L 3 COMMUNICATIONS HOLDINGS INC
Form 10-K/A
October 10, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

(Amendment No.1)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2013

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file numbers 001-14141 and 333-46983

L-3 COMMUNICATIONS HOLDINGS, INC.

L-3 COMMUNICATIONS CORPORATION

(Exact names of registrants as specified in their charters)

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

(212) 697-1111

(Telephone number)

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

Title of each class	Name of each exchange on which registered:
L-3 Communications Holdings, Inc. common stock, par value $0.01 per share	New York Stock Exchange

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

None.

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

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

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

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

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

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

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

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

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

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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EXPLANATORY NOTE

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

We are filing this Amendment No. 1 (this Amendment or Form 10-K/A) to our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 following the completion of the internal review of our Aerospace Systems segment, which is discussed below. Our Annual Report on Form 10-K for the year ended December 31, 2013 (the Form 10-K) was originally filed with the Securities and Exchange Commission (the SEC) on February 25, 2014, and subsequently updated for the re-alignment of our segments that occurred in the first quarter of 2014 and reported in our Current Report on Form 8-K filed with the SEC on May 2, 2014 (the Form 8-K and, together with the Form 10-K, the Original Form 10-K). At the time of filing our Form 10-K, we determined that our disclosure controls and procedures (DC&P) and our internal controls over financial reporting (ICFR) were each effective as of December 31, 2013.

This Amendment revises Part II, Item 9A, *Controls and Procedures*, as it relates to our conclusions regarding the effectiveness of our DC&P and our report on ICFR. As disclosed in our Current Report on Form 8-K filed with the SEC on September 26, 2014, as part of the findings from the internal review of the Aerospace Systems segment, we identified certain material weaknesses in our ICFR that existed as of December 31, 2013. Solely as a result of these material weaknesses, we have concluded that our DC&P and ICFR were not effective as of December 31, 2013.

In addition to the revision in Part II, Item 9A described above, this Amendment revises previously issued financial statements for: (1) accounting adjustments due to the internal review at our Aerospace Systems segment, (2) accounting error related to a sales-type lease transaction for flight simulator systems within our Electronic Systems segment, and (3) previously identified immaterial errors already recognized in our financial statements but not recorded in the appropriate periods. The accounting errors related to the sales-type lease transaction and immaterial out of period amounts are not related to the internal review at our Aerospace Systems segment.

See Items Amended by this Filing below for a description of the items of the Form 10-K that are being amended pursuant to this Amendment. Concurrently with the filing of this Amendment, we are also filing an amendment to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 28, 2014 (2014 First Quarter 10-Q/A), which revises that report for the items discussed above.

Controls and Procedures: As part of the internal review of our Aerospace Systems segment, discussed below, we identified material weaknesses in our ICFR. The material weaknesses, further discussed in Item 9A, *Controls and Procedures*, on page 73, are: (1) the Company did not maintain an effective control environment at its Aerospace Systems segment with respect to: (i) inadequate execution of existing controls around the annual review and approval of contract (revenue arrangement) estimates; (ii) not following established Company accounting policies, controls and procedures, and (iii) intentional override of numerous transactional and monitoring internal controls at our Army Sustainment division; and (2) Company personnel did not perform reviews of certain employee concerns regarding violations of our accounting policies and ICFR in a sufficient and effective manner.

Internal Review of Aerospace Systems Segment: We conducted an internal review related to instances of misconduct and accounting errors at our Aerospace Systems segment. This review was conducted with the assistance of outside legal and accounting advisors, and has been completed. As a result of the internal review, we identified and recorded aggregate pre-tax charges as follows: (1) $60 million for 2013, (2) $25 million for 2012, (3) $5 million for 2011, and

(4) $4 million for periods prior to 2011. Furthermore, our quarterly report on Form 10-Q for the three and six month periods ended June 27, 2014 and the 2014 First Quarter 10-Q/A also include aggregate pre-tax charges related to the internal review of Aerospace Systems segment. The aggregate pre-tax charge related to the internal review of Aerospace Systems segment for the three months ended

March 28, 2014 is approximately $20 million and for the three months ended June 27, 2014 is approximately $55 million.

The adjustments related to the internal review only affected the Logistics Solutions and Platform Systems sectors of the Aerospace Systems segment. The cumulative aggregate adjustments attributable to the Logistics Solutions sector are approximately $117 million, and at the Platform Systems sector are approximately $52 million. The Logistics Solutions sector adjustments relate to: (1) losses of $69 million with respect to the U.S. Army C-12 fixed-price maintenance and logistics support contract due to cost overruns inappropriately deferred, sales invoices inappropriately prepared, and the failure to timely and accurately perform contract estimates at completion and valuation assessments of inventories and receivables, at our Army Sustainment Division, and (2) accounting errors of $48 million in connection with the valuation of inventories and receivables, as well as the correction for certain accruals on other logistics support contracts. The Platform Systems sector adjustments are primarily due to: (1) losses of $37 million on two aircraft modification contracts and two contracts for rotary wing sub-assemblies and parts, and (2) write-offs of deferred costs of $15 million to design and test aerostructures for a new commercial aircraft.

Sales-Type Lease Transaction: We routinely perform on-site accounting and internal control review procedures on a rotational basis. As part of a previously planned review of our Simulation & Training business in the Electronic Systems segment and unrelated to the internal review at the Aerospace Systems segment, we evaluated the accounting treatment related to a sales-type lease transaction with the U.S. Army for rotary wing flight simulator systems. The period of performance under this contract began in 2004 and ends in 2023. Based on the results of this evaluation, we have adjusted our previously issued financial statements to: (1) increase interest income accretion on the net investment related to this sales-type lease transaction by an estimated aggregate amount of approximately $5 million for 2013, $3 million for each of 2012 and 2011 and $12 million for periods prior to 2011, and (2) decrease sales by approximately $7 million for 2013 and decrease cost of sales by approximately $7 million for 2013 and $5 million for periods prior to 2011. Furthermore, our quarterly report on Form 10-Q for the three and six month periods ended June 27, 2014 and the 2014 First Quarter 10-Q/A also include an increase in interest income accretion of $2 million and a decrease in sales of approximately $8 million and related decrease in cost of sales by approximately $7 million.

Out of Period Amounts: We had identified various out of period amounts included in our previously issued financial statements that were deemed to be immaterial individually and in the aggregate. In prior periods, in accordance with Accounting Standards Codification (ASC) 650-10-S99 and S55 (formerly Staff Accounting Bulletins (SAB) No. 99 and No. 108), *Accounting Changes and Error Corrections*, we concluded that these errors were, individually, and in the aggregate, not material, quantitatively or qualitatively, to the financial statements in the period recorded or to the relevant prior periods. Accordingly, we recorded these errors in our financial statements in the period that the error was identified. We are, on a voluntary basis, revising our previously issued financial statements to correct for these errors already recognized in our financial statements but not recorded in the appropriate periods to reflect them in the appropriate period. These out of period amounts were not discovered as part of the internal review of the Aerospace Systems segment discussed above, but rather represent previously identified errors resulting from mathematical mistakes, mistakes in application of generally accepted accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared, as defined in ASC 250-10-20 *Accounting Changes and Error Corrections.* We are, therefore, not treating these amounts as changes in estimates. These errors consist of: (1) increases in development and material costs related to Broadband Communication Systems that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (2) a sub-contractor subscription deposit that was recorded as sales and income in the fourth quarter of 2012 but should have been amortized to sales and income during 2013, (3) costs accrued in the fourth quarter of 2012 for goods or services received in the first quarter of 2013, (4) several unrecorded liabilities that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (5) a correction of accrued vacation that was recorded in the fourth quarter of 2013 but should have been recorded in the fourth quarter of 2012 and the first, second and third quarters of 2013, and

(6) a warranty reserve reduction recorded in the third quarter of 2012 that should have been recorded in the fourth quarter of 2011.

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With respect to each of the immaterial out of period amounts included in the Company s previously issued financial statements, the table below presents the: (1) nature of the adjustments, (2) applicable segment, (3) amount of increase (or decrease) to sales and operating income, (4) period recorded and (5) correct period.

		2013		2012		2011			
Nature of Adjustment	**Applicable Segment**	**Sales**	**Operating Income**	**Sales**	**Operating Income**	**Sales**	**Operating Income**	**Period Recorded**	**Correct Period**
					($ in millions)				
Higher development and material costs for networked communications systems	Communication Systems	$ 10	$ 10	$ (10)	$ (10)	$	$	1Q 2013	4Q 2012
Sub-contractor subscription deposit	Aerospace Systems	26	2	(26)	(2)			4Q 2012	1Q, 2Q, 3Q & Q4 2013
Costs accruals for goods/services received	Aerospace Systems	5	1	(5)	(1)			4Q 2012	1Q 2013
Unrecorded liabilities	Aerospace Systems	(2)		2				1Q 2013	4Q 2012
Accrued vacation	Aerospace Systems		1		(1)			4Q 2013	4Q 2012, 1Q, 2Q & 3Q 2013
Warranty reserve	Electronic Systems			3	(4)	(3)	4	3Q 2012	4Q 2011
Total		$ 39	$ 14	$ (36)	$ (18)	$ (3)	$ 4		

The table below presents the impact of the matters discussed above on sales and pre-tax income in total, for the six month period ended June 27, 2014, years ended December 31, 2013, 2012 and 2011, and for the years ended prior to December 31, 2011.

	Total		Six Months 2014		2013		2012		2011		Prior to 2011	
	Sales	**Pre-tax Income**	**Sales**	**Pre-tax Income**	**Sales**	**Pre-tax Income**	**Sales**	**Pre-tax Income**	**Sales**	**Pre-tax Income**	**Sales**	**Pre-tax Income**
						(in millions)						
Army C-12 Contract	$ (32)	$ (69)	$ (3)	$ (15)	$ (25)	$ (35)	$ (3)	$ (16)	$ (1)	$ (3)		
Other Logistics Support Contracts	(5)	(48)		(20)	(2)	(11)	(2)	(11)		(2)	(1)	(4)

Logistics Solutions	$ (37)	$ (117)	$ (3)	$ (35)	$ (27)	$ (46)	$ (5)	$ (27)	$ (1)	$ (5)	$ (1)	$ (4)
Platform Systems	(21)	(52)	(12)	(40)	(12)	(14)	3	2				
Total Internal Review of Aerospace Systems Segment	$ (58)	$ (169)	$ (15)	$ (75)	$ (39)	$ (60)	$ (2)	$ (25)	$ (1)	$ (5)	$ (1)	$ (4)
Sales-Type Lease Transaction	(15)	29	(8)	1	(7)	5		3		3		17
Out of Period Amounts					39	14	(36)	(18)	(3)	4		
Total Revisions	$ (73)	$ (140)	$ (23)	$ (74)	$ (7)	$ (41)	$ (38)	$ (40)	$ (4)	$ 2	$ (1)	$ 13

For additional information regarding the effect the adjustments above had on previously issued financial statements, see Note 3, on page F-15.

In accordance with ASC 650-10-S99 and S55, we performed an analysis to determine if the impact of the amounts disclosed above were material to previously issued financial statements. Based on that analysis, we believe that previously issued financial statements are not materially misstated on either a quantitative or qualitative basis. However, we believe that correcting these errors in the quarterly report on Form 10-Q for the second quarter of 2014 would, in the aggregate, cause a material misstatement to forecasted pre-tax income and net income for the fiscal year ending December 31, 2014. Accordingly, we are correcting these errors by revising our previously issued financial statements to record all the adjustments in the table above in the appropriate period.

Items Amended by this Filing

The following items of the Original Form 10-K are being amended:

- Part I Item 1. Business
- Part I Item 1A. Risk Factors
- Part II Item 6. Selected Financial Data
- Part II Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
- Part II Item 8. Financial Statements and Supplementary Data
- Part II Item 9A. Controls and Procedures
- Part IV Item 15. Exhibits and Financial Statement Schedules

Other than this Amendment and the 2014 First Quarter 10-Q Amendment, we do not intend to file any other amended Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for periods affected by the revisions. Future Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q will reflect the revisions for financial information included in this Amendment and the 2014 First Quarter 10-Q Amendment, as applicable.

This Amendment includes the updates for the matters discussed above. However, this Amendment does not reflect other subsequent information or events that have occurred after the filing date of the Form 10-K. Accordingly, this Amendment should be read in conjunction with our other filings with the SEC subsequent to the filing of the Form 10-K.

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L-3 COMMUNICATIONS HOLDINGS, INC.

L-3 COMMUNICATIONS CORPORATION

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PART I

Item 1. Business

Overview

L-3 Holdings, a Delaware corporation organized in April 1997, derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications. L-3 Communications, a Delaware corporation, is a prime contractor in aerospace systems and national security solutions. L-3 is also a leading provider of a broad range of communication and electronic systems and products used on military and commercial platforms. Our customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), allied international governments, and domestic and international commercial customers.

In the first quarter of 2014, we reorganized our business segments to better align our organizational structure with customer priorities and increase operational efficiencies. After the realignment, L-3 s structure consists of the following four segments: Aerospace Systems, Electronic Systems, Communication Systems and National Security Solutions, as further described below.

Aerospace Systems: combines the operations of the former Platform & Logistics Solutions (P&LS) segment with Intelligence, Surveillance and Reconnaissance (ISR) Systems. ISR Systems was part of the former Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR) segment. Aerospace Systems delivers integrated solutions for the global ISR market and provides modernization, upgrade, sustainment, and maintenance and logistics support for a wide variety of aircraft and ground systems. Aerospace Systems had 2013 net sales of approximately $4,551 million.

Electronic Systems: includes all of its previous businesses historically included in this segment except the Microwave Products businesses, which are now part of Communication Systems. Electronic Systems provides a broad range of components, products, subsystems, systems and related services for military and commercial customers. Electronic Systems had 2013 net sales of approximately $4,598 million.

Communication Systems: combines the operations of the Microwave Products businesses, which were previously part of the Electronic Systems segment, with the operations of the Networked and Secure Communications Products businesses, previously part of the former C^3ISR segment. Communication Systems delivers products and services for the global communications market, specializing in strategic and tactical airborne, space, ground and sea-based communication systems. Communication Systems had 2013 net sales of approximately $2,178 million.

National Security Solutions: remains unchanged. National Security Solutions will continue to provide cybersecurity solutions, high-performance computing, enterprise information technology (IT) services, analytics and intelligence analysis. National Security Solutions had 2013 net sales of approximately $1,295 million.

We have made certain reclassifications for matters specific to the segment realignment discussed above. Financial information for our segments, including sales by geographic area, is included in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 23 to our audited consolidated financial statements.

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For the year ended December 31, 2013, we generated sales of $12,622 million, operating income of $1,212 million and net cash from operating activities from continuing operations of $1,263 million. The table below presents a summary of our 2013 sales by major category of end customer. For a more detailed presentation of our sales by end customer, see Major Customers within this Business section.

	2013 Sales (in millions)	% of Total Sales
DoD	$ 8,589	68%
Other U.S. Government	597	5
Total U.S. Government	$ 9,186	73%
International (foreign governments)	1,747	14
Commercial international	1,067	8
Commercial domestic	622	5
Total sales	$ 12,622	100%

Business Strategy

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

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

Strengthen and Expand Our Market Positions. We intend to use our existing prime contractor and supplier positions and internal investments to increase our market share, grow our sales organically and continue to build strong businesses with durable discriminators that have a number one or number two market position. We intend to expand our prime contractor roles in select business areas where we have domain expertise, including aerospace systems and national security solutions. We expect to benefit from and expand our supplier positions to multiple bidders by leveraging our customer relationships and pursuing adjacent market opportunities. As an independent supplier of a broad range of products, subsystems and systems in several key business areas, our growth will partially be driven by

expanding our share of existing programs and participating in new programs. Teaming arrangements with other prime contractors and platform original equipment manufacturers is one way we intend to pursue select new business opportunities and expand our content on select platforms. We plan to maintain our diversified and broad business mix with limited reliance on any single contract, follow-on or new business opportunity. While sales to the U.S. Government, especially the DoD, will remain an integral part of L-3 s business, we also intend to continue to increase our sales from international and commercial businesses. We expect to continue to supplement our organic sales growth by acquiring, on a select basis, businesses that provide

attractive returns on investment and add new products, technologies, programs and contracts, or provide access to select DoD, other U.S. Government, international and/or commercial customers.

