

L 3 COMMUNICATIONS CORP

Form 10-Q

August 02, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 25, 2010**

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

**For the transition period from to**

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

**L-3 COMMUNICATIONS HOLDINGS, INC.  
L-3 COMMUNICATIONS CORPORATION**  
(Exact names of registrants as specified in their charters)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**600 Third Avenue, New York, NY**  
(Address of principal executive offices)

**13-3937434 and 13-3937436**  
(I.R.S. Employer  
Identification Nos.)

**10016**  
(Zip Code)

**(212) 697-1111**  
(Telephone number)

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

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were

required to submit and post such files).  Yes  No

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, non-accelerated filers, or smaller reporting companies. 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

There were 114,470,072 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on July 29, 2010.

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

**INDEX TO QUARTERLY REPORT ON FORM 10-Q  
For the quarterly period ended June 25, 2010**

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

	<b>(Unaudited)</b>	
	<b>June 25,</b>	<b>December 31,</b>
	<b>2010</b>	<b>2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,023	\$ 1,016
Billed receivables, net of allowances of \$35 in 2010 and \$32 in 2009	1,298	1,149
Contracts in process	2,545	2,395
Inventories	290	258
Deferred income taxes	200	247
Other current assets	138	123
Total current assets	5,494	5,188
Property, plant and equipment, net	893	854
Goodwill	8,576	8,190
Identifiable intangible assets	471	377
Deferred debt issue costs	47	47
Other assets	208	194
Total assets	\$ 15,689	\$ 14,850
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 1,086	\$
Accounts payable, trade	459	447
Accrued employment costs	687	642
Accrued expenses	598	537
Advance payments and billings in excess of costs incurred	493	512
Income taxes	61	10
Other current liabilities	346	371
Total current liabilities	3,730	2,519
Pension and postretirement benefits	819	817
Deferred income taxes	351	272

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Other liabilities	424	470
Long-term debt	3,439	4,112
Total liabilities	8,763	8,190
Commitments and contingencies (see Note 17)		
Equity:		
L-3 shareholders' equity:		
L-3 Communications Holdings, Inc.'s common stock: \$.01 par value; 300,000,000 shares authorized, 114,834,828 shares outstanding at June 25, 2010 and 115,353,546 shares outstanding at December 31, 2009 (L-3 Communications Corporation's common stock: \$.01 par value, 100 shares authorized, issued and outstanding)	4,657	4,449
L-3 Communications Holdings, Inc.'s treasury stock (at cost), 23,928,293 shares at June 25, 2010 and 21,040,541 shares at December 31, 2009	(2,078)	(1,824)
Retained earnings	4,463	4,108
Accumulated other comprehensive loss	(209)	(166)
Total L-3 shareholders' equity	6,833	6,567
Noncontrolling interests	93	93
Total equity	6,926	6,660
Total liabilities and equity	\$ 15,689	\$ 14,850

See notes to unaudited condensed consolidated financial statements.

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

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share data)

	<b>Second Quarter Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>
Net sales:		
Products	\$ 1,921	\$ 1,884
Services	2,045	2,045
Total net sales	3,966	3,929
Cost of sales:		
Products	1,674	1,690
Services	1,850	1,822
Total cost of sales	3,524	3,512
Operating income	442	417
Interest and other income, net	8	6
Interest expense	72	69
Debt retirement charge	13	
Income before income taxes	365	354
Provision for income taxes	134	127
Net income	\$ 231	\$ 227
Less: Net income attributable to noncontrolling interests	3	2
Net income attributable to L-3	\$ 228	\$ 225
Less: Net income allocable to participating securities	1	2
Net income allocable to L-3 Holdings common shareholders	\$ 227	\$ 223
Earnings per share allocable to L-3 Holdings common shareholders:		
Basic	\$ 1.97	\$ 1.91
Diluted	\$ 1.95	\$ 1.90
L-3 Holdings weighted average common shares outstanding:		
Basic	115.4	116.5
Diluted	116.5	117.2

See notes to unaudited condensed consolidated financial statements.



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

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share data)

	<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>
Net sales:		
Products	\$ 3,635	\$ 3,646
Services	3,955	3,919
 Total net sales	 7,590	 7,565
Cost of sales:		
Products	3,162	3,256
Services	3,576	3,516
 Total cost of sales	 6,738	 6,772
 Operating income	 852	 793
Interest and other income, net	12	9
Interest expense	136	135
Debt retirement charge	13	
 Income before income taxes	 715	 667
Provision for income taxes	262	239
 Net income	 \$ 453	 \$ 428
Less: Net income attributable to noncontrolling interests	4	4
 Net income attributable to L-3	 \$ 449	 \$ 424
Less: Net income allocable to participating securities	3	4
 Net income allocable to L-3 Holdings common shareholders	 \$ 446	 \$ 420
 Earnings per share allocable to L-3 Holdings common shareholders:		
Basic	\$ 3.85	\$ 3.58
Diluted	\$ 3.82	\$ 3.56
 L-3 Holdings weighted average common shares outstanding:		
Basic	115.7	117.4
Diluted	116.7	118.0

See notes to unaudited condensed consolidated financial statements.

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

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY**  
(in millions, except per share data)

	L-3 Holdings				Accumulated				
	Common	Stock	Additional	Treasury	Retained	Other	Noncontrolling	Total	
	Shares	Par	Paid-in	Stock	Earnings	Comprehensive	Interests	Equity	
	Issued	Value	Capital			(Loss)			
<b>For the first half ended</b>									
<b>June 25, 2010:</b>									
Balance at December 31, 2009	115.4	\$ 1	\$ 4,448	\$ (1,824)	\$ 4,108	\$ (166)	\$ 93	\$ 6,660	
Comprehensive income:									
Net income					449		4	453	
Pension and postretirement benefit plans:									
Net gain arising during the period							2	2	
Amortization of net loss and prior service cost previously recognized, net of income taxes of \$7							12	12	
Foreign currency translation adjustment							(58)	(58)	
Unrealized gains on hedging instruments, net of income taxes of \$2							1	1	
Total comprehensive income								410	
Distributions to noncontrolling interests							(4)	(4)	
Cash dividends paid on common stock (\$0.80 per share)						(93)		(93)	
Shares issued:									
Employee savings plans	0.9		74					74	
Exercise of stock options	0.9		60					60	
Employee stock purchase plan	0.5		32					32	
Stock-based compensation expense			42					42	

Treasury stock purchased	(2.9)			(254)					(254)
Other					(1)				(1)
Balance at June 25, 2010	114.8	\$ 1	\$ 4,656	\$ (2,078)	\$ 4.463	\$ (209)	\$ 93	\$ 6,926	
<b>For the first half ended June 26, 2009:</b>									
Balance at December 31, 2008	118.6	\$ 1	\$ 4,135	\$ (1,319)	\$ 3,373	\$ (332)	\$ 83	\$ 5,941	
Comprehensive income:									
Net income					424		4	428	
Pension and postretirement benefit plans:									
Amortization of net loss and prior service cost previously recognized, net of income taxes of \$10							15	15	
Foreign currency translation adjustment							50	50	
Unrealized loss on hedging instruments, net of income taxes of \$1							(1)	(1)	
Total comprehensive income								492	
Distributions to noncontrolling interests							(3)	(3)	
Cash dividends paid on common stock (\$0.70 per share)						(84)		(84)	
Recognition of non-controlling interest in consolidated subsidiary							8	8	
Shares issued:									
Employee savings plans	1.1		74					74	
Exercise of stock options	0.1		4					4	
Employee stock purchase plan	0.6		34					34	
Stock-based compensation expense			35					35	
Treasury stock purchased	(4.4)			(301)				(301)	
Other			3					3	
Balance at June 26, 2009	116.0	\$ 1	\$ 4,285	\$ (1,620)	\$ 3,713	\$ (268)	\$ 92	\$ 6,203	



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

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions)

	<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>
<b>Operating activities:</b>		
Net income	\$ 453	\$ 428
Depreciation of property, plant and equipment	77	77
Amortization of intangibles and other assets	31	30
Deferred income tax provision	65	29
Stock-based employee compensation expense	42	35
Contributions to employee savings plans in L-3 Holdings common stock	74	74
Amortization of pension and postretirement benefit plans net loss and prior service cost	19	26
Amortization of bond discounts (included in interest expense)	12	11
Amortization of deferred debt issue costs (included in interest expense)	6	6
Other non-cash items	3	(3)
Subtotal	782	713
Changes in operating assets and liabilities, excluding acquired and divested amounts:		
Billed receivables	(139)	(83)
Contracts in process	(148)	(116)
Inventories	3	(9)
Accounts payable, trade	8	70
Accrued employment costs	45	(46)
Accrued expenses	66	(1)
Advance payments and billings in excess of costs incurred	(14)	(43)
Income taxes	30	21
Excess income tax benefits related to share-based payment arrangements	(6)	(1)
Other current liabilities	(25)	(8)
Pension and postretirement benefits	9	31
All other operating activities	(22)	
Subtotal	(193)	(185)
Net cash from operating activities	589	528
<b>Investing activities:</b>		
Business acquisitions, net of cash acquired	(616)	(82)
Capital expenditures	(64)	(86)
Dispositions of property, plant and equipment	1	6
Investments in equity investees	(9)	

Net cash used in investing activities	(688)	(162)
<b>Financing activities:</b>		
Proceeds from sale of senior notes	797	
Redemption of senior subordinated notes	(400)	
Common stock repurchased	(254)	(301)
Dividends paid on L-3 Holdings common stock	(93)	(84)
Proceeds from exercises of stock options	55	3
Proceeds from employee stock purchase plan	32	34
Debt issue costs	(7)	
Excess income tax benefits related to share-based payment arrangements	6	1
Other financing activities	(4)	1
Net cash from (used in) financing activities	132	(346)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(26)	10
Net increase in cash and cash equivalents	7	30
Cash and cash equivalents, beginning of the period	1,016	867
Cash and cash equivalents, end of the period	\$ 1,023	\$ 897

See notes to unaudited condensed consolidated financial statements.

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

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS**

**1. Description of Business**

L-3 Communications Holdings, Inc. derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a prime contractor in Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) systems, aircraft modernization and maintenance, and government services. L-3 is also a leading provider of a broad range of electronic systems used on military and commercial platforms. The Company's customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), U.S. Department of Justice (DoJ), allied foreign governments, domestic and foreign commercial customers and select other U.S. federal, state and local government agencies.

The Company has the following four reportable segments: (1) C<sup>3</sup>ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Electronic Systems. Financial information with respect to each of the Company's reportable segments is included in Note 21. C<sup>3</sup>ISR provides products and services for the global ISR market, C<sup>3</sup> systems, networked communications systems and secure communications products. The Company believes that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Government Services provides a full range of engineering, technical, analytical, information technology (IT), advisory, training, logistics and support services to the DoD, DoS, DoJ, and U.S. Government intelligence agencies and allied foreign governments. AM&M provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. The Company sells these services primarily to the DoD, the Canadian Department of National Defense and other allied foreign governments. Electronic Systems provides a broad range of products and services, including components, products, subsystems, systems, and related services to military and commercial customers in several niche markets across several business areas, including power & control systems, electro-optic/infrared (EO/IR), microwave, simulation & training, precision engagement, aviation products, security & detection, propulsion systems, displays, telemetry & advanced technology, undersea warfare, and marine services.

**2. Basis of Presentation**

These unaudited condensed consolidated financial statements for the quarterly and first half periods ended June 25, 2010 should be read in conjunction with the audited consolidated financial statements of L-3 Holdings and L-3 Communications included in their Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

The accompanying financial statements comprise the consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings' only asset is its investment in the common stock of L-3 Communications, its wholly-owned subsidiary, and its only obligations are: (1) the 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued by L-3 Holdings on July 29, 2005, (2) its guarantee of borrowings under the revolving credit facility of L-3 Communications and (3) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and



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

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. In the opinion of management, all adjustments

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

(consisting of normal and recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year.

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

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs of sales during the reporting period. The most significant of these estimates and assumptions relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, market values for inventories reported at lower of cost or market, pension and post-retirement benefit obligations, stock-based employee compensation expense, income taxes, including the valuations of deferred tax assets, litigation reserves and environmental obligations, accrued product warranty costs, and the recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Changes in estimates are reflected in the periods during which they become known. Actual amounts will differ from these estimates and could differ materially. For a more complete discussion of these estimates and assumptions, see the Annual Report of L-3 Holdings and L-3 Communications on Form 10-K for the fiscal year ended December 31, 2009.

During the quarter ended June 25, 2010, the Company made certain reclassifications between its Government Services and Electronic Systems reportable segments due to a re-alignment of a business unit in the Company's management and organizational structure. See Note 21 for the prior period amounts reclassified between reportable segments.

Certain reclassifications have been made to conform prior year amounts to the current year presentation.

**3. New Accounting Standards Implemented**

In June 2009, the Financial Accounting Standards Board (FASB) issued a revised standard for the accounting for variable interest entities (VIE), which replaces the quantitative-based risks and rewards approach with a qualitative approach and requires certain additional disclosures. The new qualitative approach focuses on determining which entity has the power and control to direct the activities of a VIE and requires an ongoing assessment of that conclusion. The revised accounting standard was effective for the Company beginning on January 1, 2010 and did not have a material impact on the Company's financial position, results of operations or cash flows.

**4. Acquisitions**

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

***2010 Business Acquisitions***

On April 14, 2010, the Company acquired all of the outstanding stock of Insight Technology Incorporated (Insight), a manufacturer of mission critical night vision and electro-optical equipment, for a preliminary purchase price of \$613 million. The purchase price was funded with cash on hand and is subject to adjustment based on the closing date actual net working capital. Additional consideration, if any, will be accounted for as goodwill. Based on the preliminary purchase price allocation, the amount of goodwill recognized was \$422 million, which was assigned to the Electronic Systems reportable segment, of which \$412 million is expected to be deductible for income tax purposes. The Company recognized \$124 million, based on a preliminary estimate of fair value, for identifiable intangible assets, including technology and customer relationships, that are expected to be amortized over a weighted average useful life of 14 years. The final purchase price allocation is expected to be completed by the fourth quarter of 2010 and will be based on the final purchase price and final appraisals and other analyses of fair values for acquired assets and assumed

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

liabilities. The Company does not expect any of the differences between the preliminary and final purchase price allocations to have a material impact on its results of operations or financial position.

***2009 Business Acquisitions***

On January 30, 2009, the Company acquired all of the outstanding stock of Chesapeake Sciences Corporation (CSC) for a purchase price of \$91 million in cash, which included a \$7 million net working capital adjustment and \$4 million related to certain tax benefits acquired. The net working capital adjustment included \$6 million for cash acquired. The acquisition was financed using cash on hand. CSC is a developer and manufacturer of anti-submarine warfare systems for use onboard submarines and surface ship combatants. Based on the final purchase price allocation, the amount of goodwill recognized was \$56 million, which was assigned to the Electronic Systems reportable segment, and is not expected to be deductible for income tax purposes.

