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

• ACCEL (Tianjin) Flight Simulation Co., Ltd (ACCEL): ACCEL is a joint venture with Haite Group, for the joint development and production of commercial flight simulators in China

• ADARI Aviation Technology Limited (ADARI): ADARI is a joint venture with Aviation Data Communication Corporation Co., LTD, that operates remote ground stations around China and develops certain content delivery management software

• AVIC Leihua Rockwell Collins Avionics Company (ALRAC): ALRAC is a joint venture with China Leihua Electronic Technology Research Institute (a subsidiary of the Aviation Industry Corporation of China, or AVIC), for the joint production of integrated surveillance system products for the C919 aircraft in China

• Data Link Solutions LLC (DLS): DLS is a joint venture with BAE Systems, plc for the joint pursuit of the worldwide military data link market

• ESA Vision Systems LLC (ESA): ESA is a joint venture with Elbit Systems, Ltd. for the joint pursuit of helmet-mounted cueing systems for the worldwide military fixed wing aircraft market

• Integrated Guidance Systems LLC (IGS): IGS is a joint venture with Honeywell International Inc. for the joint pursuit of integrated precision guidance solutions for worldwide guided weapons systems

• Quest Flight Training Limited (Quest): Quest is a joint venture with Quadrant Group plc that provides aircrew training services primarily for the United Kingdom Ministry of Defence

• Rockwell Collins CETC Avionics Co., Ltd (RCCAC): RCCAC is a joint venture with CETC Avionics Co., Ltd (CETCA) for the development and delivery of products related to the C919 program

Each joint venture is 50 percent owned by the Company and accounted for under the equity method. Under the equity method of accounting for investments, the Company's proportionate share of the earnings or losses of its equity affiliates are included in Net income and classified as Other income, net in the Consolidated Statement of Operations. For segment performance reporting purposes, Rockwell Collins' share of earnings or losses of ESA, DLS, IGS and Quest are included in the operating results of the Government Systems segment, ACCEL, ALRAC and RCCAC are included in the operating results of the Commercial Systems segment and ADARI is included in the operating results of the Information Management Services segment.

In the normal course of business or pursuant to the underlying joint venture agreements, the Company may sell products or services to equity affiliates. The Company defers a portion of the profit generated from these sales equal to its ownership interest in the equity affiliates until the underlying product is ultimately sold to an unrelated third party. Sales to equity affiliates were \$229 million, \$196 million and \$177 million for the years ended September 30, 2016, 2015 and 2014, respectively. The deferred portion of profit generated from sales to equity affiliates was \$2 million at September 30, 2016 and \$1 million at September 30, 2015.

Exchange and Rental Assets

Exchange and rental assets consist primarily of Company products that are either exchanged or rented to customers on a short-term basis in connection with warranty and other service related activities. These assets are recorded at acquisition or production cost and depreciated using the straight-line method over their estimated lives, up to 15 years.

Depreciation methods and lives are reviewed periodically with any changes recorded on a prospective basis. Depreciation expense for exchange and rental assets was \$9 million, \$10 million and \$10 million for the years ended September 30, 2016, 2015 and 2014, respectively.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Debt

Short-term Debt

(in millions, except weighted average amounts)	September 30, 2016	September 30, 2015
Short-term commercial paper borrowings outstanding ⁽¹⁾	\$ 440	\$ 448
Current portion of long-term debt	300	—
Short-term debt	\$ 740	\$ 448
Weighted average interest rate of commercial paper borrowings	0.79 %	0.52 %
Weighted average maturity period of commercial paper borrowings (days)	15	25

⁽¹⁾ The maximum amount of short-term commercial paper borrowings outstanding during the year ended September 30, 2016 was \$929 million.

Commercial Paper Program

Under the Company's commercial paper program, the Company may sell up to \$1.2 billion face amount of unsecured short-term promissory notes in the commercial paper market. The commercial paper program is supported by the Company's \$1 billion five-year and \$200 million 364-day revolving credit facilities.

Revolving Credit Facilities

The Company has a five-year \$1 billion credit facility that expires in December 2018 and a 364-day \$200 million credit facility that was executed in February 2016 and expires in February 2017. At September 30, 2016 and 2015, there were no outstanding borrowings under these revolving credit facilities.

The credit facilities include one financial covenant, requiring the Company to maintain a consolidated debt to total capitalization ratio of not greater than 60 percent (excluding the equity impact on accumulated other comprehensive loss related to defined benefit retirement plans). The Company was in compliance with this financial covenant at September 30, 2016. The credit facilities also contain covenants that require the Company to satisfy certain conditions in order to incur debt secured by liens, engage in sale/leaseback transactions or merge or consolidate with another entity.

Short-term credit facilities available to non-U.S. subsidiaries amounted to \$38 million as of September 30, 2016, of which \$3 million was utilized to support commitments in the form of commercial letters of credit. At September 30, 2016 and September 30, 2015, there were no borrowings outstanding under these credit facilities.

At September 30, 2016 and 2015, there were no significant commitment fees or compensating balance requirements under any of the Company's credit facilities.

Long-term Debt

The principal amount of long-term debt, net of discount, is summarized as follows:

(in millions, except interest rate figures)	Interest Rate	September 30, 2016	September 30, 2015
Fixed-rate notes due:			
December 2043	4.80%	\$ 398	\$ 398
December 2023	3.70%	399	399
November 2021	3.10%	250	250

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July 2019	5.25%	300	299
Variable-rate note due:			
December 2016	3 month LIBOR + 0.35% ⁽¹⁾	300	300
Fair value swap adjustment (Notes 14 and 15)		35	34
Total		\$ 1,682	\$ 1,680
Less current portion of long-term debt		300	—
Long-term Debt, Net		\$ 1,382	\$ 1,680

⁽¹⁾ The three-month LIBOR rate at September 30, 2016 was approximately 0.85 percent.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The notes listed above are included in the Consolidated Statement of Financial Position, net of any unamortized discount, within the caption Long-term Debt, Net. Debt issuance costs are capitalized within Other Assets on the Consolidated Statement of Financial Position. Debt issuance costs and any discount are amortized over the life of the debt and recorded in Interest expense on the Consolidated Statement of Operations.

Interest paid on debt for the years ended September 30, 2016, 2015 and 2014 was \$56 million, \$54 million and \$47 million, respectively.

10. Retirement Benefits

The Company sponsors defined benefit pension (Pension Benefits) and other postretirement (Other Retirement Benefits) plans which provide monthly pension and other benefits to eligible employees upon retirement.

In 2015, the Company early adopted a new accounting standard (see Note 2) that provides a practical expedient permitting entities with a fiscal year end that does not coincide with a month end to measure defined benefit plan assets and obligations using the month end date closest to the fiscal year end. The Company used September 30 as the date closest to its fiscal year end to value plan assets of all its defined benefit plans. There was no material impact of adoption of this accounting standard on the fair value of plan assets in 2015. In 2016, there is no impact due to the fiscal year ending on September 30.

Pension Benefits

The Company historically provided pension benefits to most of the Company's U.S. employees in the form of non-contributory, defined benefit plans that are considered qualified plans under applicable laws. The benefits provided under these plans for salaried employees are generally based on years of service and average compensation. The benefits provided under these plans for hourly employees are generally based on specified benefit amounts and years of service. In addition, the Company sponsors an unfunded non-qualified defined benefit plan for certain employees.

In June 2003, the Company amended its U.S. qualified and non-qualified defined benefit pension plans to discontinue benefit accruals for salary increases and services rendered after September 30, 2006. These changes impacted all of the Company's U.S. pension plans for all salaried and hourly employees who were not covered by collective bargaining agreements. Concurrently, the Company supplemented its existing defined contribution savings plan effective October 1, 2006 to include an additional Company contribution.

The Company also maintains five defined benefit pension plans in countries outside of the U.S., two of which are unfunded.

Other Retirement Benefits

Other retirement benefits consist of retiree health care and life insurance benefits that are provided to substantially all of the Company's U.S. employees hired before October 1, 2006 and their beneficiaries. Employees generally become eligible to receive these benefits if they retire after age 55 with at least 10 years of service. Most plans are contributory with retiree contributions generally based upon years of service and adjusted annually by the Company. Retiree medical plans pay a stated percentage of expenses reduced by deductibles and other coverage. The amount the Company will contribute toward retiree medical coverage for most participants is fixed. Additional premium

contributions will be required from participants for all costs in excess of the Company's fixed contribution amount. Retiree life insurance plans provide coverage at a flat dollar amount or as a multiple of salary. With the exception of certain bargaining unit plans, Other Retirement Benefits are funded as expenses are incurred.

ARINC Pension Plan

With the acquisition of ARINC in 2014, the Company acquired ARINC's pension plan, which was comprised of two sub-plans, one for union employees and one for non-union employees. Effective April 1, 2006, ARINC froze the majority of its pension plans for employees not covered by bargaining unit agreements. As a result, most of the non-union participants in the ARINC pension plans are no longer accruing contribution credits. The plans generally allow for employees who retire, or terminate, to elect to receive their pension benefits in a lump sum and certain existing participants in the plans continue to earn vesting rights and accrue interest on their account balance at rates established by the plans.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Effective January 1, 2016, ARINC's pension plan merged with the Company's legacy pension plan, and the two ARINC sub-plans became sub-plans of the Company's pension plan.

ARINC Other Retirement Benefits

ARINC also provides postretirement health coverage for many of its current and former employees and postretirement life insurance benefits for certain retirees. These benefits vary by employment status, age, service and salary level at retirement.

Components of Expense (Income)

The components of expense (income) for Pension Benefits and Other Retirement Benefits are summarized below:

(in millions)	Pension Benefits			Other Retirement Benefits		
	2016	2015	2014	2016	2015	2014
Service cost	\$11	\$12	\$10	\$3	\$3	\$3
Interest cost	126	155	168	6	7	9
Expected return on plan assets	(238)	(242)	(228)	(2)	(1)	(1)
Amortization:						
Prior service credit	(1)	(3)	(12)	(1)	(5)	(9)
Net actuarial loss	78	72	72	8	7	8
Net benefit expense (income)	\$(24)	\$(6)	\$10	\$14	\$11	\$10

In 2015 and prior, the Company used a single-weighted average discount rate to calculate pension interest and service cost. Beginning in 2016, a "spot rate approach" is being used to calculate pension interest and service cost. The spot rate approach applies separate discount rates for each projected benefit payment in the calculation of pension interest and service cost. This calculation change is considered a change in accounting estimate and was applied prospectively beginning in 2016. The use of the spot rate approach had a favorable impact to pension income and pre-tax earnings of \$35 million in 2016, relative to the estimated pension income amount had the Company not changed its approach.