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

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

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

Achieve Outstanding Program Performance. We believe that outstanding performance on our existing programs and contracts in terms of on-budget, on-schedule and satisfying and exceeding technical and other contractual performance requirements, is the foundation for expanding L-3 s prime contractor and supplier positions and growing market share. We believe that a prerequisite for growing and winning new business is to retain our existing business by successfully meeting the performance criteria included in our contracts. We will continue to focus on delivering superior contract performance with affordable prices to our customers in order to maintain our reputation as an agile and responsive contractor and to differentiate ourselves from our competitors.

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

Business Acquisitions and Divestitures

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

Products and Services

Our four reportable segments provide a wide range of products and services to various customers and are described below. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Reportable Segment Results of Operations and Note 23 to our audited consolidated financial statements for financial information about each segment.

Aerospace Systems Reportable Segment

In 2013, Aerospace Systems net sales of $4,551 million represented 36% of our total net sales. The businesses in this reportable segment provide products and services for the global ISR market, specializing in signals

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intelligence (SIGINT) and communications intelligence (COMINT) systems. These products and services provide the warfighter with the ability to collect and analyze data from command centers, communication nodes and air defense systems for real-time situational awareness and response. The businesses in this reportable segment provide Command, Control and Communications (C^3) systems products for military and other U.S. Government and allied international government intelligence, reconnaissance and surveillance applications. We believe that these products and services are critical elements for a substantial number of major command, control and communication and intelligence gathering systems. The businesses in this reportable segment also provide modernization, upgrades and sustainment, maintenance and logistics support solutions for military and various government aircraft and other platforms. We sell these services primarily to the DoD, the Canadian Department of National Defence (DND) and other allied international governments. Major products and services for this reportable segment include:

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

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

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

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

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

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

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
ISR Systems		
Prime mission systems integration, sensor development and operations and support	Signal processing, airborne SIGINT applications, antenna technology, real-time process control and software development	U.S. Air Force (USAF), United Kingdom Ministry of Defence (U.K.MoD), and other allied international military ISR aircraft platforms and ground systems
Fleet management of special mission aircraft, including avionics and mission system upgrades and logistics support	Measurement collection and signal intelligence, special missions	DoD and classified customers within the U.S. Government
ISR operations and support	Data link support and services, special applications, classified projects, spares and repairs	USAF and U.S. Army ISR aircraft platforms and ground systems
Logistics Solutions		
Logistics support, maintenance and refurbishment	Aircraft maintenance repair and overhaul, flight operations support for training, cargo and special mission aircraft	U.S. Army, USAF, U.S. Navy (USN), Canadian Department of National Defence (DND) and other allied international militaries
Contract Field Teams (CFT)	Deployment of highly mobile, quick response field teams to customer locations to supplement the customer s resources for various ground vehicles and aircraft	U.S. Army, USAF, USN and U.S. Marine Corps (USMC)
Contractor Operated and Managed Base Supply (COMBS)	Inventory management activities relating to flight support and maintenance, including procurement and field distribution	Military training and cargo aircraft
Platform Systems		
Modernization and life extension maintenance upgrades and support	Aircraft structural modifications and inspections, installation of mission equipment, navigation and avionics products, interior modifications	USN, USAF, Canadian DND, Royal Australian Air Force, other allied international governments, original equipment manufacturers

		(OEMs), VIP and HOS aircraft, and various military fixed and rotary wing aircraft
Fabrication and assembly of fixed and rotary wing aeronautical structures	Rotary wing cabin assemblies, new and modified wings and subassemblies, and parts fabrication for OEMs	U.S. Army, USN, USMC, Canadian DND and OEMs

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Electronic Systems Reportable Segment

In 2013, Electronic Systems net sales of $4,598 million represented 36% of our total net sales. The businesses in this reportable segment provide a broad range of products and services, including components, products, subsystems, systems and related services to military and commercial customers in several niche markets. The table below provides a summary of the segment s business areas and the percentage that each contributed to Electronic Systems net sales in 2013.

Business Area	% of 2013 Segment Sales
Precision Engagement & Training	23%
Sensor Systems	21
Power & Propulsion Systems	19
Marine Systems International	11
Aviation Products	10
Warrior Systems	10
Security & Detection Systems	6
Total Electronic Systems	100%

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

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Precision Engagement & Training		
Military and commercial aircraft flight simulators, reconfigurable training devices, distributed mission training suites	Advanced simulation technologies and training for pilots, navigators, flight engineers, gunners and operators	Fixed and rotary winged aircraft and ground vehicles for USAF, USN, U.S. Army, Canadian DND, allied international militaries, commercial airlines and aircraft OEMs
Training services, courseware integrated logistics support and maintenance	Systems management, operations, and maintenance	Various DoD and allied international military customers
Vehicle driver training and courseware	Drive safety, efficiency, and productivity training	Various commercial transport companies
Unmanned systems and components	Tactical unmanned air systems (UAS), medium altitude long endurance (MALE) UAS, small expendable UAS, flight controls, sensors and remote	U.S. DoD and allied international ministries of defense

	viewing systems	
Radar-based sensors and systems	Electronic warfare, unmanned systems, ISR and precision-guided munitions	U.S. DoD and DHS

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Global Positioning System (GPS) receivers	Location tracking	Guided projectiles and precision munitions
Fuzing and ordnance systems	Precision munitions, fuzes, and electronic and electro safety arming devices (ESADs)	Various DoD and allied international military customers
Remote viewing video and exploitation systems	Portable situational awareness and video exploitation software and hardware for soldiers, ships and vehicles	USMC, USN and various DoD
Lightweight man portable computer/displays for dismounted soldiers	Situational awareness and connectivity for dismounted soldiers	U.K. MoD
Navigation systems and positioning navigation units	Satellite launch and orbiting navigation and navigation for ground vehicles and fire control systems	USAF, U.S. Army, USMC and NASA
Sensor Systems		
Targeted stabilized camera systems with integrated sensors and wireless communication systems	Intelligence data collection and surveillance and reconnaissance	DoD, intelligence and security agencies, law enforcement, manned/unmanned platforms
Submarine photonic systems and periscopes	Virginia class submarines	USN
Airborne and ground based high energy laser beam directors, laser designators and high tracking rate telescopes	Directed energy systems, space surveillance, satellite laser ranging and laser communications, airborne and ground target designation/illumination	USAF and National Aeronautics Space Administration (NASA)
Improvised Explosive Device (IED) Defense Systems	Vehicle based and manpack IED detection and jamming systems	U.K. MoD and international allies
Force protection, electronic warfare and satellite monitoring	Counter IED systems, jamming and satellite monitoring	U.K. MoD and other international security agencies and ministries of defense

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Power & Propulsion Systems		
Naval power delivery, conversion and switching products, and hybrid electric drives	Switching, distribution and protection, frequency and voltage conversion, propulsion motors and drive units	Naval submarines, surface ships and aircraft carriers
Automation, navigation, communications, and sensors and integrated Command, Control, Communications, Computers and Navigation (C^4N) solutions	Vessel bridge and machinery plant platform management systems, and C^4N systems	USN and allied international navies and other government agencies
Power plant simulation, modeling, computer systems, and training services	Submarines, nuclear and other power plants	Allied international navies, nuclear and other power plant companies
Airborne dipping sonars, submarine and surface ship towed arrays	Submarine and surface ship detection and localization	USN and allied international navies
Underwater sensor ranges	Monitor nuclear testing, track submarines and surface vessels	U.S. and international military and commercial customers
Service life extensions	Landing craft air cushion amphibious vehicle	USN
In-service engineering, ship repair, overhaul, upgrades and maintenance, and battle force tactical training	Embedded shipboard training systems, towed arrays, navigation systems, radar systems and electronic warfare systems	USN, U.S. Coast Guard (USCG), U.S. Army and commercial shipowners
Ballistic missile targets	Targets for ground based ballistic missile intercept systems	U.S. Missile Defense Agency (MDA)
Heavy fuel engines, cross drive variable transmissions, turret drive systems, vehicle suspension, advanced drive systems and auxiliary power generators	Power trains and suspension systems for military vehicles, power and energy management for military hybrid electric vehicles, non-portable and under armor auxiliary power units, and heavy fueled engines for unmanned systems	U.S. Army, USMC and allied international ministries of defense, manned/unmanned military platforms
High power microwave sources, systems & effects, pulse power systems and electromagnetics hardened construction	Forensic analysis of weapons of mass destruction, and active detection of special nuclear material.	U.K. MoD, U.S. Defense Threat Reduction Agency, U.S. Army and USAF

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Marine Systems International		
Integrated electrical power and electric propulsion packages, integrated automation, navigation, communication, and dynamic positioning systems, and audio/visual solutions and safety systems	Surface ships ranging from shipping vessels, container carriers, environmental, research and offshore construction ships, naval frigates, ferries, cruise liners and mega yachts	Commercial shipbuilders and shipowners and allied international navies
Aviation Products		
Solid state crash protected cockpit voice and flight data recorders	Aircraft voice and flight data recorders that continuously record voice and sounds from cockpit and aircraft intercommunications	Commercial transport, business, regional and military aircraft
Airborne traffic and collision avoidance systems, terrain awareness warning systems	Reduce the potential for midair aircraft collisions and crashes into terrain by providing visual and audible warnings and maneuvering instructions to pilots	Commercial transport, business, regional and military aircraft
Advanced cockpit avionics	Pilot safety, navigation and situation awareness products	Commercial transport, business, regional and military aircraft
Cockpit and mission displays	High performance, ruggedized flat panel and cathode ray tube displays and processors	Various military aircraft
Warrior Systems		
Enhanced vision and weapon sights products	Image intensified night vision goggles/sights, holographic weapon sights, thermal sights and images, and driver viewers for special forces, pilots and aircrews, soldiers, marines, sailors and law enforcement personnel	U.S. Army, USN, USMC, DHS, allied international militaries and law enforcement agencies
Laser designation and range finder systems	Airborne and ground target designation/illumination	DoD, law enforcement and allied international customers
Weapons Training Systems	Laser marksmanship training systems and advanced integrated technologies for security products and services	DoD and law enforcement agencies

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Security & Detection Systems		
Airport security systems, explosives detection systems and whole body imaging systems	Rapid scanning of passenger checked baggage and carry-on luggage, scanning of large cargo containers	DHS, including the U.S. Transportation Security Administration (TSA), domestic and international airports and state and local governments
Non-invasive security systems and portals, and sophisticated sensors with threat detection capabilities	Aviation, rail and border crossing security	TSA, U.S. Customs and Border Protection agency, various regulatory authorities and private security companies

Communication Systems Reportable Segment

In 2013, Communication Systems net sales of $2,178 million represented 18% of our total net sales. The businesses in this reportable segment provide networked communication systems, secure communications products, radio frequency components, satellite communication terminals, and space, microwave and telemetry products. These products are used to connect a variety of space, airborne, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Major products and services for this reportable segment include:

- microwave products, including passive and active microwave components and subsystems, radar antennas and radomes, power devices and mobile and ground-based satellite communications systems;
- secure data links that enable real-time information collection and dissemination to users of networked communications for airborne, satellite, ground and sea-based remote platforms, both manned and unmanned;
- secure terminal and communication network equipment and encryption management; and
- communication systems for surface and undersea vessels and manned space flights.

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

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Space & Power Systems		
Passive and active microwave components and subsystems and	Radio transmission, switching and conditioning, transponder control,	DoD and OEMs, satellite communications (SATCOM) for

non-ionizing radiation monitoring equipment	channel and frequency separation, ground vehicles, aircraft and satellites	DoD and various government agencies

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Traveling wave tubes, power modules, klystrons and digital broadcast	Microwave vacuum electron devices and power modules	DoD and allied international military manned/unmanned platforms, including satellites, radar systems, communication systems, unmanned aerial vehicles (UAVs), missile defense systems, various missile programs and commercial broadcast
Telemetry and instrumentation systems	Spacecraft telemetry tracking and control, encryption and high data rate transmitters, satellite command and control software, airborne and ground test telemetry systems, and tactical intelligence receivers	Aircraft, missiles and satellites
Tactical Satellite Communications Products		
Quick-deploy flyaway very small aperture terminals (VSAT) and vehicular satellite systems	Satellite communication systems	U.S. Army, USAF and various DoD agencies
Ultra-wide frequency and advanced radar antennas and radomes	Surveillance and radar detection	Military fixed and rotary winged aircraft, SATCOM
Broadband Communication Systems		
Airborne, space and surface data link terminals, ground stations, and transportable tactical SATCOM systems	High performance, wideband secure communication links for relaying of intelligence and reconnaissance information	Manned aircraft, UAVs, naval ships, ground vehicles and satellites for the DoD
Multi-band Manpack Receivers	Portable, ruggedized terminals used for receiving reconnaissance video and sensor data from multiple airborne platforms	U.S. Special Operations Command (USSOCOM), USAF and other DoD customers
COMSEC & Specialty RF Products		
Secure communications terminals and equipment, and secure network encryption products	Secure and non-secure voice, data and video communication for office, battlefield and secure internet protocol (IP) network applications	DoD and U.S. Government intelligence agencies

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Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Ground-based satellite communications terminals and payloads	Interoperable, transportable ground terminals	DoD and U.S. Government intelligence agencies
Shipboard communications systems	Internal and external communications (radio rooms)	USN, USCG and allied international navies
High dynamic small aperture Ku/Ka-band receive/transmit systems	Off road use on military vehicles, watercraft, and airborne platforms to provide two-way broadband connectivity while on the move	U.S. Army and various DoD agencies
Tactical ground based signal intercept and direction finding systems	Man portable and military vehicle mounted tactical signal intercept/exploitation and direction finding systems	U.S. Army and other DoD/U.S. intelligence agencies
Managed satellite networks and integrated remote VSAT satellite systems	Deployment and support of global communication networks for tactical and enterprise applications	U.S. Army, DoD/U.S. intelligence agencies, allied forces and commercial contractors
Multi-frequency time division multiple access modems and terminals that support SATCOM on the move using X, Ku, and Ka bands	On the move SATCOM and other tactical communications systems utilizing small aperture terminals	U.S. Army, USMC, and select international allies

National Security Solutions (NSS) Reportable Segment

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

- providing solutions and systems for secure communications, information systems networks and mobile devices and ensuring the integrity of information to enable trusted, interconnected, and resilient networks;
- providing operational enterprise IT solutions that help keep our customers relevant in their dynamic mission environment;
- developing solutions and systems for our customers that enable available data to be used more effectively to provide assessments, gain and maintain situation awareness, support decision-making, improve operations, and bring about customers desired effects;

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

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

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

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

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Funded Backlog and Orders

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

	Funded Backlog at December 31,		Percentage of Funded Backlog at December 31, 2013 Expected to be Recorded as	Funded Orders	
	2013	2012	Sales in 2014	2013	2012
	(in millions)			(in millions)	
Reportable Segment:					
Aerospace Systems	$ 3,498	$ 3,758	69%	$ 4,304	$ 5,024
Electronic Systems	4,421	4,407	59%	4,594	4,714
Communication Systems	1,867	2,054	68%	1,991	2,629
NSS	582	710	89%	1,167	1,431
Consolidated	$ 10,368	$ 10,929	66%	$ 12,056	$ 13,798

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

Major Customers

The table below presents a summary of our sales by end customer and the percent contributed by each to our total sales. For additional information regarding domestic and international sales, see Note 23 to our audited consolidated financial statements.

	2013 Sales (in millions)	2013 % of Total Sales	2012 Sales (in millions)	2012 % of Total Sales
Air Force	$ 3,393	27%	$ 3,570	27%
Army	2,376	19	2,811	21
Navy/Marines	1,794	14	1,896	15
Other Defense	1,026	8	1,059	8

Total DoD	$	8,589	68%	$	9,336	71%
Other U.S. Government		597	5		650	5
Total U.S. Government	$	9,186	73%	$	9,986	76%
International (foreign governments)		1,747	14		1,463	11
Commercial international		1,067	8		986	8
Commercial domestic		622	5		672	5
Total sales	$	12,622	100%	$	13,107	100%

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

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

Research and Development

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

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

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

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

Competition

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

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

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

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

historical, technical, cost and schedule performance;

our ability to attain supplier positions on contracts;

our ability to maintain an effective supplier and vendor base;

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

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

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

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

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

Patents and Licenses

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

Raw Materials

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

Contracts

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

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may

reduce our profit or cause us to sustain losses on the contract. Accounting for the sales on a fixed-price type contract that is covered by contract accounting standards requires the preparation of estimates for: (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract s statement of work, and (3) the measurement of progress towards completion. Adjustments to original estimates for a contract s revenue, estimated costs at completion and estimated total profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change.