***Unaudited Pro Forma Statements of Operations Data***

The following unaudited pro forma Statements of Operations data presents the combined results of the Company and its business acquisitions completed during the first half ended June 25, 2010 and the year ended December 31, 2009, in each case assuming that the business acquisitions completed during these periods had occurred on January 1, 2009.

	<b>Second Quarter</b>		<b>First Half Ended</b>	
	<b>Ended</b>		<b>June 25, June 26,</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions, except per share data)</b>			
Pro forma net sales	\$ 3,973	\$ 4,026	\$ 7,661	\$ 7,768
Pro forma net income attributable to L-3	\$ 229	\$ 235	\$ 451	\$ 440
Pro forma diluted EPS	\$ 1.96	\$ 1.98	\$ 3.84	\$ 3.69

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2009.

**5. Contracts in Process**

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

<b>June 25, 2010</b>	<b>December 31, 2009</b>
<b>(in millions)</b>	

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Unbilled contract receivables, gross	\$ 2,622	\$ 2,373
Less: unliquidated progress payments	(878)	(700)
Unbilled contract receivables, net	1,744	1,673
Inventoried contract costs, gross	894	837
Less: unliquidated progress payments	(93)	(115)
Inventoried contract costs, net	801	722
Total contracts in process	\$ 2,545	\$ 2,395

*Inventoried Contract Costs.* In accordance with contract accounting standards, the Company accounts for the portion of its general and administrative (G&A), independent research and development (IRAD) and bid and proposal (B&P) costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on its U.S. Government contracts (revenue arrangements) as inventoried contract costs. G&A, IRAD and B&P costs are allocated to contracts for which the U.S. Government is the end customer and are charged to costs of sales when sales on the related contracts are recognized. The Company's unallowable portion of its G&A, IRAD and B&P costs for its U.S. Government contractor businesses are expensed as incurred and are not included in inventoried contract costs.

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

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

	<b>Second Quarter Ended</b>		<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	(in millions)			
Amounts included in inventoried contract costs at beginning of the period	\$ 84	\$ 79	\$ 77	\$ 74
Add: Contract costs incurred <sup>(1)</sup>	342	333	655	641
Less: Amounts charged to cost of sales	(333)	(333)	(639)	(636)
Amounts included in inventoried contract costs at end of the period	\$ 93	\$ 79	\$ 93	\$ 79

<sup>(1)</sup> Incurred costs include IRAD and B&P costs of \$92 million for the quarter ended June 25, 2010, \$79 million for the quarter ended June 26, 2009, \$173 million for the first half ended June 25, 2010 and \$155 million for the first half ended June 26, 2009.

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

	<b>Second Quarter Ended</b>		<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	(in millions)			
Selling, general and administrative expenses	\$ 69	\$ 60	\$ 132	\$ 126
Research and development expenses	20	18	32	33
Total	\$ 89	\$ 78	\$ 164	\$ 159

**6. Inventories**

*Inventories at Lower of Cost or Market.* The table below presents the components of inventories at cost (first-in, first-out or average cost), but not in excess of realizable value.

	<b>June 25, 2010</b>	<b>December 31, 2009</b>
	<b>(in millions)</b>	
Raw materials, components and sub-assemblies	\$ 114	\$ 92
Work in process	127	129
Finished goods	49	37
Total	\$ 290	\$ 258

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**7. Goodwill and Identifiable Intangible Assets**

*Goodwill.* In accordance with the accounting standards for business combinations, the Company records the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). The table below presents the changes in goodwill allocated to the Company's reportable segments.

	C <sup>3</sup> ISR	Government Services	AM&M (in millions)	Electronic Systems	Consolidated Total
<b>Balance at December 31, 2009</b>	\$ 870	\$ 2,320	\$ 1,158	\$ 3,842	\$ 8,190
Business acquisition <sup>(1)</sup>				422	422
Foreign currency translation adjustments <sup>(2)</sup>	(4)	(1)	2	(33)	(36)
Segment reclassification <sup>(3)</sup>		(43)		43	
<b>Balance at June 25, 2010</b>	\$ 866	\$ 2,276	\$ 1,160	\$ 4,274	\$ 8,576

(1) Represents acquisition of Insight. For further discussion regarding business acquisitions, see Note 4.

(2) The net decrease in goodwill from foreign currency translation adjustments is primarily due to the strengthening of the U.S. dollar against the Euro in the first half ended June 25, 2010.

(3) As a result of a re-alignment of a business unit in the Company's management and organizational structure as discussed in Note 2, goodwill was reclassified from the Government Services reportable segment to the Electronic Systems reportable segment during the quarter ended June 25, 2010.

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

	June 25, 2010			December 31, 2009		
	Weighted Average Amortization Period (in years)	Gross Carrying Amount	Net Carrying Amount (in millions)	Gross Carrying Amount	Net Carrying Amount (in millions)	Net Carrying Amount



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Customer contractual relationships	22	\$	584	\$	182	\$	402	\$	515	\$	163	\$	352
Technology	10		120		65		55		78		58		20
Other	11		23		9		14		14		9		5
Total	20	\$	727	\$	256	\$	471	\$	607	\$	230	\$	377

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

	<b>Second Quarter Ended</b>		<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions)</b>			
Amortization expense	\$ 14	\$ 13	\$ 27	\$ 26

Based on gross carrying amounts at June 25, 2010, the Company's estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2010 through 2014 are presented in the table below.

	<b>Year Ending December 31,</b>				
	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
	<b>(in millions)</b>				
Estimated amortization expense	\$ 65	\$ 67	\$ 57	\$ 45	\$ 43

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**8. Other Current Liabilities and Other Liabilities**

The table below presents the components of other current liabilities.

	<b>June 25, 2010</b>	<b>December 31, 2009</b>
	(in millions)	
<b>Other Current Liabilities:</b>		
Accruals for pending and threatened litigation (see Note 17)	\$ 6	\$ 2
Accrued product warranty costs	86	90
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	78	81
Accrued interest	63	76
Deferred revenues	29	28
Aggregate purchase price payable for acquired businesses		4
Other	84	90
Total other current liabilities	\$ 346	\$ 371

The table below presents the components of other liabilities.

	<b>June 25, 2010</b>	<b>December 31, 2009</b>
	(in millions)	
<b>Other Liabilities:</b>		
Non-current income taxes payable (see Note 11)	\$ 195	\$ 232
Deferred compensation	78	83
Accrued workers compensation	54	46
Notes payable and capital lease obligations	10	10
Accrued product warranty costs	8	9
Unfavorable lease obligations	4	6
Other	75	84
Total other liabilities	\$ 424	\$ 470

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

	<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions)</b>	
<b>Accrued product warranty costs: <sup>(1)</sup></b>		
Balance at January 1	\$ 99	\$ 102
Acquisitions during the period	1	
Accruals for product warranties issued during the period	28	22
Foreign currency translation adjustments	(3)	1
Settlements made during the period	(31)	(27)
Balance at end of period	\$ 94	\$ 98

- <sup>(1)</sup> Warranty obligations incurred in connection with long-term production contracts that are accounted for under the percentage-of-completion cost-to-cost method are included within the contract estimates at completion and are excluded from the above amounts. The balances above include both long-term and short-term amounts.

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**9. Debt**

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

	<b>June 25, 2010</b>	<b>December 31, 2009</b>
	(in millions)	
<b>L-3 Communications:</b>		
Borrowings under Revolving Credit Facility <sup>(1)</sup>	\$	\$
5.20% Senior Notes due 2019	1,000	1,000
4.75% Senior Notes due 2020	800	
6 1/8% Senior Subordinated Notes due 2013	400	400
6 1/8% Senior Subordinated Notes due 2014		400
5 7/8% Senior Subordinated Notes due 2015	650	650
6 3/8% Senior Subordinated Notes due 2015	1,000	1,000
Subtotal	3,850	3,450
<b>L-3 Holdings:</b>		
3% Convertible Contingent Debt Securities due 2035 <sup>(2)</sup>	700	700
Principal amount of long-term debt	4,550	4,150
Less: Unamortized discounts	(25)	(38)
Carrying amount of long-term debt	4,525	4,112
Less: Current portion of long-term debt <sup>(3)</sup>	(1,086)	
Carrying amount of long-term debt, excluding current portion	\$ 3,439	\$ 4,112

(1) The Company's Revolving Credit Facility, which matures on October 23, 2012, allows for total aggregate borrowings of up to \$1 billion. At June 25, 2010, available borrowings under the Revolving Credit Facility were \$967 million after reductions for outstanding letters of credit of \$33 million.

(2) Under select conditions, including if L-3 Holdings common stock price is more than 120% (currently \$118.73) of the then current conversion price (\$98.94 as of May 14, 2010) for a specified period, the conversion feature of the CODES will require L-3 Holdings, upon conversion, to pay the \$700 million principal amount in cash, and if the settlement amount exceeds the principal amount, the excess will be settled in cash or stock or a combination

thereof, at the Company's option. At the current conversion price of \$98.94, the aggregate consideration to be delivered upon conversion would be determined based on 7.1 million shares of L-3 Holdings' common stock. See Note 10 to the audited consolidated financial statements for the year ended December 31, 2009, included in the Company's Annual Report on Form 10-K for additional information regarding the CODES, including conditions for conversion. L-3 Holdings' closing stock price on July 29, 2010 was \$73.55 per share. The effective interest rate on the CODES is 6.33%. Interest expense relates to both the contractual coupon interest and amortization of the discount on the liability components. Interest expense recognized was \$11 million for the second quarter ended June 25, 2010, \$10 million for the second quarter ended June 26, 2009, \$21 million for the first half ended June 25, 2010, and \$20 million for the first half ended June 26, 2009. The following table provides additional information about the Company's CODES:

	June 25, 2010	December 31, 2009
	(in millions)	
Carrying amount of the equity component (conversion feature)	\$ 64	\$ 64
Unamortized discount of liability component being amortized through February 1, 2011	\$ 13	\$ 24
Net carrying amount of liability component	\$ 687	\$ 676

- (3) The current portion of long-term debt at June 25, 2010 includes: (1) L-3 Holdings' \$700 million CODES, as the holders of the CODES may require us to repurchase them in whole or in part at a cash price equal to 100% of the principal amount (plus accrued and unpaid interest, including contingent interest and additional interest, if any) through the exercise of a put option on February 1, 2011, and (2) L-3 Communications' \$400 million 4.75% Senior Subordinated Notes due 2013, which were redeemed on July 15, 2010.

On May 21, 2010, L-3 Communications issued \$800 million in principal amount of 4.75% Senior Notes that mature on July 15, 2020 (2020 Senior Notes) at a discount of \$3 million. The discount was recorded as a reduction to the principal amount of the notes and will be amortized as interest expense over the term of the notes. The effective interest rate of the 2020 Senior Notes is 4.79%.

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Interest on the 2020 Senior Notes is payable semi-annually on January 15 and July 15 of each year, commencing on January 15, 2011. The net cash proceeds from this offering amounted to approximately \$790 million after deducting the discounts, commissions and estimated expenses, and were used, together with cash on hand, to redeem L-3 Communications' aggregate \$800 million 8% Senior Subordinated Notes due 2014 (2014 Notes) and 2013 (2013 Notes) on June 21 and July 15, 2010, respectively. In connection with the redemption of the 2014 Notes, the Company recorded a debt retirement charge of approximately \$13 million (\$8 million after income tax, or \$0.07 per diluted share) during the second quarter ended June 25, 2010. The Company will record a \$5 million (\$3 million after income tax, or \$0.02 per diluted share) debt retirement charge during the third quarter of 2010 related to the redemption of the 2013 Notes.

**10. Comprehensive Income**

A reconciliation of net income to comprehensive income attributable to L-3 is presented in the table below.

	<b>Second Quarter Ended</b>		<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions)</b>			
Net income	\$ 231	\$ 227	\$ 453	\$ 428
Other comprehensive income (loss):				
Foreign currency translation adjustments	(39)	62	(58)	50
Unrealized (losses) gains on hedging instruments <sup>(1)</sup>	(2)	(1)	1	(1)
Net gain from pension and postretirement benefit plans arising during the period			2	
Amortization of pension and postretirement benefit plans net loss and prior service cost <sup>(2)</sup>	6	8	12	15
Total comprehensive income	196	296	410	492
Less: Comprehensive income attributable to noncontrolling interests	3	2	4	4
Comprehensive income attributable to L-3	\$ 193	\$ 294	\$ 406	\$ 488

<sup>(1)</sup> Amounts are net of income taxes of \$1 million for the quarterly period ended June 26, 2009 and \$2 million and \$1 million for the first half periods ended June 25, 2010 and June 26, 2009, respectively.

<sup>(2)</sup> Amounts are net of income taxes of \$3 million and \$5 million for the quarterly periods ended June 25, 2010 and June 26, 2009, respectively, and \$7 million and \$10 million for the first half periods ended June 25, 2010 and

June 26, 2009, respectively. See Note 18.

## 11. Income Taxes

The U.S. Federal income tax jurisdiction is the Company's major tax jurisdiction. The statutes of limitation for the Company's U.S. Federal income tax returns for the years ended December 31, 2006 through 2008 are open as of June 25, 2010. The Internal Revenue Service (IRS) began its audit of the Company's 2006 and 2007 U.S. Federal income tax returns in April 2009. In addition, the Company has numerous state and foreign income tax return audits currently in process. As a result of filing an IRS tax accounting method change regarding compensation expense during the first half period ended June 25, 2010, the Company decreased both its unrecognized tax benefits and its current deferred tax assets by \$48 million. As of June 25, 2010, the Company anticipates that unrecognized tax benefits will decrease by approximately \$22 million over the next 12 months.

Current and non-current income taxes payable include accrued interest of \$18 million (\$11 million after income taxes) at June 25, 2010 and \$23 million (\$14 million after income taxes) at December 31, 2009, and penalties of \$10 million at June 25, 2010 and \$9 million at December 31, 2009.

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**12. L-3 Holdings Earnings Per Common Share**

A reconciliation of basic and diluted earnings per share (EPS) is presented in the table below.