Funded Status and Net Liability

The Company recognizes the unfunded status of defined benefit retirement plans on the Consolidated Statement of Financial Position as Retirement Benefits. The current portion of the liability is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next twelve months exceeds the fair value of the plan assets and is reflected in Compensation and benefits in the Consolidated Statement of Financial Position.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table reconciles the projected benefit obligations (PBO), plan assets, funded status and net liability for the Company's Pension Benefits and Other Retirement Benefits:

(in millions)	Pension Benefits		Other Retirement Benefits	
	2016	2015	2016	2015
PBO at beginning of period	\$4,167	\$4,086	\$221	\$213
Service cost	11	12	3	3
Interest cost	126	155	6	7
Discount rate and other assumption changes	436	315	17	6
Actuarial losses (gains)	29	(52)	(1)	7
Plan participant contributions	—	—	5	3
Benefits paid	(229)	(330)	(18)	(18)
Plan amendments	—	—	(2)	—
Other	(13)	(19)	—	—
PBO at end of period	4,527	4,167	231	221
Plan assets at beginning of period	2,902	3,185	19	18
Actual return on plan assets	346	(16)	1	—
Company contributions	69	69	12	16
Plan participant contributions	—	—	5	3
Benefits paid	(229)	(330)	(18)	(18)
Other	(14)	(6)	—	—
Plan assets at end of period	3,074	2,902	19	19
Funded status of plans	\$(1,453)	\$(1,265)	\$(212)	\$(202)
Funded status consists of:				
Retirement benefits liability	\$(1,448)	\$(1,264)	\$(212)	\$(202)
Compensation and benefits liability	(10)	(11)	—	—
Other assets	5	10	—	—
Net liability	\$(1,453)	\$(1,265)	\$(212)	\$(202)

During 2015, the Company's pension plan made \$121 million of benefit payments for terminated vested lump sum payouts to certain participants.

In October 2014, the Society of Actuaries published a new set of mortality tables (RP-2014) and a new mortality improvement scale (MP-2014), which updated life expectancy assumptions. The tables generally reflect longer life expectancy than was projected by past tables. For the Company's 2016 and 2015 year-end pension liability valuation, the Company used the RP-2014 tables with an adjustment for plan experience and the MP-2014 improvement scale adjusted to reflect convergence to an ultimate annual rate of mortality improvement of 0.75 percent by 2022.

The Company's non-U.S. defined benefit pension plans represented 5 percent of the total PBO at September 30, 2016 and 2015. The accumulated benefit obligation for all defined benefit pension plans was \$4.509 billion and \$4.153 billion at September 30, 2016 and 2015, respectively.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Comprehensive Loss

The following table summarizes the amounts included in Accumulated other comprehensive loss before tax related to retirement benefits as of September 30, 2016 and 2015 and changes recognized in Other comprehensive loss before tax for the years ended September 30, 2016 and 2015:

(in millions)	Pension Benefits		Other Retirement Benefits	
	Prior Service Cost (Credit)	Net Actuarial Loss	Prior Service Cost (Credit)	Net Actuarial Loss
Balance at September 30, 2014	\$6	\$ 2,035	\$(9)	\$ 99
Current year net actuarial loss	—	515	—	14
Amortization of prior service cost	3	—	5	—
Amortization of actuarial loss	—	(72)	—	(7)
Balance at September 30, 2015	9	2,478	(4)	106
Current year prior service cost	—	—	(2)	—
Current year net actuarial loss	—	351	—	18
Amortization of prior service cost	1	—	1	—
Amortization of actuarial loss	—	(78)	—	(8)
Balance at September 30, 2016	\$10	\$ 2,751	\$(5)	\$ 116

The estimated amounts that will be amortized from Accumulated other comprehensive loss into expense (income) for Pension Benefits and Other Retirement Benefits during the year ending September 30, 2017 are as follows:

(in millions)	Pension Benefits	Other Retirement Benefits	Total
Prior service cost	\$ —	\$ (1)	\$(1)
Net actuarial loss	92	8	100
Total	\$ 92	\$ 7	\$ 99

Actuarial Assumptions

The following table presents the significant assumptions used in determining the benefit obligations:

	Pension Benefits				Other Retirement Benefits	
	U.S.		Non-U.S.		U.S.	
	2016	2015	2016	2015	2016	2015
Discount rate	3.22%	3.96%	1.72%	2.94%	3.02%	3.73%
Compensation increase rate	4.00%	4.00%	3.03%	3.04%	4.00%	4.00%

Discount rates used to determine the benefit obligations are determined by using a weighted average of market-observed yields for high quality, fixed-income securities that correspond to the payment of benefits.

The Company's U.S. qualified and non-qualified plans were amended to discontinue benefit accruals for salary increases and services rendered after September 30, 2006 and after April 1, 2006 for ARINC. In the U.S., certain plans associated with collective bargaining agreements continue to accrue benefits, and only the ARINC sub-plans are impacted by increases in compensation.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Significant assumptions used in determining the net benefit expense (income) are as follows:

	Pension Benefits				Other Retirement Benefits	
	U.S.		Non-U.S.		U.S.	
	2016	2015	2016	2015	2016	2015
Discount rate	3.96 %	3.96 %	2.94 %	3.15 %	3.73 %	3.70 %
Expected long-term return on plan assets	8.23 %	8.23 %	6.73 %	6.70 %	8.25 %	8.25 %
Compensation increase rate	4.00 %	4.00 %	3.04 %	3.48 %	4.00 %	4.00 %
Health care cost gross trend rate ⁽¹⁾	—	—	—	—	7.00 %	7.48 %
Ultimate trend rate ⁽¹⁾	—	—	—	—	5.00 %	4.98 %
Year that trend reaches ultimate rate ⁽¹⁾	—	—	—	—	2019	2019

⁽¹⁾ Due to the effect of the fixed Company contribution, increasing or decreasing the health care cost trend rate by one percentage point would not have a significant impact on the Company's cost of providing Other Retirement Benefits.

Expected long-term return on plan assets for each year presented is based on both historical long-term actual and expected future investment returns considering the current investment mix of plan assets. The Company uses a market-related value of plan assets reflecting changes in the fair value of plan assets over a five-year period. The Company amortizes actuarial gains and losses in excess of 10 percent of the greater of the market-related value of plan assets or the projected benefit obligation (the corridor) on a straight-line basis over the expected future lifetime of inactive participants, which was approximately 25 years at September 30, 2016, as almost all of the plan's participants are considered inactive.

Prior service costs resulting from plan amendments are amortized in equal annual amounts over the average remaining service period of affected active participants or over the remaining life expectancy of affected retired participants.

Plan Assets

Total plan assets for Pension Benefits and Other Retirement Benefits as of September 30, 2016 and 2015 were \$3.093 billion and \$2.921 billion, respectively. The Company has established investment objectives that seek to preserve and maximize the amount of plan assets available to pay plan benefits. These objectives are achieved through investment guidelines requiring diversification and allocation strategies designed to maximize the long-term returns on plan assets while maintaining a prudent level of investment risk. These investment strategies are implemented using actively managed and indexed assets. Target and actual asset allocations as of September 30, 2016 and 2015 are as follows:

	Target Mix	2016	2015
Equities	40%-70%	53 %	54 %
Fixed income	25%-60%	45 %	44 %
Alternative investments	0% -15%	0 %	0 %
Cash	0% -5%	2 %	2 %

Alternative investments may include real estate, hedge funds, venture capital and private equity. There were no plan assets invested in the securities of the Company as of September 30, 2016 and 2015 or at any time during the years then ended. Target and actual asset allocations are periodically rebalanced between asset classes in order to mitigate investment risk and maintain asset classes within target allocations.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the fair value of the Company's pension plans' assets as of September 30, 2016 and 2015, by asset category segregated by level within the fair value hierarchy, as described in Note 14:

Asset category (in millions)	September 30, 2016				September 30, 2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
U.S. equity	\$560	\$347	\$—	—\$907	\$533	\$362	\$—	—\$895
Non-U.S. equity	683	40	—	723	575	93	—	668
Fixed income securities:								
Corporate	—	1,143	—	1,143	—	1,088	—	1,088
U.S. government	94	89	—	183	65	83	—	148
Mortgage and asset-backed	—	2	—	2	—	2	—	2
Other	—	42	3	45	—	40	3	43
Cash and cash equivalents	—	93	—	93	—	55	—	55
Sub-total	1,337	1,756	3	3,096	1,173	1,723	3	2,899
Net receivables (payables) related to investment transactions				(22)				3
Total				\$3,074				\$2,902

The following table presents the fair value of the Company's other retirement benefits plan's assets as of September 30, 2016 and 2015, by asset category segregated by level within the fair value hierarchy, as described in Note 14:

Asset category (in millions)	September 30, 2016				September 30, 2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
U.S. equity	\$8	\$—	\$—	—\$8	\$7	\$—	\$—	—\$7
Non-U.S. equity	1	—	—	1	—	—	—	—
Fixed income securities:								
Corporate	—	2	—	2	—	2	—	2
U.S. government	2	1	—	3	2	1	—	3
Mortgage and asset-backed	—	—	—	—	—	1	—	1
Cash and cash equivalents	—	5	—	5	—	6	—	6
Total	\$11	\$8	\$—	—\$19	\$9	\$10	\$—	—\$19

Valuation Techniques

Level 1 assets for the pension plans and other retirement benefits plan are primarily comprised of equity and fixed income securities. Level 1 equity securities are actively traded on U.S. and non-U.S. exchanges and are valued using the market approach at quoted market prices on the measurement date. Level 1 fixed income securities are valued using quoted market prices.

Level 2 equity securities contain equity funds that hold investments with values based on quoted market prices, but for which the funds are not valued on a quoted market basis. Level 2 fixed income securities are primarily valued using pricing models that use observable market data or bids provided by independent investment brokerage firms.

Cash and cash equivalents includes cash which is used to pay benefits and cash invested in a short-term investment fund that holds securities with values based on quoted market prices, but for which the funds are not valued on a quoted market basis. As such, the cash and cash equivalents in our pension and other retirement plan assets are classified as Level 2 in the tables above.

The Level 3 assets represent general insurance company contracts in the pension plans and are not significant. As described in Note 14, the fair value of a Level 3 asset is derived from unobservable inputs that are based on the Company's own assumptions.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Contributions

For the years ended September 30, 2016 and 2015, the Company made contributions to its pension plans as follows:

(in millions)	2016	2015
Contributions to U.S. qualified plan	\$ 55	\$ 55
Contributions to U.S. non-qualified plan	9	9
Contributions to non-U.S. plans	5	5
Total	\$ 69	\$ 69

The Company's objective with respect to the funding of its pension plans is to provide adequate assets for the payment of future benefits. Pursuant to this objective, the Company will fund its pension plans as required by governmental regulations and may consider discretionary contributions as conditions warrant. In October 2016, the Company voluntarily contributed \$55 million to its U.S. qualified pension plans, subsequent to its 2016 fiscal year end. There is no minimum statutory funding requirement for 2017 and the Company does not currently expect to make any additional discretionary contributions during 2017 to these plans. Any additional future contributions necessary to satisfy minimum statutory funding requirements are dependent upon actual plan asset returns, interest rates and actuarial assumptions. Contributions to the non-U.S. plans and the U.S. non-qualified plan are expected to total \$13 million in 2017.

