

L 3 COMMUNICATIONS HOLDINGS INC  
Form 10-K  
February 25, 2014  
Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

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

For the fiscal year ended December 31, 2013

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

For the transition period from to

**Commission file numbers 001-14141 and 333-46983**

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

**L-3 COMMUNICATIONS CORPORATION**

(Exact names of registrants as specified in their charters)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**600 Third Avenue, New York, NY**

(Address of principal executive offices)

**(212) 697-1111**

(Telephone number)

**13-3937434 and 13-3937436**

(I.R.S. Employer Identification Nos.)

**10016**

(Zip Code)

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

**Title of each class**

**Name of each exchange on which registered:**

New York Stock Exchange

Edgar Filing: L 3 COMMUNICATIONS HOLDINGS INC - Form 10-K

L-3 Communications Holdings, Inc.  
common stock, par value \$0.01 per share  
Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrants are well-known seasoned issuers, as defined in Rule 405 of the Securities Act.  Yes  No

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

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

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

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

Indicate by check mark whether the registrant L-3 Communications Holdings, Inc. 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       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant L-3 Communications Corporation 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       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Act).  Yes  No

The aggregate market value of the L-3 Communications Holdings, Inc. voting stock held by non-affiliates of the Registrants as of June 28, 2013 was approximately \$7.6 billion. For purposes of this calculation, the Registrants have assumed that their directors and executive officers are affiliates.

There were 85,847,821 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on February 19, 2014.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed with the Securities and Exchange Commission ( SEC ) pursuant to Regulation 14A relating to the Registrants Annual Meeting of Shareholders, to be held on May 6, 2014, will be incorporated by reference in this Form 10-K in response to Items 10,11,12,13 and 14 of Part III. The definitive proxy statement will be filed with the SEC no later than 120 days after the registrants fiscal year ended December 31, 2013.

**Table of Contents**

**L-3 COMMUNICATIONS HOLDINGS, INC.  
L-3 COMMUNICATIONS CORPORATION  
INDEX TO ANNUAL REPORT ON FORM 10-K  
For the Year Ended December 31, 2013**

**PART I**

Item 1:	<u>Business</u>	1
Item 1A:	<u>Risk Factors</u>	18
Item 1B:	<u>Unresolved Staff Comments</u>	27
Item 2:	<u>Properties</u>	28
Item 3:	<u>Legal Proceedings</u>	28
Item 4:	<u>Mine Safety Disclosures</u>	28

**PART II**

Item 5:	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	29
Item 6:	<u>Selected Financial Data</u>	31
Item 7:	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 7A:	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	66
Item 8:	<u>Financial Statements and Supplementary Data</u>	66
Item 9:	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	66
Item 9A:	<u>Controls and Procedures</u>	66
Item 9B:	<u>Other Information</u>	67

**PART III**

Item 10:	<u>Directors, Executive Officers and Corporate Governance</u>	68
Item 11:	<u>Executive Compensation</u>	68
Item 12:	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	68
Item 13:	<u>Certain Relationships and Related Transactions, and Director Independence</u>	68
Item 14:	<u>Principal Accountant Fees and Services</u>	68

**PART IV**

Item 15:	<u>Exhibits and Financial Statement Schedules</u>	69
	<u>Signatures</u>	75

**Table of Contents****PART I**

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

**Item 1. Business****Overview**

L-3 Holdings, a Delaware corporation organized in April 1997, derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications. L-3 Communications, a Delaware corporation, is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, Command, Control, Communications (C<sup>3</sup>) systems, platform and logistics solutions for aircraft, maritime vessels and ground vehicles, and national security solutions. L-3 is also a leading provider of a broad range of electronic systems used on military and commercial platforms. Our customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), allied international governments, and domestic and international commercial customers.

We have four reportable segments: (1) C<sup>3</sup>ISR, (2) Electronic Systems, (3) Platform and Logistics Solutions (P&LS), and (4) National Security Solutions (NSS). Financial information for our segments, including sales by geographic area, is included in Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 22 to our audited consolidated financial statements.

For the year ended December 31, 2013, we generated sales of \$12,629 million, operating income of \$1,258 million and net cash from operating activities from continuing operations of \$1,263 million. The table below presents a summary of our 2013 sales by major category of end customer. For a more detailed presentation of our sales by end customer, see Major Customers within this Business section.

	<b>2013 Sales (in millions)</b>	<b>% of Total Sales</b>
DoD	\$ 8,584	68%
Other U.S. Government	584	5
<b>Total U.S. Government</b>	<b>\$ 9,168</b>	<b>73%</b>
International (foreign governments)	1,753	14
Commercial international	1,061	8
Commercial domestic	647	5
<b>Total sales</b>	<b>\$ 12,629</b>	<b>100%</b>

**Business Strategy**

The goal of our strategy is to build and sustain strong businesses with durable competitive discriminators and number one or number two market positions. Our business strategy is customer-focused and aims to increase shareholder value by expanding our strong positions in C<sup>3</sup>ISR, electronic systems, platform and logistics solutions and national security solutions by leveraging our customer relationships and pursuing adjacent market opportunities. We intend to gain market share with innovative and affordable solutions, collaboration across L-3's business units and demonstrated past performance that address customer imperatives. We will continue shifting our business portfolio to emphasize products, systems and proprietary services. Financially, our emphasis is on growing earnings per share and cash flow. Our strategy involves a flexible and balanced combination of organic growth, cost reductions, and select business acquisitions and divestitures, enabling us to grow the company and also return cash to our shareholders in a balanced and disciplined manner. Our strategy includes the elements discussed below.