	<b>Second Quarter Ended</b>		<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions, except per share data)</b>			
<b>Reconciliation of net income:</b>				
Net income	\$ 231	\$ 227	\$ 453	\$ 428
Net income attributable to noncontrolling interests	(3)	(2)	(4)	(4)
Net income allocable to participating securities	(1)	(2)	(3)	(4)
Net income allocable to L-3 Holdings common shareholders	\$ 227	\$ 223	\$ 446	\$ 420
<b>Earnings per share allocable to L-3 Holdings common shareholders:</b>				
<b>Basic:</b>				
Weighted average common shares outstanding	115.4	116.5	115.7	117.4
<b>Basic earnings per share:</b>				
Net income	\$ 1.97	\$ 1.91	\$ 3.85	\$ 3.58
<b>Diluted:</b>				
Common and potential common shares:				
Weighted average common shares outstanding	115.4	116.5	115.7	117.4
Assumed exercise of stock options	3.2	3.5	3.4	3.5
Unvested restricted stock awards	1.4	0.1	1.2	0.1
Employee stock purchase plan contributions	0.5	0.6	0.5	0.6
Performance unit awards		0.1	0.1	
Assumed purchase of common shares for treasury	(4.0)	(3.6)	(4.2)	(3.6)
Assumed conversion of the CODES	(1)	(1)	(1)	(1)
Common and potential common shares	116.5	117.2	116.7	118.0
<b>Diluted earnings per share:</b>				
Net income	\$ 1.95	\$ 1.90	\$ 3.82	\$ 3.56



- (1) L-3 Holdings CODES had no impact on diluted EPS for the quarter or first half periods ended June 25, 2010 or June 26, 2009, because the average market price of L-3 Holdings common stock during these periods was less than the price at which the CODES would have been convertible into L-3 Holdings common stock. As of May 14, 2010 the conversion price was \$98.94.

Excluded from the computations of diluted EPS are shares related to stock options, restricted stock, and restricted stock units underlying employee stock-based compensation of 2.6 million and 2.4 million for the quarter and first half ended June 25, 2010, respectively, and 2.8 million for both the quarter and first half ended June 26, 2009 because they were anti-dilutive.

### **13. Equity**

Repurchases of L-3 Holdings common stock under the share repurchase programs, approved by the Board of Directors are made from time to time at management's discretion in accordance with applicable U.S. federal securities laws in the open market or otherwise. All share repurchases of L-3 Holdings common stock have been recorded as treasury shares. At June 25, 2010, the remaining dollar value under the share repurchase program approved by L-3 Holdings Board of Directors on November 24, 2008 was \$172 million. On July 14, 2010, L-3 Holdings Board of Directors approved a new share repurchase program that authorizes L-3 Holdings to repurchase up to an additional \$1 billion of its outstanding shares of common stock through December 31, 2012.

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From June 26, 2010 through July 29, 2010, L-3 Holdings repurchased 1,043,286 shares of its common stock at an average price of \$71.89 per share for an aggregate amount of \$75 million.

On July 13, 2010, L-3 Holdings Board of Directors declared a quarterly cash dividend of \$0.40 per share, payable on September 15, 2010 to shareholders of record at the close of business on August 17, 2010.

**14. Fair Value Measurements**

The following table presents the fair value hierarchy level for each of the Company's assets and liabilities that are measured and recorded at fair value on a recurring basis.

<b>Description</b>	<b>June 25, 2010</b>			<b>December 31, 2009</b>		
	<b>Level 1<sup>(1)</sup></b>	<b>Level 2<sup>(2)</sup></b>	<b>Level 3<sup>(3)</sup></b>	<b>Level 1<sup>(1)</sup></b>	<b>Level 2<sup>(2)</sup></b>	<b>Level 3<sup>(3)</sup></b>
<b>(in millions)</b>						
<b>Assets</b>						
Cash equivalents	\$ 788	\$	\$	\$ 891	\$	\$
Derivatives (foreign currency forward contracts)		22			16	
<b>Total Assets</b>	<b>\$ 788</b>	<b>\$ 22</b>	<b>\$</b>	<b>\$ 891</b>	<b>\$ 16</b>	<b>\$</b>
<b>Liabilities</b>						
Derivatives (foreign currency forward contracts)	\$	\$ 12	\$	\$	\$ 10	\$

(1) Level 1 is based on quoted market prices available in active markets for identical assets or liabilities as of the reporting date. Cash equivalents are primarily held in registered money market funds which are valued using quoted market prices.

(2) Level 2 is based on pricing inputs other than quoted prices in active markets, which are either directly or indirectly observable. The fair value is determined using a valuation model based on observable market inputs, including quoted foreign currency forward exchange rates and consideration of non-performance risk.

(3) Level 3 is based on pricing inputs that are not observable and not corroborated by market data. The Company has no Level 3 assets or liabilities.

**15. Financial Instruments**

At June 25, 2010 and December 31, 2009, the Company's financial instruments consisted primarily of cash and cash equivalents, billed receivables, trade accounts payable, senior notes, senior subordinated notes, CODES and foreign currency forward contracts. The carrying amounts of cash and cash equivalents, billed receivables and trade accounts

payable are representative of their respective fair values because of the short-term maturities or expected settlement dates of these instruments. The fair value of the senior notes, senior subordinated notes and CODES are based on quoted prices for these securities, except for the fair value of the 2013 Notes, which is based on the redemption price. The fair values of foreign currency forward contracts are based on forward exchange rates. The carrying amounts and estimated fair values of the Company's financial instruments are presented in the table below.

	<b>June 25, 2010</b>		<b>December 31, 2009</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
	<b>(in millions)</b>			
Senior notes	\$ 1,794	\$ 1,845	\$ 996	\$ 995
Senior subordinated notes	2,044	2,042	2,440	2,461
CODES	687	700	676	736
Foreign currency forward contracts <sup>(1)</sup>	10	10	6	6

<sup>(1)</sup> See Note 16 for additional disclosures regarding the notional amounts and fair values of foreign currency forward contracts.

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*Derivative Financial Instruments.* The Company's derivative financial instruments include foreign currency forward contracts, which are entered into for risk management purposes, and an embedded derivative representing the contingent interest payment provision related to the CODES.

*Foreign Currency Forward Contracts.* The Company's U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, the Company enters into foreign currency forward contracts. The Company's activities involving foreign currency forward contracts are designed to hedge the changes in the functional currency equivalent cash flows due to movements in foreign exchange rates compared to the functional currency. The foreign currencies hedged are primarily the Canadian dollar, the Euro, the British pound and the U.S. dollar. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. Foreign currency forward contracts are recorded in the Company's condensed consolidated balance sheets at fair value and are generally designated and accounted for as cash flow hedges in accordance with the accounting standards for derivative instruments and hedging activities. Gains and losses on designated foreign currency forward contracts that are highly effective in offsetting the corresponding change in the cash flows of the hedged transactions are recorded net of income taxes in accumulated other comprehensive income (loss) (accumulated OCI) and then recognized in income when the underlying hedged transaction affects income. Gains and losses on foreign currency forward contracts that do not meet hedge accounting criteria are recognized in income immediately.

Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The table below presents the notional amounts of the Company's outstanding foreign currency forward contracts by currency at June 25, 2010:

Currency	Notional Amount (in millions)
U.S. dollar	\$ 107
Canadian dollar	92
British pound	73
Euro	34
Other	6
Total	\$ 312

At June 25, 2010, the Company's foreign currency forward contracts had maturities through 2016.

*Embedded Derivative.* The embedded derivative related to the issuance of the CODES is recorded at fair value with changes reflected in the unaudited condensed consolidated statements of operations.

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The table below presents the fair values and the location of the Company's derivative instruments in the condensed consolidated balance sheets.

	Fair Values of Derivative Instruments <sup>(1)</sup>							
	June 25, 2010				December 31, 2009			
	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities	Other Current Assets	Other Assets	Other Current Liabilities	Other Liabilities
	(in millions)							
<b><u>Derivatives designated as hedging instruments:</u></b>								
Foreign currency forward contracts	\$ 6	\$ 12	\$ 6	\$ 2	\$ 6	\$ 7	\$ 4	\$ 2
<b><u>Derivatives not designated as hedging instruments:</u></b>								
Foreign currency forward contracts	3	1	4		2	1	3	1
Embedded derivative related to the CODES								
Total derivative instruments	\$ 9	\$ 13	\$ 10	\$ 2	\$ 8	\$ 8	\$ 7	\$ 3

<sup>(1)</sup> See Note 14 for a description of the fair value hierarchy related to the Company's foreign currency forward contracts.

The effect of gains or losses from foreign currency forward contracts was not material to the unaudited condensed consolidated statements of operations for the quarter and first half periods ended June 25, 2010 and June 26, 2009. At June 25, 2010, the estimated net existing loss that is expected to be reclassified into income within the next 12 months is less than \$1 million.

## 17. Commitments and Contingencies

A substantial majority of the Company's revenues are generated from providing products and services under legally binding agreements or contracts with U.S. Government and foreign government customers. 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 such contracts were and are being conducted in accordance with these requirements. The Company is currently cooperating with the U.S. Government on several investigations, including those specified below, from which civil, criminal or administrative proceedings have or could result and give rise to fines, penalties, compensatory and treble damages, restitution and/or forfeitures. The Company does not currently anticipate that any of these investigations will have a material adverse effect, individually or in the aggregate, on its consolidated financial position, results of operations or cash flows. However, under U.S. Government regulations, an

indictment of the Company by a federal grand jury, or an administrative finding against the Company as to its present responsibility to be a U.S. Government contractor or subcontractor, could result in the Company being suspended for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges. A conviction, or an administrative finding against the Company that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specified term. In addition, all of the Company's U.S. Government contracts: (1) are subject to audit and various pricing and cost controls, (2) include standard provisions for termination for the convenience of the U.S. Government or for default, and (3) are subject to cancellation if funds for contracts become unavailable. Foreign government contracts generally include comparable provisions relating to terminations for convenience and default, as well as other procurement clauses relevant to the foreign government.

The Company is also subject to and is involved in litigation, proceedings, claims or assessments and various contingent liabilities incidental to its businesses, including those specified below. Furthermore, in connection with certain business acquisitions, the Company has assumed some or all claims against, and liabilities of, the acquired business, including both asserted and unasserted claims and liabilities. In accordance with the accounting standard for contingencies, the Company records a liability when management believes that it is both probable that a liability has been incurred and the Company can reasonably estimate the amount of the loss. Generally, the loss is recorded at the amount the Company expects to resolve the liability. The estimated amounts of liabilities recorded for pending and threatened litigation are disclosed in Note 8. Amounts recoverable from insurance contracts or third parties are recorded as assets when deemed probable. At June 25, 2010, the Company did not record any amounts for recoveries from insurance contracts or third parties in connection with the amount of liabilities recorded for pending and threatened litigation. Legal defense costs are expensed as incurred. The Company believes it has recorded adequate provisions for its litigation and

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government investigation matters. The Company reviews these provisions quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. While it is reasonably possible that an unfavorable outcome may occur in one or more of the matters discussed below unless otherwise stated, the Company believes that it is not probable that a loss has been incurred in any of these matters. An estimate of loss or range of loss is disclosed for a particular litigation matter when such amount or amounts can be reasonably estimated and no loss has been accrued. The Company believes that any damage amounts claimed in the specific matters discussed below are not meaningful indicators of potential liability. Although the Company believes that it has valid defenses with respect to legal matters and investigations pending against it, these matters are inherently unpredictable, including those that are expected to be resolved with jury trials, for which outcomes are difficult to predict. Therefore, it is possible that the financial position, results of operations or cash flows of the Company could be materially adversely affected in any particular period by the unfavorable resolution of one or more of these or other contingencies.

*Kalitta Air.* On January 31, 1997, a predecessor of Kalitta Air filed a lawsuit in the U.S. District Court for the Northern District of California (the trial court) asserting, among other things, negligence and negligent misrepresentation against Central Texas Airborne Systems, Inc. (CTAS), a predecessor to L-3 Integrated Systems (L-3 IS), in connection with work performed by a predecessor to CTAS to convert two Boeing 747 aircraft from passenger configuration to cargo freighters. The work was performed using Supplemental Type Certificates (STCs) issued in 1988 by the Federal Aviation Administration (FAA). In 1996, following completion of the work, the FAA issued an airworthiness directive with respect to the STCs that effectively grounded the aircraft. On August 11, 2000, the trial court granted CTAS motion for summary judgment as to negligence, dismissing that claim. In January 2001, after a ruling by the trial court that excluded certain evidence from trial, a jury rendered a unanimous defense verdict in favor of CTAS on the negligent misrepresentation claim. On December 10, 2002, the U.S. Court of Appeals for the Ninth Circuit (the Court of Appeals) reversed the trial court's decisions as to summary judgment and the exclusion of evidence, and remanded the case for a new trial on both the negligence and negligent misrepresentation claims. The retrial ended on March 2, 2005 with a deadlocked jury and mistrial. On July 22, 2005, the trial court granted CTAS motion for judgment as a matter of law as to negligence, dismissing that claim, and denied CTAS motion for judgment as a matter of law as to negligent misrepresentation. On October 8, 2008, the Court of Appeals reversed the trial court's dismissal of the negligence claim and affirmed the trial court's ruling as to the negligent misrepresentation claim. As a result, the case was remanded to the trial court to reconsider the negligence claim and for further proceedings on the negligent misrepresentation claim. The trial court held a new hearing on CTAS motion to dismiss the negligence claim on April 30, 2009, after which it determined to take the matter under advisement. The case is currently scheduled to go to a third trial on November 1, 2010. The parties have participated in court-ordered mediations from time to time, and are expected to participate in future court-ordered mediations prior to trial, but to date such mediations have not resulted in a mutually acceptable resolution of this matter. In connection with these mediations, Kalitta Air has claimed it may seek damages at the third trial of between \$430 million and \$900 million, including between \$200 million and \$240 million of pre-judgment interest. CTAS insurance carrier has accepted defense of this matter and has retained counsel, subject to a reservation of rights by the insurer to dispute its obligations under the applicable insurance policies in the event of a finding against L-3. The Company believes that it has meritorious defenses to the claims asserted and the damages sought and intends to defend itself vigorously.

*Korean Lot II Program.* On April 4, 2005, Lockheed Martin Corporation (Lockheed) filed a lawsuit in the U.S. District Court for the Northern District of Georgia alleging that L-3 IS is in breach of its license agreement with



Lockheed and is infringing on Lockheed's intellectual property rights as a result of its performance of a subcontract awarded to L-3 IS for the Korean Lot II program. During the trial that began on May 4, 2009, Lockheed sought disgorgement of the monies paid or payable to L-3 IS under the subcontract (which Lockheed claims to be approximately \$315 million) or, under an alternative theory of damages, royalties of approximately \$20 million. On May 21, 2009, a jury found in favor of Lockheed and awarded \$30 million on the misappropriation claim, approximately \$7 million on the breach of license agreement claim, plus legal fees and expenses. On March 31, 2010, the court set aside the jury verdict and ordered a new trial based on its findings that Lockheed withheld certain documents from L-3 IS that were required to be produced as part of pre-trial discovery. The date for the new trial has not yet been scheduled.

*SSPD Investigation.* On June 4, 2010, the Company received notice that Integrated Systems Special Support Programs Division (L-3 SSPD, formerly known as L-3 Joint Operations Group or JOG) had been temporarily suspended from receiving new contracts or orders from U.S. Government agencies in connection with a governmental investigation into allegations that L-3 SSPD had inappropriately monitored e-mail messages on a Special Operations Forces Support Authority (SOFSA) computer network

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administered by L-3 SSPD. On July 27, 2010, the Company and the U.S. Air Force entered into an administrative agreement under which the Air Force lifted the temporary suspension and L-3 agreed, among other things, to provide periodic reporting to the Air Force regarding its ethics and compliance programs and not to protest the award of the follow-on SOFSA contract to a competitor. Although the governmental investigation is ongoing, evidence in the record to date suggests that government emails were not intentionally collected and were not reviewed, opened, or used by L-3.