The Company participates in a multi-employer arrangement that provides postretirement benefits other than pension benefits. This arrangement provides medical benefits to certain bargaining unit active employees and retirees and their dependents. Contributions to this multi-employer arrangement for postretirement benefits were \$1 million in 2016, \$1 million in 2015 and \$0 million in 2014.

Benefit Payments

The following table reflects estimated benefit payments to be made to eligible participants for each of the next five years and the following five years in the aggregate:

(in millions)	Pension Benefits	Other Retirement Benefits
2017	\$ 241	\$ 16
2018	235	16
2019	240	17
2020	244	17
2021	246	16
2022-2026	1,249	76

Estimated benefit payments for Other Retirement Benefits in the table above are shown net of plan participant contributions and therefore reflect the Company's portion only. Substantially all of the Pension Benefit payments relate to the Company's U.S. qualified funded plans which are paid from the pension trust.

Defined Contribution Savings Plan

The Company sponsors a defined contribution savings plan that is available to the majority of its employees. The plan allows employees to contribute a portion of their compensation on a pre-tax and/or after-tax basis in accordance with specified guidelines. The Company matches a percentage of employee contributions using common stock of the Company up to certain limits. Employees may transfer at any time all or a portion of their balance in Company

common stock to any of the other investment options offered within the plans. The Company is authorized to issue 16.3 million shares under the defined contribution savings plans, of which 1.1 million shares are available for future contributions at September 30, 2016. Additionally, for the majority of the Company's employees, the Company's defined contribution savings plan includes a cash contribution based on an employee's age and service.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Prior to January 1, 2016, ARINC had a defined contribution savings plan that was available to most of its employees. The plan allowed employees to contribute a portion of their compensation on a pre-tax and/or after-tax basis in accordance with specified guidelines. The Company made certain matching cash contributions to the plan, which totaled \$1 million for 2016. The ARINC defined contribution savings plan was merged into the Company defined contribution savings plan on January 1, 2016.

The Company's expense related to the defined contribution savings plans for 2016, 2015 and 2014 was as follows:

	2016	2015	2014
(in millions)	Share Expense	Share Expense	Share Expense
Contribution in shares	0.6 \$ 49	0.4 \$ 39	0.5 \$ 40
Contribution in cash	46	47	50
Total	\$ 95	\$ 86	\$ 90

Employee Stock Purchase Plan

The Company also offers an Employee Stock Purchase Plan (ESPP) which allows employees to have their base compensation withheld to purchase the Company's common stock each month at 95 percent of the fair market value on the last day of the month. As of September 30, 2016, 2.5 million shares are available for future purchase. The ESPP is considered a non-compensatory plan and accordingly no compensation expense is recorded in connection with this benefit. During 2016, 2015 and 2014, 0.1 million, 0.1 million and 0.1 million shares, respectively, of Company common stock were issued to employees at a value of \$11 million, \$11 million and \$10 million for the respective periods.

11. Shareowners' Equity

Common Stock

The Company is authorized to issue one billion shares of common stock, par value \$0.01 per share, and 25 million shares of preferred stock, without par value.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss (AOCL), net of tax, by component are as follows:

	Foreign Exchange Translation Adjustment	Pension and Other Postretirement Adjustments (1)	Change in the Fair Value of Effective Cash Flow Hedges	Total
Balance at September 30, 2013	\$ 12	\$ (1,293)	\$ (6)	\$(1,287)
Other comprehensive income (loss) before reclassifications	(27)	(92)	3	(116)
Amounts reclassified from accumulated other comprehensive income	—	37	—	37
Net current period other comprehensive income (loss)	(27)	(55)	3	(79)
Balance at September 30, 2014	(15)	(1,348)	(3)	(1,366)
Other comprehensive (loss) before reclassifications	(41)	(334)	(7)	(382)
Amounts reclassified from accumulated other comprehensive income	—	45	4	49
Net current period other comprehensive (loss)	(41)	(289)	(3)	(333)
Balance at September 30, 2015	(56)	(1,637)	(6)	(1,699)
Other comprehensive (loss) before reclassifications	(20)	(234)	(2)	(256)
Amounts reclassified from accumulated other comprehensive income	—	53	4	57
Net current period other comprehensive income (loss)	(20)	(181)	2	(199)
Balance at September 30, 2016	\$ (76)	\$ (1,818)	\$ (4)	\$(1,898)

(1) Reclassifications from AOCL to net income related to the amortization of net actuarial losses and prior service credits for the Company's retirement benefit plans and were \$84 million (\$53 million net of tax), \$71 million (\$45 million net of tax) and \$59 million (\$37 million net of tax) for 2016, 2015 and 2014, respectively. The reclassifications are included in the computation of net benefit expense. See Note 10, Retirement Benefits, for additional details.

12. Stock-Based Compensation and Earnings Per Share

Stock-Based Compensation Program Description

In February 2015, the Company's shareholders approved the Company's 2015 Long-Term Incentives Plan (2015 Plan), replacing the 2006 Long-Term Incentives Plan (2006 Plan). Under the 2015 Plan, up to 11 million shares of common stock may be issued by the Company as non-qualified options, performance units, performance shares, stock appreciation rights, restricted shares and restricted stock units. Each share issued pursuant to an award of restricted shares, restricted stock units, performance shares and performance units counts as 3.55 shares against the authorized limit. Shares available for future grant or payment under these plans were 9 million at September 30, 2016. No shares are available for future grant under the 2006 Plan.

Options to purchase common stock of the Company have been granted under various incentive plans to directors, officers and other key employees. All of the Company's stock-based incentive plans require options to be granted at

prices equal to or above the fair market value of the common stock on the dates the options are granted. The plans provide that the option price for certain options granted under the plans may be paid by the employee in cash, shares of common stock or a combination thereof. Option awards provide for accelerated vesting if there is a termination of employment in connection with a change in control. Stock options generally expire 10 years from the date they are granted and generally vest ratably over three years.

The Company utilizes performance shares, restricted stock and restricted stock units that generally cliff vest at the end of three years. The fair value of restricted stock and restricted stock units is estimated using the closing share price on the day of grant. The number of performance shares that will ultimately be issued is based on achievement of performance targets over a three-year period that may consider cumulative sales growth, return on sales and/or free cash flow as a percentage of net income, with an additional potential adjustment up or down depending on the Company's total return to shareowners compared to a group of peer companies. The fair value of performance shares is estimated using a Monte Carlo model that considers the

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

likelihood of a payout adjustment for the total shareowner return in comparison to the peer group. Up to 240 percent of the performance shares the Company grants can be earned if maximum performance is achieved.

The Company's stock-based compensation awards are designed to align management's interests with those of the Company's shareowners and to reward outstanding Company performance. The Company has an ongoing share repurchase plan and expects to satisfy stock option exercises and stock award issuances from treasury stock.

Stock-based compensation expense is recognized on a straight-line basis over the requisite service period. Total stock-based compensation expense and related income tax benefit included within the Consolidated Statement of Operations for 2016, 2015 and 2014 is as follows:

(in millions)	2016	2015	2014
Stock-based compensation expense included in:			
Product cost of sales	\$ 8	\$ 7	\$ 7
Selling, general and administrative expenses	19	17	17
Total	\$ 27	\$ 24	\$ 24
Income tax benefit	\$ 9	\$ 8	\$ 8

General Option Information

The following summarizes the activity of the Company's stock options for 2016:

	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Life (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at September 30, 2015	3,699	\$ 61.02		
Granted	642	86.77		
Exercised	(387)	56.31		
Forfeited or expired	(40)	83.85		
Outstanding at September 30, 2016	3,914	\$ 65.48	5.5	\$ 75
Vested or expected to vest ⁽¹⁾	3,905	\$ 65.43	5.5	\$ 75
Exercisable at September 30, 2016	2,759	\$ 57.93	4.2	\$ 73

⁽¹⁾ Represents outstanding options reduced by expected forfeitures

	2016	2015	2014
Weighted-average fair value per share of options granted	\$17.75	\$19.59	\$18.60
Intrinsic value of options exercised (in millions) ⁽²⁾	\$13	\$48	\$26

⁽²⁾ Represents the amount by which the stock price exceeded the exercise price of the options on the date of the exercise

The total fair value of options vested was \$10 million, \$10 million and \$10 million during the years ended September 30, 2016, 2015 and 2014, respectively. Total unrecognized compensation expense for options that have not vested as of September 30, 2016 is \$7 million and will be recognized over a weighted average period of 0.8 years.

Stock Option Fair Value Information

The Company's determination of the fair value of option awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of subjective variables. These assumptions include: the Company's expected stock price volatility, the projected employee stock option exercise term, the expected dividend yield and the risk-free interest rate. Changes in these assumptions can materially affect the estimated value of the stock options.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The fair value of each option granted by the Company was estimated using a binomial lattice pricing model and the following weighted average assumptions:

	2016 Grants	2015 Grants	2014 Grants
Risk-free interest rate	0.7% - 2.5%	0.5% - 2.6%	0.3% - 3.0%
Expected dividend yield	1.4% - 1.6%	1.6	% 1.9
Expected volatility	20.0	% 24.0	% 28.0
Expected life	7 years	7 years	7 years

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. The binomial lattice model assumes that employees' exercise behavior is a function of the option's remaining expected life and the extent to which the option is in-the-money. The binomial lattice model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and forfeitures on all past option grants made by the Company.