**Table of Contents**

***Maintain an Entrepreneurial, Accountable, Ethical and Results-Driven Culture.*** A key part of L-3's strategy is our entrepreneurial, accountable, and results-driven culture that focuses on meeting our customers' needs and on achieving L-3's strategic goals and growth objectives. L-3's culture is made up of diverse people providing creative, innovative and affordable solutions and ideas in an environment that fosters teamwork and collaboration across our business units. Operating with integrity and a commitment to the highest standards of ethical conduct and maintaining strong internal controls are foundational elements of our strategy to build and maintain the trust of our customers, shareholders, employees, suppliers and communities where we live and work.

***Strengthen and Expand Our Market Positions.*** We intend to use our existing prime contractor and supplier positions and internal investments to increase our market share, grow our sales organically and continue to build strong businesses with durable discriminators that have a number one or number two market position. We intend to expand our prime contractor roles in select business areas where we have domain expertise, including C<sup>3</sup>ISR, platform and logistics solutions and national security solutions. We expect to benefit from and expand our supplier positions to multiple bidders by leveraging our customer relationships and pursuing adjacent market opportunities. As an independent supplier of a broad range of products, subsystems and systems in several key business areas, our growth will partially be driven by expanding our share of existing programs and participating in new programs. Teaming arrangements with other prime contractors and platform original equipment manufacturers is one way we intend to pursue select new business opportunities and expand our content on select platforms. We plan to maintain our diversified and broad business mix with limited reliance on any single contract, follow-on or new business opportunity. While sales to the U.S. Government, especially the DoD, will remain an integral part of L-3's business, we also intend to continue to increase our sales from international and commercial businesses. We expect to continue to supplement our organic sales growth by acquiring, on a select basis, businesses that provide attractive returns on investment and add new products, technologies, programs and contracts, or provide access to select DoD, other U.S. Government, international and/or commercial customers.

***Collaborate to Increase Growth Opportunities.*** We intend to deepen the collaboration among our diversified businesses to develop new business opportunities, combine our leading technologies and deliver the right solutions to our customers quickly. We expect that our core strengths of agility, responsiveness and cost-effectiveness will allow us to continue to provide exceptional performance to our customers. We intend to continue our shift from a black box provider to a complete national security solutions provider.

***Leverage Our Excellent Customer Relationships.*** We will maintain and expand our excellent customer relationships. We also intend to continue to leverage our customer relationships and our capabilities, including proprietary technologies, to expand the scope of our products to existing and new customers. We also intend to continue to align our products, services, investments in research and development and business acquisitions to proactively address customer priorities and requirements and invest in growth areas such as C<sup>3</sup>ISR, sensor systems, special operations, cyber security and intelligence support.

***Proactively Manage Our Cost Structure and Optimize Our Business Portfolio.*** We intend to continue to increase productivity and to reduce our direct contract costs and overhead costs, including general and administrative costs. Our effective management of labor, material, subcontractor and other direct costs is an important element of cost control and favorable contract performance. We believe that proactively re-sizing our businesses to their anticipated sales, combined with continuous cost improvement will enable us to increase our cost competitiveness, and to selectively invest in new product development, business acquisitions, bids and proposals and other business development activities to increase our market share.

***Achieve Outstanding Program Performance.*** We believe that outstanding performance on our existing programs and contracts in terms of on-budget, on-schedule and satisfying and exceeding technical and other contractual performance

requirements, is the foundation for expanding L-3's prime contractor and supplier positions and growing market share. We believe that a prerequisite for growing and winning new business is to retain our existing business by successfully meeting the performance criteria included in our contracts. We will continue to focus on delivering superior contract performance with affordable prices to our customers in order to maintain our reputation as an agile and responsive contractor and to differentiate ourselves from our competitors.



## **Table of Contents**

***Attract and Retain Skilled Personnel.*** The success of our businesses is, to a large extent, dependent upon the knowledge and skills of our employees. We intend to continue to attract and retain employees who have management, contracting, engineering and technical skills and who have U.S. Government security clearances, particularly those with clearances of top-secret and above.

## **Business Acquisitions and Divestitures**

During the years ended December 31, 2013, 2012 and 2011, we used net cash of \$62 million, \$348 million and \$20 million for business acquisitions, respectively. Additionally, we completed the spin-off of our subsidiary, Engility Holdings, Inc. (Engility), to our shareholders on July 17, 2012. See Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Business Acquisitions and Divestitures for additional information regarding our business acquisitions and divestitures, including the spin-off of Engility.

## **Products and Services**

Our four reportable segments provide a wide range of products and services to various customers and are described below. See Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Reportable Segment Results of Operations and Note 22 to our audited consolidated financial statements for financial information about each segment.