*Derivative Action.* On July 15, 2010, a stockholder derivative complaint was filed in the Supreme Court of the State of New York, New York County, against the Company's directors and also against the Company as a nominal defendant. The complaint asserts, among other things, breaches of fiduciary duty and unjust enrichment based on allegations that the Company's directors acquiesced in, or failed to prevent, the purported inappropriate conduct at issue in the *SSPD Investigation* matter described above. The complaint seeks, among other things, monetary damages, equitable relief and an award of fees and expenses.

*Aircrew Training and Rehearsal Support (ATARS) Investigation.* Following a lawsuit filed by Lockheed on April 6, 2006 in the U.S. District Court for the Middle District of Florida against the Company and certain individuals related to the ATARS II Program (which was settled in November 2007), the Company received Grand Jury subpoenas in November 2006 and December 2007 in connection with an investigation being conducted by the United States Attorney for the Middle District of Florida, Orlando Division. The subpoenas request the production of documents related to Lockheed's allegations or produced in the civil litigation. The Company is cooperating fully with the U.S. Government.

*Titan Government Investigation.* In October 2002, The Titan Corporation (Titan) received a grand jury subpoena from the Antitrust Division of the DoJ requesting the production of documents relating to information technology services performed for the U.S. Air Force at Hanscom Air Force Base in Massachusetts and Wright-Patterson Air Force Base in Ohio. Titan was informed that other companies who have performed similar services had received subpoenas as well. The Company acquired Titan in July 2005. On September 20, 2006, counsel for the Company was informed by the New York Field Office of the DoJ's Criminal Antitrust Division that it was considering indictment. Additionally, a former Titan employee received a letter from the DoJ indicating that he was a target of the investigation. In December 2008, the DoJ contacted the Company to arrange additional employee interviews concerning a teaming agreement relating to the Wright-Patterson Air Force Base procurement. In January 2010, counsel for the Company was again informed by the New York Field Office that it was considering indictment. If the Field Office recommends indictment then, under normal DoJ procedures, Titan (now known as L-3 Services, Inc.) will be afforded an opportunity to make a presentation to the Criminal Antitrust Division in Washington, D.C. before the DoJ acts on the recommendation. It is not known whether an indictment of L-3 Services or any of its current or former employees will occur. If it does occur, it is possible that L-3 Services could be suspended or debarred from conducting business with the U.S. Government. The Company is cooperating fully with the U.S. Government.

*CyTerra Government Investigation.* Since November 2006, CyTerra has been served with civil and Grand Jury subpoenas by the DoD Office of the Inspector General and the DoJ and has been asked to facilitate employee interviews. The Company is cooperating fully with the U.S. Government. The Company believes that it is entitled to indemnification for any course of defense related to this matter out of, and has made a claim against, a \$15 million escrow fund established in connection with the Company's acquisition of CyTerra in March 2006.

*Bashkirian Airways.* On July 1, 2004, lawsuits were filed on behalf of the estates of 31 Russian children in the state courts of Washington, Arizona, California, Florida, New York and New Jersey against Honeywell, Honeywell TCAS, Thales USA, Thales France, the Company and Aviation Communications & Surveillance Systems (ACSS), which is a joint venture of L-3 and Thales. The suits relate to the crash over southern Germany of Bashkirian Airways Tupelov TU 154M aircraft and a DHL Boeing 757 cargo aircraft. On-board the Tupelov aircraft were 9 crew members and 60 passengers, including 45 children. The Boeing aircraft carried a crew of two. Both aircraft were equipped with Honeywell/ACSS Model 2000, Change 7 Traffic Collision and Avoidance Systems (TCAS). Sensing the other aircraft, the on-board DHL TCAS instructed the DHL pilot to descend, and the Tupelov on-board TCAS instructed the Tupelov pilot to climb. However, the Swiss air traffic controller ordered the Tupelov pilot to descend. The Tupelov pilot disregarded the on-board TCAS and put the Tupelov aircraft into a descent striking the DHL aircraft in midair at approximately 35,000 feet. All crew and passengers of both planes were lost. Investigations by the National Transportation Safety Board after the crash revealed that both TCAS units were performing as designed. The suits allege negligence and strict product liability based upon the design of the units and the training provided to resolve conflicting commands and seek approximately \$315 million in damages, including \$150 million in punitive damages. The Company's insurers have accepted defense of this matter and have retained counsel. The matters were consolidated in the U.S. District Court for the District of New Jersey, which has dismissed the actions on the basis of forum non conveniens. The plaintiffs re-filed a complaint on April 23, 2007 with the Barcelona Court's Registry in Spain. On

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March 9, 2010, the court ruled in favor of the plaintiffs and entered judgment against ACSS in the amount of approximately \$6.7 million, all of which represented compensatory damages. The Company believes that the verdict and the damages awarded are inconsistent with the law and evidence presented. Accordingly, ACSS filed an appeal of this ruling on April 27, 2010. The plaintiffs also filed an appeal of this ruling on the same date.

*Gol Airlines.* A complaint was filed on November 7, 2006 in the U.S. District Court for the Eastern District of New York against ExcelAire, Joseph Lepore, Jan Paul Paladino, and Honeywell. On October 23, 2007, an amended complaint was filed to include Lockheed, Raytheon, Amazon Technologies and ACSS. The complaints relate to the September 29, 2006 airplane crash over Brazil of a Boeing 737-800 operated by GOL Linhas Aereas Inteligentes, S.A. and an Embraer 600 business jet operated by ExcelAire. The complaints allege that ACSS designed the Traffic Collision and Avoidance System (TCAS) on the ExcelAire jet, and assert claims of negligence, strict products liability and breach of warranty against ACSS based on the design of the TCAS and the instructions provided for its use. The complaints seek unspecified monetary damages, including punitive damages. The Company's insurers have accepted defense of this matter and have retained counsel. On July 2, 2008, the District Court dismissed the actions on the basis of forum non conveniens on the grounds that Brazil was the location of the accident and is more convenient for witnesses and document availability. On December 2, 2009, the U.S. Court of Appeals for the Second Circuit upheld this decision. Some of the plaintiffs re-filed their complaints in the Lower Civil Court in the Judicial District of Peixoto de Azevedo in Brazil on July 3, 2009.

**18. Pension and Other Postretirement Benefits**

The following table summarizes the components of net periodic benefit cost for the Company's pension and postretirement benefit plans.

	<b>Pension Plans</b>				<b>Postretirement Benefit Plans</b>			
	<b>Second Quarter</b>		<b>First Half</b>		<b>Second Quarter</b>		<b>First Half</b>	
	<b>Ended</b>		<b>Ended</b>		<b>Ended</b>		<b>Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions)</b>							

**Components of net periodic benefit cost:**

Service cost	\$ 25	\$ 23	\$ 49	\$ 45	\$ 2	\$ 1	\$ 3	\$ 2
Interest cost	30	28	60	55	3	3	6	6
Expected return on plan assets	(28)	(23)	(56)	(45)	(1)		(1)	(1)
Amortization of prior service costs (credits)	1	1	2	2	(1)		(2)	(1)
Amortization of net losses (gains)	9	13	19	26		(1)		(1)
Curtailment loss (gain)				1	(2)		(2)	
Net periodic benefit cost	\$ 37	\$ 42	\$ 74	\$ 84	\$ 1	\$ 3	\$ 4	\$ 5

*Contributions.* For the year ending December 31, 2010, the Company currently expects to contribute cash of approximately \$140 million to its pension plans, and approximately \$13 million to its postretirement benefit plans. The Company contributed cash of \$44 million to its pension plans and \$5 million to its postretirement benefit plans during the first half ended June 25, 2010.

## **19. Employee Stock-Based Compensation**

During the first half ended June 25, 2010, the Company granted stock-based compensation awards under the 2008 Long Term Performance Plan (2008 LTTP) in the form of stock options, restricted stock units and performance units.

*Stock Options.* The Company granted 555,363 stock options with an exercise price equal to the fair market value of L-3 Holdings common stock on the date of grant. The options expire after 10 years from the date of grant and vest ratably over a three-year period on the annual anniversary of the date of grant. The weighted average grant date fair value for the options awarded was \$18.41 and was

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estimated using the Black-Scholes option-pricing model. The weighted average assumptions used in the valuation model for options granted during the first half ended June 25, 2010 are presented in the table below:

Expected holding period (in years)	4.7
Expected volatility	26.2%
Expected dividend yield	2.2%
Risk-free interest rate	2.3%

*Restricted Stock Units.* The Company granted 603,020 restricted stock units with a weighted average grant date fair value of \$90.24 per share. These units automatically convert into shares of L-3 Holdings' common stock upon vesting, and are subject to forfeiture until certain restrictions have lapsed, including a three year cliff vesting period for employees and a one year cliff vesting period for non-employee directors, in each case starting on the date of grant.

*Performance Units.* The Company granted 69,918 performance units with a weighted average grant date fair value per unit of \$103.71. The payout for these units is based on the achievement of pre-determined performance goals established by the compensation committee of the Company's Board of Directors for the three-year period ending December 31, 2012. The payout can range from zero to 200% of the original number of units awarded, which are converted into shares of L-3 Holdings' common stock and/or an amount of cash based on the then existing closing price at the end of the performance period.

On April 27, 2010, the stockholders of L-3 Holdings approved an amendment to the 2008 LTPP. The principal purpose of the amendment was to increase the number of shares authorized for issuance under the 2008 LTPP to approximately 12.2 million shares, except that each share of L-3 Holdings' common stock issued under a full value award (awards other than stock options or stock appreciation rights) will be counted as 2.6 shares for purposes of this share limit.

**20. Supplemental Cash Flow Information**

	<b>First Half Ended</b>	
	<b>June 25, 2010</b>	<b>June 26, 2009</b>
	<b>(in millions)</b>	
Interest paid on outstanding debt	\$ 130	\$ 123
Income tax payments	171	191
Income tax refunds	5	2

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**21. Segment Information**

The Company has four reportable segments, which are described in Note 1. The tables below present net sales, operating income, depreciation and amortization and total assets by reportable segment.

	Second Quarter Ended		First Half Ended	
	June 25, 2010	June 26, 2009 <sup>(1)</sup>	June 25, 2010	June 26, 2009 <sup>(1)</sup>
(in millions)				
<b>Net Sales:</b>				
C <sup>3</sup> ISR	\$ 832	\$ 771	\$ 1,637	\$ 1,486
Government Services	1,007	1,053	1,937	2,045
AM&M	823	729	1,542	1,401
Electronic Systems	1,420	1,452	2,699	2,753
Elimination of intercompany sales	(116)	(76)	(225)	(120)
Consolidated total	\$ 3,966	\$ 3,929	\$ 7,590	\$ 7,565
<b>Operating Income:</b>				
C <sup>3</sup> ISR	\$ 101	\$ 95	\$ 207	\$ 173
Government Services	84	101	161	191
AM&M	58	51	118	117
Electronic Systems	199	170	366	312
Consolidated total	\$ 442	\$ 417	\$ 852	\$ 793
<b>Depreciation and amortization:</b>				
C <sup>3</sup> ISR	\$ 7	\$ 11	\$ 21	\$ 21
Government Services	9	9	19	19
AM&M	4	5	9	10
Electronic Systems	32	29	59	57
Consolidated total	\$ 52	\$ 54	\$ 108	\$ 107

June 25,      December 31,  
2010          2009 <sup>(1)</sup>  
(in millions)

**Total Assets:**

C <sup>3</sup> ISR	\$ 1,955	\$ 1,875
Government Services	3,395	3,285
AM&M	1,990	1,914
Electronic Systems	7,348	6,599
Corporate	1,001	1,177
Consolidated total	\$ 15,689	\$ 14,850

- (1) As a result of a re-alignment of a business unit in the Company's management and organizational structure as discussed in Note 2, sales of \$17 million and \$32 million and operating income of less than \$1 million and \$1 million were reclassified from the Government Service reportable segment to the Electronic Systems reportable segment for the quarter and first half ended June 26, 2009. At December 31, 2009, \$48 million of assets were reclassified from the Government Services reportable segment to the Electronic Systems reportable segment.



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**22. Accounting Standards Issued and Not Yet Implemented**

In October 2009, the FASB issued a revised accounting standard for revenue arrangements with multiple deliverables. The revision: (1) removes the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, (2) provides a hierarchy that entities must use to estimate the selling price, (3) eliminates the use of the residual method for allocation, and (4) expands the ongoing disclosure requirements. The revised accounting standard is effective for the Company beginning on January 1, 2011, with early adoption permitted. The Company is currently assessing the impact the revised accounting standard will have on its consolidated financial statements.

In October 2009, the FASB issued a revised accounting standard for certain revenue arrangements that include software elements. Under the revised standard, tangible products that contain both software and non-software components that work together to deliver a product's essential functionality will be removed from the scope of pre-existing software revenue recognition standards. In addition, hardware components of a tangible product containing software components will always be excluded from software revenue recognition standards. The revised accounting standard is effective for the Company beginning on January 1, 2011, with early adoption permitted. The Company is currently assessing the impact the revised accounting standard will have on its consolidated financial statements.

**23. Unaudited Financial Information of L-3 Communications and Its Subsidiaries**

L-3 Communications is a wholly-owned subsidiary of L-3 Holdings. The debt of L-3 Communications, including the Senior Notes, Senior Subordinated Notes and borrowings under amounts drawn against the Revolving Credit Facility, are guaranteed, on a joint and several, full and unconditional basis, by certain of its domestic subsidiaries (the Guarantor Subsidiaries). The foreign subsidiaries and certain domestic subsidiaries of L-3 Communications (the Non-Guarantor Subsidiaries) do not guarantee the debt of L-3 Communications. None of the debt of L-3 Communications has been issued by its subsidiaries. There are no restrictions on the payment of dividends from the Guarantor Subsidiaries to L-3 Communications.

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The following unaudited condensed combining financial information presents the results of operations, financial position and cash flows of: (1) L-3 Holdings, excluding L-3 Communications and its consolidated subsidiaries (the Parent ), (2) L-3 Communications, excluding its consolidated subsidiaries, (3) the Guarantor Subsidiaries, (4) the Non-Guarantor Subsidiaries, and (5) the eliminations to arrive at the information for L-3 on a consolidated basis.