Performance Shares, Restricted Stock and Restricted Stock Units Information

The following summarizes the Company's performance shares, restricted stock and restricted stock units for 2016:

(shares in thousands)	Performance Shares		Restricted Stock		Restricted Stock Units	
	Weighted Average Grant	Weighted Average Fair Value	Weighted Average Grant	Weighted Average Fair Value	Weighted Average Grant	Weighted Average Fair Value
Nonvested at September 30, 2015	438	\$ 68.92	23	\$ 30.24	340	\$ 64.34
Granted	131	85.13	—	—	72	85.85
Vested	(168)	56.10	—	—	(54)	54.37
Forfeited	(15)	79.47	—	—	(7)	78.68
Nonvested at September 30, 2016	386	\$ 79.60	23	\$ 30.24	351	\$ 69.86

(in millions)	Performance Shares	Restricted Stock	Restricted Stock Units
Total unrecognized compensation costs at September 30, 2016	\$ 12	\$ —	\$ 5
Weighted-average life remaining at September 30, 2016, in years	0.9	0	0.9
Weighted-average fair value per share granted in 2015	\$ 82.76	\$ —	\$ 84.63
Weighted-average fair value per share granted in 2014	\$ 71.63	\$ —	\$ 72.42

The maximum number of shares of common stock that can be issued in respect of performance shares granted in 2016 based on the achievement of performance targets for 2016 through 2018 is approximately 304,000. The maximum number of shares of common stock that can be issued in respect of performance shares granted in 2015 based on the achievement of performance targets for 2015 through 2017 is approximately 295,000. For purposes of determining the maximum number of shares of common stock that can be issued with respect to the performance shares granted in 2015 and 2016, the maximums have been updated to reflect reductions arising as a result of terminations and retirements. The number of shares of common stock that will be issued in respect of performance shares granted in 2014 based on the achievement of performance targets for 2014 through 2016 is approximately 134,000.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Earnings Per Share and Diluted Share Equivalents

The computation of basic and diluted earnings per share is as follows:

(in millions, except per share amounts)	2016	2015	2014
Numerator for basic and diluted earnings per share:			
Income from continuing operations	\$727	\$694	\$618
Income (loss) from discontinued operations, net of taxes	1	(8)	(14)
Net income	\$728	\$686	\$604
Denominator:			
Denominator for basic earnings per share – weighted average common shares	130.5	132.3	135.1
Effect of dilutive securities:			
Stock options	1.0	1.0	1.2
Performance shares, restricted stock and restricted stock units	0.6	0.4	0.4
Dilutive potential common shares	1.6	1.4	1.6
Denominator for diluted earnings per share – adjusted weighted average shares and assumed conversion	132.1	133.7	136.7
Earnings (loss) per share:			
Basic			
Continuing operations	\$5.57	\$5.25	\$4.57
Discontinued operations	0.01	(0.06)	(0.10)
Basic earnings per share	\$5.58	\$5.19	\$4.47
Diluted			
Continuing operations	\$5.50	\$5.19	\$4.52
Discontinued operations	0.01	(0.06)	(0.10)
Diluted earnings per share	\$5.51	\$5.13	\$4.42

The Company adopted the new standard on accounting for share-based payments (see Note 2) during 2016. This standard requires excess tax benefits or deficiencies associated with share-based payments to be recorded as a discrete income tax benefit or expense in the period incurred, rather than within Additional paid-in capital. The new standard also requires excess tax benefits and deficiencies to be excluded from assumed future proceeds in the calculation of diluted shares outstanding. The Company adopted the standard prospectively, resulting in a \$4 million and \$0.02 increase to net income from continuing operations and diluted earnings per share from continuing operations, respectively, in 2016.

The average outstanding diluted shares calculation excludes options with an exercise price that exceeds the average market price of shares during the period. Stock options excluded from the average outstanding diluted shares calculation were 0.6 million, 0.0 million and 0.0 million in 2016, 2015 and 2014, respectively.

13. Income Taxes

Income tax expense from continuing operations was calculated based on the following components of income before income taxes:

(in millions)	2016	2015	2014
U.S. income	\$824	\$835	\$754
Non-U.S. income	111	127	128
Total	\$935	\$962	\$882

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of income tax expense from continuing operations are as follows:

(in millions)	2016	2015	2014
Current:			
U.S. federal	\$120	\$169	\$110
Non-U.S.	29	38	37
U.S. state and local	11	11	4
Total current	160	218	151
Deferred:			
U.S. federal	47	49	105
Non-U.S.	—	(4)	(2)
U.S. state and local	1	5	10
Total deferred	48	50	113
Income tax expense	\$208	\$268	\$264

The effective income tax rate from continuing operations differed from the U.S. statutory tax rate as detailed below:

	2016	2015	2014
Statutory tax rate	35.0 %	35.0 %	35.0 %
Foreign rate differential	(0.7)	(1.0)	(1.1)
State and local income taxes	1.1	1.2	1.3
Research and development credit	(6.4)	(3.2)	(1.1)
Domestic manufacturing deduction	(2.0)	(2.0)	(1.7)
Tax settlements	—	(1.6)	(0.9)
Change in valuation allowance	(4.5)	—	—
Other	(0.3)	(0.5)	(1.6)
Effective income tax rate	22.2 %	27.9 %	29.9 %

Deferred income tax assets and liabilities are included in the Consolidated Statement of Financial Position as follows:

	September 30	
(in millions)	2016	2015
Deferred income taxes	\$219	\$165
Other liabilities	(1)	(3)
Deferred income taxes, net	\$218	\$162

As discussed in Note 2, during 2016, the Company retrospectively adopted a new standard related to the balance sheet classification of deferred taxes. The effects of the accounting change on the September 30, 2015 Consolidated Statement of Financial Position were as follows:

	September 30, 2015	
(in millions)	Revised	As Reported
Current deferred income tax asset	\$—	\$ 9
Current deferred income tax liability	—	(84)
Current deferred income taxes, net	\$—	\$ (75)
Long-term deferred income taxes	\$165	\$ 241

Other liabilities	(3)	(4)
Long-term deferred income taxes, net	\$ 162	\$ 237

84

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net long-term deferred income tax benefits (liabilities) consist of the tax effects of temporary differences related to the following:

(in millions)	September 30	
	2016	2015
Inventory	\$(282)	\$(226)
Product warranty costs	29	29
Customer incentives	68	62
Contract reserves	6	11
Retirement benefits	549	487
Intangibles	(171)	(177)
Capital lease liability	20	21
Property	(179)	(154)
Stock-based compensation	33	30
Deferred compensation	16	15
Capital loss carryover	41	42
Compensation and benefits	28	29
Valuation allowance	—	(42)
Other	60	35
Deferred income taxes, net	\$218	\$162

Management believes it is more likely than not that the long-term deferred tax assets will be realized through the reduction of future taxable income. Significant factors considered by management in its determination of the probability of the realization of the deferred tax assets include: (a) the historical operating results of the Company (\$1.549 billion of U.S. taxable income over the past three years), (b) expectations of future earnings, (c) the extended period of time over which the retirement benefit liabilities will be paid and (d) our ability to implement tax planning strategies.

Changes in the valuation allowance for deferred tax assets are summarized as follows:

(in millions)	September 30		
	2016	2015	2014
Balance at beginning of year	\$42	\$43	\$11
Charged to costs and expenses ⁽¹⁾	—	—	43
Deductions ^{(2) (3)}	(42)	(1)	(11)
Balance at September 30	\$—	\$42	\$43

⁽¹⁾ 2014 increase was recorded in discontinued operations

⁽²⁾ 2014 deduction of \$11 million was due to the divestiture of a foreign subsidiary

⁽³⁾ 2016 deduction of \$42 million was primarily due to the creation of a tax planning strategy

The Company's U.S. Federal income tax returns for the tax year ended September 30, 2011 and prior years have been audited by the IRS and are closed to further adjustments by the IRS. The IRS has closed its audit of the Company's tax returns for the years ended September 30, 2012 and 2013; however, the Company has filed a protest related to the taxation of a foreign subsidiary. An acquired subsidiary is also under examination by the IRS for calendar years 2012 and 2013 legacy tax filings. The Company is also currently under audit in various U.S. states and non-U.S. jurisdictions. The U.S. states and non-U.S. jurisdictions have statutes of limitations generally ranging from 3 to 5

years. The Company believes it has adequately provided for any tax adjustments that may result from the various audits.

No provision has been made as of September 30, 2016 for U.S. federal or state, or additional non-U.S. income taxes related to approximately \$551 million of undistributed earnings of non-U.S. subsidiaries which have been or are intended to be permanently reinvested. Thus, it is not practicable to estimate the amount of tax that might be payable on the undistributed earnings.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company had net income tax payments of \$130 million, \$182 million and \$182 million in 2016, 2015 and 2014, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(in millions)	September 30		
	2016	2015	2014
Beginning balance	\$39	\$48	\$56
Additions for tax positions related to the current year	11	8	13
Additions for tax positions of prior years	7	6	1
Additions for tax positions related to acquisitions	—	—	8
Reductions for tax positions of prior years	(10)	(17)	(17)
Reductions for tax positions of prior years related to lapse of statute of limitations	—	(1)	(2)
Reductions for tax positions related to settlements with taxing authorities	(2)	(5)	(11)
Ending balance	\$45	\$39	\$48

The total amount of unrecognized tax benefits that, if recognized, would affect the effective income tax rate were \$20 million, \$11 million and \$25 million as of September 30, 2016, 2015 and 2014, respectively. Although the timing and outcome of tax settlements are uncertain, it is reasonably possible that during the next 12 months a reduction in unrecognized tax benefits may occur in the range of \$0 to \$1 million based on the outcome of tax examinations or as a result of the expiration of various statutes of limitations.

The Company includes income tax-related interest and penalties in income tax expense. The total amount of interest and penalties recognized within Other Liabilities in the Consolidated Statement of Financial Position were not significant as of September 30, 2016 and 2015. The total amount of interest and penalties recorded as an expense or (income) within Income tax expense in the Consolidated Statement of Operations were not significant for the years ended September 30, 2016, 2015 and 2014.

14. Fair Value Measurements

The FASB defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The FASB's guidance classifies the inputs used to measure fair value into the following hierarchy:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 - quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument
- Level 3 - unobservable inputs based on the Company's own assumptions used to measure assets and liabilities at fair value

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and liabilities

The fair value of the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2016 and 2015 are as follows:

(in millions)	Fair Value Hierarchy	September 30,	September 30,
		2016	2015
		Fair Value Asset (Liability)	Fair Value Asset (Liability)
Deferred compensation plan investments	Level 1	\$ 55	\$ 50
Interest rate swap assets	Level 2	35	34
Foreign currency forward exchange contract assets	Level 2	11	7
Foreign currency forward exchange contract liabilities	Level 2	(13)	(11)
Contingent consideration for ICG acquisition	Level 3	(13)	(12)

During 2016, a corporate asset was written down to its fair market value of \$3 million, resulting in an asset impairment charge of \$4 million recorded in Selling, general and administrative expenses on the Consolidated Statement of Operations (see Note 20). The asset is recognized at fair value on a nonrecurring basis and is classified within Level 2 of the fair value hierarchy.

The change in fair value of the Level 3 contingent consideration is as follows:

(in millions)	Fair Value (Liability)
Balance at September 30, 2015	\$ (12)
Fair value adjustment ⁽¹⁾	(1)
Balance at September 30, 2016	\$ (13)

⁽¹⁾ The fair value adjustment is included in Interest expense on the Consolidated Statement of Operations.

There were no transfers between Levels of the fair value hierarchy during 2016 or 2015.

Valuation Techniques

The deferred compensation plan investments consist of investments in marketable securities (primarily mutual funds) and the fair value is determined using the market approach based on quoted market prices of identical assets in active markets.

The fair value of the interest rate swaps is determined using the market approach and is calculated by a pricing model with observable market inputs.

The fair value of foreign currency forward exchange contracts is determined using the market approach and is calculated as the value of the quoted forward currency exchange rate less the contract rate multiplied by the notional amount.