### ***C<sup>3</sup>ISR Reportable Segment***

In 2013, C<sup>3</sup>ISR net sales of \$3,367 million represented 27% of our total net sales. The businesses in this reportable segment provide products and services for the global ISR market, specializing in signals intelligence (SIGINT) and communications intelligence (COMINT) systems. These products and services provide the warfighter with the unique ability to collect and analyze data from command centers, communication nodes and air defense systems for real-time situational awareness and response. The businesses in this reportable segment also provide C<sup>3</sup> systems, networked communication systems and secure communications products for military and other U.S. Government and allied international government intelligence, reconnaissance and surveillance applications. We believe that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Major products and services for this reportable segment include:

highly specialized fleet management sustainment and support services, including procurement, systems integration, sensor development, modifications and periodic depot maintenance for ISR and special mission aircraft and airborne systems;

strategic and tactical SIGINT systems that detect, collect, identify, analyze and disseminate information;

secure data links that enable real-time information collection and dissemination to users of networked communications for airborne, satellite, ground and sea-based remote platforms, both manned and unmanned;

secure terminal and communication network equipment and encryption management; and

communication systems for surface and undersea vessels and manned space flights.

**Table of Contents**

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

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
<i>ISR Systems</i>		
Prime mission systems integration, sensor development and operations and support	Signal processing, airborne (SIGINT) applications, antenna technology, real-time process control and software development	U.S. Air Force (USAF), United Kingdom Ministry of Defence (U.K.MoD), and other allied international military ISR aircraft platforms and ground systems
Fleet management of special mission aircraft, including avionics and mission system upgrades and logistics support	Measurement collection and signal intelligence, special missions	DoD and classified customers within the U.S. Government
ISR operations and support	Data link support and services, special applications, classified projects, spares and repairs	USAF and U.S. Army ISR aircraft platforms and ground systems
<i>Networked Communications</i>		
Airborne, space and surface data link terminals, ground stations, and transportable tactical satellite communications (SATCOM) systems	High performance, wideband secure communication links for relaying of intelligence and reconnaissance information	Manned aircraft, unmanned aerial vehicles (UAVs), naval ships, ground vehicles and satellites for the DoD
Multi-band Manpack Receivers	Portable, ruggedized terminals used for receiving reconnaissance video and sensor data from multiple airborne platforms	U.S. Special Operations Command (USSOCOM), USAF and other DoD customers
<i>Secure Communications Products</i>		
Secure communications terminals and equipment, and secure network encryption products	Secure and non-secure voice, data and video communication for office, battlefield and secure internet protocol (IP) network applications	DoD and U.S. Government intelligence agencies
Ground-based satellite communications terminals and payloads	Interoperable, transportable ground terminals	DoD and U.S. Government intelligence agencies

Edgar Filing: L 3 COMMUNICATIONS HOLDINGS INC - Form 10-K

Shipboard communications  
systems

Internal and external communications  
(radio rooms)

U.S. Navy (USN), U.S. Coast  
Guard (USCG) and allied  
international navies

4

**Table of Contents*****Electronic Systems Reportable Segment***

In 2013, Electronic Systems net sales of \$5,524 million represented 44% of our total net sales. The businesses in this reportable segment provide a broad range of products and services, including components, products, subsystems, systems and related services to military and commercial customers in several niche markets. The table below provides a summary of the segment's business areas and the percentage that each contributed to Electronic Systems' net sales in 2013.

<b>Business Area</b>	<b>% of 2013 Segment Sales</b>
Marine & Power Systems	21%
Microwave Products	17
Sensor Systems	17
Simulation & Training	13
Aviation Products	8
Warrior Systems	8
Precision Engagement	7
Security & Detection Systems	5
Space & Propulsion Systems	4
Total Electronic Systems	100%

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

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
<i>Marine &amp; Power Systems</i>		
Integrated electrical power and electric propulsion packages, integrated automation, navigation, communication, and dynamic positioning systems, and audio/visual solutions and safety systems	Surface ships ranging from shipping vessels, container carriers, environmental, research and offshore construction ships, naval frigates, ferries, cruise liners and mega yachts	Commercial shipbuilders and shipowners and allied international navies
Naval power delivery, conversion and switching products, and hybrid electric drives	Switching, distribution and protection, frequency and voltage conversion, propulsion motors and drive units	Naval submarines, surface ships and aircraft carriers
Automation, navigation, communications, and sensors and integrated Command, Control, Communications, Computers and	Vessel bridge and machinery plant platform management systems, and C <sup>4</sup> N systems	USN and allied international navies and other government agencies