	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communication</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated L-3</b>
	<b>(in millions)</b>					
<b><u>Condensed Combining Balance</u></b>						
<b><u>Sheets:</u></b>						
<b><u>At June 25, 2010:</u></b>						
Current assets:						
Cash and cash equivalents	\$	\$ 667	\$ 3	\$ 439	\$ (86)	\$ 1,023
Billed receivables, net		286	771	241		1,298
Contracts in process		765	1,546	234		2,545
Other current assets		289	161	178		628
Total current assets		2,007	2,481	1,092	(86)	5,494
Goodwill		1,219	5,831	1,526		8,576
Other assets	2	471	779	369	(2)	1,619
Investment in and amounts due from consolidated subsidiaries	7,518	9,699	2,132		(19,349)	
Total assets	\$ 7,520	\$ 13,396	\$ 11,223	\$ 2,987	\$ (19,437)	\$ 15,689
Current portion of long-term debt	\$ 687	\$ 1,086	\$	\$	\$ (687)	\$ 1,086
Other current liabilities		760	1,372	598	(86)	2,644
Amounts due to consolidated subsidiaries				418	(418)	
Other long-term liabilities		1,278	236	80		1,594
Long-term debt		3,439				3,439
Total liabilities	687	6,563	1,608	1,096	(1,191)	8,763
L-3 shareholders' equity	6,833	6,833	9,615	1,891	(18,339)	6,833
Noncontrolling interests					93	93
Total equity	6,833	6,833	9,615	1,891	(18,246)	6,926
Total liabilities and equity	\$ 7,520	\$ 13,396	\$ 11,223	\$ 2,987	\$ (19,437)	\$ 15,689

**At December 31, 2009:**

## Current assets:

Cash and cash equivalents	\$	\$	797	\$	4	\$	364	\$	(149)	\$	1,016	
Billed receivables, net			321		629		199				1,149	
Contracts in process			616		1,538		241				2,395	
Other current assets			334		164		130				628	
Total current assets			2,068		2,335		934		(149)		5,188	
Goodwill			1,190		5,828		1,172				8,190	
Other assets		3	485		810		177		(3)		1,472	
Investment in and amounts due from consolidated subsidiaries		7,240	8,916		1,949				(18,105)			
Total assets	\$	7,243	\$	12,659	\$	10,922	\$	2,283	\$	(18,257)	\$	14,850
Current liabilities	\$		\$	737	\$	1,343	\$	588	\$	(149)	\$	2,519
Amounts due to consolidated subsidiaries							260		(260)			
Other long-term liabilities				1,243		226		90			1,559	
Long-term debt		676		4,112					(676)		4,112	
Total liabilities		676		6,092		1,569		938		(1,085)	8,190	
L-3 shareholders' equity		6,567		6,567		9,353		1,345		(17,265)	6,567	
Noncontrolling interests										93	93	
Total equity		6,567		6,567		9,353		1,345		(17,172)	6,660	
Total liabilities and equity	\$	7,243	\$	12,659	\$	10,922	\$	2,283	\$	(18,257)	\$	14,850

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	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communications</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated L-3</b>
	<b>(in millions)</b>					
<b><u>Condensed Combining Statements</u></b>						
<b><u>of Operations:</u></b>						
<b><u>For the quarter ended June 25,</u></b>						
<b><u>2010:</u></b>						
Net sales	\$	\$	842	\$	2,622	\$
Cost of sales		23	721		2,382	\$
				587	(85)	3,966
				507	(109)	3,524
Operating (loss) income	(23)	121	240	80	24	442
Interest and other income, net		31	5	1	(29)	8
Interest expense	12	70	28	2	(40)	72
Debt retirement charge		13				13
(Loss) income before income taxes	(35)	69	217	79	35	365
(Benefit) provision for income taxes	(13)	26	79	29	13	134
Equity in net income of consolidated subsidiaries	250	185			(435)	
Net income	228	228	138	50	(413)	231
Net income attributable to noncontrolling interests					3	3
Net income attributable to L-3	\$ 228	\$ 228	\$ 138	\$ 50	\$ (416)	\$ 228
<b><u>For the quarter ended June 26,</u></b>						
<b><u>2009:</u></b>						
Net sales	\$	\$	893	\$	2,588	\$
Cost of sales		18	788		2,325	\$
				485	(37)	3,929
				436	(55)	3,512
Operating (loss) income	(18)	105	263	49	18	417
Interest and other income, net		33	1	1	(29)	6
Interest expense	11	68	28	2	(40)	69
(Loss) income before income taxes	(29)	70	236	48	29	354
(Benefit) provision for income taxes	(10)	24	86	17	10	127
Equity in net income of consolidated subsidiaries	244	179			(423)	

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Net income	225	225	150	31	(404)	227
Net income attributable to noncontrolling interests					2	2
Net income attributable to L-3	\$ 225	\$ 225	\$ 150	\$ 31	\$ (406)	\$ 225

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	<b>L-3</b>		<b>L-3</b>	<b>Guarantor</b>	<b>Non-</b>		<b>Consolidated</b>
	<b>Holdings</b>		<b>Communications</b>	<b>Subsidiaries</b>	<b>Guarantor</b>	<b>Eliminations</b>	<b>L-3</b>
	<b>(Parent)</b>				<b>Subsidiaries</b>		
					<b>(in millions)</b>		
<b><u>Condensed Combining</u></b>							
<b><u>Statements of Operations:</u></b>							
<b><u>For the first half ended June 25,</u></b>							
<b><u>2010:</u></b>							
Net sales	\$		\$ 1,639	\$ 5,012	\$ 1,079	\$ (140)	\$ 7,590
Cost of sales		42	1,390	4,546	942	(182)	6,738
Operating (loss) income		(42)	249	466	137	42	852
Interest and other income, net			63	5	1	(57)	12
Interest expense		23	134	56	3	(80)	136
Debt retirement charge			13				13
(Loss) income before income taxes		(65)	165	415	135	65	715
(Benefit) provision for income taxes		(24)	61	152	49	24	262
Equity in net income of consolidated subsidiaries		490	345			(835)	
Net income		449	449	263	86	(794)	453
Net income attributable to noncontrolling interests						4	4
Net income attributable to L-3	\$	449	\$ 449	\$ 263	\$ 86	\$ (798)	\$ 449
<b><u>For the first half ended June 26,</u></b>							
<b><u>2009:</u></b>							
Net sales	\$		\$ 1,687	\$ 5,032	\$ 910	\$ (64)	\$ 7,565
Cost of sales		35	1,485	4,536	815	(99)	6,772
Operating (loss) income		(35)	202	496	95	35	793
Interest and other income, net			63	1	2	(57)	9
Interest expense		22	134	55	3	(79)	135
(Loss) income before income taxes		(57)	131	442	94	57	667
		(20)	44	161	34	20	239

(Benefit) provision for income taxes							
Equity in net income of consolidated subsidiaries	461	337			(798)		
Net income	424	424	281	60	(761)	428	
Net income attributable to noncontrolling interests					4	4	
Net income attributable to L-3	\$ 424	\$ 424	\$ 281	\$ 60	\$ (765)	\$ 424	

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

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

	<b>L-3 Holdings (Parent)</b>	<b>L-3 Communication Subsidiaries</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated L-3</b>
	<b>(in millions)</b>					
<b><u>Condensed Combining Statements</u></b>						
<b><u>of Cash Flows:</u></b>						
<b><u>For the first half ended June 25,</u></b>						
<b><u>2010:</u></b>						
<b>Operating activities:</b>						
Net cash from operating activities	\$ 347	\$ 53	\$ 431	\$ 105	\$ (347)	\$ 589
<b>Investing activities:</b>						
Business acquisitions, net of cash acquired		(616)				(616)
Other investing activities	(83)	(23)	(43)	(6)	83	(72)
Net cash used in investing activities	(83)	(639)	(43)	(6)	83	(688)
<b>Financing activities:</b>						
Proceeds from sale of senior notes		797				797
Redemption of senior subordinated notes		(400)				(400)
Common stock repurchased	(254)					(254)
Other financing activities	(10)	59	(389)	2	327	(11)
Net cash (used in) from financing activities	(264)	456	(389)	2	327	132
Effect of foreign currency exchange rate changes on cash				(26)		(26)
Net (decrease) increase in cash		(130)	(1)	75	63	7
Cash and cash equivalents, beginning of the period		797	4	364	(149)	1,016
Cash and cash equivalents, end of the period	\$	\$ 667	\$ 3	\$ 439	\$ (86)	\$ 1,023

**For the first half ended June 26,**  
**2009:**



**Operating activities:**

Net cash from operating activities	\$	384	\$		\$	423	\$	105	\$	(384)	\$	528
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**Investing activities:**

Business acquisitions, net of cash acquired				(82)								(82)
Other investing activities		(35)		(22)		(55)		(3)		35		(80)
Net cash used in investing activities		(35)		(104)		(55)		(3)		35		(162)

**Financing activities:**

Common stock repurchased		(301)										(301)
Other financing activities		(48)		(13)		(295)		(38)		349		(45)
Net cash used in financing activities		(349)		(13)		(295)		(38)		349		(346)

Effect of foreign currency exchange rate changes on cash								10				10
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Net (decrease) increase in cash				(117)		73		74				30
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Cash and cash equivalents, beginning of the period				720		(81)		228				867
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Cash and cash equivalents, end of the period	\$		\$	603	\$	(8)	\$	302	\$		\$	897
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**Table of Contents****ITEM 2.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS*****Financial Section Roadmap***

Management's discussion and analysis (MD&A) can be found on pages 28 to 38, and our unaudited condensed consolidated financial statements and related notes contained in this quarterly report can be found on pages 1 to 27. The following table is designed to assist in your review of MD&A.

<b>Topic</b>	<b>Location</b>
Overview and Outlook:	
L-3's Business	Pages 28 - 29
Key Performance Measures	Pages 29 - 30
Business Acquisitions and Business and Product Line Dispositions	Page 30
Results of Operations (includes business segments)	Pages 30 - 34
Liquidity and Capital Resources:	
Anticipated Sources and Uses of Cash Flow	Page 35
Balance Sheet	Pages 35 - 36
Statement of Cash Flows	Pages 36 - 38
Legal Proceedings and Contingencies	Page 38

***Overview and Outlook******L-3's Business***

L-3 is a prime contractor in Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) systems, aircraft modernization and maintenance, and government services. 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), U.S. Department of Justice (DoJ), allied foreign governments, domestic and foreign commercial customers, and select other U.S. federal, state and local government agencies.

For the year ended December 31, 2009, we generated sales of \$15.6 billion. Our primary customer was the DoD. The table below presents a summary of our 2009 sales by major category of end customer and the percent contributed by each end customer to our total 2009 sales. We currently do not anticipate significant changes to our end customer sales mix for the year ending December 31, 2010.

	<b>2009 Sales (in millions)</b>	<b>% of 2009 Sales</b>
DoD	\$ 11,932	76%
Other U.S. Government	1,127	7

Total U.S. Government	13,059	83%
Foreign governments	1,082	7
Commercial foreign	867	6
Commercial domestic	607	4
Total sales	\$ 15,615	100%

We have the following four reportable segments: (1) C<sup>3</sup>ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Electronic Systems. Financial information with respect to each of our reportable segments is included in Note 21 to our unaudited condensed consolidated financial statements contained in this quarterly report. C<sup>3</sup>ISR provides products and services for the global ISR market, C<sup>3</sup> systems, networked communications systems and secure communications products. We believe that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space,

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ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Government Services provides a full range of engineering, technical, analytical, information technology (IT), advisory, training, logistics and support services to the DoD, DoS, DoJ, and U.S. Government intelligence agencies and allied foreign governments. AM&M provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. We sell these services primarily to the DoD, the Canadian Department of National Defense and other allied foreign governments. Electronic Systems provides a broad range of products and services, including components, products, subsystems, systems, and related services to military and commercial customers in several niche markets across several business areas, including power & control systems, electro-optic/infrared (EO/IR), microwave, simulation & training, precision engagement, aviation products, security & detection, propulsion systems, displays, telemetry & advanced technology, undersea warfare, and marine services.

*Key Performance Measures*

The primary financial performance measures that L-3 uses to manage its businesses and monitor results of operations are sales growth and operating income growth. Management believes that these financial performance measures are the primary growth drivers for L-3's earnings per common share and net cash from operating activities. L-3's business strategy is focused on increasing sales from organic growth and select business acquisitions. We define organic sales growth as the increase or decrease in sales for the current period compared to the prior period, excluding sales in the: (1) current period from business and product line acquisitions that are included in L-3's actual results of operations for less than twelve months, and (2) prior period from business and product line divestitures that are included in L-3's actual results of operations for the twelve-month period prior to the divestiture date. We expect to supplement our organic sales growth by selectively acquiring businesses that: (1) add important new technologies, services, and products, (2) provide access to select customers, programs and contracts, and (3) provide attractive returns on investments. The two main determinants of our operating income growth are sales growth and improvements in direct and indirect contract costs. We define operating margin as operating income as a percentage of sales.

*Sales Growth.* Sales growth for the year ended December 31, 2009 was 5%, comprised of organic sales growth of 4%, and sales growth from business acquisitions, net of divestitures, of 1%. For the quarter ended June 25, 2010 (2010 Second Quarter), consolidated net sales of \$3,966 million increased by 0.9%, comprised of sales growth from acquisitions of \$51 million or 1.3%, partially offset by an organic sales decline of 0.4%, compared to the quarter ended June 26, 2009 (2009 Second Quarter). For the first half ended June 25, 2010 (2010 First Half), consolidated net sales of \$7,590 million increased by 0.3%, comprised of sales growth from acquisitions of \$67 million or 0.9%, partially offset by an organic sales decline of 0.6%, compared to the first half ended June 26, 2009 (2009 First Half). Currently, we expect 2010 sales growth to be in the low single digits.

For the year ended December 31, 2009, our largest contract (revenue arrangement) in terms of annual sales was the Special Operations Forces Support Activity (SOFSA) contract, which generated approximately 3% of our sales. On June 21, 2010, SOFSA unexpectedly announced that the SOFSA follow-on contract was awarded to another contractor. The transition to the successor contractor began immediately for a period of 120 days and is expected to end in October 2010. We had previously expected, based on communication from the SOFSA customer, that an amended solicitation for the follow-on contract was to have been released in June 2010 with an award by January 2011. See Note 17 to our unaudited condensed consolidated financial statements contained in this quarterly report for further discussion.

As is the case with most other U.S. defense contractors, we have benefited from the upward trend in DoD budget authorization and spending outlays over recent years, including supplemental appropriations for military operations in Iraq and Afghanistan. We expect future DoD budgets, including supplemental appropriations, to grow at a significantly slower pace than the past several years, and to possibly flatten or decline. However, we believe that our

businesses should be able to continue to generate modest organic sales growth because we anticipate the defense budget and spending priorities will continue to focus on several areas that match L-3's core competencies, such as communications and ISR, sensors, special operations support, helicopter crew training and maintenance and simulation & training.

We expect to continue to generate modest annual increases in operating margin as we expect to grow sales at a rate faster than the increase in our indirect costs, and improve our overall contract performance. However, we may not be able to continue to expand our operating margin on an annual basis. In addition, business acquisitions and new business, including contract renewals and new contracts, could result in decreased operating margins if their margins are lower than L-3's operating margin on existing business and contracts. Our business objectives include growing earnings per common share and net cash from operating activities. Improving operating margins is one method for achieving these goals, but it is not the only one.