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

	Year Ended December 31,		
	2013	**2012**	**2011**
Sales from Cost-Plus Contracts with:		**(in millions)**	
Award fees	$ 556	$ 621	$ 663
Incentive fees	557	711	842
Performance based fees	$ 1,113	$ 1,332	$ 1,505

	Year Ended December 31,		
	2013	**2012**	**2011**
Percentage of Available Performance Based Award Fees Achieved	91%	91%	91%

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

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

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

Regulatory Environment

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

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

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

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

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

Environmental Matters

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

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

Employees

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

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

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L-3 Holdings Obligations

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

Available Information

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

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

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

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

Item 1A. Risk Factors

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

We have determined that material weaknesses exist in our internal control over financial reporting which could, if not remediated, have a material adverse impact on our ability to produce timely and accurate financial statements.

We are responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. As discussed in Item 9A on page 73, we identified material weaknesses in our internal control over financial reporting as of December 31, 2013. Solely as a result

of these material weaknesses, we concluded that our internal control over financial reporting were not effective as of December 31, 2013 and that our disclosure controls and procedures were not effective as of December 31, 2013.

A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Although we continue to devote significant time and attention to remedy the identified material weaknesses in internal control over financial reporting, we do not expect that our internal control over financial reporting will be considered effective as of December 31, 2014 because we do not expect to complete our testing of the remediated controls by such time. See Item 9A beginning on page 73 for a description of the identified material weaknesses and related remediation plan. In addition, our remedial efforts may not be successful. Until our remediation plan is fully implemented, our management will continue to devote significant time and attention to these efforts. If we do not complete our remediation in a timely fashion, or at all, or if our remediation plan is inadequate or we encounter difficulties in the implementation or maintenance of our internal control over financial reporting or disclosure controls and procedures, there will continue to be an increased risk that we will be unable to timely file future periodic reports with the SEC and/or remain in compliance with certain covenants included in our outstanding debt agreements. In addition, any failure to implement or any difficulties we encounter with our remediation plan could result in additional material weaknesses or deficiencies in our internal control or future material misstatements in our annual or interim consolidated financial statements.

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

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

Our government contracts and sales are highly correlated and dependent upon the U.S. defense budget which is subject to the congressional budget authorization and appropriations process. Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress in future fiscal years. DoD budgets are a function of factors beyond our control, including, but not limited to, changes in U.S. procurement policies, budget considerations, current and future economic conditions, presidential administration priorities, changing national security and defense requirements, geopolitical developments and actual fiscal year congressional appropriations for defense budgets. Any of these factors could result in a significant decline in, or redirection of, current and future DoD budgets and impact our future results of operations, including our sales and operating income growth rates.

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

cash flows.

In addition, in the event that the federal debt limit is met, we may be required to continue to perform for some period of time on certain of our U.S Government contracts even if the U.S Government is unable to make timely payments. Furthermore, such limits could also potentially delay program/contract start dates or the U.S

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Government may issue a stop work order and choose to either resume the work or terminate the contract altogether. Any of these events would likely result in a material adverse effect on our financial position, results of operations and cash flows.

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

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

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

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

- curtailment of the U.S. Government s use of technology or other services and product providers, including curtailment due to government budget reductions and related fiscal matters;
- developments in Afghanistan or other geopolitical developments that affect demand for our products and services;
- our ability to hire and retain personnel to meet increasing demand for our services; and
- technological developments that impact purchasing decisions or our competitive position.

The DoD s wide-ranging efficiency and better buying power initiatives, which target affordability and cost growth, could have a material effect on the procurement process and may adversely affect our existing contracts and the award of new contracts.

The DoD has implemented best practices to the procurement process that are intended to control cost growth throughout the acquisition cycle by developing a competitive strategy for each program. As a result, the Company has and continues to engage in more frequent negotiations and re-competitions on a cost or price analysis basis with every

competitive bid in which it participates. This initiative is organized into seven focus areas: affordability, cost control, productivity incentives and innovation, competition, services acquisition, and improved professionalism. This initiative significantly changed the way the U.S. Government solicits, negotiates and manages its contracts and could result in a reduction in expenditures for the type of products we manufacture for, and services we provide to, the U.S. Government, which could have a material negative impact on our future sales, earnings and cash flows.

In addition, the FY 2013 DoD budget reduced contractor support services and consolidation of enterprise IT systems as part of an effort to achieve another $60 billion of efficiency savings over the five fiscal years FY 2013 through FY 2017. This initiative primarily affects our businesses within the National Security Solutions reportable segment and could result in the loss of certain of our existing contracts (revenue arrangements) depending on how the DoD implements this initiative.

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Our government contracts contain unfavorable termination provisions and are subject to audit and modification. If a termination right is exercised by the government, it could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Companies engaged primarily in supplying defense-related equipment and services to U.S. Government agencies are subject to certain business risks peculiar to the defense industry. These risks include the ability of the U.S. Government to unilaterally:

- suspend us from receiving new contracts pending resolution of alleged violations of procurement laws or regulations;
- terminate existing contracts;
- reduce the value of existing contracts; and
- audit our contract-related costs and fees, including allocated indirect costs.

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

U.S. Government agencies, including the Defense Contract Audit Agency and various agency Inspectors General, routinely audit and investigate our costs and performance on contracts, as well as our accounting and general business practices. Based on the results of such audits, the U.S. Government may adjust our contract related costs and fees, including allocated indirect costs. In addition, under U.S. Government purchasing regulations, some of our costs, including certain business acquisition costs, most financing costs, portions of research and development costs, and certain marketing expenses may not be reimbursable under U.S. Government contracts.

We currently have a backlog of funded orders, primarily under contracts with the U.S. Government. Our total funded backlog was $10,368 million at December 31, 2013. As described above, the U.S. Government may unilaterally modify or terminate its contracts with us. Accordingly, most of our backlog could be modified or terminated by the U.S. Government, which would negatively impact our future sales, results of operations and cash flows.

We may not be able to win competitively awarded contracts or receive required licenses to export our products, which could have a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects.

Our government contracts are subject to competitive bidding. We obtain many of our U.S. Government contracts through a competitive bidding process. We may not be able to continue to win competitively awarded contracts. In addition, awarded contracts may not generate sales sufficient to result in our profitability. We are also subject to risks associated with the following:

the frequent need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties and/or cost overruns;

the substantial time, effort and experience required to prepare bids and proposals for competitively awarded contracts that may not be awarded to us;

design complexity and rapid technological obsolescence; and

the constant need for design improvement.

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In addition to these U.S. Government contract risks, we are not permitted to export some of our products and are also required to obtain licenses from U.S. Government agencies to export many of our products and systems. Failure to receive required licenses would eliminate our ability to sell our products and systems outside the United States.

Intense competition and bid protests may adversely affect our sales, results of operations and cash flows.

The defense and commercial industries in which our businesses operate are highly competitive. We expect that the DoD s increased use of commercial off-the-shelf products and components in military equipment will continue to encourage new competitors to enter the market. We also expect increased competition for our products and services from other providers due to the uncertainty of future U.S. defense budgets. Furthermore, the current competitive environment has resulted in an increase of bid protests from unsuccessful bidders, which typically extends the time until work on a contract can begin. Additionally, some of our competitors are larger than we are and have more financial and other resources than we have. For more information concerning the factors that affect our ability to compete, see Part I Item 1 Business Competition.

We are subject to government investigations, which could have a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects.

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. As discussed in Note 20 to our audited consolidated financial statements, we are currently cooperating with the U.S. Government on several investigations. Under U.S. Government regulations, an indictment of the Company by a federal grand jury, or an administrative finding against us as to our present responsibility to be a U.S. Government contractor or subcontractor, could result in us 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 us that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specific term.

We are subject to the risks of current and future legal proceedings, which could have a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects.

At any given time, we are a defendant in various material legal proceedings and litigation matters arising in the ordinary course of business, including litigation, claims and assessments that have been asserted against acquired businesses, which we have assumed. Although we maintain insurance policies, these policies may not be adequate to protect us from all material judgments and expenses related to current or future claims and may not cover the conduct that is the subject of the litigation. Desired levels of insurance may not be available in the future at economical prices or at all. In addition, we believe that while we have valid defenses with respect to legal matters pending against us, the results of litigation can be difficult to predict, including those involving jury trials. Accordingly, our current judgment as to the likelihood of our loss (or our current estimate as to the potential range of loss, if applicable) with respect to any particular litigation matter may turn out to be wrong. A significant judgment against us, arising out of any of our current or future legal proceedings and litigation, could have a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects. For a discussion of material litigation to which we are currently a party, see Note 20 to our audited consolidated financial statements.

If we are unable to keep pace with rapidly evolving products and service offerings and technological change, there could be a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects.

The rapid change of technology is a key feature of most of the markets in which our products, services and systems oriented businesses operate. To succeed in the future, we will need to continue to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. Historically, our technology has been developed through customer-funded and internally funded research and development and through certain business acquisitions. We may not be able to continue to maintain

comparable levels of research and development or successfully complete such acquisitions. In the past, we have allocated substantial funds to capital expenditures, programs and other investments. This practice will continue to be required in the future. Even so, we may not be able to successfully identify new opportunities and may not have the necessary financial resources to develop new products and systems in a timely or cost-effective manner. At the same time, products and technologies developed by others may render our products, services and systems obsolete or non-competitive.

Goodwill represents a significant asset on our balance sheet and may become impaired.

Goodwill represents the largest asset on our balance sheet, with an aggregate balance of $7,796 million at December 31, 2013. We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also review goodwill annually in accordance with the accounting standards for goodwill and intangible assets. The annual impairment test requires us to determine the fair value of our reporting units in comparison to their carrying values. A decline in the estimated fair value of a reporting unit could result in a goodwill impairment, and a related non-cash impairment charge against earnings, if estimated fair value for the reporting unit is less than the carrying value of the net assets of the reporting unit, including its goodwill.

Our annual impairment tests at November 30, 2013 and 2012 did not result in impairments to goodwill; we did record a non-cash goodwill impairment charge of $43 million as a result of our annual impairment test at November 30, 2011. The fair value of four of our reporting units exceeded the carrying value of the net assets of those reporting units by 20% or less at November 30, 2013, the date of our annual impairment assessment. These four reporting units had aggregate goodwill of approximately $2,861 million. The estimated fair values of our reporting units could be negatively impacted by potential additional reductions to the DoD budget that impact our programs, including how sequestration cuts will be implemented in FY 2015 and future fiscal year DoD budgets. A decline in the estimated fair value of one or more of our reporting units could potentially trigger goodwill impairment charges and a material adverse effect on our results of operations. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Goodwill and Identifiable Intangible Assets for further discussion.

Our results of operations and cash flows are substantially affected by our mix of fixed-price, cost-plus and time-and-material type contracts.

Our sales are transacted using written revenue arrangements, or contracts, which are generally fixed-price, cost-plus or time-and-material. For a description of our revenue recognition policies, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies. The table below presents the percentage of our total sales generated from each contract type.

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

Substantially all of our cost-plus and time-and-material type contracts are with the U.S. Government, primarily the DoD. Substantially all of our sales to commercial customers are transacted under fixed-price sales arrangements and are included in our fixed-price type contract sales.

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract.

On a cost-plus type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit, which can be fixed or variable depending on the contract s fee arrangement up to predetermined funding levels established by our customers. On a time-and-material type contract (revenue arrangement), we are paid on the basis of direct labor hours expended at specified fixed-price hourly rates (that include wages, overhead, allowable general and administrative expenses and profit) and materials at cost. Therefore, on cost-plus and time-and-material type contracts, we do not bear the risks of unexpected cost overruns, provided that we do not incur costs that exceed the predetermined funded amounts.

Additionally, the impact of revisions in profit or loss estimates for all types of contracts subject to percentage of completion accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. Provisions for anticipated losses on contracts are recorded in the period in which they become evident. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as reduce the valuations of receivables and inventories; and in some cases, result in liabilities to complete contracts in a loss position.

Pension expense and funding may fluctuate significantly because of changes in key estimates and assumptions, including discount rates and assumed long-term rate of return on assets, as well as our actual investment returns and regulatory actions, which could negatively impact our results of operations, cash flows and financial condition.

Determining our pension expense requires significant judgment, particularly with respect to our discount rates, assumed long-term rate of return on assets and other actuarial assumptions. If our assumptions change significantly due to changes in economic, legislative, demographic experience and/or circumstances, our pension expense, the funded status of our plans and our cash contributions to such plans would be impacted, which could negatively affect our results of operations, cash flows and financial condition. In addition, differences between our actual investment returns and our assumed long-term rate of return on assets could also impact our pension expense, the funded status of our plans and our required cash contributions to the plans. Further, our pension expense and the funded status of our plans, including required cash contributions to the Plans, may be impacted by regulatory actions in any given year.

Additionally, pension plan cost recoveries under Cost Accounting Standards (CAS) for our U.S. Government contracts occur in different periods from when pension expense is recognized under accounting principles generally accepted in the U.S. or when cash contributions are made. Although CAS has been revised to better align the minimum required contributions under the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act of 2006, and pension plan cost recoveries under CAS, timing differences could have a material adverse effect on our cash flow.

Our business could be negatively impacted by security threats and other disruptions.

As a U.S. defense contractor, we face various security threats, including threats to the physical security of our facilities and employees, cyber security attacks to our information technology infrastructure and attempts to gain access to our proprietary or classified information as well as the proprietary or classified information of our customers. Although we utilize various procedures and controls to monitor, deter and mitigate these threats, these procedures and controls may not be sufficient to prevent disruptions in mission critical systems, the unauthorized release of confidential, sensitive or classified information and the corruption of data. Accordingly, any significant operational delays, or any destruction, manipulation or improper use of our data or of our customers, information systems or networks could adversely affect our financial results and damage the reputation for our products and services.

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Our sales to certain international customers expose us to risks associated with operating internationally.

For the year ended December 31, 2013, sales to international customers, excluding our international sales made under FMS agreements directly between the U.S. Government and allied international governments, represented approximately 17% of our consolidated sales. Consequently, our businesses are subject to a variety of risks that are specific to international operations, including the following:

- export regulations that could erode profit margins or restrict exports;
- compliance with the U.S. Foreign Corrupt Practices Act and similar non-U.S. regulations;
- the burden and cost of compliance with foreign laws, treaties and technical standards and changes in those regulations;
- contract award and funding delays;
- potential restrictions on transfers of funds;
- currency fluctuations;
- import and export duties and value added taxes;
- transportation delays and interruptions;
- uncertainties arising from international local business practices and cultural considerations; and
- potential military conflicts and political risks.

While we have and will continue to adopt measures to reduce the potential impact of losses resulting from the risks of our international business, we cannot ensure that such measures will be adequate.

If we are unable to attract and retain key management and personnel, we may become unable to operate our business effectively.

Our future success depends to a significant degree upon the continued contributions of our management, and our ability to attract and retain highly qualified management and technical personnel, including employees who have U.S. Government security clearances, particularly clearances of top-secret and above. We do not maintain any key person life insurance policies for members of our management. We face competition for management and technical

personnel from other companies and organizations. Failure to attract and retain such personnel would damage our future prospects.

Environmental laws and regulations may subject us to significant liability.

Our operations are subject to various U.S. federal, state and local as well as certain foreign environmental laws and regulations within the countries in which we operate relating to the discharge, storage, treatment, handling, disposal and remediation of certain materials, substances and wastes used in our operations.

New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean-up requirements may require us to incur a significant amount of additional costs in the future and could decrease the amount of cash flow available to us for other purposes, including capital expenditures, research and development and other investments and could have a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects.

Our business acquisition strategy involves risks, and we may not successfully implement our strategy.

We opportunistically seek to acquire businesses that enhance our capabilities and add new technologies, products, services, programs, contracts, and customers to our existing businesses. We may not be able to

continue to identify acquisition candidates on commercially reasonable terms or at all. If we make additional business acquisitions, we may not realize the benefits anticipated from these acquisitions, including sales growth, cost synergies and improving margins. Furthermore, we may not be able to obtain additional financing for business acquisitions, since such additional financing could be restricted or limited by the terms of our debt agreements or due to unfavorable capital market conditions.

The process of integrating the operations of acquired businesses into our existing operations may result in unforeseen difficulties and may require significant financial and managerial resources that would otherwise be available for the ongoing development or expansion of our existing operations. Possible future business acquisitions could result in the incurrence of additional debt and related interest expense and contingent liabilities, each of which could result in an increase to our already significant level of outstanding debt, as well as more restrictive covenants.