Navigation (C<sup>4</sup>N) solutions

Power plant simulation, modeling, computer systems, and training services

Submarines, nuclear and other power plants

Allied international navies, nuclear and other power plant companies

Airborne dipping sonars, submarine and surface ship towed arrays

Submarine and surface ship detection and localization

USN and allied international navies

**Table of Contents**

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
Underwater sensor ranges	Monitor nuclear testing, track submarines and surface vessels	U.S. and international military and commercial customers
Service life extensions	Landing craft air cushion amphibious vehicle	USN
In-service engineering, ship repair, overhaul, upgrades and maintenance, and battle force tactical training	Embedded shipboard training systems, towed arrays, navigation systems, radar systems and electronic warfare systems	USN, USCG, U.S. Army and commercial shipowners
<i>Microwave Products</i>		
Passive and active microwave components and subsystems and non-ionizing radiation monitoring equipment	Radio transmission, switching and conditioning, transponder control, channel and frequency separation, ground vehicles, aircraft and satellites	DoD and original equipment manufacturers (OEMs), SATCOM for DoD and various government agencies
Traveling wave tubes, power modules, klystrons and digital broadcast	Microwave vacuum electron devices and power modules	DoD and allied international military manned/unmanned platforms, including satellites, radar systems, communication systems, UAVs, missile defense systems, various missile programs and commercial broadcast
Quick-deploy flyaway very small aperture terminals (VSAT) and vehicular satellite systems	Satellite communication systems	U.S. Army, USAF and various DoD agencies
High dynamic small aperture Ku/Ka-band receive/transmit systems	Off road use on military vehicles, watercraft, and airborne platforms to provide two-way broadband connectivity while on the move	U.S. Army and various DoD agencies
Tactical ground based signal intercept and direction finding systems	Man portable and military vehicle mounted tactical signal intercept/exploitation and direction finding systems	U.S. Army and other DoD/U.S. intelligence agencies
Managed satellite networks and integrated remote VSAT satellite systems	Deployment and support of global communication networks for tactical and enterprise applications	U.S. Army, DoD/U.S. intelligence agencies, allied forces and commercial contractors
Multi-frequency time division multiple access modems and terminals that support SATCOM on	On the move SATCOM and other tactical communications systems utilizing small aperture terminals	U.S. Army, U.S Marine Corps (USMC), and select international allies

the move using X, Ku, and Ka bands



**Table of Contents**

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
Ultra-wide frequency and advanced radar antennas and radomes	Surveillance and radar detection	Military fixed and rotary winged aircraft, SATCOM
Telemetry and instrumentation systems	Spacecraft telemetry tracking and control, encryption and high data rate transmitters, satellite command and control software, airborne and ground test telemetry systems, and tactical intelligence receivers	Aircraft, missiles and satellites
<i>Sensor Systems</i>		
Targeted stabilized camera systems with integrated sensors and wireless communication systems	Intelligence data collection and surveillance and reconnaissance	DoD, intelligence and security agencies, law enforcement, manned/unmanned platforms
Submarine photonic systems and periscopes	Virginia class submarines	USN
Airborne and ground based high energy laser beam directors, laser designators and high tracking rate telescopes	Directed energy systems, space surveillance, satellite laser ranging and laser communications, airborne and ground target designation/illumination	USAF and National Aeronautics Space Administration (NASA)
Improvised Explosive Device (IED) Defense Systems	Vehicle based and manpack IED detection and jamming systems	U.K. MoD and international allies
Force protection, electronic warfare and satellite monitoring	Counter IED systems, jamming and satellite monitoring	U.K. MoD and other international security agencies and ministries of defense
<i>Simulation &amp; Training</i>		
Military and commercial aircraft flight simulators, reconfigurable training devices, distributed mission training suites	Advanced simulation technologies and training for pilots, navigators, flight engineers, gunners and operators	Fixed and rotary winged aircraft and ground vehicles for USAF, USN, U.S. Army, Canadian Department of National Defence (DND), allied international militaries, commercial airlines and aircraft OEMs
Training services, courseware integrated logistics support and maintenance	Systems management, operations, and maintenance	Various DoD and allied international military customers
Vehicle driver training and courseware	Drive safety, efficiency, and productivity training	Various commercial transport companies



**Table of Contents**

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
<i>Aviation Products</i>		
Solid state crash protected cockpit voice and flight data recorders	Aircraft voice and flight data recorders that continuously record voice and sounds from cockpit and aircraft intercommunications	Commercial transport, business, regional and military aircraft
Airborne traffic and collision avoidance systems, terrain awareness warning systems	Reduce the potential for midair aircraft collisions and crashes into terrain by providing visual and audible warnings and maneuvering instructions to pilots	Commercial transport, business, regional and military aircraft
Advanced cockpit avionics	Pilot safety, navigation and situation awareness products	Commercial transport, business, regional and military aircraft
Cockpit and mission displays	High performance, ruggedized flat panel and cathode ray tube displays and processors	Various military aircraft
<i>Warrior Systems</i>		
Enhanced vision and weapon sights products	Image intensified night vision goggles/sights, holographic weapon sights, thermal sights and images, and driver viewers for special forces, pilots and aircrews, soldiers, marines, sailors and law enforcement personnel	U.S. Army, USN, USMC, DHS, allied international militaries and law enforcement agencies
Laser designation and range finder systems	Airborne and ground target designation/illumination	DoD, law enforcement and allied international customers
Weapons Training Systems	Laser marksmanship training systems and advanced integrated technologies for security products and services	DoD and law enforcement agencies
<i>Precision Engagement</i>		
Unmanned systems and components	Tactical unmanned air systems (UAS), medium altitude long endurance (MALE) UAS, small expendable UAS, flight controls, sensors and remote viewing systems	U.S. DoD and allied international ministries of defense
Radar-based sensors and systems	Electronic warfare, unmanned systems, ISR and precision-guided munitions	U.S. DoD and DHS