**Table of Contents***Other Events*

**Debt Issuance and Repayments.** On May 21, 2010, L-3 Communications issued \$800 million in principal amount of 4.75% Senior Notes that mature on July 15, 2020 (2020 Senior Notes) at a discount of \$3 million. The net cash proceeds from this offering, together with cash on hand, were used to redeem L-3 Communications' aggregate \$800 million of 6 1/8% Senior Subordinated Notes due 2014 (2014 Notes) and 2013 (2013 Notes). In connection with the redemption of the 2014 Notes, we recorded a debt retirement charge of approximately \$13 million (\$8 million after income tax, or \$0.07 per diluted share) during the 2010 Second Quarter. We will record a \$5 million (\$3 million after income tax, or \$0.02 per diluted share) debt retirement charge in the third quarter of 2010 related to the redemption of the 2013 Notes on July 15, 2010. See "Liquidity and Capital Resources - Debt" on page 37 for a further discussion.

**Business Acquisitions and Business and Product Line Dispositions**

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 summarizes the business acquisitions and business and product line dispositions that we completed during the three years ended December 31, 2009. Also, see Note 4 to our unaudited condensed consolidated financial statements contained in this quarterly report for a discussion of the acquisition of Insight Technology Incorporated (Insight) on April 14, 2010. During the 2010 First Half, we used \$616 million of cash primarily to acquire Insight. All of our business acquisitions are included in our consolidated results of operations from their dates of acquisition. We regularly evaluate potential business acquisitions.

**Results of Operations**

The following information should be read in conjunction with our unaudited condensed consolidated financial statements contained in this quarterly report. Our results of operations for the periods presented are affected by our business acquisitions. See Note 4 to our audited consolidated financial statements for the year ended December 31, 2009, included in our Annual Report on Form 10-K, for a discussion of our 2009 business acquisitions, and Note 4 to our unaudited condensed consolidated financial statements, included in this report, for a discussion of the Insight acquisition.

**Consolidated Results of Operations**

The table below provides selected financial data for L-3 for the 2010 Second Quarter compared with the 2009 Second Quarter and the 2010 First Half compared with the 2009 First Half.

(in millions, except per share data)	Second Quarter			First Half Ended		
	Ended		Increase/ (decrease)	June 25,		Increase/ (decrease)
	June 25, 2010	June 26, 2009		June 25, 2010	June 26, 2009	
Net sales	\$ 3,966	\$ 3,929	\$ 37	\$ 7,590	\$ 7,565	\$ 25
Operating income	\$ 442	\$ 417	\$ 25	\$ 852	\$ 793	\$ 59
Operating margin	11.1%	10.6%	50bpts	11.2%	10.5%	70bpts
Net interest expense and other income	\$ 77	\$ 63	\$ 14	\$ 137	\$ 126	\$ 11
Effective income tax rate	36.7%	35.9%	80bpts	36.6%	35.8%	80bpts
Net income attributable to L-3	\$ 228	\$ 225	\$ 3	\$ 449	\$ 424	\$ 25
Diluted earnings per share	\$ 1.95	\$ 1.90	\$ 0.05	\$ 3.82	\$ 3.56	\$ 0.26

Diluted weighted average common shares outstanding	116.5	117.2	(0.7)	116.7	118.0	(1.3)
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*Net Sales:* For the 2010 Second Quarter, consolidated net sales increased 1% compared to the 2009 Second Quarter. Sales growth from the Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) and the Aircraft Modernization and Maintenance (AM&M) reportable segments was partially offset by lower sales from the Government Services and Electronic Systems reportable segments. Net sales from acquired businesses were \$51 million in the 2010 Second Quarter. Sales from services, which include services performed by businesses primarily in our Government Services, AM&M and C<sup>3</sup>ISR reportable segments, as well as marine services, simulation & training, and maintenance for security and detection systems within our Electronic Systems reportable segment, were \$2,045 million for the 2010 and 2009 Second Quarters, representing approximately 52% of consolidated net sales for those periods. Service sales increased due primarily to organic sales growth in ISR systems, information technology (IT) support services for the U.S. Special Operations Forces (SOF), and system field support services for U.S. Army rotary wing training aircraft, which were fully offset by reduced subcontractor pass-through sales for systems and software engineering and sustainment (SSES) services, a decrease for Iraq support, including linguist and intelligence support services, and

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lower volume for contract field services and the SOFSA contract. Sales from products, which primarily includes products from our C<sup>3</sup>ISR and Electronic Systems reportable segments, increased by \$37 million to \$1,921 million for the 2010 Second Quarter, compared to \$1,884 million for the 2009 Second Quarter, representing approximately 48% of consolidated net sales for both periods. The increase was primarily due to organic sales growth in aircraft modernization, networked communications, EO/IR, and security & detection, and sales from the Insight acquired business. These increases were partially offset by decreases for combat propulsion systems, commercial shipbuilding products, displays and training & simulation.

For the 2010 First Half, consolidated net sales increased slightly compared to the 2009 First Half. Sales growth from the C<sup>3</sup>ISR and AM&M reportable segments was substantially offset by lower sales from the Government Services and Electronic Systems reportable segments. The increase in net sales from acquired businesses was \$67 million in the 2010 First Half. Sales from services increased by \$36 million to \$3,955 million for the 2010 First Half, compared to \$3,919 million for the 2009 First Half, representing approximately 52% of consolidated net sales for both periods. Service sales increased primarily due to organic sales growth in ISR systems, logistics, training and law enforcement services for the U.S. Army, system field support services for U.S. Army rotary wing training aircraft, and IT support services for SOF. These increases were partially offset by reduced subcontractor pass-through sales for SSES services, a decrease for Iraq support and lower volume for contract field services and the SOFSA contract. Sales from products decreased by \$11 million to \$3,635 million for the 2010 First Half, compared to \$3,646 million for the 2009 First Half, representing approximately 48% of consolidated net sales for both periods. The decrease in product sales was primarily due to decreases for combat propulsion systems, commercial shipbuilding products, precision engagement and displays. These decreases were partially offset by organic sales growth for aircraft modernization, EO/IR, microwave, and networked communications and sales from the Insight acquired business. See the reportable segment results below for additional discussion of our sales results.

*Operating income and operating margin:* The 2010 Second Quarter operating income increased by 6% compared to the 2009 Second Quarter. Operating margin increased to 11.1% for the 2010 Second Quarter from 10.6% for the 2009 Second Quarter. The operating margin increase was driven by improved contract performance and favorable sales mix for businesses in the Electronic Systems reportable segment. In addition, lower pension expense of \$4 million (\$3 million after income taxes, or \$0.03 per diluted share) increased operating margin by 10 basis points. These increases were partially offset by lower operating margins in the Government Services reportable segment.

The 2010 First Half operating income increased by 7% compared to the 2009 First Half. Operating margin increased to 11.2% for the 2010 First Half from 10.5% for the 2009 First Half. The operating margin increase was driven by improved contract performance and favorable sales mix for businesses in the C<sup>3</sup>ISR and Electronic Systems reportable segments. In addition, lower pension expense of \$9 million (\$6 million after income taxes, or \$0.05 per diluted share) increased operating margin by 10 basis points. These increases were partially offset by lower operating margins in the Government Services reportable segment. See the reportable segment results below for additional discussion of our segment operating margin.

*Net interest expense and other income:* Net interest expense and other income increased by \$14 million for the 2010 Second Quarter compared to the same period last year. The increase was primarily due to a debt retirement charge of \$13 million related to our redemption of the 2014 Notes and approximately \$3 million (\$2 million after income taxes, or \$0.02 per diluted share) related to overlapping debt prior to the redemption of the outstanding 2013 and 2014 Notes. These increases were partially offset by increased income from investments accounted for using the equity method.

Net interest expense and other income for the 2010 First Half increased by \$11 million compared to the same period last year primarily due to the debt retirement charge related to our redemption of the 2014 Notes and interest expense related to overlapping debt. These increases were partially offset by increased income from investments accounted for



using the equity method.

*Effective income tax rate:* The effective tax rate for both the 2010 Second Quarter and 2010 First Half increased by 80 basis points compared to the same respective periods last year, primarily due to the expiration of the U.S. Federal research and experimentation tax credit as of December 31, 2009. In addition, the 2010 First Half includes a tax provision of \$5 million, or \$0.04 per diluted share, related to the U.S. Federal Patient Protection and Affordable Care Act, which changed the tax treatment for certain retiree prescription drug benefits.

*Diluted earnings per share and net income attributable to L-3:* L-3 Holdings' diluted earnings per share (diluted EPS) increased by \$0.05, or 3%, to \$1.95 for the 2010 Second Quarter from \$1.90 for the 2009 Second Quarter, and net income attributable to L-3 increased by \$3 million, or 1%, to \$228 million from \$225 million for the same periods.

L-3 Holdings' diluted EPS increased by \$0.26, or 7%, to \$3.82 for the 2010 First Half from \$3.56 for the 2009 First Half, and net income attributable to L-3 increased by \$25 million, or 6%, to \$449 million from \$424 million for the same periods.

*Diluted weighted average common shares outstanding:* Diluted weighted average common shares outstanding for the 2010 Second Quarter and 2010 Second Half decreased by 0.7 million and 1.3 million shares, respectively. The decrease in both periods was

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primarily due to repurchases of our common stock in connection with our share repurchase program authorized by our Board of Directors, partially offset by additional shares issued in connection with various employee stock-based compensation programs and contributions to employee savings plans made in common stock.

**Reportable Segment Results of Operations**

The table below presents selected data by reportable segment reconciled to consolidated totals. See Note 21 to our unaudited condensed consolidated financial statements contained in this quarterly report for additional reportable segment data.

	Second Quarter Ended		First Half Ended	
	June 25, 2010	June 26, 2009 <sup>(1)</sup>	June 25, 2010	June 26, 2009 <sup>(1)</sup>
	(dollars in millions)			
Net sales: <sup>(2)</sup>				
C <sup>3</sup> ISR	\$ 814.3	\$ 761.4	\$ 1,602.3	\$ 1,471.5
Government Services	1,005.6	1,052.0	1,933.6	2,041.7
AM&M	760.2	695.3	1,412.3	1,358.8
Electronic Systems	1,386.0	1,420.7	2,641.6	2,693.1
Consolidated net sales	\$ 3,966.1	\$ 3,929.4	\$ 7,589.8	\$ 7,565.1
Operating income:				
C <sup>3</sup> ISR	\$ 101.5	\$ 95.1	\$ 207.3	\$ 173.3
Government Services	84.2	100.5	160.7	190.8
AM&M	57.9	51.0	117.4	116.8
Electronic Systems	198.2	170.3	366.1	311.9
Consolidated operating income	\$ 441.8	\$ 416.9	\$ 851.5	\$ 792.8
Operating margin:				
C <sup>3</sup> ISR	12.5%	12.5%	12.9%	11.8%
Government Services	8.4%	9.6%	8.3%	9.3%
AM&M	7.6%	7.3%	8.3%	8.6%
Electronic Systems	14.3%	12.0%	13.9%	11.6%
Consolidated operating margin	11.1%	10.6%	11.2%	10.5%

<sup>(1)</sup> As a result of a re-alignment of a business unit in the Company's management and organizational structure as discussed in Note 2 to our unaudited condensed consolidated financial statements contained in this quarterly report, sales of \$17 million and \$32 million and operating income of less than \$1 million and \$1 million were reclassified from the Government Services reportable segment to the Electronic Systems reportable segment for the 2009 Second Quarter and 2009 First Half. At December 31, 2009, \$48 million of assets were reclassified from the Government Services reportable segment to the Electronic Systems reportable segment.

<sup>(2)</sup> Net sales are after intercompany eliminations.

**C<sup>3</sup>ISR**

	Second Quarter Ended			First Half Ended		Increase
	June 25, 2010	June 26, 2009	Increase	June 25, 2010	June 26, 2009	
			(dollars in millions)			
Net sales	\$ 814.3	\$ 761.4	\$ 52.9	\$ 1,602.3	\$ 1,471.5	\$ 130.8
Operating income	101.5	95.1	6.4	207.3	173.3	34.0
Operating margin	12.5%	12.5%	bpts	12.9%	11.8%	110bpts

*Second Quarter:* C<sup>3</sup>ISR net sales for the 2010 Second Quarter increased by 7% compared to the 2009 Second Quarter, primarily due to increased demand and new business from the DoD for airborne ISR systems and services and networked communication systems for manned and unmanned platforms.

C<sup>3</sup>ISR operating income for the 2010 Second Quarter increased by 7% compared to the 2009 Second Quarter. Operating margin remained the same as compared to the 2009 Second Quarter. Higher sales volumes and improved contract performance for networked

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communications systems increased operating margin by 60 basis points and lower pension expense of \$2 million increased operating margin by 30 basis points. These increases were fully offset by lower margin sales mix, primarily related to higher sales for logistics support services for airborne ISR platforms.

*First Half:* C<sup>3</sup>ISR net sales for the 2010 First Half increased by 9% compared to the 2009 First Half, primarily due to increased demand and new business from the DoD for airborne ISR systems and services and networked communications systems for manned and unmanned platforms and from foreign ministries of defense for force protection products.

C<sup>3</sup>ISR operating income for the 2010 First Half increased by 20% compared to the 2009 First Half. Operating margin increased by 110 basis points. Higher sales volume and improved contract performance increased operating margin by 90 basis points. In addition, lower pension expense of \$4 million increased operating margin by 20 basis points.

**Government Services**

	Second Quarter Ended			First Half Ended		
	June 25, 2010	June 26, 2009	Decrease	June 25, 2010	June 26, 2009	Decrease
	(dollars in millions)					
Net sales	\$ 1,005.6	\$ 1,052.0	\$ (46.4)	\$ 1,933.6	\$ 2,041.7	\$ (108.1)
Operating income	84.2	100.5	(16.3)	160.7	190.8	(30.1)
Operating margin	8.4%	9.6%	(120) bpts	8.3%	9.3%	(100) bpts

*Second Quarter:* Government Services net sales for the 2010 Second Quarter decreased by 4% compared to the 2009 Second Quarter. The decrease was primarily due to: (1) reduced subcontractor pass-through sales volume of \$41 million related to task order renewals for U.S. Army SSES services that migrated to a contract where L-3 is not a prime contractor, and (2) lower sales volume of \$29 million related to Iraq support, including linguist and intelligence support services. These decreases were partially offset by \$23 million of higher sales primarily for logistics, training and law enforcement support services for the U.S. Army due to higher volume on new and existing contracts, and information technology support services for SOF. The increase in net sales from acquired businesses was \$1 million.

Government Services operating income for the 2010 Second Quarter decreased by 16% compared to the 2009 Second Quarter. Operating margin decreased by 120 basis points. Operating margin was reduced by 160 basis points primarily due to lower margins on select contract renewals due to competitive price pressures and the timing of the receipt of award fees. These decreases were partially offset primarily by a decline in lower margin subcontractor pass-through sales, which increased operating margin by 40 basis points.