The contingent consideration for the ICG acquisition represents the estimated fair value of post-closing consideration owed to the sellers associated with the acquisition. This is categorized as Level 3 in the fair value hierarchy and the fair value is determined using a probability-weighted approach. The liability recorded was derived from the estimated probability that certain contingent payment milestones will be met in accordance with the terms of the purchase agreement.

As of September 30, 2016, there has not been any impact to the fair value of derivative liabilities due to the Company's own credit risk. Similarly, there has not been any impact to the fair value of derivative assets based on the Company's evaluation of counterparties' credit risks.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial Instruments

The carrying amounts and fair values of the Company's financial instruments are as follows:

(in millions)	Asset (Liability)		September 30, September 30,	
	2016	2015	2016	2015
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$340	\$340	\$252	\$252
Short-term debt	(740)	(740)	(448)	(448)
Long-term debt	(1,347)	(1,508)	(1,646)	(1,750)

The fair value of cash and cash equivalents, and the commercial paper portion of short-term debt, approximates their carrying value due to the short-term nature of the instruments. These items are within Level 1 of the fair value hierarchy. Fair value information for notes due December 2016 classified as short-term debt, and all long-term debt, is within Level 2 of the fair value hierarchy. The fair value of these financial instruments was based on current market interest rates and estimates of current market conditions for instruments with similar terms, maturities and degree of risk. The carrying amount and fair value of short-term and long-term debt excludes the interest rate swaps fair value adjustment. These fair value estimates do not necessarily reflect the amounts the Company would realize in a current market exchange.

15. Derivative Financial Instruments

Interest Rate Swaps

The Company manages its exposure to interest rate risk by maintaining an appropriate mix of fixed and variable rate debt, which over time should moderate the costs of debt financing. To meet this objective, the Company may use financial instruments in the form of interest rate swaps.

In January 2010, the Company entered into two interest rate swap contracts which expire on July 15, 2019 and effectively converted \$150 million of the 2019 Notes to floating rate debt based on six-month LIBOR plus 1.235 percent. In June 2015, the Company entered into two interest rate swap contracts which expire on July 15, 2019 and effectively converted the remaining \$150 million of the 2019 Notes to floating rate debt based on three-month LIBOR plus 3.56 percent (collectively the 2019 Swaps).

In March 2014, the Company entered into three interest rate swap contracts (the 2023 Swaps) which expire on December 15, 2023 and effectively converted \$200 million of the 2023 Notes to floating rate debt based on one-month LIBOR plus 0.94 percent.

The Company designated the 2019 and 2023 Swaps (the Swaps) as fair value hedges. The Swaps are recorded within Other Assets at a fair value of \$35 million, offset by a fair value adjustment to Long-term Debt (Note 9) of \$35 million at September 30, 2016. At September 30, 2015, the Swaps were recorded within Other Assets at a fair value of \$34 million, offset by a fair value adjustment to Long-term Debt (Note 9) of \$34 million. Cash payments or receipts between the Company and the counterparties to the Swaps are recorded as an adjustment to interest expense.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Forward Starting Interest Rate Swaps

In September 2013, the Company entered into forward starting interest rate swap agreements with combined notional values of \$200 million to effectively lock in fixed interest rates on a portion of the long-term debt it incurred in December 2013 to refinance maturing debt and to fund the acquisition of ARINC. In October 2013, the Company entered into an additional \$300 million notional value of forward starting interest rate swap agreements. These forward starting interest rate swaps were designated as cash flow hedges and were executed to hedge the risk of potentially higher benchmark U.S. Treasury bond yields on long-term debt with maturities ranging from 2023 to 2043 and fixed interest rates ranging between 2.8150 percent and 3.8775 percent. The forward starting interest rate swaps were terminated in December 2013 concurrent with the Company's debt issuance. Upon termination, the forward starting swaps were valued at a net loss of \$2 million. This net loss has been deferred within Accumulated other comprehensive losses in the Consolidated Statement of Financial Position and will be amortized into interest expense over the life of the corresponding debt.

Foreign Currency Forward Exchange Contracts

The Company transacts business in various foreign currencies which subjects the Company's cash flows and earnings to exposure related to changes in foreign currency exchange rates. These exposures arise primarily from purchases or sales of products and services from third parties and intercompany transactions. Foreign currency forward exchange contracts provide for the purchase or sale of foreign currencies at specified future dates at specified exchange rates and are used to offset changes in the fair value of certain assets or liabilities or forecasted cash flows resulting from transactions denominated in foreign currencies. As of September 30, 2016 and September 30, 2015, the Company had outstanding foreign currency forward exchange contracts with notional amounts of \$384 million and \$359 million, respectively. These notional values consist primarily of contracts for the British pound sterling, European euro and Swedish krona, and are stated in U.S. dollar equivalents at spot exchange rates at the respective dates.

Fair Value of Derivative Instruments

Fair values of derivative instruments in the Consolidated Statement of Financial Position as of September 30, 2016 and 2015 are as follows:

(in millions)	Classification	Asset Derivatives	
		September 30, 2016	September 30, 2015
Foreign currency forward exchange contracts	Other current assets	\$ 11	\$ 7
Interest rate swaps	Other assets	35	34
Total		\$ 46	\$ 41

(in millions)	Classification	Liability Derivatives	
		September 30, 2016	September 30, 2015
Foreign currency forward exchange contracts	Other current liabilities	\$ 13	\$ 11

The fair values of derivative instruments are presented on a gross basis as the Company does not have any derivative contracts which are subject to master netting arrangements. As of September 30, 2016, there were undesignated foreign currency forward exchange contracts classified within Other current assets of \$2 million and Other current liabilities of \$2 million.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The effect of derivative instruments on the Consolidated Statement of Operations for the fiscal years ended September 30, 2016 and 2015 is as follows:

(in millions)	Location of Gain (Loss)	Amount of Gain (Loss)	
		September 30, 2016	September 30, 2015
Derivatives Designated as Hedging Instruments:			
Fair Value Hedges			
Interest rate swaps	Interest expense	\$ 10	\$ 11
Cash Flow Hedges			
Foreign currency forward exchange contracts:			
Amount of (loss) recognized in AOCL (effective portion, before deferred tax impact)	AOCL	(3)	(10)
Amount of (loss) reclassified from AOCL into income	Cost of sales	(6)	(6)
Derivatives Not Designated as Hedging Instruments:			
Foreign currency forward exchange contracts	Cost of sales	(1)	(8)

There was no significant impact to the Company's earnings related to the ineffective portion of any hedging instruments during the fiscal year ended September 30, 2016. In addition, there was no significant impact to the Company's earnings when a hedged firm commitment no longer qualified as a fair value hedge or when a hedged forecasted transaction no longer qualified as a cash flow hedge during the fiscal year ended September 30, 2016.

The Company did not have any hedges with credit-risk-related contingent features or that required the posting of collateral as of September 30, 2016. The cash flows from derivative contracts are recorded in operating activities in the Consolidated Statement of Cash Flows.

The Company expects to reclassify approximately \$1 million of AOCL losses from cash flow hedges into earnings over the next 12 months. The maximum duration of a foreign currency cash flow hedge contract at September 30, 2016 was 64 months.

16. Guarantees and Indemnifications

Product Warranty Costs

Accrued liabilities are recorded to reflect the Company's contractual obligations relating to warranty commitments to customers. Warranty coverage of various lengths and terms is provided to customers depending on standard offerings and negotiated contractual agreements. An estimate for warranty expense is recorded within product cost of sales at the time of sale based on the length of the warranty and historical warranty return rates and repair costs.

Changes in the carrying amount of accrued product warranty costs are summarized as follows:

(in millions)	September 30		
	2016	2015	2014
Balance at beginning of year	\$89	\$104	\$121
Warranty costs incurred	(42)	(46)	(47)
Product warranty accrual	46	42	46
Changes in estimates for prior years	(6)	(10)	(15)

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Increase from acquisitions	—	1	—
Foreign currency translation adjustments and other	—	(2)	(1)
Balance at September 30	\$87	\$89	\$104

90

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Letters of credit

The Company has contingent commitments in the form of letters of credit. Outstanding letters of credit are issued by banks on the Company's behalf to support certain contractual obligations to its customers. If the Company fails to meet these contractual obligations, these letters of credit may become liabilities of the Company. Total outstanding letters of credit at September 30, 2016 were \$239 million. These commitments are not reflected as liabilities on the Company's Consolidated Statement of Financial Position.

Indemnifications

The Company enters into indemnifications with lenders, counterparties in transactions such as administration of employee benefit plans and other customary indemnifications with third parties in the normal course of business. The following are other than customary indemnifications based on the judgment of management:

In connection with agreements for the sale of portions of its business, the Company at times retains various liabilities of a business that relate to events occurring prior to its sale, such as tax, environmental, litigation and employment matters. The Company at times indemnifies the purchaser of a Rockwell Collins business in the event that a third party asserts a claim that relates to a liability retained by the Company.

The Company also provides indemnifications of varying scope and amounts to certain customers against claims of product liability or intellectual property infringement made by third parties arising from the use of Company or customer products or intellectual property. These indemnifications generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party product liability or intellectual property claims arising from these transactions.

The amount the Company could be required to pay under its indemnification agreements is generally limited based on amounts specified in the underlying agreements, or in the case of some agreements, the maximum potential amount of future payments that could be required is not limited. When a potential claim is asserted under these agreements, the Company considers such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. A liability is recorded when a potential claim is both probable and estimable. The nature of these agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay should counterparties to these agreements assert a claim; however, the Company currently has no material claims pending related to such agreements.

17. Contractual Obligations and Other Commitments

The following table reflects certain of the Company's non-cancelable contractual commitments as of September 30, 2016:

(in millions)	Payments Due By Period						Total
	2017	2018	2019	2020	2021	Thereafter	
Non-cancelable operating leases	\$63	\$52	\$39	\$28	\$21	\$113	\$316
Purchase contracts	34	32	29	27	26	40	188
Long-term debt	300	—	300	—	—	1,050	1,650
Interest on long-term debt	58	58	58	42	42	473	731
Total	\$455	\$142	\$426	\$97	\$89	\$1,676	\$2,885

Non-cancelable Operating Leases

The Company leases certain office and manufacturing facilities as well as certain machinery and equipment under various lease contracts with terms that meet the accounting definition of operating leases. Some leases include renewal options, which permit extensions of the expiration dates at rates approximating fair market rental rates. Rent expense for the years ended September 30, 2016, 2015 and 2014 was \$77 million, \$73 million and \$65 million, respectively. The Company's commitments under these operating leases, in the form of non-cancelable future lease payments, are not reflected as a liability on the Consolidated Statement of Financial Position.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Purchase Contracts

The Company may enter into purchase contracts with suppliers under which there is a commitment to buy a minimum amount of products or pay a specified amount. These commitments are not reflected as a liability on the Company's Consolidated Statement of Financial Position. Amounts purchased under these agreements for the years ended September 30, 2016, 2015 and 2014 were \$57 million, \$50 million and \$38 million, respectively.