**Table of Contents**

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
Global Positioning System (GPS) receivers	Location tracking	Guided projectiles and precision munitions
Fuzing and ordnance systems	Precision munitions, fuzes, and electronic and electro safety arming devices (ESADs)	Various DoD and allied international military customers
Remote viewing video and exploitation systems	Portable situational awareness and video exploitation software and hardware for soldiers, ships and vehicles	USMC, USN and various DoD
Lightweight man portable computer/displays for dismounted soldiers	Situational awareness and connectivity for dismounted soldiers	U.K. MoD
<i>Security &amp; Detection Systems</i>		
Airport security systems, explosives detection systems and whole body imaging systems	Rapid scanning of passenger checked baggage and carry-on luggage, scanning of large cargo containers	DHS, including the U.S. Transportation Security Administration (TSA), domestic and international airports and state and local governments
Non-invasive security systems and portals, and sophisticated sensors with threat detection capabilities	Aviation, rail and border crossing security	TSA, U.S. Customs and Border Protection agency, various regulatory authorities and private security companies
<i>Space &amp; Propulsion Systems</i>		
Navigation systems and positioning navigation units	Satellite launch and orbiting navigation and navigation for ground vehicles and fire control systems	USAF, U.S. Army, USMC and NASA
Ballistic missile targets	Targets for ground based ballistic missile intercept systems	U.S. Missile Defense Agency (MDA)
Heavy fuel engines, cross drive variable transmissions, turret drive systems, vehicle suspension, advanced drive systems and auxiliary power generators	Power trains and suspension systems for military vehicles, power and energy management for military hybrid electric vehicles, non-portable and under armor auxiliary power units, and heavy fueled engines for unmanned systems	U.S. Army, USMC and allied international ministries of defense, manned/unmanned military platforms

High power microwave sources,  
systems & effects, pulse power  
systems and electromagnetics  
hardened construction

Forensic analysis of weapons of mass  
destruction, and active detection of  
special nuclear material.

U.K. MoD, U.S. Defense Threat  
Reduction Agency, U.S. Army and  
USAF

**Table of Contents*****Platform & Logistics Solutions (P&LS) Reportable Segment***

In 2013, P&LS net sales of \$2,443 million represented 19% of our total net sales. The businesses in this reportable segment provide modernization, upgrades and sustainment, maintenance and logistics support solutions for military and various government aircraft and other platforms. We sell these services primarily to the DoD, the Canadian DND and other allied international governments. Major products and services for this reportable segment include:

engineering, modification, maintenance, logistics and upgrades for aircraft, ground vehicles and personnel equipment;

turnkey aviation life cycle management services that integrate custom developed and commercial off-the-shelf products for various military fixed and rotary wing aircraft, including heavy maintenance and structural modifications and interior modifications and construction; and

aerospace and other technical services related to large fleet support, such as aircraft and vehicle modernization, maintenance, repair and overhaul, logistics, support and supply chain management, primarily for military training, tactical, cargo and utility aircraft.

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

<b>Systems/Products/Services</b>	<b>Selected Applications</b>	<b>Selected Platforms/End Users</b>
<i>Logistics Solutions</i>		
Logistics support, maintenance and refurbishment	Aircraft maintenance repair and overhaul, flight operations support for training, cargo and special mission aircraft	U.S. Army, USAF, USN, Canadian DND and other allied international militaries
Contract Field Teams (CFT)	Deployment of highly mobile, quick response field teams to customer locations to supplement the customer's resources for various ground vehicles and aircraft	U.S. Army, USAF, USN and USMC
Contractor Operated and Managed Base Supply (COMBS)	Inventory management activities relating to flight support and maintenance, including procurement and field distribution	Military training and cargo aircraft

*Platform Solutions*

Edgar Filing: L 3 COMMUNICATIONS HOLDINGS INC - Form 10-K

Modernization and life extension maintenance upgrades and support	Aircraft structural modifications and inspections, installation of mission equipment, navigation and avionics products, interior modifications	USN, USAF, Canadian DND, Royal Australian Air Force, other allied international governments, OEMs, very important person (VIP) and head of state aircraft, and various military fixed and rotary wing aircraft
Fabrication and assembly of fixed and rotary wing aeronautical structures	Rotary wing cabin assemblies, new and modified wings and subassemblies, and parts fabrication for OEMs	U.S. Army, USN, USMC, Canadian DND and OEMs



**Table of Contents**

***National Security Solutions (NSS) Reportable Segment***

In 2013, NSS net sales of \$1,295 million represented 10% of our total net sales. The businesses in this reportable segment provide full-spectrum cyber operations support, enterprise and mission information technology (IT) solutions, intelligence operations support, and operational infrastructure solutions to the DoD, U.S. Government intelligence agencies, federal civilian agencies and allied international governments. Major services, solutions and systems for this reportable segment include:

providing solutions and systems for secure communications, information systems networks and mobile devices and ensuring the integrity of information to enable trusted, interconnected, and resilient networks;

providing operational enterprise IT solutions that help keep our customers relevant in their dynamic mission environment;

developing solutions and systems for our customers that enable available data to be used more effectively to provide assessments, gain and maintain situation awareness, support decision-making, improve operations, and bring about customers' desired effects;

supporting intelligence collection, tasking, exploitation, analysis, dissemination, training, situational awareness, visualization, normalization, minimization and outcome assurance; and

developing next-generation solutions and systems that help our customers solve operational, informational, and physical security challenges that can place facilities, infrastructure, installations, borders and perimeters, and transportation environments at risk.

**Table of Contents**

The table below provides additional information for the solutions, systems and services; selected applications and capabilities; and selected end users of our NSS reportable segment.