*First Half:* Government Services net sales for the 2010 First Half decreased by 5% compared to the 2009 First Half. The decrease was primarily due to: (1) reduced subcontractor pass-through sales volume of \$86 million related to the SSES contract, and (2) lower sales volume of \$66 million related to Iraq support, including linguist and intelligence support services. These decreases were partially offset by \$31 million of higher sales primarily for logistics, training and law enforcement support services for the U.S. Army due to higher volume on new and existing contracts and information technology support services for SOF. The increase in net sales from acquired businesses was \$13 million, or 1%.

Government Services operating income for the 2010 First Half decreased by 16% compared to the 2009 First Half. Operating margin decreased by 100 basis points. Operating margin was reduced by 150 basis points primarily due to

lower margins on select contract renewals, higher costs for a security systems contract for the U.S. Department of Homeland Security and the timing of the receipt of award fees. These decreases were partially offset primarily by a decline in lower margin subcontractor pass-through sales, which increased operating margin by 50 basis points.

**Aircraft Modernization and Maintenance (AM&M)**

	Second Quarter Ended		Increase	First Half Ended		Increase/ (decrease)
	June 25, 2010	June 26, 2009		June 25, 2010	June 26, 2009	
			(dollars in millions)			
Net sales	\$ 760.2	\$ 695.3	\$ 64.9	\$ 1,412.3	\$ 1,358.8	\$ 53.5
Operating income	57.9	51.0	6.9	117.4	116.8	0.6
Operating margin	7.6%	7.3%	30 bpts	8.3%	8.6%	(30) bpts

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*Second Quarter:* AM&M net sales for the 2010 Second Quarter increased by 9% compared to the 2009 Second Quarter. The increase was primarily due to: (1) \$73 million of higher sales for the Joint Cargo Aircraft (JCA) contract, (2) higher aircraft modernization sales of \$23 million primarily for special mission aircraft and deliveries of rotary wing cabin assemblies, and (3) \$21 million of higher sales due to increased demand from existing contracts for system field support for U.S. Army rotary wing training aircraft. These increases were partially offset by \$52 million in sales volume declines primarily for contract field services (CFS) and the SOFSA contract because of reduced tasking, and a competitive loss of an aircraft maintenance contract with the U.S. Customs and Border Patrol.

AM&M operating income for the 2010 Second Quarter increased by 14% compared to the 2009 Second Quarter. Operating margin increased by 30 basis points. Improved contract performance on international aircraft modernization sales increased operating margin by 130 basis points. This increase was partially offset by lower margin sales mix, primarily related to higher JCA volume.

*First Half:* AM&M net sales for the 2010 First Half increased by 4% compared to the 2009 First Half. The increase was primarily due to: (1) \$66 million of higher sales for JCA, (2) \$46 million of higher aircraft modernization sales primarily for U.S. Navy maritime patrol aircraft, SOF special mission aircraft and deliveries of rotary wing cabin assemblies, and (3) \$19 million of higher sales for increased volume for systems field support for U.S. Army rotary wing training aircraft. These increases were partially offset primarily by \$77 million in sales volume declines for CFS and the SOFSA contract because of reduced tasking, and a competitive loss of an aircraft maintenance contract with the U.S. Customs and Border Patrol.

AM&M operating income for the 2010 First Half increased slightly compared to the 2009 First Half. Operating margin decreased by 30 basis points. Lower margin sales mix, primarily related to higher JCA volume, and lower sales prices for systems field support were partially offset by improved contract performance on international aircraft modernization sales.

**Electronic Systems**

	Second Quarter Ended			First Half Ended		
	June 25, 2010	June 26, 2009	Increase/ (decrease)	June 25, 2010	June 26, 2009	Increase/ (decrease)
	(dollars in millions)					
Net sales	\$ 1,386.0	\$ 1,420.7	\$ (34.7)	\$ 2,641.6	\$ 2,693.1	\$ (51.5)
Operating income	198.2	170.3	27.9	366.1	311.9	54.2
Operating margin	14.3%	12.0%	230 bpts	13.9%	11.6%	230 bpts

*Second Quarter:* Electronic Systems net sales for the 2010 Second Quarter decreased by 2% compared to the 2009 Second Quarter. Sales volume declined by: (1) \$36 million for combat propulsion systems primarily due to a reduction in DoD funding for the Bradley fighting vehicle, (2) \$35 million for commercial shipbuilding products as a result of reduced demand, and (3) \$37 million for training & simulation and displays due to contracts nearing completion. These decreases were partially offset by volume increases of \$23 million due to higher demand primarily for EO/IR products to the U.S. Army, and security & detection due to the timing of deliveries. The increase in net sales from the Insight acquired business was \$50 million.

Electronic Systems operating income for the 2010 Second Quarter increased by 16% compared to the 2009 Second Quarter. Operating margin increased by 230 basis points. The increase was due to favorable sales mix and improved contract performance primarily for EO/IR products, which increased operating margin by 390 basis points. In

addition, lower pension expense of \$3 million increased operating margin by 20 basis points. These increases were partially offset by lower sales volume for commercial shipbuilding products and training & simulation, and lower margin sales mix for commercial space-based microwave products.

*First Half:* Electronic Systems net sales for the 2010 First Half decreased by 2% compared to the 2009 First Half. Sales volume declined by: (1) \$57 million for combat propulsion systems due to a reduction in DoD funding for the Bradley fighting vehicle, (2) \$44 million for commercial shipbuilding products, and (3) \$44 million for displays and precision engagement due to contracts nearing completion. These decreases were partially offset by volume increases of \$40 million due to higher demand primarily for EO/IR products for the U.S. Air Force and U.S. Army, and microwave products primarily due to deliveries of power devices for satellite communication systems. The increase in net sales from acquired businesses was \$54 million, primarily related to Insight.

Electronic Systems operating income for the 2010 First Half increased by 17% compared to the 2009 First Half. Operating margin increased by 230 basis points. The increase was due to favorable sales mix and improved contract performance primarily for EO/IR products, which increased operating margin by 300 basis points. In addition, lower pension expense of \$6 million increased operating margin by 20 basis points. These increases were offset by lower sales volume for commercial shipbuilding and training & simulation, and lower margin sales mix for commercial space-based microwave products.

**Table of Contents****Liquidity and Capital Resources****Anticipated Sources and Uses of Cash Flow**

Our primary source of liquidity is cash flow generated from operations. As of June 25, 2010, we also had, subject to certain conditions, \$967 million of borrowings available under our \$1 billion Revolving Credit Facility, after reductions of \$33 million for outstanding letters of credit. Our \$1 billion Revolving Credit Facility expires on October 23, 2012. We currently believe that our cash from operating activities together with our cash on hand and available borrowings under our Revolving Credit Facility will be adequate for the foreseeable future to meet our anticipated requirements for working capital, capital expenditures, defined benefit plan contributions, commitments, contingencies, research and development expenditures, business acquisitions (depending on the size), contingent purchase price payments on previous business acquisitions, program and other discretionary investments, interest payments, income tax payments, and, to the extent approved by our Board of Directors, L-3 Holdings dividends and share repurchases, and potential debt repurchases. Holders of our \$700 million Convertible Contingent Debt Securities (CODES) may require us to repurchase them in whole or in part at a cash repurchase price equal to 100% of the principal amount (plus accrued and unpaid interest, including contingent interest and additional interest, if any) through the exercise of a put option on February 1, 2011. In such an event, we intend to either complete a refinancing of all or a portion of the CODES, if we have the ability to do so on terms and conditions acceptable to us, or repurchase any amount of the CODES put to L-3 with cash on hand. The next scheduled maturity of our existing debt is our \$650 million 5 7/8% Senior Subordinated Notes maturing on January 15, 2015.

Our business may not continue to generate cash flow at current levels, and it is possible that currently anticipated improvements may not be achieved. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to reduce costs and expenses, sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing and we may not be able to do so on a timely basis, on satisfactory terms, or at all. Our ability to make scheduled principal payments or to pay interest on or to refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the U.S. defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

For a discussion of our recent debt issuance and repayments in the second and third quarters of 2010, which improved our debt maturity profile and reduced our cost of capital, see Financing Activities Debt on page 37.

**Balance Sheet**

Billed receivables increased by \$149 million to \$1,298 million at June 25, 2010, from \$1,149 million at December 31, 2009 primarily due to: (1) the timing of billings and collections mostly for government services and ISR systems, (2) higher sales primarily for EO/IR products to the U.S. Army, and (3) \$22 million of acquired billed receivables from the acquisition of Insight. These increases were partially offset by decreases for secure communications products and displays due to collections and \$11 million for foreign currency translation adjustments.

Contracts in process increased by \$150 million to \$2,545 million at June 25, 2010, from \$2,395 million at December 31, 2009. The increase included \$6 million primarily for acquired contracts-in-process, a \$7 million decrease for currency translation adjustments, a \$3 million reclassification from property, plant and equipment to inventoried contract costs, and a \$148 million increase from:

Increases of \$72 million in unbilled contract receivables primarily due to sales exceeding billings for aircraft modernization and networked communications, partially offset by decreases due to billings for government services and ISR systems; and



Increases of \$76 million in inventoried contract costs across several business areas, primarily networked communications systems, EO/IR products and displays to support customer demand.

L-3's receivables days sales outstanding (DSO) was 70 at June 25, 2010, compared with 66 at December 31, 2009 and 72 at June 26, 2009. We calculate our DSO by dividing: (1) our aggregate end of period billed receivables and net unbilled contract receivables, by (2) our trailing 12 month sales adjusted, on a pro forma basis, to include sales from business acquisitions and exclude sales from business divestitures that we completed as of the end of the period, multiplied by the number of calendar days in the trailing 12 month period (364 days at June 25, 2010, 365 days at December 31, 2009 and 364 days at June 26, 2009). Our trailing 12 month pro forma sales were \$15,846 million at June 25, 2010, \$15,621 million at December 31, 2009 and \$15,284 million at June 26, 2009.

The increase in inventories was primarily due to \$47 million of acquired inventories from the acquisition of Insight, partially offset by a decrease of \$11 million for foreign currency translation adjustments.

The decrease in current deferred income tax assets and other non-current liabilities (non-current income taxes payable) was due to an Internal Revenue Service tax accounting method change regarding compensation expense during the 2010 First Half.

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The increase in net property, plant and equipment (PP&E) was principally due to capital expenditures and \$59 million of acquired PP&E from the acquisition of Insight, partially offset by depreciation expense.

Goodwill increased by \$386 million to \$8,576 million at June 25, 2010 from \$8,190 million at December 31, 2009. The table below presents the changes in goodwill allocated to our reportable segments.

	C <sup>3</sup> ISR	Government Services	AM&M (in millions)	Electronic Systems	Consolidated Total
<b>Balance at December 31, 2009</b>	\$ 870	\$ 2,320	\$ 1,158	\$ 3,842	\$ 8,190
Business acquisition <sup>(1)</sup>				422	422
Foreign currency translation adjustments <sup>(2)</sup>	(4)	(1)	2	(33)	(36)
Segment reclassification <sup>(3)</sup>		(43)		43	
<b>Balance at June 25, 2010</b>	\$ 866	\$ 2,276	\$ 1,160	\$ 4,274	\$ 8,576

- (1) Represents acquisition of Insight. For further discussion regarding business acquisitions, see Note 4 to our unaudited condensed consolidated financial statements contained in this quarterly report.
- (2) The net decrease in goodwill from foreign currency translation adjustments is primarily due to the strengthening of the U.S. dollar against the Euro during the 2010 First Half.
- (3) As a result of a re-alignment of a business unit in our management and organizational structure as discussed in Note 2 to our unaudited condensed consolidated financial statements contained in this quarterly report, goodwill was reclassified from the Government Services reportable segment to the Electronic Systems reportable segment during the 2010 Second Quarter.

The increase in identifiable intangible assets was primarily due to the recognition of \$124 million of intangible assets for the acquisition of Insight, partially offset by amortization expense.

The increase in accrued employment costs was primarily due to the timing of payroll dates and payments for salaries and wages. The increase in accrued expenses was primarily due to the timing of when invoices were received for purchases from third-party vendors and subcontractors. The increase in income taxes payable is due primarily to assumed tax liabilities related to the Insight acquisition.

The increase in pension and postretirement benefit plan liabilities was primarily due to pension expenses exceeding pension cash contributions during the 2010 First Half. We expect to contribute cash of approximately \$140 million to our pension plans for all of 2010, of which \$44 million was contributed during the 2010 First Half.

Non-current deferred income tax liabilities increased primarily due to tax amortization of certain goodwill and other identifiable intangible assets.

**Statement of Cash Flows**

***First Half Ended June 25, 2010 Compared with First Half Ended June 26, 2009***

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

	<b>First Half Ended</b>	
	<b>June 25,</b>	<b>June 26,</b>
	<b>2010</b>	<b>2009</b>
	<b>(in millions)</b>	
Net cash from operating activities	\$ 589	\$ 528
Net cash used in investing activities	(688)	(162)
Net cash from (used in) financing activities	132	(346)

***Operating Activities***

We generated \$589 million of cash from operating activities during the 2010 First Half, an increase of \$61 million compared with \$528 million generated during the 2009 First Half. The increase was due to: (1) an increase in net income of \$25 million, and (2) higher non-cash expenses of \$44 million primarily due to higher deferred income taxes. These increases were partially offset by \$8 million of more net cash used for changes in operating assets and liabilities. The net cash used for changes in operating assets and liabilities is further discussed above under *Liquidity and Capital Resources* *Balance Sheet* beginning on page 35.

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### *Investing Activities*

During the 2010 First Half, we used \$688 million of cash in the aggregate primarily to: (1) acquire Insight for \$613 million, (2) pay \$64 million for capital expenditures and (3) invest \$9 million in an unconsolidated subsidiary accounted for using the equity method.

### *Financing Activities*

#### ***Debt***

At June 25, 2010, total outstanding debt was \$4,525 million, of which \$1,794 million was senior debt and \$2,731 million was subordinated debt and CODES, compared to \$4,112 million at December 31, 2009, of which \$996 million was senior debt and \$3,116 million was subordinated debt and CODES. At June 25, 2010, subject to certain conditions, borrowings available under our Revolving Credit Facility were \$967 million, after reduction for outstanding letters of credit of \$33 million. There were no borrowings outstanding under our Revolving Credit Facility at June 25, 2010. Our Revolving Credit Facility expires on October 23, 2012.