We consider and may enter into strategic business acquisitions on an ongoing basis and may be evaluating acquisitions or engaging in acquisition negotiations at any given time. We regularly evaluate potential acquisitions and joint venture transactions and have not entered into any agreements with respect to any material transactions at this time. Furthermore, in certain of our business acquisitions we have assumed all claims against and liabilities of the acquired business, including both asserted and unasserted claims and liabilities.

Our Amended and Restated Revolving Credit Facility and Senior Notes restrict our ability to finance our future operations and, if we are unable to meet our financial ratios, could cause our existing debt to be accelerated.

Our Amended and Restated Revolving Credit Facility and Senior Notes contain certain significant covenants that, among other things, include, depending on the debt instrument, restrictions on our ability to:

- sell assets;
- incur more indebtedness;
- create liens;
- make certain investments or business acquisitions;
- engage in business mergers or consolidations; and
- engage in certain transactions with subsidiaries and affiliates.

These restrictions could impair our ability to finance our future operations or capital needs or engage in other business activities that may be in our interest. In addition, our Amended and Restated Revolving Credit Facility also requires us to maintain compliance with certain financial ratios, including (1) total consolidated earnings before interest, taxes, depreciation and amortization to total consolidated cash interest expense, (2) total consolidated funded indebtedness less designated cash balances to total consolidated earnings before interest, taxes, depreciation and amortization, and

(3) consolidated senior indebtedness less designated cash balances to consolidated earnings before interest, taxes, depreciation and amortization. Our ability to comply with these ratios and covenants may be affected by events beyond our control. A breach of any of these agreements or our inability to comply with the required financial ratios or covenants could result in a default under those debt agreements. In the event of any such default, the lenders under those debt agreements could elect to declare all outstanding debt, accrued interest and fees to be due and immediately payable.

For further discussion of our financial ratios, debt agreements and other payment restrictions, see Note 11 to our audited consolidated financial statements.

Our significant level of debt and our ability to make payments on or service our indebtedness may adversely affect our financial and operating activities or our ability to incur additional debt.

At December 31, 2013, we had approximately $3,639 million in aggregate principal amount of outstanding debt and the availability of substantially all of our Amended and Restated Revolving Credit Facility which

expires on February 3, 2017. In the future, we may increase our borrowings, subject to any limitations imposed on us by our debt agreements. The first scheduled maturity of our existing debt is our $500 million aggregate principal amount of our 3.95% Senior Notes maturing November 15, 2016. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Debt and Note 11 to our audited consolidated financial statements.

Our ability to make scheduled payments of principal and interest on our indebtedness and to refinance our existing debt depends on our future financial performance as well as our ability to access the capital markets, and the relative attractiveness of available financing terms. We do not have complete control over our future financial performance because it is subject to economic, political, financial (including credit market conditions), competitive, regulatory and other factors affecting the aerospace and defense industry, as well as commercial industries in which we operate. It is possible that in the future our businesses may not generate sufficient cash flow from operations to allow us to service our debt and make necessary capital expenditures. If this situation occurs, we may have to reduce costs and expenses, sell assets, restructure debt or obtain additional equity capital. We may not be able to do so in a timely manner or upon acceptable terms in accordance with the restrictions contained in our debt agreements. Our level of indebtedness has important consequences to us. These consequences may include:

- requiring a substantial portion of our net cash flow from operations to be used to pay interest and principal on our debt and therefore be unavailable for other purposes, including acquisitions, capital expenditures, paying dividends to our shareholders, repurchasing shares of our common stock, research and development and other investments;

- limiting our ability to obtain additional financing for acquisitions, working capital, investments or other expenditures, which, in each case, may limit our ability to carry out our acquisition strategy;

- increasing interest expense due to higher interest rates on our Amended and Restated Revolving Credit Facility as it has a variable interest rate;

- heightening our vulnerability to downturns in our business or in the general economy and restricting us from making acquisitions, introducing new technologies and products or exploiting business opportunities; and

- impacting debt covenants that limit our ability to borrow additional funds or dispose of assets. Failure to comply with such covenants could result in an event of default which, if not cured or waived, could result in the acceleration of our outstanding indebtedness.

Additionally, on December 31, 2013, we had $8,181 million of contractual obligations (including outstanding indebtedness). For a detailed listing of the components of our contractual obligations, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations.

The Company s spin-off of Engility could result in substantial tax liability to the Company and its shareholders.

We received an Internal Revenue Service (IRS) Ruling stating that L-3 and its shareholders would not recognize any taxable income, gain or loss for U.S. federal income tax purposes as a result of the spin-off of Engility. In addition, we

received an opinion of counsel that the spin-off satisfies certain requirements for tax-free treatment that are not covered in the IRS Ruling; however, an opinion of counsel is not binding on the IRS. Accordingly, the IRS or the courts may reach conclusions with respect to the spin-off that are different from the conclusions reached in the opinion of counsel. Moreover, both the IRS Ruling and the opinion of counsel are based on certain factual statements and representations made by us, which, if incomplete or untrue in any material respect, could invalidate the IRS Ruling or opinion of counsel.

If, notwithstanding receipt of the IRS Ruling and opinion of counsel, the spin-off and certain related transactions were determined to be taxable, then we would be subject to a substantial tax liability. In addition, if

the spin-off were taxable, each holder of our common stock who receives shares of Engility would generally be treated as receiving a taxable distribution of property in an amount equal to the fair market value of the shares of Engility received.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

At December 31, 2013, we operated in 374 locations consisting of manufacturing facilities, administration, research and development and other properties throughout the United States and internationally. Of these, we owned 35 locations consisting of approximately 5.6 million square feet and leased space at 339 locations consisting of approximately 14.7 million square feet.

Our reportable segments have major operations at the following locations:

Aerospace Systems Huntsville, Alabama; Crestview, Florida; Madison, Mississippi; Greenville, Rockwall and Waco, Texas; and Quebec, Canada.

Electronic Systems Phoenix and Tempe, Arizona; Anaheim, San Leandro and Sylmar, California; Orlando, Sarasota and St. Petersburg, Florida; Northampton, Massachusetts; Grand Rapids and Muskegon, Michigan; Londonderry, New Hampshire; Budd Lake, New Jersey; Albuquerque, New Mexico; Binghamton, New York; Cincinnati and Mason, Ohio; Tulsa, Oklahoma; Philadelphia and Pittsburgh, Pennsylvania; Arlington, Carrollton, Garland and Plano, Texas; Norfolk, Virginia; Ontario, Canada; Elmenhorst and Hamburg, Germany; Bologna, Italy; and Crawley and Tewkesbury, U.K.

Communication Systems Ayer, Massachusetts; Camden, New Jersey; Hauppauge, New York; Salt Lake City, Utah; San Carlos, San Diego, Simi Valley and Torrance, California; and Williamsport, Pennsylvania.

NSS Annapolis, Maryland; and Reston, Virginia.

Corporate and other locations New York, New York; and Arlington, Virginia.

A summary of square footage by reportable segment as of December 31, 2013 is presented below.

	Leased	**Owned**	**Total**
		(Square feet in millions)	
Aerospace Systems	4.4	1.7	6.1
Electronic Systems	6.1	3.3	9.4
Communication Systems	3.3	0.6	3.9
NSS	0.8		0.8
Corporate	0.1		0.1
Total	14.7	5.6	20.3

Management believes all of our properties have been well maintained, are in good condition, and are adequate to meet our current contractual requirements.

Item 3. Legal Proceedings

The information required with respect to this item can be found in Note 20 to our audited consolidated financial statements and is incorporated by reference into this Item 3.

Item 4. Mine Safety Disclosures

None.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of L-3 Holdings is traded on the New York Stock Exchange (NYSE) under the symbol LLL . On February 14, 2014, the number of holders of L-3 Holdings common stock was approximately 27,917. On February 19, 2014 the closing price, as reported by the NYSE, was $113.67 per share.

The table below sets forth the high and low closing price of L-3 Holdings common stock as reported on the NYSE and the amount of dividends paid per share during the past two calendar years.

	Dividends Paid		Closing Price (High-Low)			
			2013		2012	
	2013	2012				
Common Stock Dividends Paid and Market Prices[1]						
First Quarter	$ 0.55	$ 0.50	$ 81.21	$74.86	$ 71.34	$66.91
Second Quarter	0.55	0.50	87.37	80.03	74.01	67.11
Third Quarter	0.55	0.50	96.09	85.06	74.45	68.27
Fourth Quarter	0.55	0.50	107.13	91.94	77.91	72.10
Year Ended December 31	$ 2.20	$ 2.00	$ 107.13	$74.86	$ 77.91	$66.91

(1) The stock prices in the table above on or prior to July 17, 2012, the date of the Engility spin-off, have not been adjusted for the impact of the spin-off.

On February 11, 2014, L-3 Holdings announced that its Board of Directors increased L-3 Holdings regular quarterly cash dividend by 9% to $0.60 per share, payable on March 17, 2014, to shareholders of record at the close of business on March 3, 2014. L-3 Holdings relies on dividends received from L-3 Communications to generate the funds necessary to pay dividends on L-3 Holdings common stock.

Issuer Purchases of Equity Securities

The following table provides information about 2013 fourth quarter repurchases of L-3 Holdings common stock that are registered pursuant to Section 12 of the Exchange Act. Repurchases are made from time to time at management s discretion in accordance with applicable federal securities laws. All share repurchases of L-3 Holdings common stock have been recorded as treasury shares.

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced	Maximum Number (or Approximate Dollar

			Plans or Programs	Value) of Shares That May Yet Be Purchased Under The Plan or Program[1] (in millions)
September 28 October 31, 2013	713,209	$ 94.40	713,209	$ 1,197
November 1 30, 2013	1,053,949	101.50	1,053,949	$ 1,090
December 1 31, 2013	2,156,570	102.77	2,156,570	$ 868
Total	3,923,728	$ 100.91	3,923,728	

(1) The share repurchases described in the table above were made pursuant to the $1.5 billion share repurchase program authorized by L-3 Holdings Board of Directors on February 5, 2013, which expires on June 30, 2015.

L-3 Holdings repurchased 928,040 shares of its common stock at an average price of $107.52 per share for an aggregate amount of approximately $100 million from January 1, 2014 through February 19, 2014.

The graph below compares the cumulative total returns of our common stock with the cumulative total return of the Standard & Poor s 500 Composite Stock Index and the Standard & Poor s 1500 Aerospace & Defense Index, for the period from December 31, 2008 to December 31, 2013. These figures assume that all dividends paid over the performance period were reinvested. On July 17, 2012, we completed the Engility spin-off. Our shareholders received one share of Engility common stock for every six shares of our common stock held on the record date (July 16, 2012). The effect of the spin-off is reflected in the cumulative total return as a reinvested dividend for the year ended December 31, 2012. The figures also assume that the starting value of each index and the investment in our common stock was $100 on December 31, 2008.

We are one of the companies included in the Standard & Poor s 1500 Aerospace & Defense Index and the Standard & Poor s 500 Composite Stock Index. The starting point for the measurement of our common stock cumulative total return was our stock price of $73.78 per share on December 31, 2008. The graph is not, and is not intended to be, indicative of future performance of our common stock.

Item 6. Selected Financial Data

The selected financial data presented below is derived from our audited consolidated financial statements and has been adjusted to reflect the spin-off of Engility and related classification of its assets, liabilities, results of operations and cash flows as discontinued operations. As discussed in the Explanatory Note to this Form 10-K/A, we are revising our audited consolidated financial statements for the fiscal years ended December 31, 2013, 2012 and 2011, and the information below with respect to such fiscal years reflects these revisions. See Note 3 to our audited consolidated financial statements for information regarding these revisions. In addition, we have determined that certain of these revisions are also applicable to fiscal years ended December 31, 2010 and 2009, and, accordingly, are also included in the revised selected financial data below.

	Year Ended December 31,				
	2013	**2012**	**2011[(1)]**	**2010**	**2009**
	(in millions, except per share data)				
Statement of Operations Data:					
Net sales	$ 12,622	$ 13,107	$ 13,154	$ 13,389	$ 13,146
Operating income	$ 1,212	$ 1,308	$ 1,398	$ 1,483	$ 1,366
Goodwill impairment charge			43		
Segment operating income	$ 1,212	$ 1,308	$ 1,441	$ 1,483	$ 1,366
Operating margin	9.6%	10.0%	10.6%	11.1%	10.4%
Segment operating margin	9.6%	10.0%	11.0%	11.1%	10.4%
Interest expense	$ (177)	$ (184)	$ (204)	$ (236)	$ (245)
Interest and other income, net	$ 20	$ 11	$ 3	$ 25	$ 23
Debt retirement charge	$	$ (13)	$ (35)	$ (18)	$ (10)
Income from continuing operations before income taxes	$ 1,055	$ 1,122	$ 1,162	$ 1,254	$ 1,134
Provision for income taxes	(295)	(360)	(296)	(429)	(376)
Income from continuing operations	760	762	866	825	758
Income from discontinued operations, net of income tax		32	104	142	154
Net income	760	794	970	967	912
Net income attributable to noncontrolling interests	(9)	(10)	(12)	(11)	(10)
Net income attributable to L-3	$ 751	$ 784	$ 958	$ 956	$ 902
Earnings per share allocable to L-3 Holdings common shareholders:					
Basic:					
Continuing operations	$ 8.40	$ 7.85	$ 8.19	$ 7.10	$ 6.34
Discontinued operations		0.29	0.97	1.22	1.31

Basic earnings per share	$	8.40	$	8.14	$	9.16	$	8.32	$	7.65
Diluted:										
Continuing operations	$	8.24	$	7.74	$	8.10	$	7.05	$	6.31
Discontinued operations				0.29		0.95		1.21		1.31
Diluted earnings per share	$	8.24	$	8.03	$	9.05	$	8.26	$	7.62
L-3 Holdings weighted average common shares outstanding:										
Basic		89.4		96.3		104.4		114.3		116.8
Diluted		91.1		97.6		105.6		115.1		117.4
Cash dividends paid per common share	$	2.20	$	2.00	$	1.80	$	1.60	$	1.40

(1) The year ended December 31, 2011 includes: (1) a tax benefit of $78 million, or $0.74 per diluted share, for a net reversal of amounts previously accrued related to tax years for which the statutes of limitations has expired, (2) a non-cash goodwill impairment charge of $43 million ($42 million after income taxes, or $0.40 per diluted share), due to a decline in the estimated fair value of our Marine Services business, and (3) $14 million ($8 million after income taxes, or $0.08 per diluted share), for our portion of an impairment charge for long-lived assets at an equity method investment. The goodwill impairment charge is included in consolidated operating income, but excluded from segment operating income because the charge was excluded by management for purposes of assessing segment operating performance.

	Year Ended December 31,				
	2013	2012	2011	2010	2009
			(in millions)		
Balance Sheet Data (at year end):					
Working capital[1]	$ 2,060	$ 1,921	$ 2,403	$ 2,156	$ 2,402
Total assets	13,988	13,800	15,520	15,463	14,886
Long-term debt	3,630	3,629	4,125	4,126	4,112
Equity	6,056	5,527	6,733	6,772	6,573
Cash Flow Data:					
Net cash from operating activities from continuing operations	$ 1,263	$ 1,231	$ 1,231	$ 1,270	$ 1,147
Net cash used in investing activities from continuing operations	(261)	(200)	(199)	(944)	(262)
Net cash used in financing activities from continuing operations	(849)	(1,527)	(1,119)	(917)	(1,004)

(1) Based on continuing operations.

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

Overview and Outlook

Explanatory Note

We are filing this Amendment No. 1 (this Amendment or Form 10-K/A) to our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 following the completion of the internal review of our Aerospace Systems segment, which is discussed below. Our Annual Report on Form 10-K for the year ended December 31, 2013 (the Form 10-K) was originally filed with the Securities and Exchange Commission (the SEC) on February 25, 2014, and subsequently updated for the re-alignment of our segments that occurred in the first quarter of 2014 and reported in our Current Report on Form 8-K filed with the SEC on May 2, 2014 (the 8-K and, together with the Form 10-K, the Original Form 10-K). At the time of filing our Form 10-K, we determined that our disclosure controls and procedures (DC&P) and our internal controls over financial reporting (ICFR) were each effective as of December 31, 2013.