<b>Solutions/Systems/Services</b>	<b>Selected Applications/Capabilities</b>	<b>Selected End Users</b>
Full-Spectrum Cyber Operations Support	High-performance computing, dynamic network protection, advanced forensics and exploitation, modeling, simulation and wargaming, cloud and mobile security, and network virtualization	USAF, U.S. Government intelligence agencies, U.S. Combatant Commands and Defense Information Systems Agency
Enterprise and Mission IT	Enterprise architecture and systems engineering, systems integration and development, operations and maintenance (O&M) transformations for efficiencies and cost reductions, performance-based managed services, agile software engineering and development, space communications and launch support	U.S. Army, USAF, U.S. Navy, USSOCOM, U.S. Government intelligence agencies, U.K. MoD, Department of the Interior, DoS, NASA, and state and local government agencies
Intelligence Operations Support	Data fusion and analytics, visualization and decision-making, training and workforce development, mission engineering and operations support, mission-essential staffing and knowledge management	U.S. Army, USAF, USN, U.S. Combatant Commands, DoS, U.S. Government intelligence agencies, and U.K. MoD
Operational Infrastructure Support	Risk, threat and vulnerability assessment, complex systems architecture, enterprise-level command and control systems, intelligent surveillance, logistics and integrated sustainment, and surveillance, detection and response systems	USAF, USN, U.S. MDA, U.S. Strategic Command, DHS, National Oceanic and Atmospheric Administration (NOAA), and international governments

**Table of Contents****Funded Backlog and Orders**

We define funded backlog as the value of funded orders received from customers, less the cumulative amount of sales recognized on such orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. The table below presents our funded backlog, percentage of funded backlog at December 31, 2013 expected to be recorded as sales in 2014 and funded orders for each of our reportable segments and on a consolidated basis.

Reportable Segment:	Funded Backlog at December 31,		Percentage of Funded Backlog at December 31, 2013 Expected to be Recorded as Sales in 2014	Funded Orders	
	2013 (in millions)	2012 (in millions)		2013 (in millions)	2012 (in millions)
C <sup>3</sup> ISR	\$ 2,783	\$ 2,936	67%	\$ 3,231	\$ 3,706
Electronic Systems	5,086	5,070	62%	5,506	5,745
P&LS	1,865	2,168	69%	2,152	2,916
NSS	582	710	89%	1,167	1,431
Consolidated	\$ 10,316	\$ 10,884	66%	\$ 12,056	\$ 13,798

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

**Major Customers**

The table below presents a summary of our sales by end customer and the percent contributed by each to our total sales. For additional information regarding domestic and international sales, see Note 22 to our audited consolidated financial statements.

	2013 Sales (in millions)	2013 % of Total Sales	2012 Sales (in millions)	2012 % of Total Sales
Air Force	\$ 3,354	27%	\$ 3,599	27%
Army	2,400	19	2,824	22

Edgar Filing: L 3 COMMUNICATIONS HOLDINGS INC - Form 10-K

Navy/Marines	1,800	14	1,897	14
Other Defense	1,030	8	1,056	8
<b>Total DoD</b>	<b>\$ 8,584</b>	<b>68%</b>	<b>\$ 9,376</b>	<b>71%</b>
Other U.S. Government	584	5	650	5
<b>Total U.S. Government</b>	<b>\$ 9,168</b>	<b>73%</b>	<b>\$ 10,026</b>	<b>76%</b>
International (foreign governments)	1,753	14	1,463	11
Commercial international	1,061	8	985	8
Commercial domestic	647	5	672	5
<b>Total sales</b>	<b>\$ 12,629</b>	<b>100%</b>	<b>\$ 13,146</b>	<b>100%</b>

Direct sales to the end customer represented approximately 68% of our consolidated 2013 sales, and sales as a subcontractor or supplier represented the remaining 32%. Additionally, approximately 69% of our DoD sales for 2013 were direct to the customer, and approximately 31% were indirect through other prime system contractors and subcontractors of the DoD.

**Table of Contents**

Our sales are predominantly derived from contracts with agencies of, and prime system contractors to, the U.S. Government. Various U.S. Government agencies and contracting entities exercise independent and individual purchasing decisions, subject to annual appropriations by the U.S. Congress. For the year ended December 31, 2013, our five largest contracts (revenue arrangements) generated 12% of our consolidated sales and our largest contract (revenue arrangement) in terms of annual sales was the Fort Rucker Maintenance Support contract with the U.S. Army Aviation and Missile Life Cycle Management Command (AMCOM), which is included in our P&LS segment. Under this contract, which generated approximately 4% of our 2013 sales, we provide maintenance, logistics and other related sustainment support services for rotary wing aircraft assigned to Fort Rucker and satellite units in Alabama. Our period of performance, including unexercised annual options, continues through September 30, 2017.

**Research and Development**

We conduct research and development activities that consist of projects involving applied research, new product and systems development and select concept studies. We employ scientific, engineering and other personnel to improve our existing product-lines and systems and develop new products, technologies, and systems. As of December 31, 2013, we employed approximately 11,400 engineers, substantially all of whom hold advanced degrees, who work on company-sponsored research and development efforts and customer funded research and development contracts.

Company-sponsored (Independent) research and development costs for our businesses that are U.S. Government contractors are allocated to U.S. Government contracts and are charged to cost of sales when the related sales are recognized as revenue. Research and development costs for our commercial businesses are expensed as incurred and are also charged to cost of sales. The table below presents company-sponsored (Independent) research and development expenses incurred for the years ended December 31, 2013, 2012 and 2011 for our U.S. Government businesses and our commercial businesses.