On May 21, 2010, L-3 Communications issued \$800 million in principal amount of 4.75% Senior Notes that mature on July 15, 2020 (2020 Senior Notes) at a discount of \$3 million. The effective interest rate of the 2020 Senior Notes is 4.79%. Interest on the 2020 Senior Notes is payable semi-annually on January 15 and July 15 of each year, commencing on January 15, 2011. The net cash proceeds from this offering amounted to approximately \$790 million after deducting the discounts, commissions and estimated expenses, and were used, together with cash on hand, to redeem L-3 Communications' 2013 and 2014 Notes. In connection with the redemption of the 2014 Notes, we recorded a debt retirement charge of approximately \$13 million (\$8 million after income tax, or \$0.07 per diluted share) during the 2010 Second Quarter. We will record a \$5 million (\$3 million after income tax, or \$0.02 per diluted share) debt retirement charge in the third quarter of 2010 related to the redemption of the 2013 Notes on July 15, 2010.

Excluding the 2013 Notes which were redeemed on July 15, 2010 and have been classified as a current liability at June 25, 2010, our outstanding debt has scheduled maturities between January 15, 2015 and August 1, 2035. In addition, holders of our CODES may require us to repurchase them in whole or in part at a cash price equal to 100% of the principal amount (plus accrued and unpaid interest, including contingent interest and additional interest, if any) through the exercise of a put option on February 1, 2011. As a result, the CODES have been classified as a current liability at June 25, 2010. See Note 9 to our unaudited condensed consolidated financial statements contained in this quarterly report for the components of our current and long-term debt at June 25, 2010.

*Debt Covenants and Other Provisions.* The Revolving Credit Facility, senior notes and senior subordinated notes contain financial and/or other restrictive covenants. See Note 10 to our audited consolidated financial statements for the year ended December 31, 2009, included in our Annual Report on Form 10-K, for a description of our debt and related financial covenants, including dividend payment and share repurchase restrictions and cross default provisions. As of June 25, 2010, we were in compliance with our financial and other restrictive covenants.

Under select conditions, including if L-3 Holdings' common stock price is more than 120% (currently \$118.73) of the then current conversion price (\$98.94 as of May 14, 2010) for a specified period, the conversion feature of the CODES will require L-3 Holdings, upon conversion, to pay the \$700 million principal amount in cash, and if the settlement amount exceeds the principal amount, the excess will be settled in cash or stock or a combination thereof, at our option. See Note 10 to our audited consolidated financial statements for the year ended December 31, 2009, included in our Annual Report on Form 10-K, for additional information regarding the CODES, including conditions for conversion. L-3 Holdings' closing stock price on July 29, 2010 was \$73.55 per share.

*Guarantees.* The borrowings under the Revolving Credit Facility are fully and unconditionally guaranteed by L-3 Holdings and by substantially all of the material wholly-owned domestic subsidiaries of L-3 Communications on an unsecured senior basis. The payment of principal and premium, if any, and interest on the senior notes are fully and unconditionally guaranteed, on an unsecured senior basis, jointly and severally, by L-3 Communications' material wholly-owned domestic subsidiaries that guarantee any of our other indebtedness. The payment of principal and premium, if any, and interest on the senior subordinated notes are fully and unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by L-3 Communications' wholly-owned domestic subsidiaries that guarantee any of our other indebtedness. The payment of principal and premium, if any, and interest on the CODES are fully and unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by L-3 Communications and its wholly-owned domestic subsidiaries that guarantee any of our other liabilities.

*Subordination.* The guarantees of the Revolving Credit Facility and the senior notes rank senior to the guarantees of the senior subordinated notes and the CODES and rank pari passu with each other. The guarantees of the senior subordinated notes and CODES rank pari passu with each other and are junior to the guarantees of the Revolving Credit Facility and senior notes.

**Table of Contents*****Equity***

Repurchases of L-3 Holdings common stock under the share repurchase programs, approved by the Board of Directors are made from time to time at management's discretion in accordance with applicable U.S. federal securities laws in the open market or otherwise. All share repurchases of L-3 Holdings' common stock have been recorded as treasury shares. On July 14, 2010, L-3 Holdings' Board of Directors approved a new share repurchase program that authorizes L-3 Holdings to repurchase up to an additional \$1 billion of its outstanding shares of common stock through December 31, 2012.

The table below presents our repurchases of L-3 Holdings common stock during the 2010 First Half.

	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Treasury Stock (at cost in millions)</b>
January 1 – March 26, 2010	1,381,372	\$ 89.29	\$ 123
March 27 – June 25, 2010	1,506,380	\$ 86.58	\$ 131

At June 25, 2010, the remaining dollar value under the share repurchase program approved by L-3 Holdings' Board of Directors on November 24, 2008 was \$172 million.

From June 26, 2010 through July 29, 2010, L-3 Holdings repurchased 1,043,286 shares of its common stock at an average price of \$71.89 per share for an aggregate amount of \$75 million.

During the 2010 First Half, L-3 Holdings' Board of Directors authorized the following quarterly cash dividends:

<b>Date Declared</b>	<b>Record Date</b>	<b>Cash Dividend Per Share</b>	<b>Date Paid</b>	<b>Total Dividends Paid (in millions)</b>
February 2, 2010	March 1, 2010	\$ 0.40	March 15, 2010	\$ 47
April 27, 2010	May 17, 2010	\$ 0.40	June 15, 2010	\$ 46

On July 13, 2010, L-3 Holdings' Board of Directors declared a quarterly cash dividend of \$0.40 per share, payable on September 15, 2010 to shareholders of record at the close of business on August 17, 2010.

**Legal Proceedings and Contingencies**

For a discussion of legal proceedings and contingencies that could impact our results of operations, financial condition or cash flows, see Note 17 to our unaudited condensed consolidated financial statements contained in this quarterly report.

### **Accounting Standards Issued and Not Yet Implemented**

For a discussion of accounting standards issued and not yet implemented, see Note 22 to our unaudited condensed consolidated financial statements contained in this quarterly report.

### **Forward-Looking Statements**

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

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

our dependence on the defense industry and the business risks peculiar to that industry, including changing priorities or reductions in the U.S. Government defense budget;

our reliance on contracts with a limited number of agencies of, or contractors to, the U.S. Government and the possibility of termination of government contracts by unilateral government action or for failure to perform;

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

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

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

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

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

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

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

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

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

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

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

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

global economic uncertainty;

the DoD's contractor support services in-sourcing initiative;

events beyond our control such as acts of terrorism;

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

our international operations, including sales to foreign customers;

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

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



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

the outcome of current or future litigation matters, including those that are expected to be resolved by jury trials, which are inherently risky and for which outcomes are difficult to predict;

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

the impact on our business of improper conduct by our employees, agents or business partners;

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

outcome of matters relating to the Foreign Corrupt Practices Act (FCPA);

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

significant increases in competitive pressure among companies in our industry; and

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

In addition, for a discussion of other risks and uncertainties that could impair our results of operations or financial condition, see Part I Item 1A Risk Factors and Note 19 to our audited consolidated financial statements, in each case included in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

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

**ITEM 3.**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

See Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Derivative Financial Instruments, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 for a discussion of our exposure to market risks. There were no material changes in those risks during the 2010 First Half. See Notes 15 and 16 to our unaudited condensed consolidated financial statements contained in this quarterly report for the aggregate fair values and notional amounts of our foreign currency forward contracts at June 25, 2010.

**ITEM 4.**

**CONTROLS AND PROCEDURES**

***Conclusions Regarding Effectiveness of Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934 related to L-3 Holdings and L-3 Communications is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's (SEC) rules and forms, and that such information is accumulated and communicated to our management, including our Chairman, President and Chief Executive Officer, and our Senior Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, with the participation of our Chairman, President and Chief Executive Officer, and our Senior Vice President and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 25, 2010. Based upon that evaluation and subject to the foregoing, our Chairman, President and Chief Executive Officer, and our Senior Vice President and Chief Financial Officer concluded that, as of June 25, 2010, the design and operation of our disclosure controls and procedures were effective to accomplish their objectives at the reasonable assurance level.

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 25, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****ITEM 1.****LEGAL PROCEEDINGS**

The information required with respect to this item can be found in Note 17 to our unaudited condensed consolidated financial statements contained in this quarterly report and is incorporated by reference into this Item 1.

**ITEM 1A.****RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**ITEM 2.****UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Issuer Purchases of Equity Securities**

The following table provides information about share repurchases made by L-3 Holdings of its common stock during the 2010 Second Quarter. Repurchases are made from time to time at management's discretion in accordance with applicable federal securities law. All share repurchases of L-3 Holdings' common stock have been recorded as treasury shares.

	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (in millions)</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares That May Yet be Purchased Under the Plans or Programs<sup>(1)</sup></b>
March 27 - April 30, 2010	247,079	\$ 94.46	247,079	\$ 279
May 1 - May 31, 2010	715,169	\$ 87.05	715,169	\$ 217
June 1 - June 25, 2010	544,132	\$ 82.38	544,132	\$ 172

Total	1,506,380	\$	86.58	1,506,380
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<sup>(1)</sup> All purchases of shares described in the table above were made pursuant to the \$1 billion share repurchase program approved by L-3 Holdings Board of Directors prior to July 14, 2010, which expires on December 31, 2010. On July 14, 2010, L-3 Holdings Board of Directors approved a new share repurchase program that authorizes L-3 Holdings to repurchase up to an additional \$1 billion of its outstanding shares of common stock through December 31, 2012.

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES**

**Not applicable**

**ITEM 4.**

**(REMOVED AND RESERVED)**

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**ITEM 5.**

**OTHER INFORMATION**

**Not applicable**

**ITEM 6.**

**EXHIBITS**

For a list of exhibits, see the Exhibit Index in this Form 10-Q.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned, thereunto duly authorized.

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

**L-3 COMMUNICATIONS CORPORATION**

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

Date: August 2, 2010

**Table of Contents****EXHIBIT INDEX**

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

<b>Exhibit No.</b>	<b>Description of Exhibits</b>
3.1	Certificate of Incorporation of L-3 Communications Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Registrants' Quarterly Report on Form 10-Q for the period ended June 30, 2002).
3.2	Amended and Restated By-Laws of L-3 Communications Holdings, Inc. (incorporated by reference to Exhibit 3(ii) to the Registrants' Current Report on Form 8-K filed on April 29, 2009).
3.3	Certificate of Incorporation of L-3 Communications Corporation (incorporated by reference to Exhibit 3.1 to L-3 Communications Corporation's Registration Statement on Form S-4 (File No. 333-31649)).
3.4	Amended and Restated Bylaws of L-3 Communications Corporation (incorporated by reference to Exhibit 3.2 to the Registrants' Current Report on Form 8-K filed on December 17, 2007).
*4.1	Form of Common Stock Certificate of L-3 Communications Holdings, Inc.
4.2	Credit Agreement, dated as of October 23, 2009, among L-3 Communications Corporation, L-3 Communications Holdings, Inc. and certain subsidiaries of the Registrants from time to time party thereto as guarantors, the lenders from time to time party thereto, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.1 to the Registrants' Current Report on Form 8-K dated October 26, 2009).
4.3	Indenture dated as of November 12, 2004 among L-3 Communications Corporation, the Guarantors and The Bank of New York Mellon (formerly known as The Bank of New York), as Trustee (incorporated by reference to Exhibit 4.1 to L-3 Communications Corporation's Registration Statement on Form S-4 (File No. 333-122499)).
4.4	Supplemental Indenture dated as of October 1, 2009 among L-3 Communications Corporation, The Bank of New York Mellon (formerly known as The Bank of New York), as trustee, and the guarantors named therein to the Indenture dated as of November 12, 2004 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York Mellon, as trustee (incorporated by reference to Exhibit 4.10 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended September 25, 2009).
4.5	Indenture dated as of July 29, 2005 (Notes Indenture) among L-3 Communications Corporation, the guarantors named therein and The Bank of New York Mellon (formerly known as The Bank of New York), as Trustee (incorporated by reference to Exhibit 10.69 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).
4.6	Supplemental Indenture dated as of October 1, 2009 among L-3 Communications Corporation, The Bank of New York Mellon (formerly known as The Bank of New York), as trustee, and the guarantors named therein to the Notes Indenture dated as of July 29, 2005 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York Mellon, as trustee (incorporated by reference to Exhibit 4.12 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended September 25, 2009).
4.7	Indenture dated as of July 29, 2005 (CODES Indenture) among L-3 Communications Holdings, Inc., the guarantors named therein and The Bank of New York Mellon (formerly known as The Bank of New York), as Trustee (incorporated by reference to Exhibit 10.70 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).
4.8	

- Supplemental Indenture dated as of October 1, 2009 among L-3 Communications Holdings, Inc., The Bank of New York Mellon (formerly known as The Bank of New York), as trustee, and the guarantors named therein to the CODES Indenture dated as of July 29, 2005 among L-3 Communications Holdings, Inc., the guarantors named therein and The Bank of New York Mellon, as trustee (incorporated by reference to Exhibit 4.14 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended September 25, 2009).
- 4.9 Indenture dated as of October 2, 2009 among L-3 Communications Corporation, the guarantors named therein and The Bank of New York Mellon, as Trustee (incorporated by reference to Exhibit 4.15 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended September 25, 2009).
- 4.10 Indenture, dated as of May 21, 2010, among L-3 Communications Corporation, the guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.1 to the Registrants' Current Report on Form 8-K dated May 24, 2010).
- 4.11 First Supplemental Indenture, dated as of May 21, 2010, among L-3 Communications Corporation, the guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.2 to the Registrants' Current Report on Form 8-K dated May 24, 2010).
- 10.1 Professional Services Agreement and Statement of Work, dated June 1, 2010, between L-3 Communications Corporation and Carl E. Vuono (incorporated by reference to Exhibit 10.1 to the Registrants' Current Report on Form 8-K dated June 7, 2010).



**Table of Contents**

<b>Exhibit No.</b>	<b>Description of Exhibits</b>
**11	L-3 Communications Holdings, Inc. Computation of Basic Earnings Per Share and Diluted Earnings Per Common Share.
*12	Ratio of Earnings to Fixed Charges.
*31.1	Certification of Chairman, President and Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
*31.2	Certification of Senior Vice President and Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities and Exchange Act, as amended.
*32	Section 1350 Certification.
*99.1	Administrative Agreement dated July 27, 2010 between L-3 Communications Holdings, Inc. and the United States Department of the Air Force.
99.2	L-3 Communications Holdings, Inc. Amended and Restated 2008 Long Term Performance Plan Restricted Stock Unit Agreement for Carl E. Vuono, as amended (incorporated herein by reference to Exhibit 99.1 to the Registrants' Current Report on Form 8-K dated April 30, 2010)
***101. INS	XBRL Instance Document
***101. SCH	XBRL Taxonomy Extension Schema Document
***101. CAL	XBRL Taxonomy Extension Calculation Linkbase Document
***101. LAB	XBRL Taxonomy Extension Label Linkbase Document
***101. PRE	XBRL Taxonomy Extension Presentation Linkbase Document
***101. DEF	XBRL Taxonomy Definition Linkbase Document

\* Filed herewith.

\*\* The information required in this exhibit is presented in Note 12 to the unaudited condensed consolidated financial statements as of June 25, 2010 in accordance with the provisions of ASC 260, *Earnings Per Share*.

\*\*\* Furnished electronically with this report.