This Amendment revises Part II, Item 9A, *Controls and Procedures*, as it relates to our conclusions regarding the effectiveness of our DC&P and our report on ICFR. As disclosed in our Current Report on Form 8-K filed with the SEC on September 26, 2014, as part of the findings from the internal review of the Aerospace Systems segment we

identified certain material weaknesses in our ICFR that existed as of December 31, 2013. Solely as a result of these material weaknesses, we have concluded that our DC&P and ICFR were not effective as of December 31, 2013.

In addition to the revision in Part II, Item 9A described above, this Amendment revises previously issued financial statements for: (1) accounting adjustments due to the internal review at our Aerospace Systems segment, (2) accounting error related to a sales-type lease transaction for flight simulator systems within our Electronic Systems segment, and (3) previously identified immaterial errors already recognized in our financial statements but not recorded in the appropriate periods. The accounting errors related to the sales-type lease transaction and immaterial out of period amounts are not related to the internal review at our Aerospace Systems segment.

Controls and Procedures: As part of the internal review of our Aerospace Systems segment, discussed below, we identified material weaknesses in our ICFR. The material weaknesses, further discussed in Item 9A, *Controls and Procedures*, on page 73, are: (1) the Company did not maintain an effective control environment at its Aerospace Systems segment, with respect to: (i) inadequate execution of existing controls around the annual review and approval of contract (revenue arrangement) estimates; (ii) not following established Company accounting policies, controls and procedures, and (iii) intentional override of numerous transactional and monitoring internal controls at our Army Sustainment division; and (2) Company personnel did not perform reviews of certain employee concerns regarding violations of our accounting policies and ICFR in a sufficient and effective manner.

Internal Review of Aerospace Systems Segment: We conducted an internal review related to instances of misconduct and accounting errors at our Aerospace Systems segment. This review was conducted with the assistance of outside legal and accounting advisors, and has been completed. As a result of the internal review, we identified and recorded aggregate pre-tax charges as follows: (1) $60 million for 2013, (2) $25 million for 2012, (3) $5 million for 2011, and (4) $4 million for periods prior to 2011. Furthermore, our quarterly report on Form 10-Q for the three and six month periods ended June 27, 2014 and the 2014 First Quarter 10-Q/A also include aggregate pre-tax charges related to the internal review of Aerospace Systems segment. The aggregate pre-tax charge related to the internal review of Aerospace Systems segment for the three months ended March 28, 2014 is approximately $20 million and for the three months ended June 27, 2014 is approximately $55 million.

The adjustments related to the internal review only affected the Logistics Solutions and Platform Systems sectors of the Aerospace Systems segment. The cumulative aggregate adjustments attributable to the Logistics Solutions sector are approximately $117 million, and at the Platform Systems sector are approximately $52 million. The Logistics Solutions sector adjustments relate to: (1) losses of $69 million with respect to the U.S. Army C-12 fixed-price maintenance and logistics support contract due to cost overruns inappropriately deferred, sales invoices inappropriately prepared, and the failure to timely and accurately perform contract estimates at completion and valuation assessments of inventories and receivables, at our Army Sustainment Division, and (2) accounting errors of $48 million in connection with the valuation of inventories and receivables, as well as the correction for certain accruals on other logistics support contracts. The Platform Systems sector adjustments are primarily due to: (1) losses of $37 million on two aircraft modification contracts and two contracts for rotary wing sub-assemblies and parts, and (2) write-offs of deferred costs of $15 million to design and test aerostructures for a new commercial aircraft.

Sales-Type Lease Transaction: We routinely perform on-site accounting and internal control review procedures on a rotational basis. As part of a previously planned review of our Simulation & Training business in the Electronic Systems segment and unrelated to the internal review at the Aerospace Systems segment, we evaluated the accounting treatment related to a sales-type lease transaction with the U.S. Army for rotary wing flight simulator systems. The period of performance under this contract began in 2004 and ends in 2023. Based on the results of this evaluation, we have adjusted our previously issued financial statements to: (1) increase interest income accretion on the net investment related to this sales-type lease transaction by an estimated aggregate amount of approximately $5 million for 2013, $3 million for each of 2012 and 2011 and $12 million for periods prior to 2011, and (2) decrease sales by approximately $7 million for 2013 and decrease cost of sales by approximately $7 million for 2013 and $5 million for periods prior to 2011. Furthermore, our quarterly report on Form 10-Q for the three and six month periods ended June 27, 2014 and the 2014 First Quarter 10-Q/A also include an increase in interest income accretion of $2 million and a decrease in sales of approximately $8 million and related decrease in cost of sales by approximately $7 million.

Out of Period Amounts: We had identified various out of period amounts included in our previously issued financial statements that were deemed to be immaterial individually and in the aggregate. In prior periods, in accordance with Accounting Standards Codification (ASC) 650-10-S99 and S55 (formerly Staff Accounting Bulletins (SAB) No. 99 and No. 108), *Accounting Changes and Error Corrections*, we concluded that these errors were, individually, and in

the aggregate, not material, quantitatively or qualitatively, to the financial

statements in the period recorded or to the relevant prior periods. Accordingly, we recorded these errors in our financial statements in the period that the error was identified. We are, on a voluntary basis, revising our previously issued financial statements to correct for these errors already recognized in our financial statements but not recorded in the appropriate periods to reflect them in the appropriate period. These out of period amounts were not discovered as part of the internal review of the Aerospace Systems segment discussed above, but rather represent previously identified errors resulting from mathematical mistakes, mistakes in application of generally accepted accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared, as defined in ASC 250-10-20 *Accounting Changes and Error Corrections.* We are, therefore, not treating these amounts as changes in estimates. These errors consist of: (1) increases in development and material costs related to Broadband Communication Systems that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (2) a sub-contractor subscription deposit that was recorded as sales and income in the fourth quarter of 2012 but should have been amortized to sales and income during 2013, (3) costs accrued in the fourth quarter of 2012 for goods or services received in the first quarter of 2013, (4) several unrecorded liabilities that were recorded in the first quarter of 2013 but should have been recorded in the fourth quarter of 2012, (5) a correction of accrued vacation that was recorded in the fourth quarter of 2013 but should have been recorded in the fourth quarter of 2012 and the first, second and third quarters of 2013, and (6) a warranty reserve reduction recorded in the third quarter of 2012 that should have been recorded in the fourth quarter of 2011.

With respect to each of the immaterial out of period amounts included in the Company s previously issued financial statements, the table below presents the: (1) nature of the adjustments, (2) applicable segment, (3) amount of increase (or decrease) to sales and operating income, (4) period recorded and (5) correct period.

Nature of Adjustment	Applicable Segment	2013 Sales	2013 Operating Income	2012 Sales	2012 Operating Income	2011 Sales	2011 Operating Income	Period Recorded	Correct Period
		($ in millions)							
Higher development and material costs for networked communications systems	Communication Systems	$ 10	$ 10	$ (10)	$ (10)	$	$	1Q 2013	4Q 2012
Sub-contractor subscription deposit	Aerospace Systems	26	2	(26)	(2)			4Q 2012	1Q, 2Q, 3Q & Q4 2013
Costs accruals for goods/services received	Aerospace Systems	5	1	(5)	(1)			4Q 2012	1Q 2013
Unrecorded liabilities	Aerospace Systems	(2)		2				1Q 2013	4Q 2012
Accrued vacation	Aerospace Systems		1		(1)			4Q 2013	4Q 2012, 1Q, 2Q & 3Q 2013
Warranty reserve	Electronic Systems			3	(4)	(3)	4	3Q 2012	4Q 2011
Total		$ 39	$ 14	$ (36)	$ (18)	$ (3)	$ 4		

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The table below presents the impact of the revisions discussed above on sales and pre-tax income in total, for the six month period ended June 27, 2014, years ended December 31, 2013, 2012 and 2011, and for the years ended prior to December 31, 2011.

	Total		Six months 2014		2013		2012		2011		Prior to 2011	
	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income	Sales	Pre-tax Income
					(in millions)							
Army C-12 Contract	$ (32)	$ (69)	$ (3)	$ (15)	$ (25)	$ (35)	$ (3)	$ (16)	$ (1)	$ (3)		
Other Logistics Support Contracts	(5)	(48)		(20)	(2)	(11)	(2)	(11)		(2)	(1)	(4)
Logistics Solutions	$ (37)	$ (117)	$ (3)	$ (35)	$ (27)	$ (46)	$ (5)	$ (27)	$ (1)	$ (5)	$ (1)	$ (4)
Platform Systems	(21)	(52)	(12)	(40)	(12)	(14)	3	2				
Total Internal Review of Aerospace Systems Segment	$ (58)	$ (169)	$ (15)	$ (75)	$ (39)	$ (60)	$ (2)	$ (25)	$ (1)	$ (5)	$ (1)	$ (4)
Sales-Type Lease Transaction	(15)	29	(8)	1	(7)	5		3		3		17
Out of Period Amounts					39	14	(36)	(18)	(3)	4		
Total Revisions	$ (73)	$ (140)	$ (23)	$ (74)	$ (7)	$ (41)	$ (38)	$ (40)	$ (4)	$ 2	$ (1)	$ 13

For additional information regarding the effect the adjustments above had on previously issued financial statements, see Note 3 on page F-15.

In accordance with ASC 650-10-S99 and S55, we performed an analysis to determine if the impact of the amounts disclosed above were material to previously issued financial statements. Based on that analysis, we believe that previously issued financial statements are not materially misstated on either a quantitative or qualitative basis. However, we believe that correcting these errors in the quarterly report on Form 10-Q for the second quarter of 2014 would, in the aggregate, cause a material misstatement to forecasted pre-tax income and net income for the fiscal year ending December 31, 2014. Accordingly, we are correcting these errors by revising our previously issued financial statements to record all the adjustments in the table above in the appropriate period.

This Management s Discussion and Analysis of Financial Condition and Results of Operations gives effect to the revisions for the years ended December 31, 2013, 2012 and 2011. See Note 3, Revisions to Previously Issued Financial Statements to our consolidated financial statements contained in this annual report, which accompany the financial statements in Part II, Item 8 of this Form 10-K/A for further detail. In addition, for information regarding findings with respect to our disclosure controls and procedures and internal control over financial reporting and related remedial actions, see Part II, Item 9A, Controls and Procedures of this Form 10-K/A.

L-3 s Business

L-3 is a prime contractor in aerospace systems and national security solutions. L-3 is also a leading provider of a broad range of communication and electronic systems and products used on military and commercial platforms. Our customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), allied international governments, and domestic and international commercial customers.

In the first quarter of 2014, we reorganized our business segments to better align our organizational structure with customer priorities and increase operational efficiencies. After the realignment, L-3 s structure consists of the following four segments: Aerospace Systems, Electronic Systems, Communication Systems and National Security Solutions, as further described below.

Aerospace Systems: combines the operations of the former Platform & Logistics Solutions (P&LS) segment with Intelligence, Surveillance and Reconnaissance (ISR) Systems. ISR Systems was part of the former Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR) segment. Aerospace Systems delivers integrated solutions for the global ISR market and provides modernization, upgrade, sustainment, and maintenance and logistics support for a wide variety of aircraft and ground systems. Aerospace Systems had 2013 net sales of $4,551 million.

Electronic Systems: includes all of its previous businesses historically included in this segment except the Microwave Products businesses, which are now part of Communication Systems. Electronic Systems provides a broad range of components, products, subsystems, systems and related services for military and commercial customers in several niche markets across several business areas. These businesses include marine & power systems, marine systems international, sensor systems, precision engagement and training, aviation products, warrior systems, security & detection and space & propulsion. Electronic Systems had 2013 net sales of $4,598 million.

Communication Systems: combines the operations of the Microwave Products businesses, which were previously part of the Electronic Systems segment, with the operations of the Networked and Secure Communications Products businesses, previously part of the former C^3ISR segment. Communication Systems delivers products and services for the global communications market, specializing in strategic and tactical airborne, space, ground and sea-based communication systems. Communication Systems had 2013 net sales of $2,178 million.

National Security Solutions: remains unchanged. National Security Solutions will continue to provide cybersecurity solutions, high-performance computing, enterprise IT services, analytics and intelligence analysis. National Security Solutions had 2013 net sales of $1,295 million.

We have made certain reclassifications for matters specific to the segment realignment discussed above. Financial information with respect to each of the Company s segments is included in Note 23 to our audited consolidated financial statements.

On July 17, 2012, L-3 completed the spin-off of its subsidiary, Engility Holdings, Inc. (Engility) to L-3 s shareholders. As a result of the spin-off, the results of operations and cash flows of the Engility businesses have been classified as discontinued operations for the years ended December 31, 2012 and 2011. References to financial data are to L-3 s continuing operations, unless specifically noted. See Spin-off of Engility within this section for additional information.

We generated sales of $12,622 million and $13,107 million for the years ended December 31, 2013 and 2012 and our primary customer was the DoD. The table below presents a summary of our sales by end customer and the percent contributed by each to our total sales.

	2013 Sales (in millions)	2013 % of Total Sales	2012 Sales (in millions)	2012 % of Total Sales
Air Force	$ 3,393	27%	$ 3,570	27%
Army	2,376	19	2,811	21
Navy/Marines	1,794	14	1,896	15
Other Defense	1,026	8	1,059	8
Total DoD	$ 8,589	68%	$ 9,336	71%
Other U.S. Government	597	5	650	5
Total U.S. Government	$ 9,186	73%	$ 9,986	76%
International (foreign governments)	1,747	14	1,463	11
Commercial international	1,067	8	986	8

Commercial domestic		622	5		672	5
Total sales	$	12,622	100%	$	13,107	100%

Most of our contracts (revenue arrangements) with the U.S. Government are subject to U.S. Defense Contract Audit Agency audits and various cost and pricing regulations, and include standard provisions for termination for the convenience of the U.S. Government. Multiyear U.S. Government contracts and related orders are subject to cancellation if funds for contract performance for any subsequent year become unavailable. International government contracts generally include comparable provisions relating to termination for the convenience of the relevant international government.

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Business Environment

U.S. Government Markets. Sales to U.S. Government customers represented 73% of our 2013 sales, and were primarily to DoD customers, which comprised 68% of our sales. Therefore, our annual sales are generally highly correlated to changes in U.S. Government spending levels, especially DoD budget levels.

The DoD budget peaked in the fiscal year ended September 30, 2010 (FY 2010) at $690 billion and has declined since. The total DoD budget for FY 2013 was $584 billion, which declined 10% compared to the FY 2012 budget, with the base budget 5% lower than FY 2012 and the Overseas Contingency Operations (OCO) budget 29% lower than FY 2012. The total DoD enacted budget for FY 2014 is $583 billion, which is $1 billion lower than FY 2013.

The enacted FY 2013 and FY 2014 DoD budgets comply with the sequestration cuts required by the Budget Control Act of 2011 (BCA), as amended by The American Taxpayer Relief Act (ATRA), which was enacted on January 2, 2013. ATRA delayed the effective date of the BCA sequester cuts by two months to March 1, 2013 and reduced the sequester cuts to the FY 2013 DoD budget by $9 billion to approximately $41 billion. The actual FY 2013 sequester cuts announced by the DoD in June 2013 were further reduced by the Administration to approximately $37 billion, with $6 billion of such reductions applied to prior-year unobligated DoD budget balances. This resulted in a $31 billion sequester cut to the total enacted DoD budget for FY 2013 as compared to the FY 2013 Proposed Budget Request (PBR), submitted to Congress in February 2012, and also compares favorably to the originally anticipated $50 billion sequester cut to the FY 2013 DoD budget. After ATRA, the sequestration cuts for the FY 2014 DoD budget were supposed to be $46 billion and approximately $52 billion per year from FY 2015 to FY 2018.

On December 26, 2013, President Obama signed the Bipartisan Budget Act of 2013 (BBA) into law, which reduced DoD budget uncertainty for FY 2014 and FY 2015 by increasing BCA spending caps, and lowering sequester cuts to the DoD base budget by $22 billion for FY 2014 and $9 billion for FY 2015. Additionally, Congress also increased the FY 2014 OCO budget by $6 billion more than the amount included in the FY 2014 PBR.

The table below presents the FY 2011 through FY 2014 enacted DoD budgets, the FY 2015 DoD budget adjusted for the BBA, and the Administration s DoD budget projections for FY 2016 to FY 2018, as provided in the FY 2014 PBR. The PBR, submitted to Congress in April 2013, reduced the annual sequestration cuts by approximately $52 billion each year for FY 2015 through FY 2018.