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>(in millions)</b>		
<b>Company-Sponsored Research and Development Costs:</b>			
U.S. Government Contractor Businesses	\$ 184	\$ 196	\$ 206
Commercial Businesses	74	88	73
Total	\$ 258	\$ 284	\$ 279

Customer-funded research and development costs pursuant to contracts (revenue arrangements) are not included in the table above because they are direct contract costs and are charged to cost of sales when the corresponding revenue is recognized. See Note 2 to our audited consolidated financial statements for additional information regarding research and development.

**Competition**

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

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

the effectiveness and innovation of our technologies, systems and research and development programs;

our ability to offer superior program performance at an affordable and competitive cost;

historical, technical, cost and schedule performance;

our ability to attain supplier positions on contracts;

our ability to maintain an effective supplier and vendor base;

## **Table of Contents**

our ability to retain our employees and hire new ones, particularly those who have U.S. Government security clearances;

the capabilities of our facilities, equipment and personnel to undertake the business for which we compete; and

our ability to quickly and flexibly meet customer requirements and priorities.

L-3 is an aerospace and defense contractor with a broad and diverse portfolio of products and services. We are primarily a non-platform prime contractor and have diverse subcontractor positions. We supply our products and services to other prime system contractors. However, we also compete directly with other large prime system contractors for: (1) certain products, subsystems and systems, where they have vertically integrated businesses and (2) niche areas where we are a prime contractor. We also compete with numerous other aerospace, defense and government technical services contractors, which generally provide similar products, subsystems, systems or services.

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

## **Patents and Licenses**

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

## **Raw Materials**

Although we generated 57% of our 2013 sales from products and systems, our businesses are generally engaged in limited manufacturing activities and have minimal exposure to fluctuations in the supply of raw materials. For those businesses that manufacture and sell products and systems, most of the value that we provide is labor oriented, such as design, engineering, assembly and test activities. In manufacturing our products, we use our own production capabilities as well as a diverse base of third party suppliers and subcontractors. Although certain aspects of our manufacturing activities require relatively scarce raw materials, we have not experienced difficulty in our ability to procure raw materials, components, sub-assemblies and other supplies required in our manufacturing processes.

## **Contracts**

Generally, the sales price arrangements for our contracts are either fixed-price, cost-plus or time-and-material type. Generally, a fixed-price type contract offers higher profit margin potential than a cost-plus type or time-and-material type contract due to the greater levels of risk we assume on a fixed-price type contract.

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract. Accounting for the sales on a fixed-price type contract that is covered by contract accounting standards requires the preparation of estimates for: (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract

and the estimated costs to complete the contract's statement of work, and (3) the measurement of progress towards completion. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated total profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change.



**Table of Contents**

On a cost-plus type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit which can be fixed or variable depending on the contract's fee arrangement up to predetermined funding levels determined by our customers. Cost-plus type contracts with award and incentive fee provisions are our primary variable contract fee arrangement. Award fees provide for a fee based on actual performance relative to contractually specified performance criteria. Incentive fees provide for a fee based on the relationship which total allowable costs bear to target cost. The tables below present our sales from cost-plus type contracts with award fees and incentive fees and the percentage of available performance-based award fees we achieved.

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Sales from Cost-Plus Contracts with:</b>	<b>(in millions)</b>		
Award fees	\$ 585	\$ 624	\$ 664
Incentive fees	557	711	842
Performance based fees	\$ 1,142	\$ 1,335	\$ 1,506

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
Percentage of Available Performance Based Award Fees Achieved	91%	91%	91%

On a time-and-material type contract (revenue arrangement), we are paid on the basis of direct labor hours expended at specified fixed-price hourly rates (that include wages, overhead, allowable general and administrative expenses and profit) and materials at cost. Therefore, on cost-plus type and time-and-material type contracts we do not bear the risks of unexpected cost overruns, provided that we do not incur costs that exceed the predetermined funded amounts.

Substantially all of our cost-plus type contracts and time-and-material type contracts are with U.S. Government customers while sales to commercial customers are transacted under fixed-price sales arrangements and are included in our fixed-price contract type sales. The table below presents the percentage of our total sales generated from each contract type for the years ended December 31, 2013, 2012 and 2011.

<b>Contract Type</b>	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
Fixed-price	71%	71%	69%
Cost-plus	24%	24%	23%
Time-and-material	5%	5%	8%
Total sales	100%	100%	100%

**Regulatory Environment**

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

Our U.S. Government contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance

## **Table of Contents**

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

In 2013, sales under foreign military sales (FMS) agreements, which are included in the international (foreign governments) category in the Major Customers table above, were \$608 million, or 5% of our total consolidated sales. FMS agreements are made directly between the U.S. Government and allied international governments. In such cases, because we serve only as the supplier, we do not have unilateral control over the terms of the agreements. Certain of our sales are direct commercial sales to allied international governments. These sales are subject to U.S. Government approval and licensing under the Arms Export Control Act. Legal restrictions on sales of sensitive U.S. technology also limit the extent to which we can sell our products to allied international governments or private parties.