Interest on Long-term Debt

Interest payments under long-term debt obligations exclude the potential effects of the related interest rate swap contracts.

18. Environmental Matters

The Company is subject to federal, state and local regulations relating to the discharge of substances into the environment, the disposal of hazardous wastes and other activities affecting the environment that have had and will continue to have an impact on the Company's manufacturing operations. These environmental protection regulations may require the investigation and remediation of environmental impairments at current and previously owned or leased properties. In addition, lawsuits, claims and proceedings have been asserted on occasion against the Company alleging violations of environmental protection regulations, or seeking remediation of alleged environmental impairments, principally at previously owned or leased properties. As of September 30, 2016, the Company is involved in the investigation or remediation of seven sites under these regulations or pursuant to lawsuits asserted by third parties. Management estimates that the total reasonably possible future costs the Company could incur for six of these sites is not significant. Management estimates that the total reasonably possible future costs the Company could incur from one of these sites to be approximately \$12 million. The Company has recorded environmental reserves for this site of \$6 million as of September 30, 2016, which represents management's best estimate of the probable future cost for this site.

To date, compliance with environmental regulations and resolution of environmental claims has been accomplished without material effect on the Company's liquidity and capital resources, competitive position or financial condition. Management believes that expenditures for environmental capital investment and remediation necessary to comply with present regulations governing environmental protection and other expenditures for the resolution of environmental claims will not have a material effect on the Company's business or financial position.

19. Legal Matters

The Company is subject to various lawsuits, claims and proceedings that have been or may be instituted or asserted against the Company relating to the conduct of the Company's business, including those pertaining to product liability, antitrust, intellectual property, safety and health, exporting and importing, contract, employment and regulatory matters. Although the outcome of these matters cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to the Company, management believes there are no material pending legal proceedings.

20. Restructuring, Pension Settlement and Asset Impairment Charges, Net

During the first quarter of 2016, the Company recorded corporate restructuring and asset impairment charges totaling \$45 million as follows:

(in millions)	Cost of Sales	Selling, General and Administrative Expenses	Total
Employee separation costs	\$ 31	\$ 8	\$ 39
Asset impairment charges	2	4	6
Restructuring and asset impairment charges	\$ 33	\$ 12	\$ 45

The 2016 employee separation costs primarily resulted from the Company's execution of a voluntary separation incentive program in response to certain challenging market conditions, particularly in business aviation. As of September 30, 2016, all employee separation costs have been paid. Asset impairment charges primarily relate to the write-down to fair market value of a corporate asset, as well as the write-off of certain long-lived assets.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2014, the Company recorded pension settlement and restructuring charges totaling \$9 million. This amount was comprised of (i) \$5 million for pension settlement charges (included within Selling, general and administrative expense) and (ii) \$4 million for employee severance costs related to the consolidation and closure of two service centers as part of a plan to optimize the efficiency of the Company's global service center footprint. These severance costs were included within cost of sales. Through September 30, 2015, the Company completed all cash payments associated with these actions.

21. Operating Segment Information

Rockwell Collins designs, produces and supports communications and aviation systems for commercial and military customers and provides information management services through voice and data communication networks and solutions worldwide. The Company has three operating segments consisting of the Commercial Systems, Government Systems and Information Management Services businesses.

Commercial Systems supplies aviation electronics systems, products and services to customers located throughout the world. The customer base is comprised of OEMs of commercial air transport, business and regional aircraft, commercial airlines and business aircraft operators.

Government Systems provides avionics, communication products, surface solutions and navigation products to the U.S. Department of Defense, other government agencies, civil agencies, aerospace and defense contractors and foreign ministries of defense around the world.

Information Management Services enables mission-critical data and voice communications throughout the world to customers using high-performance, high-quality and high-assurance proprietary radio and terrestrial networks, enhancing customer efficiency, safety and connectivity.

Sales made by the Company to the U.S. Government were 33 percent, 29 percent and 30 percent of total sales for the years ended September 30, 2016, 2015 and 2014, respectively.

The Company evaluates performance and allocates resources based upon, among other considerations, segment operating earnings. The Company's definition of segment operating earnings excludes income taxes, stock-based compensation, unallocated general corporate expenses, interest expense, significant gains and losses from the disposition of businesses and other special items as identified by management from time to time, such as significant restructuring and asset impairment charges. Intersegment sales are not material and have been eliminated. The accounting policies used in preparing the segment information are consistent with the policies described in Note 2.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The sales and earnings of continuing operations of the Company's operating segments are summarized as follows:

(in millions)	2016	2015	2014
Sales:			
Commercial Systems	\$2,395	\$2,434	\$2,299
Government Systems	2,206	2,187	2,209
Information Management Services	658	623	471
Total sales	\$5,259	\$5,244	\$4,979
Segment operating earnings:			
Commercial Systems	\$531	\$554	\$509
Government Systems	477	457	465
Information Management Services	107	95	62
Total segment operating earnings	1,115	1,106	1,036
Interest expense ⁽¹⁾	(64)	(61)	(59)
Stock-based compensation	(27)	(24)	(24)
General corporate, net	(44)	(59)	(59)
Gain on divestiture of business	—	—	10
ARINC transaction costs ⁽¹⁾	—	—	(13)
Restructuring, pension settlement and asset impairment charges, net	(45)	—	(9)
Income from continuing operations before income taxes	935	962	882
Income tax expense	(208)	(268)	(264)
Income from continuing operations	\$727	\$694	\$618

⁽¹⁾ During the year ended September 30, 2014, the Company incurred \$3 million of bridge facility fees related to the acquisition of ARINC. These costs are included in interest expense; therefore total transaction costs related to the acquisition of ARINC during this period was \$16 million.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables summarize the identifiable assets and investments in equity affiliates at September 30, 2016, 2015 and 2014, as well as the provision for depreciation and amortization, the amount of capital expenditures for property and earnings from equity affiliates for each of the three years ended September 30, for each of the operating segments and Corporate:

(in millions)	2016	2015	2014
Identifiable assets:			
Commercial Systems	\$3,050	\$2,906	\$2,655
Government Systems	2,052	1,953	1,938
Information Management Services	1,906	1,886	1,885
Corporate	699	559	527
Total identifiable assets	\$7,707	\$7,304	\$7,005
Investments in equity affiliates:			
Commercial Systems	\$4	\$7	\$—
Government Systems	6	6	8
Information Management Services	—	—	—
Total investments in equity affiliates	\$10	\$13	\$8
Depreciation and amortization:			
Commercial Systems	\$125	\$117	\$108
Government Systems	74	83	80
Information Management Services	54	52	37
Total depreciation and amortization	\$253	\$252	\$225
Capital expenditures for property:			
Commercial Systems	\$74	\$90	\$68
Government Systems	69	81	66
Information Management Services	50	39	29
Total capital expenditures for property	\$193	\$210	\$163
Earnings (loss) from equity affiliates:			
Commercial Systems	\$(3)	\$—	\$—
Government Systems	2	3	7
Information Management Services	—	—	—
Total earnings (loss) from equity affiliates	\$(1)	\$3	\$7

The Company's operating segments share many common resources, infrastructures and assets in the normal course of business. Certain assets have been allocated between the operating segments primarily based on occupancy or usage, principally property, plant and equipment. Identifiable assets at Corporate consist principally of cash and net deferred income tax assets for all years presented.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes sales by product category for the years ended September 30, 2016, 2015 and 2014:

(in millions)	2016	2015	2014
Commercial Systems product categories:			
Air transport aviation electronics	\$ 1,430	\$ 1,385	\$ 1,285
Business and regional aviation electronics	965	1,049	1,014
Commercial Systems sales	2,395	2,434	2,299
Government Systems product categories:			
Avionics	1,483	1,436	1,409
Communication and Navigation	723	751	800
Government Systems sales	2,206	2,187	2,209
Information Management Services sales	658	623	471
Total sales	\$5,259	\$5,244	\$4,979

The air transport and business and regional aviation electronics sales categories are delineated based on the difference in underlying customer base, size of aircraft and markets served. For the years ended September 30, 2016, 2015 and 2014, product category sales for air transport aviation electronics include revenue from wide-body in-flight entertainment products and services of \$38 million, \$57 million and \$70 million, respectively.

Beginning in 2016, product category sales for Government Systems have been consolidated as a result of an internal reorganization and are delineated based upon underlying product technologies. The previously reported sales categories of Communication products, Surface solutions and Navigation products are now primarily consolidated into Communication and navigation. Government Systems sales have been reclassified to conform to the current year presentation.

The following table reflects sales for the years ended September 30, 2016, 2015 and 2014 by location of our customers and property at September 30, 2016, 2015 and 2014 by geographic region:

(in millions)	Sales			Property		
	2016	2015	2014	2016	2015	2014
U.S. ⁽¹⁾	\$3,292	\$3,174	\$2,993	\$921	\$861	\$805
Europe / Africa / Middle East	937	1,070	1,040	86	83	90
Asia-Pacific	545	503	486	17	15	19
Americas, excluding U.S.	485	497	460	11	5	5
Non U.S.	1,967	2,070	1,986	114	103	114
Total	\$5,259	\$5,244	\$4,979	\$1,035	\$964	\$919

⁽¹⁾ For the years ended September 30, 2016, 2015 and 2014, U.S. sales include revenue from foreign military sales of \$171 million, \$171 million and \$176 million, respectively.

Sales are attributable to geographic region based on the location of our customers.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

22. Quarterly Financial Information (Unaudited)

Quarterly financial information for the years ended September 30, 2016 and 2015 is summarized as follows:

(in millions, except per share amounts)	2016 Quarters				
	First	Second	Third	Fourth	Total
Sales	\$1,169	\$1,311	\$1,334	\$1,445	\$5,259
Gross profit (total sales less product and service cost of sales)	333	404	419	461	1,617
Income from continuing operations	133	172	214	208	727
Income (loss) from discontinued operations, net of taxes	2	(1)	—	—	1
Net income	\$135	\$171	\$214	\$208	\$728
Earnings (loss) per share:					
Basic					
Continuing operations	\$1.01	\$1.31	\$1.65	\$1.60	\$5.57
Discontinued operations	0.02	—	—	—	0.01
Basic earnings per share	\$1.03	\$1.31	\$1.65	\$1.60	\$5.58
Diluted					
Continuing operations	\$1.00	\$1.30	\$1.63	\$1.58	\$5.50
Discontinued operations	0.02	(0.01)	—	—	0.01
Diluted earnings per share	\$1.02	\$1.29	\$1.63	\$1.58	\$5.51

Net income in the first quarter of 2016 includes \$45 million of pre-tax restructuring and asset impairment charges primarily related to employee separation costs. In addition, net income includes a \$24 million income tax benefit from the retroactive reinstatement of the Federal R&D Tax Credit.