	DoD Budget (includes Sequestration Cuts/BBA)			Annual Total Budget
Fiscal Year (Ending September 30)	**Base**	**OCO**	**Total**	**Change**
		(in billions)		
2011	$ 528	$ 159	$ 687	0%
2012	$ 531	$ 115	$ 646	-6%
2013	$ 502	$ 82	$ 584	-10%
2014	$ 498	$ 85	$ 583	0%
2015	$ 499	$ 37	$ 536	-8%
2016	$ 499	$ 37	$ 536	0%
2017	$ 508	$ 37	$ 545	+2%
2018	$ 517	$ 37	$ 554	+2%

While we believe that L-3 is well positioned to benefit from several of the DoD s focus areas, declining DoD budgets will generally pressure and possibly reduce funding for some of our contracts, which could reduce our sales and operating income and negatively impact our results of operations and cash flows. Uncertainty continues to exist, even with the recent passage of the BBA, regarding how sequestration cuts will be implemented in future fiscal year DoD budgets and what challenges this may present for the defense industry, including L-3, our customers and suppliers. Furthermore, while members of Congress and the Administration continue to discuss

various options to address sequestration and the U.S. Government s overall fiscal challenges, we cannot predict the outcome of these efforts. We do not believe the FY 2014 sequester cuts to the DoD budget will have a significant negative impact on our results of operations or cash flows for the year ending December 31, 2014. However, depending on how future sequestration cuts are implemented, we believe that sequestration could have a material, negative impact on our results of operations and cash flows in the future. In addition, declining DoD budgets due to sequestration or other reductions could also potentially trigger non-cash goodwill impairment charges depending on how these reductions impact each of our reporting units. See Critical Accounting Policies Goodwill and Identifiable Intangible Assets within this section.

International and Commercial Markets. Sales to end customers other than the U.S. Government represented 27% of our 2013 sales. These sales are generally affected by international government security and military priorities, as well as the fiscal situations of our international government end customers, global economic conditions for our commercial end markets and our competitive success in winning new business and increasing market share.

Key Performance Measures

The primary financial performance measures that we use to manage our businesses and monitor results of operations are sales and operating income trends. Management believes that these financial performance measures are the primary growth drivers for our earnings and cash flow per common share. Generally, in evaluating our businesses and contract performance, we focus on net sales, operating income and operating margin, and not by type or amount of operating costs.

One of our primary business objectives is to increase 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 acquisitions that are included in our actual results of operations for less than twelve months, and (2) prior period from business and product line divestitures that are included in our actual results of operations for the twelve-month period prior to the divestiture date. We expect to supplement, strengthen and enhance our existing businesses by selectively acquiring businesses that: (1) add important new technologies and products, (2) provide access to select customers, programs and contracts and (3) provide attractive returns on investment. Another important financial performance measure that we use is operating margin, which we define as operating income as a percentage of sales, because sales growth combined with operating margin levels determine our operating income levels.

Sales Trends. For the year ended December 31, 2013, consolidated net sales of $12,622 million declined by 3.7%, comprised of organic sales decline of 4.3%, partially offset by net sales from business acquisitions of 0.6%, compared to the year ended December 31, 2012. Our average annual sales growth for the five years ended December 31, 2013 was 0.8%, as average annual organic sales declined by approximately 0.3% and average annual sales growth from business acquisitions, net of divestitures, was approximately 1.1%. See Results of Operations , including segment results below for further discussion of sales.

For the years ended December 31, 2013, 2012, and 2011, our largest contract (revenue arrangement) in terms of annual sales was the Fort Rucker Maintenance Support contract with the U.S. Army Aviation and Missile Life Cycle Management Command (AMCOM), which is included in our Aerospace Systems segment. Under this contract, which generated approximately 4% of our 2013, 2012 and 2011 sales, we provide maintenance, logistics and other related sustainment support services for rotary wing aircraft assigned to Fort Rucker and satellite units in Alabama. Our period of performance, including unexercised annual options, continues through September 30, 2017.

We derived approximately 68% of our 2013 sales from DoD customers and, as a result, our sales are highly correlated to DoD budget levels. DoD budgets are a function of several factors and uncertainties beyond our control, including, but not limited to, changes in U.S. procurement policies, budget considerations, current and future economic conditions, presidential administration priorities, U.S. military engagements, changing national security and defense requirements, geo-political developments, actual fiscal year congressional appropriations for

defense budgets, and sequestration and other DoD budget reductions. Any of these factors could result in a significant increase, decrease or redirection of DoD budgets and impact L-3 s future results of operations, including our sales and operating income growth rates. Additionally, L-3 s future results of operations will be affected by our ability to retain our existing business, including our revenue arrangements with DoD customers, and to successfully re-compete for existing business and compete for new business, which largely depends on: (1) our successful performance on existing contracts, (2) the effectiveness and innovation of our technologies and research and development activities, (3) our ability to offer better program performance than our competitors at an affordable cost, and (4) our ability to retain our employees and hire new ones, particularly those employees who have U.S. Government security clearances. We expect our 2014 consolidated sales to decline by approximately 5% compared to 2013, primarily due to the declines in DoD budgets.

Segment Operating Income Trends. For the year ended December 31, 2013, our segment operating income was $1,212 million, a decrease of 7.3% from $1,308 million for the year ended December 31, 2012. Our segment operating income as a percentage of sales (segment operating margin) was 9.6% for the year ended December 31, 2013, a decrease of 40 basis points from 10.0% for the year ended December 31, 2012. See Results of Operations , including segment results below for a discussion of operating margin.

While we continue to undertake cost management actions, such as reducing our indirect costs, resizing select business units, and improving our productivity and contract performance in an effort to maintain or even increase operating margin, these efforts may not be successful. Changes in the competitive environment and DoD procurement practices, reductions to the DoD budget, lower consolidated sales, and changes in our annual pension expense and severance costs could result in lower operating margin. Furthermore, select business acquisitions and select new business, including contract renewals and new contracts, could have lower operating margins than L-3 s operating margins on existing business and contracts. While our 2013 consolidated operating margin declined compared to 2012, we expect our 2014 annual consolidated operating margin to increase as compared to 2013, primarily due to lower expected pension expense.

Other Events

Spin-off of Engility. On July 17, 2012, L-3 completed the spin-off of its subsidiary, Engility, to L-3 s shareholders. The spin-off was a tax-free distribution to L-3 shareholders for U.S. federal tax purposes, except for cash received in lieu of fractional shares. L-3 shareholders of record on July 16, 2012 (the record date) received one share of Engility common stock for every six shares of L-3 common stock held on the record date. Engility began trading as an independent publicly traded company on the New York Stock Exchange on July 18, 2012.

In connection with the spin-off, Engility made a cash distribution of $335 million to L-3. We used a portion of the proceeds to redeem $250 million of our 6 $^{3}/_{8}$% Senior Subordinated Notes due 2015 (6 $^{3}/_{8}$% 2015 Notes) on July 26, 2012 and the remaining proceeds were used primarily to repurchase outstanding shares of our common stock. There was no gain or loss recognized by us as a result of the spin-off transaction.

Prior to the completion of the spin-off, L-3 and Engility entered into a Distribution Agreement dated July 16, 2012 and several other agreements that govern certain aspects of our relationship with Engility following the spin-off. These agreements generally provide that each party is responsible for its respective assets, liabilities and obligations, including employee benefits, insurance and tax-related assets and liabilities, following the spin-off, whether accrued or contingent. The agreements also describe certain services that L-3 provided to Engility that were substantially completed by December 31, 2013.

As a result of the spin-off, the assets, liabilities, non-controlling interest, results of operations and cash flows of the Engility businesses have been classified as discontinued operations for all periods presented. We incurred transaction expenses in connection with the spin-off of $19 million ($14 million after income taxes) for the year ended December 31, 2012 and $9 million ($7 million after income taxes) for the year ended December 31, 2011, which have been included in discontinued operations. In addition, we allocated interest expense for debt not directly attributable or related to L-3 s other operations of $14 million and $31 million to discontinued operations

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for the years ended December 31, 2012 and 2011, respectively. Interest expense was allocated in accordance with the accounting standards for discontinued operations and was based on the ratio of Engility net assets to the sum of: (1) total L-3 consolidated net assets and (2) L-3 consolidated total debt.

Engility s statement of operations data, which has been classified as discontinued operations, is provided in the table below. See Note 5 to the audited consolidated financial statements for additional information.

	January 1 to July 17, 2012	Year Ended December 31, 2011
	(in millions)	
Product and service revenues	$ 911	$ 2,011
Operating income from discontinued operations before income taxes	68	199
Interest expense allocated to discontinued operations	(14)	(31)
Income from discontinued operations before income taxes	$ 54	$ 168
Income tax expense	(22)	(64)
Income from discontinued operations, net of income taxes	$ 32	$ 104
Net income from discontinued operations attributable to noncontrolling interests	(4)	(3)
Net income from discontinued operations attributable to L-3	$ 28	$ 101

2012 Amended and Restated Revolving Credit Facility. On February 3, 2012, we amended and restated our $1 billion Revolving Credit Facility, which extended the expiration date to February 3, 2017. The terms of the Amended and Restated Revolving Credit Facility are substantially consistent with the terms of this facility prior to its amendment and restatement except that: (1) provisions that previously limited the ability of L-3 Communications to pay dividends, repurchase L-3 Holdings common stock and make other distributions with respect to any capital stock were eliminated, (2) a provision that previously limited the ability of L-3 Communications to make investments in L-3 Holdings was made less restrictive and (3) the cost of borrowings, loan commitment fees and letter of credit fees were reduced. In addition, the Amended and Restated Revolving Credit Facility provides for uncommitted incremental revolving facilities and additional term loan facilities in an aggregate principal amount of up to $500 million. See Note 11 of our audited consolidated financial statements for additional information regarding the amendment of our $1 billion Amended and Restated Revolving Credit Facility.

Debt Repurchases, Issuances and Redemptions. On July 26, 2012, (the redemption date), L-3 Communications used a portion of the proceeds from the spin-off of Engility to redeem $250 million of L-3 Communications 6 $^3/_8$% Senior Subordinated Notes due 2015 (6 $^3/_8$% 2015 Notes) at a redemption price of 102.125%, plus accrued and unpaid interest, up to but not including the redemption date. In connection with the redemption of the 6 $^3/_8$% 2015 Notes, the Company recorded a debt retirement charge of $8 million ($5 million after income tax, or $0.05 per diluted share).

On October 15, 2012 (the redemption date), L-3 Communications redeemed the remaining outstanding $250 million of its 6 $^3/_8$% 2015 Notes at a redemption price of 101.063%, plus accrued and unpaid interest, up to but not including the redemption date. In connection with the redemption, the Company recorded a debt retirement charge of

approximately $5 million ($3 million after income tax, or $0.03 per diluted share).

On February 2, 2011, we repurchased approximately $11 million of our CODES as a result of the exercise by the holders of their contractual right to require us to repurchase their CODES.

On February 7, 2011, L-3 Communications issued $650 million in principal amount of 4.95% Senior Notes that mature on February 15, 2021 (2021 Senior Notes). The 2021 Senior Notes were issued at a discount of $4 million. On March 9, 2011, the net cash proceeds from this offering, together with cash on hand, were used to redeem L-3 Communications $650 million 5 $^{7}/_{8}$% Senior Subordinated Notes due January 15, 2015 (5 $^{7}/_{8}$% 2015

Notes). In connection with the redemption of the 5 $^{7}/_{8}$% 2015 Notes, we recorded a debt retirement charge of $18 million ($11 million after income taxes, or $0.10 per diluted share).

On November 22, 2011, L-3 Communications issued $500 million in principal amount of 3.95% Senior Notes that mature on November 15, 2016 (2016 Senior Notes). The 2016 Senior Notes were issued at a discount of $4 million. On December 22, 2011, the net proceeds from this offering, together with cash on hand, were used to redeem $500 million of L-3 Communications 6 $^{3}/_{8}$% 2015 Notes. In connection with the redemption of the 6 $^{3}/_{8}$% 2015 Notes, we recorded a debt retirement charge of $17 million ($10 million after income tax, or $0.10 per diluted share).

Q4 2011 Items. Our 2011 results were impacted by the items discussed below, which increased net income attributable to L-3 by $28 million and diluted earnings per share by $0.26 (collectively referred to as the Q4 2011 Items):

- A tax benefit of $78 million, or $0.74 per diluted share, for a net reversal of amounts previously accrued related to tax years for which the statutes of limitations has expired; and

- Non-cash impairment charges of $57 million ($50 million after income taxes), or $0.48 per diluted share. The impairment charges include: (1) a goodwill impairment charge of $43 million, ($42 million after income taxes, or $0.40 per diluted share), which is included in operating income, and (2) $14 million, ($8 million after income taxes, or $0.08 per diluted share), which is included in interest and other income, net, for our portion of an impairment charge for long-lived assets at an equity method investment. The goodwill impairment charge was due to a decline in the estimated fair value of the Marine Services business, which is part of the Electronic Systems segment, as a result of a decline in its projected future cash flows.

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Business Acquisitions and Divestitures

As discussed above, one aspect of our strategy is to selectively acquire businesses that add new products and technologies, or provide access to select customers, programs and contracts. We intend to continue acquiring select businesses for reasonable valuations that will provide attractive returns to L-3. Our business acquisitions, depending on their contract-type, sales mix or other factors, could reduce L-3 s consolidated operating margin while still increasing L-3 s operating income, earnings per share, and net cash from operating activities. In addition, we may also dispose of certain businesses if we determine that they no longer fit into L-3 s overall business strategy and we are able to receive an attractive price.

Acquisitions. The table below summarizes the acquisitions that we have completed during the years ended December 31, 2011, 2012, and 2013 referred to herein as business acquisitions. See Note 5 to our audited consolidated financial statements for further information regarding our business acquisitions. During the year ended December 31, 2013, we used net cash of $62 million primarily for business acquisitions, including an earnout payment and a purchase price adjustment for acquisitions completed prior to January 1, 2013.

Business Acquisitions	Date Acquired	Segment	Purchase Price[1] (in millions)
2011			
Communications and engineering business of ComHouse Wireless L.P.	July 1, 2011	Communication Systems	$ 13
Cargo radiation screening business of Detector Network International (DNI)	October 28, 2011	Electronic Systems	5[2]
Total 2011			$ 18
2012			
L-3 KEO	February 6, 2012	Electronic Systems	$ 205
MAVCO, Inc.	April 13, 2012	Electronic Systems	10
Link Simulation & Training U.K. Limited	August 6, 2012	Electronic Systems	134[3]
Total 2012			$ 349
2013			
Mustang Technology Group, L.P. (Mustang)	December 19, 2013	Electronic Systems	54
Total 2013			$ 54

(1) The purchase price represents the contractual consideration for the acquired business, excluding adjustments for net cash acquired and acquisition transaction costs.

(2) Excludes additional purchase price, not to exceed $10 million, which is contingent upon the post acquisition financial performance of DNI through December 31, 2014. See Note 5 to our audited consolidated financial statements for additional information on the additional purchase price for this acquisition.

(3) Excludes additional purchase price of $6 million for a final net working capital adjustment. See Note 5 to our consolidated financial statements for additional information on the final net working capital adjustment.

All of our business acquisitions are included in our consolidated results of operations from their dates of acquisition. We regularly evaluate potential business acquisitions.

Divestitures. On February 22, 2011, we divested the MOI business of Microdyne Corporation (Microdyne), which was within the Electronic Systems segment. This divestiture transaction resulted in a pre-tax loss of approximately $2 million. Microdyne s annual revenues (approximately $8 million), pre-tax income and net assets were not material for any period presented, and, therefore, these divestitures are not reported as discontinued operations.

Spin-off of Engility: On July 17, 2012*,* we completed the spin-off of our subsidiary, Engility Holdings, Inc. See Spin-off of Engility within this section for further discussion of the spin-off, distribution of proceeds and impact on our financial results and financial position.

Critical Accounting Policies

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires us 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 cost 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 period during which they become known. Actual amounts will differ from these estimates and could differ materially. We believe that our critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are uncertain and require judgment at the time of the estimate; (2) use of reasonably different assumptions could have changed our estimates, particularly with respect to estimates of contract revenues and costs, and recoverability of assets, and (3) changes in the estimate could have a material effect on our financial condition or results of operations. We believe the following critical accounting policies contain the more significant judgments and estimates used in the preparation of our financial statements.