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

## **Environmental Matters**

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

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

## **Employees**

As of December 31, 2013, we employed approximately 48,000 full-time and part-time employees, 83% of whom were located in the United States. Of these employees, approximately 20% are covered by approximately 180 separate collective bargaining agreements with various labor unions. The success of our business is, to a large extent, dependent upon the knowledge of our employees and on the management, contracting, engineering and technical skills of our employees. In addition, our ability to grow our businesses, obtain additional orders for our products and services and to satisfy contractual obligations under certain of our existing revenue arrangements is largely dependent

upon our ability to attract and retain employees who have U.S. Government security clearances, particularly those with clearances of top-secret and above. Historically, we have renegotiated labor agreements without significant disruptions to operating activities and we believe that relations with our employees are positive.

---

**Table of Contents**

**L-3 Holdings Obligations**

The only obligations of L-3 Holdings at December 31, 2013 were: (1) its 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued by L-3 Holdings on July 29, 2005, (2) its guarantee of borrowings under the revolving credit facility of L-3 Communications and (3) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and unconditionally guaranteed by L-3 Communications and certain of its 100% owned domestic subsidiaries. In order to generate the funds necessary to repurchase its common stock and pay dividends declared and principal and interest on its outstanding indebtedness, if any, L-3 Holdings relies on dividends and other payments from its subsidiaries.

**Available Information**

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

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

We also have a Corporate Governance webpage. You can access our Corporate Governance Guidelines and charters for the audit, compensation and nominating/corporate governance committees of our Board of Directors through our website, <http://www.L-3com.com>, by clicking on the Corporate Governance link under the heading Investor Relations. We post our Code of Ethics and Business Conduct on our Code of Ethics webpage under the link Code of Ethics and Business Conduct. Our Code of Ethics and Business Conduct applies to all directors, officers and employees, including our chairman, president and chief executive officer, our senior vice president and chief financial officer, and our vice president, controller and principal accounting officer. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. ( NYSE ), on our website within the required periods. The information on our website is not incorporated by reference into this report.

To learn more about L-3, please visit our website at <http://www.L-3com.com>. From time to time we use our website as a channel of distribution of material company information. Financial and other material information regarding L-3 is routinely posted on our website and is readily accessible.

**Item 1A. Risk Factors**

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

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

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

Our government contracts and sales are highly correlated and dependent upon the U.S. defense budget which is subject to the congressional budget authorization and appropriations process. Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may

---

**Table of Contents**

extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress in future fiscal years. DoD budgets are a function of factors beyond our control, including, but not limited to, changes in U.S. procurement policies, budget considerations, current and future economic conditions, presidential administration priorities, changing national security and defense requirements, geopolitical developments and actual fiscal year congressional appropriations for defense budgets. Any of these factors could result in a significant decline in, or redirection of, current and future DoD budgets and impact our future results of operations, including our sales and operating income growth rates.

The DoD budget peaked in the fiscal year ended September 30, 2010 (FY 2010) at \$690 billion and has declined since. The total DoD enacted budget for the FY 2014 is \$583 billion and complies with the sequestration cuts required by the Budget Control Act of 2011 (BCA), as amended by The American Taxpayer Relief Act (ATRA), which was enacted on January 2, 2013. ATRA delayed the effective date of the BCA sequester cuts by two months to March 1, 2013 and reduced the sequester cuts to the FY 2013 budget by \$9 billion to approximately \$41 billion. After ATRA, the sequestration cuts for the FY 2014 DoD budget were supposed to be \$46 billion and approximately \$52 billion per year from FY 2015 to FY 2018. On December 26, 2013, President Obama signed the Bipartisan Budget Act of 2013 (BBA) into law, which reduced DoD budget uncertainty for FY 2014 and FY 2015 by increasing BCA spending caps and lowering sequester cuts to the DoD base budget by \$22 billion for FY 2014 and \$9 billion for FY 2015. Additionally, Congress also increased the FY 2014 Overseas Contingency Operations budget by \$6 billion more than the amount included in the FY 2014 Proposed Budget Request. The declining DoD budgets will reduce funding for some of our revenue arrangements and generally will have a negative impact on our sales, results of operations and cash flows.

In addition, in the event that the federal debt limit is met, we may be required to continue to perform for some period of time on certain of our U.S Government contracts even if the U.S Government is unable to make timely payments. Furthermore, such limits could also potentially delay program/contract start dates or the U.S Government may issue a stop work order and choose to either resume the work or terminate the contract altogether. Any of these events would likely result in a material adverse effect on our financial position, results of operations and cash flows.

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

Our sales are predominantly derived from contracts (revenue arrangements) with agencies of, and prime system contractors to, the U.S. Government. The loss or delay of all or a substantial portion of our sales to the U.S. Government would have a material adverse effect on our results of operations and cash flows. Approximately 73%, or \$9.2 billion, of our sales for the year ended December 31, 2013 were made directly or indirectly to U.S. Government agencies, including 68% to the DoD. Aggregate sales for our five largest contracts (revenue arrangements) amounted to approximately \$1.6 billion, or 12% of our sales for the year ended December 31, 2013. Our largest contract (revenue arrangement) in terms of annual sales for the year ended December 31, 2013 was the Fort Rucker Maintenance Support contract with AMCOM, which is included in our P&LS segment and generated approximately 4% of our 2013 sales.

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

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

curtailment of the U.S. Government's use of technology or other services and product providers, including curtailment due to government budget reductions and related fiscal matters;



**Table of Contents**