Net income in the third quarter of 2016 includes a \$41 million income tax benefit due to the release of a valuation allowance for a U.S. capital loss carryforward.

(in millions, except per share amounts)	2015 Quarters				
	First	Second	Third	Fourth	Total
Sales	\$1,226	\$1,341	\$1,293	\$1,384	\$5,244
Gross profit (total sales less product and service cost of sales)	369	404	405	436	1,614
Income from continuing operations	169	163	178	184	694
Income (loss) from discontinued operations, net of taxes	(2)	(6)	—	—	(8)
Net income	\$167	\$157	\$178	\$184	\$686
Earnings (loss) per share:					
Basic					
Continuing operations	\$1.28	\$1.23	\$1.35	\$1.40	\$5.25
Discontinued operations	(0.02)	(0.04)	—	—	(0.06)
Basic earnings per share	\$1.26	\$1.19	\$1.35	\$1.40	\$5.19
Diluted					
Continuing operations	\$1.26	\$1.22	\$1.33	\$1.38	\$5.19
Discontinued operations	(0.02)	(0.05)	—	—	(0.06)
Diluted earnings per share	\$1.24	\$1.17	\$1.33	\$1.38	\$5.13

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net income in the first quarter of 2015 includes a \$22 million income tax benefit from the retroactive reinstatement of the Federal R&D Tax Credit.

Net income in the third quarter of 2015 includes a \$14 million income tax benefit related to the remeasurement of certain prior year tax positions.

Earnings per share amounts are computed independently each quarter. As a result, the sum of each quarter's per share amount may not equal the total per share amount for the respective year.

23. Subsequent Event

On October 23, 2016, the Company reached a definitive agreement to acquire B/E Aerospace, a leading manufacturer of aircraft cabin interior products, for approximately \$6.4 billion in cash and stock, plus the assumption of \$1.9 billion in net debt. Under the terms of the agreement, each B/E Aerospace shareowner will receive total consideration of \$62.00 per share, comprised of \$34.10 per share in cash and \$27.90 in shares of the Company's common stock, subject to a 7.5 percent collar.

The transaction, which is expected to close during the spring of 2017, has been unanimously approved by the Boards of Directors of both companies and is subject to the the satisfaction of customary closing conditions and approval by certain regulators, the Company's shareowners and B/E Aerospace shareowners. Upon closing, B/E Aerospace results will be reported as part of a newly created aircraft interior systems segment. The Company intends to finance the cash portion of the transaction with debt financing, of which a significant portion has been committed. For additional information regarding the agreement, refer to the Form 8-K filed by the Company on October 27, 2016.

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

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures.

We maintain disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, including controls and procedures designed to ensure that such information is accumulated and communicated to our management, including our Chairman, President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's disclosure control objectives.

We have carried out an evaluation, under the supervision and with the participation of our management, including our Chairman, President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report (the "Evaluation Date"). Based upon that evaluation, our Chairman, President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of the Evaluation Date.

Evaluation of Internal Control Over Financial Reporting

Management's report on internal control over financial reporting as of September 30, 2016 is included within Item 8 of this Annual Report on Form 10-K. The report of Deloitte & Touche LLP on the effectiveness of internal control over financial reporting is included within Item 9A of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareowners of
Rockwell Collins, Inc.

We have audited the internal control over financial reporting of Rockwell Collins, Inc. and subsidiaries (the "Company") as of September 30, 2016, based on criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2016, based on the criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended September 30, 2016 of the Company and our report dated November 15, 2016 expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP

Chicago, Illinois
November 15, 2016

100

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

See the information under the captions Election of Directors, Information as to Nominees for Directors and Continuing Directors and Section 16(a) Beneficial Ownership Reporting Compliance in the 2017 Proxy Statement. See also the information with respect to executive officers of the Company under Item 4A of Part I.

No nominee for director was selected pursuant to any arrangement or understanding between the nominee and any person other than us pursuant to which such person is or was to be selected as a director or nominee.

The members of the Audit Committee of our Board of Directors are: Chris A. Davis, Andrew J. Policano and David Lilley. The Board of Directors has determined that all these members are "independent" as defined under applicable SEC and New York Stock Exchange rules and are "audit committee financial experts." The Board's affirmative determination with respect to Ms. Davis was based upon her education and more than twenty years in chief financial officer positions of public companies and her extensive audit committee experience. The Board's affirmative determination with respect to Dr. Policano was based upon his education and his extensive audit and finance committee experience. The Board's affirmative determination with respect to Mr. Lilley was based upon his relevant education and experience as an executive officer of a public company in actively supervising financial officers and his audit committee experience.

We have adopted a handbook entitled Rockwell Collins Standards of Business Conduct, and we have supporting policies covering standards of business conduct and conflicts of interest (collectively, the "code of ethics"). The code of ethics applies to our Chief Executive Officer, Chief Financial Officer, Vice President, Finance & Controller (who serves as our principal accounting officer), as well as to all of our other employees and to the members of our Board of Directors. The code of ethics is publicly available on our website at www.rockwellcollins.com. If we make any amendments to the code of ethics or grant any waiver, including any implicit waiver, from a provision of the code applicable to our Chief Executive Officer, Chief Financial Officer or principal accounting officer requiring disclosure under applicable SEC rules, we intend to disclose the nature of such amendment or waiver on our website.

Item 11. Executive Compensation.

See the information under the captions Compensation of Directors, Compensation Discussion and Analysis, Compensation Committee Report, Summary Compensation Table, Grants of Plan-Based Awards, Outstanding Equity Awards at Fiscal Year End, Option Exercises and Stock Vested, Pension Benefits, Non-Qualified Deferred Compensation and Potential Payments Upon Termination of Change of Control in the 2017 Proxy Statement.

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

See the information under the captions Voting Securities and Equity Ownership of Certain Beneficial Owners and Management in the 2017 Proxy Statement.

Equity Compensation Plan Information

The following table gives information as of September 30, 2016 about our Common Stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans:

Plan Category	(a) Number Of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants And Rights	(b) Weighted-Average Exercise Price Of Outstanding Options, Warrants And Rights	(c) Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a))
Equity Compensation Plans Approved By Security Holders ⁽¹⁾	4,998,114	(2) \$ 65.48	11,481,695 ⁽³⁾⁽⁴⁾
Equity Compensation Plans Not Approved By Security Holders	0	0	0
Total	4,998,114	\$ 65.48	11,481,695

⁽¹⁾ Consists of the 2015 Long-Term Incentives Plan.

⁽²⁾ Includes 732,945 performance shares, which is the maximum number of shares that can be issued in the future if maximum performance is achieved under performance agreements granted in November 2014 and 2015. Of these performance shares, 133,602 will be issued in November 2016 based on performance shares granted in November 2013. Also includes 350,815 restricted stock units (RSUs). Such performance shares and RSUs are not included in the weighted average price calculation.

⁽³⁾ Also includes 2,511,766 shares available under our ESPP, which allows employees to have up to 15 percent of their base compensation withheld toward the purchase of our common stock. Shares are purchased each month by participants at 95 percent of the fair market value on the last day of the month pursuant to the ESPP.

⁽⁴⁾ Of the 8,969,929 shares available for future grant under the 2015 Long-Term Incentives Plan, each share issued pursuant to an award of restricted stock, restricted stock units, performance shares and performance units counts as 3.55 shares against this limit in accordance with the terms of the plan.

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

See the information under the caption Corporate Governance: Board of Directors and Committees and Certain Transactions and Other Relationships in the 2017 Proxy Statement.

Item 14. Principal Accounting Fees and Services.

See the information under the caption Proposal to Approve the Selection of Independent Auditors in the 2017 Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) Financial Statements, Financial Statement Schedules and Exhibits.

(1) Financial Statements

The financial statements are included under Item 8 of this Annual Report on Form 10-K:
 Consolidated Statement of Financial Position, as of September 30, 2016 and 2015
 Consolidated Statement of Operations, years ended September 30, 2016, 2015 and 2014
 Consolidated Statement of Comprehensive Income, years ended September 30, 2016, 2015 and 2014
 Consolidated Statement of Cash Flows, years ended September 30, 2016, 2015 and 2014
 Consolidated Statement of Equity, years ended September 30, 2016, 2015 and 2014
 Notes to Consolidated Financial Statements
 Report of Independent Registered Public Accounting Firm

All other schedules not filed herewith are omitted because of the absence of conditions under which they are required or because the information called for is shown in the financial statements or notes thereto.
 Exhibits

- 3-a-1 Restated Certificate of Incorporation of the Company, as amended, filed as Exhibit 3-a-1 to the Company's Form 10-K for year ended September 30, 2001, is incorporated herein by reference.
- 3-a-2 Certificate of Merger effecting name change of the Company from "New Rockwell Collins, Inc." to "Rockwell Collins, Inc.", filed as Exhibit 3-a-2 to the Company's Form 10-K for year ended September 30, 2001, is incorporated herein by reference.
- 3-b-1 By-Laws of the Company, as amended and restated effective April 20, 2016, filed as Exhibit 3-b-1 to the Company's Form 8-K dated April 20, 2016, is incorporated herein by reference.
- 4-a-1 Indenture dated as of November 1, 2001 between the Company and Citibank, N.A., as Trustee, filed as Exhibit 4.b to the Company's Registration Statement on Form S-3 (No. 333-72914), is incorporated herein by reference.
- 4-a-3 Form of Supplemental Indenture dated as of December 4, 2006 between the Company and The Bank of New York Trust Company, N.A. (as incoming trustee), filed as Exhibit 4-a-4 to the Company's Form 8-K dated November 9, 2006, is incorporated herein by reference.
- 4-a-4 Form of certificate for the Company's 5.25% Notes due July 15, 2019, filed as Exhibit 4 to the Company's Form 8-K dated May 1, 2009, is incorporated herein by reference.
- 4-a-6 Form of certificate for the Company's 3.100% notes due November 15, 2021, filed as Exhibit 4 to the Company's Form 8-K dated November 16, 2011, is incorporated herein by reference.
- 4-a-7 Underwriting Agreement, dated December 11, 2013, between the Company and Citigroup Global Markets Inc., J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Wells Fargo Securities, LLC, as representatives of the several Underwriters named in Schedule 1 to the Underwriting Agreement, filed as Exhibit 1 to the Company's Form 8-K dated December 17, 2013, is incorporated herein by reference.
- 4-a-8 Form of certificate for the Company's Floating Rate Notes due 2016, filed as Exhibit 4.1 to the Company's Form 8-K dated December 17, 2013, is incorporated herein by reference.
- 4-a-9 Form of certificate for the Company's 3.700% Notes due 2023, filed as Exhibit 4.2 to the Company's Form 8-K dated December 17, 2013, is incorporated herein by reference.
- 4-a-10 Form of certificate for the Company's 4.800% Notes due 2043, filed as Exhibit 4.3 to the Company's Form 8-K dated December 17, 2013, is incorporated herein by reference.
- *10-a-1 The Company's 2001 Long-Term Incentives Plan, as amended, filed as Exhibit 10-a-9 to the Company's Form 10-K for year ended September 30, 2007, is incorporated herein by reference.
- *10-a-2

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Forms of Stock Option Agreements under the Company's 2001 Long-Term Incentives Plan, filed as Exhibit 10-a-2 to the Company's Form 10-K for year ended September 30, 2001, are incorporated herein by reference.