Contract Revenue Recognition and Contract Estimates. Approximately 47% of our consolidated net sales are generated from contracts (revenue arrangements) that require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services according to the buyer s specifications. These revenue arrangements or contracts are generally fixed-price, cost-plus, or time-and-material type and are covered by accounting standards for construction-type and production-type contracts and federal government contractors. Substantially all of our cost-plus type and time-and-material type contracts are with the U.S. Government, primarily the DoD. Certain of our contracts with the U.S. Government are multi-year contracts that are funded annually by the customer, and sales on these multi-year contracts are based on amounts appropriated (funded) by the U.S. Government. Our remaining sales are accounted for in accordance with accounting standards for revenue arrangements with commercial customers.

Sales and profits on fixed-price type contracts that are covered by accounting standards for construction-type and production-type contracts and federal government contractors are substantially recognized using percentage-of-completion (POC) methods of accounting. Sales on such contracts represent approximately 38% of our consolidated net sales. Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the units-of-delivery method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to total estimated costs at completion of the contract multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the cost-to-cost method). Under both POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

Accounting for the sales on these fixed-price contracts requires the preparation of estimates of: (1) total contract revenue, (2) total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract s statement of work, and (3) measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units-of-delivery method,

sales on a fixed-price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost-to-cost method, sales on a fixed-price type contract are recorded at amounts equal to the ratio of actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (i) the total estimated contract revenue, less (ii) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to (i) the current estimated total profit margin multiplied by the cumulative sales recognized, less (ii) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenues, a loss arises, and a provision for the entire loss is recorded in the period that the loss becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded as a component of other current liabilities entitled Estimated cost in excess of estimated contract value to complete contracts in process in a loss position.

Adjustments to estimates for a contract s revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained and more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to percentage-of-completion accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates increased operating income by $114 million, or 9%, for the year ended December 31, 2013, $72 million, or 6%, for the year ended December 31, 2012, and $73 million, or 5%, for the year ended December 31, 2011.

Sales and profits on cost-plus type contracts that are covered by accounting standards for government contractors are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. Sales on such contracts represent approximately 9% of our consolidated net sales. The estimated profit on a cost-plus contract is fixed or variable based on the contractual fee arrangement. Incentive and award fees are our primary variable fee contractual arrangement. Incentive and award fees on cost-plus type contracts are included as an element of total estimated contract revenues and recorded to sales when a basis exists for the reasonable prediction of performance in relation to established contractual targets and we are able to make reasonably dependable estimates for them. Sales and profits on time-and-material type contracts are recognized on the basis of direct labor hours expended multiplied by the contractual fixed rate per hour, plus the actual costs of material and other direct non-labor costs. On a time-and-material type contract, the fixed hourly rates include amounts for the cost of direct labor, indirect contract costs and profit. Cost-plus type or time-and-material type contracts generally contain less estimation risks than fixed-price type contracts.

Sales on arrangements for (1) fixed-price type contracts that require us to perform services that are not related to production of tangible assets (Fixed-Price Service Contracts), and (2) certain commercial customers are recognized in accordance with accounting standards for revenue arrangements with commercial customers. Sales for our businesses whose customers are primarily commercial business enterprises are substantially generated from single element revenue arrangements. Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectability is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on a straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are generally recognized when the units of work are completed. Sales and profit on cost-plus and time-and-material type contracts within the scope of revenue recognition accounting standards for

revenue arrangements with commercial customers are recognized in the same manner as those within the scope of contract accounting standards, except for incentive and award fees. Cost-based incentive fees are recognized when they are realizable in the amount that would be due under the contractual termination provisions as if the contract was terminated. Performance based incentive fees and award fees are recorded as sales when awarded by the customer.

For contracts with multiple deliverables, we apply the separation and allocation guidance under the accounting standard for revenue arrangements with multiple deliverables, unless all the deliverables are covered by contract accounting standards, in which case we apply the separation and allocation guidance under contract accounting standards. Revenue arrangements with multiple deliverables are evaluated to determine if the deliverables should be separated into more than one unit of accounting. We recognize revenue for each unit of accounting based on the revenue recognition policies discussed above.

Sales and profit in connection with contracts to provide services to the U.S. Government that contain collection risk because the contracts are incrementally funded and subject to the availability of funds appropriated, are deferred until the contract modification is obtained, indicating that adequate funds are available to the contract or task order.

Goodwill and Identifiable Intangible Assets. In accordance with the accounting standards for business combinations, we record 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). Identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged. However, we do not recognize separate intangible assets for the assembled workforces of our business acquisitions.

Generally, the largest separately identifiable intangible asset from the businesses that we acquire is the value of their assembled workforces, which includes the human capital of the management, administrative, marketing and business development, scientific, engineering and technical employees of the acquired businesses. The success of our businesses, including their ability to retain existing business (revenue arrangements) and to successfully compete for and win new business (revenue arrangements), is primarily dependent on the management, marketing and business development, contracting, engineering and technical skills and knowledge of our employees, rather than on productive capital (plant and equipment, and technology and intellectual property). Additionally, for a significant portion of our businesses, our ability to attract and retain employees who have U.S. Government security clearances, particularly those with top-secret and above clearances, is critical to our success, and is often a prerequisite for retaining existing revenue arrangements and pursuing new ones. Generally, patents, trademarks and licenses are not material for our acquired businesses. Furthermore, our U.S. Government contracts (revenue arrangements) generally permit other companies to use our patents in most domestic work performed by such other companies for the U.S. Government. Therefore, because intangible assets for assembled workforces are part of goodwill, the substantial majority of the intangible assets for our acquired business acquisitions are recognized as goodwill. Additionally, the value assigned to goodwill for our business acquisitions also includes the value that we expect to realize from cost reduction measures that we implement for our acquired businesses. Goodwill equals the amount of the purchase price of the business acquired in excess of the sum of the fair value of identifiable acquired assets, both tangible and intangible, less the fair value of liabilities assumed. At December 31, 2013, we had goodwill of $7,796 million and identifiable intangible assets of $285 million.

The most significant identifiable intangible asset that is separately recognized in accordance with U.S. GAAP for our business acquisitions is customer contractual relationships. All of our customer relationships are established through written customer contracts (revenue arrangements). The fair value for customer contractual relationships is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows from working capital) arising from the follow-on sales on contract (revenue arrangement) renewals expected from customer contractual relationships over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory asset charge, all of which is discounted to present value. All identifiable intangible assets are amortized over their estimated useful lives as the economic benefits are consumed. We review customer contractual relationships for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable in accordance with the

accounting standards for long-lived assets. If any such event or change in circumstances occurs, and, if our revised estimates of future after-tax cash flows are

significantly lower than our estimates at the date we acquired the customer contractual relationships, we may be required to record an impairment charge to write-down these intangible assets to their realizable values. We also review and update our estimates of the duration of our customer contractual relationships, at least annually. If such estimates indicate that the duration of our customer contractual relationships has decreased compared to the estimates made as of the date we acquired these intangible assets, then we accelerate the amortization period for our customer contractual relationships over their remaining useful economic lives.

We review goodwill for impairment annually as of November 30 and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The accounting standards for goodwill allow for the assessment of qualitative factors, such as macroeconomic conditions, industry and market conditions and entity relevant events or circumstances to determine whether it is more likely or not that the fair value of a reporting unit is less than its carrying amount. L-3 did not utilize a qualitative assessment approach for the November 30, 2013 goodwill impairment test, as we chose instead to complete the quantitative two-step testing process for each reporting unit.

A reporting unit is an operating segment, as defined by the segment reporting accounting standards, or a component of an operating segment. A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and is reviewed by operating segment management. Two or more components of an operating segment may be aggregated and deemed a single reporting unit for goodwill impairment testing purposes if the components have similar economic characteristics.

L-3 had 13 reporting units at December 31, 2013 (and at November 30, 2013 when our annual goodwill impairment assessment was completed) compared to 15 reporting units at December 31, 2012. The reduction in the number of our reporting units was due to a change in L-3 s management and reporting structure that resulted in the consolidation of three reporting units into a single reporting unit. The reporting units that were consolidated had fair values in excess of their carrying values at the time of the realignments and the related goodwill for each was included in the current reporting unit.

As previously discussed, during the quarter ended March 28, 2014, L-3 realigned its business segments. After the realignment, L-3 s structure consists of four reportable segments: (1) Aerospace Systems, (2) Electronic Systems, (3) Communication Systems, and (4) National Security Solutions. As a result of the reorganization and related changes to L-3 s operating segments, L-3 now has 12 reporting units compared to 13 as of December 31, 2013. Four reporting units were consolidated into two reporting units and one reporting unit was separated into two. The reporting units that were consolidated consisted of the: (1) Communication Systems and Microwave Products reporting units, and (2) Precision Engagement and Training & Simulation reporting units. The Marine Systems International reporting unit was separated from the Marine & Power Systems reporting unit. The following discussion of goodwill and our annual impairment assessment reflects the current reporting structure and number of reporting units.

L-3 s aggregate balance of goodwill increased by $20 million to $7,796 million at December 31, 2013 from $7,776 million at December 31, 2012 due to $44 million for business acquisitions, offset by reductions of $22 million for foreign currency translation adjustments and $2 million for a business disposition. The table below presents the number of reporting units and the associated goodwill at December 31, 2013 for each of our reportable segments.

Reportable Segment	**Number of Reporting Units**	**Aggregate Goodwill (in millions)**

Aerospace Systems	2	$	1,751
Electronic Systems	8		4,085
Communication Systems	1		992
NSS	1		968
Total	12	$	7,796

The first step in the process of testing goodwill for potential impairment is to compare the carrying value of the reporting unit to its fair value. If a potential impairment is identified, the second step is to measure the impairment loss by comparing the implied fair value of goodwill with the carrying value of goodwill of the reporting unit. Our methodology for determining the fair value of a reporting unit is estimated using a discounted cash flow (DCF) valuation approach, and is dependent on estimates for future sales, operating income, depreciation and amortization, income tax payments, working capital changes, and capital expenditures, as well as expected long-term growth rates for cash flows. All of these factors are affected by economic conditions related to the industries in which we operate (predominantly the U.S. defense industry), as well as, conditions in the U.S. capital markets.

The more significant assumptions used in our DCF valuations to determine the fair values of our reporting units in connection with the goodwill valuation assessment at November 30, 2013 were: (1) detailed three-year cash flow projections for each of our reporting units, which are based primarily on our estimates of future sales, operating income, and cash flows, (2) the expected long-term cash flow growth rates for each of our reporting units (commonly known as Terminal Growth Rates), which approximate the expected long-term nominal growth rate for the U.S. DoD budget, U.S. economy and the respective industries in which the reporting units operate, expected inflation rates, and specific circumstances for each reporting unit, including contracts or programs ending and expected new business, and (3) risk adjusted discount rates, which represent the weighted average cost of capital (WACC) for each reporting unit and include the estimated risk-free rate of return that is used to discount future cash flow projections to their present values. There were no changes to the underlying methods used in 2013 as compared to the prior year DCF valuations of our reporting units.

Each reporting unit WACC was comprised of: (1) an estimated required rate of return on equity, based on publicly traded companies with business and economic risk characteristics comparable to each of L-3 s reporting units (Market Participants), including a risk free rate of return of 3.82% on the 30 year U.S. Treasury Bond as of November 29, 2013 (2.81% as of November 30, 2012) and an equity risk premium of 5% (6% as of November 30, 2012) and (2) an after-tax rate of return on Market Participants debt, each weighted by the relative market value percentages of Market Participants equity and debt. The WACC assumptions for each reporting unit are based on a number of market inputs that are outside of our control and are updated annually to reflect changes to such market inputs as of the date of our annual goodwill impairment assessments, including changes to: (1) the estimated required rate of return on equity based on historical returns on common stock securities of Market Participants and the Standard & Poor s 500 Index over the prior two-year period, (2) the risk free rate of return based on the prevailing market yield on the 30 year U.S. Treasury Bond, (3) the rate of return of Market Participants publically traded debt securities, and (4) the relative market value percentages of Market Participants equity and debt.

The table below presents the weighted average risk adjusted discount rate assumptions in WACC, used in our DCF valuation for each of our reportable segments for our goodwill impairment assessments at November 30, 2013 and 2012.

	WACC	
Reportable Segments	**2013**	**2012**
Aerospace Systems(1)	7.42%	6.56%
Electronic Systems(2)	7.57%	6.73%
Communication Systems	7.57%	6.76%
NSS	8.09%	6.94%

(1) Both reporting units within the Aerospace Systems reportable segment used the risk adjusted discount rate in WACC as presented in the table above.

(2) The weighted average risk adjusted discount rate in WACC for the Electronic Systems reportable segment is comprised of separate discount rates for each reporting unit within the segment that range from 7.42% to 8.03% for 2013 and 6.56% to 7.33% for 2012.

As presented in the table below, L-3 s historical three-year average annual cash flow growth rates for 2013, 2012 and 2011 for our reportable segments ranged from a negative 4% to a positive 64%. The annual cash flows generated by each of our reporting units varies from year to year, and, therefore, the annual cash flow growth

rates do not result in linear trends, due to a number of factors, including, but not limited to: (1) variability of annual sales volume and sales growth rates, (2) increases and decreases in working capital, including customer advance payments and billings on multi-year contracts (revenue arrangements) with long-term performance periods (exceeding one year), (3) the timing of invoicing and cash collections between fiscal years from receivables due from customers on multi-year contracts (revenue arrangements), (4) the timing of increases and decreases of select inventories procured and produced in anticipation of future product sales, which frequently overlap the ending and beginning of fiscal years, (5) the timing of the receipt of award fee and incentive fee payments from customers on contracts (revenue arrangements), (6) variability in annual cash outlays for research and development costs, (7) changes in cash outlays for capital expenditures for property, plant and equipment, and (8) increases in annual sales and costs and expense volumes of a reporting unit resulting from business acquisitions. As a result of the factors discussed above and the varying sizes of our reporting units, the annual cash flow levels and growth rates at the reporting unit level tend to fluctuate significantly from year to year.

The 2013 cash flow amount and the cash flow growth rate for each of the last three years for each of our segments are presented in the following table.

Reportable Segment	**Estimated 2013 Cash Flow[1] (in millions)**	**Estimated Average Annual Cash Flow Growth Rate[1]**			
		2013	**2012**	**2011**	**3 Yr. Average**
Aerospace Systems[2]	$ 382	12%	(6)%	6%	4%
Electronic Systems[3]	$ 410	5%	(16)%	(2)%	(4)%
Communication Systems[4]	$ 153	(9)%	33%	29%	18%
NSS[5]	$ 83	(43)%	20%	214%	64%

(1) Reportable segment estimated cash flow excludes interest payments on debt and other corporate cash flows.

(2) The increase in 2013 cash flow for Aerospace Systems was due to small ISR aircraft sales to the DoD and a decrease in tax payments as a result of lower operating income and a lower effective tax rate. The decrease in 2012 cash flow was primarily due to higher working capital requirements, primarily for inventory on new contracts that began in 2012 and an increase in estimated tax payments, partially offset by higher operating income and an increase in advance payments. The increase in 2011 cash flow was due to growth in operating income and an increase in advance payments.

(3) The increase in 2013 cash flows for Electronic Systems was primarily due to a decrease in tax payments as a result of lower operating income and a lower effective tax rate, as well as working capital improvements at Precision Engagement & Training. The decrease in 2012 cash flows was primarily due to lower operating income compared to 2011 for Space & Propulsion Systems, Marine Systems International, and Power & Control Systems. The decrease in 2011 cash flows was primarily due to lower operating income compared to 2010 for Warrior Systems, Precision Engagement & Training, and Space & Propulsion Systems, partially offset by lower working capital requirements at Warrior Systems.

(4) The decrease in 2013 cash flow for Communication Systems was due to lower operating income, partially offset by lower capital expenditures and working capital requirements. The increase in 2012 cash flow was primarily due to the timing of billings and cash receipts and an increase in advance payments. The increase in 2011 cash flow was primarily due to working capital improvements, and timing of billings and cash receipts on fixed-price contracts, partially offset by lower operating income and liquidation of advance payments.

(5) The decrease in 2013 cash flow for NSS was primarily due to lower sales, as well as 2012 cash inflows that did not recur, including collections of billed receivables and customer advance payments. The increase in 2012 cash flow was primarily due to the timing of billings and cash receipt and an increase in advance payments. The increase in 2011 cash flow was primarily due to working capital reductions due to lower sales volume and a decrease in tax payments.

We consistently consider several factors to determine expected future annual cash flows for our reporting units, including, historical multi-year average cash flow trends by reporting unit and the expected future cash flow growth rates for each of our reporting units primarily based on our estimates of future sales, operating income, and working capital changes. Furthermore, the substantial majority of our reporting units are primarily dependent upon the DoD budget and spending. Sales from DoD customers generate a significant portion of our annual sales and have historically represented approximately 70% or more of our total sales. Accordingly, to determine expected future annual cash flows for our reporting units we also consider: (1) the DoD budget and spending priorities, (2) expansion into new markets, (3) changing conditions in existing markets for our products, systems, and services, (4) possible termination of certain government contracts, (5) expected success in new

business competitions and re-competitions on existing business, and (6) anticipated operating margins and working capital requirements, which vary significantly depending on the stage of completion (early, mature, ending) of contracts (revenue arrangements). We closely monitor changes in these factors and their impact on the expected cash flow of our reporting units. In addition to these factors that were relevant and specific to each of our reporting units, our goodwill impairment assessments as of November 30, 2013 assumed a declining DoD base budget through FY 2014, a flat base budget in both FY 2015 and FY 2016, and 2% nominal growth in the base budget beginning with FY 2017, consistent with our discussion of the business environment.

Additionally, our actual cash flows may be higher than our projections and the DCF valuation does not reflect actions that we may take to increase the profitability and cash flows of our reporting units, including our four reporting units with fair value cushions of at least 20% in the second table below. Actions we may take include consolidating and streamlining select business operations, creating future synergies with other L-3 businesses, or pursuing incremental targeted growth opportunities. Additionally, the DCF valuations do not assume future business acquisitions or divestitures.

The table below presents the estimated: (1) 2014 cash flow amount, (2) average annual cash flow growth rates for 2014 2016, and (3) weighted average annual cash flow growth rates after 2016 for each of our reportable segments.

Reportable Segment	Estimated 2014 Cash Flow (in millions)	Estimated Average Annual Cash Flow Growth Rates 3 Yr. Average 2014 2016	2017-2018	After 2018 Terminal Growth Rate
Aerospace Systems[1]	$ 286[1]	(5)%	2%	2%
Electronic Systems[2]	$ 272[2]	5%	2%	2%
Communications Systems[3]	$ 154[3]	2%	2%	2%
NSS[4]	$ 71[4]	(5)%	2%	2%

(1) Aerospace Systems projected cash flow is expected decrease by $97 million from $383 million in 2013 to $286 million in 2014. The decrease is mainly due to small ISR aircraft sales to the DoD in 2013 that will not recur in 2014.

(2) Electronic Systems projected cash flow is expected to decrease by $138 million from $410 million in 2013 to $272 million in 2014. The decrease is mainly due to lower sales and operating income and liquidations of advance payments received in 2013 at Marine & Power Systems, and higher capital expenditures and working capital requirements at Precision Engagement & Training.

(3) Communications Systems projected cash flow is expected to increase by $1 million from $153 million in 2013 to $154 million in 2014. The increase is primarily due to higher expected operating income and lower working capital requirements and capital expenditures at Broadband Communication Systems offset by lower sales and operating income at Tactical Satellite Communications Products and COMSEC & Specialty RF Products.

(4) NSS projected cash flow is expected to decrease by $12 million from $83 million in 2013 to $71 million in 2014. The expected decrease is primarily due to 2013 working capital improvements, primarily due to timing of payments to vendors, not expected to recur in 2014. Projected 2014 sales and operating income are also expected to decline as compared to 2013, although at a slower rate, which will also contribute to the decline in 2014 cash flow.

A decline in the estimated fair value of a reporting unit could result in a goodwill impairment, and a related non-cash impairment charge against earnings, if the estimated fair value for the reporting unit is less than the carrying value of the net assets of the reporting unit, including its goodwill. A large decline in estimated fair value of a reporting unit could result in an adverse effect on our financial condition and results of operations.

As discussed above, the more significant assumptions used in our DCF valuations for each of our reporting units were detailed three-year undiscounted cash flow projections, risk adjusted discount rates, or WACC, used to discount the cash flow projections to their present value and expected Terminal Growth Rates. The current year (2014-2016) consolidated three-year undiscounted cash flow projections remained substantially the same compared to the prior year (2013-2015), although the changes by each reporting unit ranged from a decline of 78% to an increase of 23%. The risk adjusted discount rate, or WACC, increased by an average of 80 basis points compared to the prior year valuations primarily due to an increase of approximately 100 basis points in the risk free rate of return and higher equity to debt ratio as a result of higher equity values among Market Participants within each peer group. The expected Terminal Growth Rates utilized in the current year valuations were higher than those utilized in the prior year valuations by an average of approximately 100 basis points. The expected Terminal Growth Rates utilized in the prior year valuations

were approximately 1% compared to approximately 2% utilized in the current year valuations. The increase in the terminal growth rates assumption was based on several factors, including but not limited to: (1) an increase in the expected inflation rate and economic growth rate, (2) an increase in interest rate levels during 2013 from 2012, consistent with the increase in the risk free rate, (3) an improved outlook for DoD budgets with smaller than BCA required sequestration cuts legislated by Congress for FY 2013, FY 2014 and FY 2015, and a return to a nominal annual growth rate of 2% by FY 2017, and (4) multi-year and Indefinite Delivery/Indefinite Quantity contract wins during 2013 that are expected to generate sales growth at select reporting units.

We evaluated the sensitivity of the DCF fair value estimates for each reporting unit, which were used for our goodwill impairment assessment, by separately assessing the impact on the estimated fair value of each reporting unit by: (1) increasing the risk adjusted discount rate (WACC) by 50 basis points, or (2) reducing the Terminal Growth Rate by 50 basis points, compared to those used in our estimated fair value calculations, while holding all other assumptions unchanged. All of our reporting units would have had a fair value in excess of their carrying value, except for the NSS reporting unit under both scenarios. In each of the two scenarios, the fair value of the NSS reporting unit would have been less than its carrying value and step two of the impairment assessment would have been required. In addition, we applied hypothetical decreases to the estimated fair values of each of our reporting units. We determined that a decrease in fair value of at least 20% would be required before any reporting unit, with the exception of four reporting units presented in the table below, would have a carrying value in excess of its fair value. The table below presents the: (1) risk adjusted discount rates, (2) annual cash flow and three-year average growth rate, (3) 2013 cash flow, (4) goodwill balance, and (5) excess fair value percentage and dollar amount, for each of these four reporting units.

Reporting Unit ($ in millions)	Risk Adjusted Discount Rates	Estimated Annual Cash Flow Growth Rate[1] 2013	2012	2011	3-Year Average	Estimated 2013 Cash Flows[1]	Goodwill Balance[2]	Excess Fair Value[3]	
NSS[4]	8.09%	(43)%	20%	214%	63%	$ 83	$ 968	5%	$ 55
Space & Propulsion Systems[5]	7.42%	(268)%	(111)%	(46)%	(142)%	$ 5	$ 240	9%	$ 32
Warrior Systems[6]	7.49%	(34)%	84%	(40)%	6%	$ 28	$ 605	16%	$ 177
Marine & Power Systems[7]	7.42%	36%	(59)%	(2)%	(8)%	$ 57	$ 840	19%	$ 191

(1) Reporting unit cash flow excludes interest payments on debt and other corporate cash flows.

(2) The goodwill balance is as of November 30, 2013, our goodwill impairment testing date.

(3) The excess fair value represents the percentage and dollar amount by which the fair value of a reporting unit must decline before a potential impairment is identified and would require the second step of the goodwill impairment assessment to be performed.

(4) Our DCF valuation for this reporting unit assumed lower projected cash flow of approximately 15% in 2014 compared to 2013 due to lower expected sales and operating income, as well as the timing of payments to vendors in 2013. In addition, our DCF valuation assumed that projected cash flow will remain approximately 15% below 2013 levels in 2015 and 2016 due to continued constraints on DoD budgets, particularly for services. Projected cash flows are expected grow 2% starting in 2017.

(5) Our DCF valuation for this reporting unit assumed cash used of $3 million in 2014 compared to cash flows of $5 million in 2013 due to the liquidation of a customer advance in 2014 on a large international contract that was received in 2013. In 2015, cash flows are assumed to increase to $18 million due to increased sales and operating income, as well as lower working capital requirements, primarily for inventory levels. In 2016, cash flows decrease $23 million to cash used of $5 million due to the liquidation of the customer advance on the large international contract received in 2013. Projected cash flows are expected to grow 2% annually beginning in 2017.

(6) Our DCF valuation for this reporting unit assumed higher projected cash flow of approximately 81% in 2014 compared to 2013 due higher sales and operating income and lower working capital requirements, primarily for inventory. In addition, our DCF valuation assumed that projected cash flow in 2015 and 2016 will grow 129% and 164% above 2013 levels (growth of 51% and 74% above 2012 levels), primarily due to increased international sales at higher margins and associated customer advance payments, and higher margins on domestic programs due to improved performance. Projected cash flows are expected to grow 2% starting in 2017.

(7) Our DCF valuation for this reporting unit assumed that cash flows would decrease approximately 61% in 2014 compared to 2013, before increasing in 2015 and 2016. Cash flow levels for 2014, 2015 and 2016 are projected to be at 40%, 102% and 114% of the 2013 cash flow level. Cash flows decline in 2014 primarily due to the liquidation of the customer advances received in 2013, as well as lower sales and operating income. The increase in cash flows in 2015 and 2016, as compared to 2014, is due to increasing sales and operating income as well as the timing of customer advances on new and follow-on contracts with international customers. Projected cash flows are expected to grow 2% annually beginning in 2017.

As discussed previously, in addition to the annual goodwill impairment assessment, we review goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount of a reporting unit s goodwill may not be recoverable. As such, listed below are certain circumstances, depending on their outcomes, that may require us to review goodwill for impairment for one or more of the four reporting units in the table above prior to the next annual assessment (November 30, 2014):

- lower than expected annual sales from our contracts with the DoD, arising from unanticipated changes or reductions to future DoD budgets;

- the ability of the reporting units to achieve: (1) 2014 projected sales, operating income and cash flow and (2) the win-loss experience on 2014 contract re-competitions and new business pursuits;

- the ability of NSS to successfully win re-competes and new business, particularly its largest contract in terms of annual sales, which is scheduled for re-competition in the middle of 2014; and

- the ability of Space & Propulsion Systems to achieve projected award fees over the five year life of the Missile Defense Agency Medium-Range Ballistic Missile target vehicle contract.

Pension Plan and Postretirement Benefit Plan Obligations. The obligations for our pension plans and postretirement benefit plans and the related annual costs of employee benefits are calculated based on several long-term assumptions, including discount rates and expected mortality for employee benefit liabilities, and rates of return on plan assets, and expected annual rates for salary increases for employee participants in the case of pension plans, and expected annual increases in the costs of medical and other health care benefits in the case of postretirement benefit obligations. These long-term assumptions are subject to revision based on changes in interest rates, financial market conditions, expected versus actual returns on plan assets, expected participant mortality and other actuarial assumptions, including future rates of salary increases, benefit formulas and levels, and rates of increase in the costs of benefits. Changes in the assumptions, if significant, could materially affect the amount of annual net periodic benefit costs recognized in our results of operations from one year to the next, the liabilities for the pension plans and postretirement benefit plans, and our annual cash requirements to fund these plans. Our pension expense for 2014 is expected to decrease by $101 million to $80 million from $181 million in 2013. Our discount rate assumption increased from a weighted average rate of 4.15% in 2012 to 5.03% in 2013. The expected decrease in our 2014 pension expense is primarily due to the increase in the weighted average discount rate and the increase in our actual asset return. See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Pension Plans for a further discussion of our estimated 2014 pension expense.

Discount rates are used to determine the present value of our pension obligations and also affect the amount of pension expense in any given period. The discount rate assumptions used to determine our pension and postretirement benefit obligations at December 31, 2013 and 2012 were based on a hypothetical AA yield curve represented by a series of annualized individual discount rates. Each bond issue underlying the yield curve is required to have a rating of AA or better by Moody s Investors Service, Inc. and/or Standard & Poor s. The resulting discount rate reflects the matching of plan liability cash flows to the yield curve. For a sensitivity analysis projecting the impact of a change in the discount rate on our projected benefit obligation and pension expense, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Pension Plans.

Valuation of Deferred Income Tax Assets and Liabilities. At December 31, 2013, we had deferred tax assets of $549 million, deferred tax liabilities of $1,015 million and a valuation allowance of $22 million. The deferred tax assets include $24 million for loss carryforwards and $7 million for tax credit carryforwards which are subject to various limitations and will expire if unused within their respective carryforward periods. Deferred income taxes are determined separately for each of our tax-paying entities in each tax jurisdiction. The future realization of our deferred income tax assets ultimately depends on our ability to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law and, to a lesser extent, our ability to execute successful tax planning

strategies. Based on our estimates of the amounts and timing of future taxable income and tax planning strategies, we believe that we will be able to realize our deferred tax assets, except for capital losses and certain U.S. Federal, foreign and state net operating losses. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement desired tax planning strategies, could affect our ability to realize the future tax deductions underlying our deferred tax assets, and require us to provide a valuation allowance against our deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and, if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

Liabilities for Pending and Threatened Litigation. We are subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business or assumed in connection with certain business acquisitions. In accordance with the accounting standards for contingencies, we accrue a charge for a loss contingency when we believe it is both probable that a liability has been incurred, and the amount of the loss can be reasonably estimated. If the loss is within a range of specified amounts, the most likely amount is accrued, and we accrue the minimum amount in the range if no amount within the range represents a better estimate. Generally, we record the loss contingency at the amount we expect to pay to resolve the contingency and the amount is generally not discounted to the present value. Amounts recoverable under insurance contracts are recorded as assets when recovery is deemed probable. Contingencies that might result in a gain are not recognized until realizable. Changes to the amount of the estimated loss, or resolution of one or more contingencies could have a material impact on our results of operations, financial position and cash flows. See Note 20 to our audited consolidated financial statements for further discussion of our litigation matters.

Valuation of Long-Lived Assets. In addition to goodwill and identifiable intangible assets recognized in connection with our business acquisitions, our long-lived assets also include property, plant and equipment, capitalized software development costs for software to be sold, leased or otherwise marketed, and certain long-term investments. As of December 31, 2013, the consolidated carrying values of our property, plant and equipment were $1,042 million, certain long-term investments were $12 million, and capitalized software development costs were $52 million. As of December 31, 2013, the carrying value of our property, plant and equipment represented 7% of total assets and the carrying value of our capitalized software development costs and certain long-term investments each represented less than 1% of total assets. We review the valuation of our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value or net realizable value expected to result from the asset s use and eventual disposition. We use a variety of factors to assess valuation, depending upon the asset. Long-lived assets are evaluated based upon the expected period the asset will be utilized, and other factors depending on the asset, including estimated future sales, profits and related cash flows, estimated product acceptance and product life cycles, changes in technology and customer demand, and the performance of invested companies and joint ventures. Changes in estimates and judgments on any of these factors could have a material impact on our results of operations and financial position.

Results of Operations

The following information should be read in conjunction with our audited consolidated financial statements. The following information has been adjusted to reflect the spin-off of Engility and related classification of results of operations and cash flows as discontinued operations. Also, our results of operations for the periods presented are affected by our business acquisitions. See Note 5 to our audited consolidated financial statements for a discussion of our business acquisitions.

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Consolidated Results of Operations

The table below provides selected financial data, excluding discontinued operations, for the years ended December 31, 2013, 2012 and 2011.

	Year Ended December 31,			Year Ended December 31,		
(in millions, except per share data)	**2013**	**2012**	**Increase/ (decrease)**	**2012**	**2011[1]**	**Increase/ (decrease)**
Net sales	$ 12,622	$ 13,107	(3.7)%	$ 13,107	$ 13,154	(0.4)%
Operating income	$ 1,212	$ 1,308	(7.3)%	$ 1,308	$ 1,398	(6.4)%
Goodwill impairment charge					43	nm
Segment operating income	$ 1,212	$ 1,308	(7.3)%	$ 1,308	$ 1,441	(9.2)%
Operating margin	9.6%	10.0%	(40) bpts	10.0%	10.6%	(60)bpts
Goodwill impairment charge	%	%		%	0.4%	(40)bpts
Segment operating margin	9.6%	10.0%	(40) bpts	10.0%	11.0%	(100)bpts