*10-a-4 The Company's 2006 Long-Term Incentives Plan, as amended, filed as Appendix A to the Company's Notice and Proxy Statement dated December 18, 2009, is incorporated herein by reference.

- *10-a-5 The Company's First Amendment to the Amended and Restated 2006 Long-Term Incentives Plan, as amended, filed as Exhibit 10-a-1 to the Company's Form 10-Q for the quarter ended June 30, 2012, is incorporated herein by reference.
- *10-a-6 Form of Restricted Stock Unit Award under the Company's 2006 Long-Term Incentives Plan, filed as Exhibit 10.1 to the Company's Form 8-K dated February 7, 2006, is incorporated herein by reference.
- *10-a-7 Forms of Stock Option Agreements under the Company's 2006 Long-Term Incentives Plan filed as Exhibit 10-a-8 to the Company's Form 10-K for year ended September 30, 2006, is incorporated herein by reference.
- *10-a-8 The Company's 2006 Annual Incentive Compensation Plan for Senior Executives, as amended, filed as Exhibit 10-a-1 to the Company's Form 10-Q for quarter ended December 31, 2015, is incorporated herein by reference.
- *10-a-9 Forms of Stock Option Agreements, adopted November 20, 2009, under the Company's 2006 Long-Term Incentives Plan, filed as Exhibit 10-a-9 to the Company's Form 10-K for year ended September 30, 2009, is incorporated herein by reference.
- *10-a-10 The Company's 2015 Long-Term Incentives Plan filed as Appendix B to the Company's Notice and Proxy Statement dated December 17, 2014, is incorporated herein by reference.
- *10-a-11 Form of Stock Option Agreement under the Company's 2006 and 2015 Long-Term Incentives Plans, filed as Exhibit 10-a-1 to the Company's Form 10-Q for the quarter ended December 31, 2014, is incorporated herein by reference.
- *10-a-12 Form of Performance Share Agreement under the Company's 2006 and 2015 Long-Term Incentives Plans, filed as Exhibit 10-a-2 to the Company's Form 10-Q for the quarter ended December 31, 2014, is incorporated herein by reference.
- *10-b-1 The Company's Directors Stock Plan, adopted by the Company's Board of Directors on June 1, 2001 and approved by the Company's shareowners at the 2002 Annual Meeting of Shareowners, filed as Exhibit 10.2 to the Company's Registration Statement on Form 10 (File No. 001-16445) (the "Form 10"), is incorporated herein by reference.
- *10-b-3 Form of Restricted Stock Agreement under the Company's Directors Stock Plan, filed as Exhibit 10-b-3 to the Company's Form 10-K for year ended September 30, 2001, is incorporated herein by reference.
- *10-c-1 Compensation Recovery Policy acknowledgment and agreement filed as Exhibit 10-c-1 to the Company's Form 10-Q for the quarter ended December 31, 2012, is incorporated herein by reference.
- *10-d-1 The Company's Incentive Compensation Plan, as amended, filed as Exhibit 10-d-2 to the Company's Form 10-K for year ended September 30, 2007, is incorporated herein by reference.
- *10-f-1 The Company's Deferred Compensation Plan, as amended, filed as Exhibit 10-f-2 to the Company's Form 10-K for year ended September 30, 2007, is incorporated herein by reference.
- *10-f-2 The Company's 2005 Deferred Compensation Plan, as amended and restated, filed as Exhibit 10-f-1 to the Company's Form 10-Q for quarter ended March 31, 2014, is incorporated herein by reference.
- *10-g-1 The Company's Non-Qualified Savings Plan, as amended, filed as Exhibit 10-g-2 to the Company's Form 10-K for year ended September 30, 2007, is incorporated herein by reference.
- *10-g-2 The Company's 2005 Non-Qualified Retirement Savings Plan, as amended, filed as Exhibit 10-g-3 to the Company's Form 10-Q for quarter ended December 31, 2010, is incorporated herein by reference.
- *10-g-3 Amendment No. 1 to the Company's 2005 Non-Qualified Retirement Savings Plan as amended, filed as Exhibit 10-h-2 to the Company's Form 10-Q for the quarter ended December 31, 2015, is incorporated herein by reference.
- *10-h-1 The Company's 2005 Non-Qualified Pension Plan, as amended, filed as Exhibit 10-h-1 to the Company's Form 10-Q for quarter ended June 30, 2012, is incorporated herein by reference.
- *10-h-2 Amendment No. 1 to the Company's 2005 Non-Qualified Pension Plan, as amended, filed as Exhibit 10-h-1 to the Company's Form 10-Q for the quarter ended December 31, 2015, incorporated herein by reference.
- *10-h-3

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The Company's Non-Qualified Pension Plan, as amended, filed as Exhibit 10-h-3 to the Company's Form 10-K for the year ended September 30, 2008, is incorporated herein by reference.

*10-i-1 The Company's Master Trust, as amended, filed as Exhibit 10-i-2 to the Company's Form 10-K for year ended September 30, 2007, is incorporated herein by reference.

10-k-1 Distribution Agreement dated as of June 29, 2001 by and among Rockwell International Corporation, the Company and Rockwell Scientific Company LLC, filed as Exhibit 2.1 to the Company's Form 8-K dated July 11, 2001, is incorporated herein by reference.

10-l-1 Employee Matters Agreement dated as of June 29, 2001 by and among Rockwell International Corporation, the Company and Rockwell Scientific Company LLC, filed as Exhibit 2.2 to the Company's Form 8-K dated July 11, 2001, is incorporated herein by reference.

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10-m-1	Tax Allocation Agreement dated as of June 29, 2001 by and between Rockwell International Corporation and the Company, filed as Exhibit 2.3 to the Company's Form 8-K dated July 11, 2001, is incorporated herein by reference.
*10-n-1	Form of Change of Control Agreement between the Company and certain executives of the Company (Three-Year Agreement), as amended, filed as Exhibit 10-n-1 to the Company's Form 8-K dated April 21, 2009, is incorporated herein by reference.
10-o-3	Five-Year Credit Agreement dated as of September 24, 2013 among us, the Banks listed therein, JPMorgan Chase Bank, N.A., as Administrative Agent, Citibank, N.A., as Syndication Agent, Credit Agricole Corporate & Investment Bank, Mizuho Bank Ltd., The Bank of New York Mellon, U.S. Bank National Association and Wells Fargo Bank, N.A., as Co-Documentation Agents, and Citigroup Global Markets Inc. and J.P. Morgan Securities LLC, as Joint Lead Arrangers and Bookrunners, filed as Exhibit 10.2 to the Company's Form 8-K dated September 24, 2013, is incorporated herein by reference.
10-o-4	364-Day Credit Agreement dated as of September 24, 2013 among us, the Banks listed therein, JPMorgan Chase Bank, N.A., as Administrative Agent, Citibank, N.A., as Syndication Agent, Bank of America, N.A. Credit Agricole Corporate & Investment Bank, Mizuho Bank (USA), The Bank of New York Mellon, U.S. Bank National Association and Wells Fargo Bank, N.A., as Co-Documentation Agents, and Citigroup Global Markets Inc. and J.P. Morgan Securities LLC, as Joint Lead Arrangers and Bookrunners, filed as Exhibit 10.3 to the Company's Form 8-K dated September 24, 2013, is incorporated herein by reference.
*10-q-7	Forms of Three-Year Performance Share Agreements, adopted on November 20, 2009, filed as Exhibit 10-q-7 to the Company's Form 10-K for year ended September 30, 2009, is incorporated herein by reference.
*10-q-8	Forms of Three-Year Performance Share Agreements, adopted on November 14, 2011, filed as Exhibit 10-q-8 to the Company's Form 10-K for year ended September 30, 2011, is incorporated herein by reference.
*10-q-9	Form of Three-Year Performance Share Agreement filed as Exhibit 10-q-1 to the Company's Form 10-Q for the quarter ended December 31, 2015, is incorporated herein by reference.
*10-s-1	Non-Employee Director Compensation Summary.
*10-s-2	Non-Employee Director Deferral Election Forms.
10-t-1	Agreement and Plan of Merger, dated as of August 10, 2013, by and among Rockwell Collins, Inc., Avatar Merger Sub, Inc., Radio Holdings, Inc. and TC Group IV Managing GP, L.L.C., filed as Exhibit 99.1 to the Company's Form 8-K dated November 12, 2013, is incorporated herein by reference.
12	Statement re: Computation of Ratio of Earnings to Fixed Charges.
21	List of subsidiaries of the Company.
23	Consent of Independent Registered Public Accounting Firm.
24	Powers of Attorney authorizing certain persons to sign this Annual Report on Form 10-K on behalf of certain directors and officers of the Company.
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.

101.LAB

XBRL Taxonomy Extension Label Linkbase.

101.PRE

XBRL Taxonomy Extension Presentation Linkbase.

* Management contract or compensatory plan or arrangement.

105

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ROCKWELL COLLINS, INC.

By/s/ ROBERT J. PERNA

Robert J. Perna

Senior Vice President, General Counsel and Secretary

Dated: November 15, 2016

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 15th day of November 2016 by the following persons on behalf of the registrant and in the capacities indicated.

/s/ ROBERT K.

ORTBERG

Chairman, President and Chief Executive Officer (principal executive officer)

Robert K. Ortberg

ANTHONY J.

CARBONE*

Director

CHRIS A. DAVIS*

Director

RALPH E.

EBERHART*

Director

JOHN A.

EDWARDSON*

Director

DAVID LILLEY*

Director

ANDREW J.

POLICANO*

Director

CHERYL L.

SHAVERS*

Director

JEFFREY L.

TURNER*

Director

/s/ PATRICK E.

ALLEN

Senior Vice President and Chief Financial Officer (principal financial officer)

Patrick E. Allen

/s/ TATUM J. BUSE

Tatum J. Buse

Vice President, Finance and Corporate Controller (principal accounting officer)

*By /s/ ROBERT J.

PERNA

Robert J. Perna,

Attorney-in-fact**

** By authority of the powers of attorney filed herewith.

EXHIBIT INDEX

Exhibit Number	Description
*10-s-1	Non-Employee Director Compensation Summary.
*10-s-2	Non-Employee Director Deferral Election Forms.
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21	List of subsidiaries of the Company.
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24	Powers of Attorney authorizing certain persons to sign this Annual Report on Form 10-K on behalf of certain directors and officers of the Company.
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

* Management contract or compensatory plan or arrangement.