

LOCKHEED MARTIN CORP
Form 10-Q
July 24, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the quarterly period ended June 24, 2018
Commission file number: 1-11437

LOCKHEED MARTIN CORPORATION

(Exact name of registrant as specified in its charter)

Maryland 52-1893632
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

6801 Rockledge Drive, Bethesda, Maryland 20817
(Address of principal executive offices) (Zip Code)
(301) 897-6000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 registrant was required to submit such files). YES NO

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

There were 284,781,066 shares of our common stock, \$1 par value per share, outstanding as of June 24, 2018.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

Lockheed Martin Corporation

Consolidated Statements of Earnings

(unaudited; in millions, except per share data)

| | Quarters Ended | | Six Months Ended | |
|--------------------------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | | | | |
| Products | \$11,150 | \$10,622 | \$20,912 | \$20,235 |
| Services | 2,248 | 1,941 | 4,121 | 3,540 |
| Total net sales | 13,398 | 12,563 | 25,033 | 23,775 |
| Cost of sales | | | | |
| Products | (9,993) | (9,562) | (18,690) | (18,306) |
| Services | (1,967) | (1,706) | (3,656) | (3,140) |
| Severance and restructuring charges | (96) | — | (96) | — |
| Other unallocated, net | 411 | 361 | 820 | 733 |
| Total cost of sales | (11,645) | (10,907) | (21,622) | (20,713) |
| Gross profit | 1,753 | 1,656 | 3,411 | 3,062 |
| Other income, net | 42 | 60 | 109 | 56 |
| Operating profit | 1,795 | 1,716 | 3,520 | 3,118 |
| Interest expense | (165) | (160) | (320) | (315) |
| Other non-operating expense, net | (210) | (214) | (420) | (426) |
| Earnings before income taxes | 1,420 | 1,342 | 2,780 | 2,377 |
| Income tax expense | (257) | (387) | (460) | (633) |
| Net earnings | \$1,163 | \$955 | \$2,320 | \$1,744 |
| Earnings per common share | | | | |
| Basic | \$4.08 | \$3.31 | \$8.13 | \$6.03 |
| Diluted | \$4.05 | \$3.28 | \$8.07 | \$5.97 |
| Cash dividends paid per common share | \$2.00 | \$1.82 | \$4.00 | \$3.64 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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Lockheed Martin Corporation
 Consolidated Statements of Comprehensive Income
 (unaudited; in millions)

| | Quarters Ended | | Six Months Ended | |
|--|------------------|---------------------|------------------|---------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net earnings | \$1,163 | \$955 | \$2,320 | \$1,744 |
| Other comprehensive income, net of tax | | | | |
| Postretirement benefit plans | | | | |
| Amounts reclassified from accumulated other comprehensive loss | 300 | 200 | 600 | 402 |
| Other comprehensive gain recognized during the period | — | — | — | 3 |
| Other, net | (106) | 55 | (48) | 60 |
| Other comprehensive income, net of tax | 194 | 255 | 552 | 465 |
| Comprehensive income | \$1,357 | \$1,210 | \$2,872 | \$2,209 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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Lockheed Martin Corporation
 Consolidated Balance Sheets
 (unaudited; in millions, except par value)

| | June 24, 2018 | December 31, 2017 |
|--|------------------|-------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$1,181 | \$2,861 |
| Receivables, net | 2,482 | 2,265 |
| Contract assets | 9,281 | 7,992 |
| Inventories | 3,038 | 2,878 |
| Other current assets | 522 | 1,509 |
| Total current assets | 16,504 | 17,505 |
| Property, plant and equipment, net | 5,786 | 5,775 |
| Goodwill | 10,781 | 10,807 |
| Intangible assets, net | 3,646 | 3,797 |
| Deferred income taxes | 3,051 | 3,156 |
| Other noncurrent assets | 5,357 | 5,580 |
| Total assets | \$45,125 | \$46,620 |
| Liabilities and equity | | |
| Current liabilities | | |
| Accounts payable | \$2,675 | \$1,467 |
| Contract liabilities | 6,413 | 7,028 |
| Salaries, benefits and payroll taxes | 2,051 | 1,785 |
| Current maturities of long-term debt | 750 | 750 |
| Other current liabilities | 1,992 | 1,883 |
| Total current liabilities | 13,881 | 12,913 |
| Long-term debt, net | 13,479 | 13,513 |
| Accrued pension liabilities | 12,196 | 15,703 |
| Other postretirement benefit liabilities | 706 | 719 |
| Other noncurrent liabilities | 4,384 | 4,548 |
| Total liabilities | 44,646 | 47,396 |
| Stockholders' equity | | |
| Common stock, \$1 par value per share | 283 | 284 |
| Additional paid-in capital | — | — |
| Retained earnings | 14,528 | 11,405 |
| Accumulated other comprehensive loss | (14,395) | (12,539) |
| Total stockholders' equity (deficit) | 416 | (850) |
| Noncontrolling interests in subsidiary | 63 | 74 |
| Total equity (deficit) | 479 | (776) |
| Total liabilities and equity | \$45,125 | \$46,620 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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Lockheed Martin Corporation
 Consolidated Statements of Cash Flows
 (unaudited; in millions)

| | Six Months Ended | |
|--|------------------|------------------|
| | June 24, 2018 | June 25, 2017 |
| Operating activities | | |
| Net earnings | \$2,320 | \$1,744 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Depreciation and amortization | 566 | 581 |
| Stock-based compensation | 98 | 101 |
| Severance and restructuring charges | 96 | — |
| Changes in assets and liabilities | | |
| Receivables, net | (217) | (619) |
| Contract assets | (1,289) | (170) |
| Inventories | (160) | (38) |
| Accounts payable | 1,224 | 940 |
| Contract liabilities | (615) | (388) |
| Postretirement benefit plans | (2,790) | 685 |
| Income taxes | 928 | 3 |
| Other, net | 399 | 371 |
| Net cash provided by operating activities | 560 | 3,210 |
| Investing activities | | |
| Capital expenditures | (480) | (448) |
| Other, net | 151 | 9 |
| Net cash used for investing activities | (329) | (439) |
| Financing activities | | |
| Dividends paid | (1,156) | (1,069) |
| Repurchases of common stock | (610) | (1,000) |
| Other, net | (145) | (87) |
| Net cash used for financing activities | (1,911) | (2,156) |
| Net change in cash and cash equivalents | (1,680) | 615 |
| Cash and cash equivalents at beginning of period | 2,861 | 1,837 |
| Cash and cash equivalents at end of period | \$1,181 | \$2,452 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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Consolidated Statements of Equity
(unaudited; in millions)

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total Stockholders' Equity | Noncontrolling Interests in Subsidiary | Total Equity |
|--|-----------------|----------------------------------|----------------------|---|----------------------------------|--|-----------------|
| Balance at December 31, 2017 | \$ 284 | \$ — | \$ 11,405 | \$ (12,539) | \$ (850) | \$ 74 | \$(776) |
| Net earnings | — | — | 2,320 | — | 2,320 | — | 2,320 |
| Other comprehensive income, net of tax | — | — | — | 552 | 552 | — | 552 |
| Repurchases of common stock | (2) | (161) | (460) | — | (623) | — | (623) |
| Dividends declared | — | — | (1,145) | — | (1,145) | — | (1,145) |
| Stock-based awards, ESOP activity and other | 1 | 161 | — | — | 162 | — | 162 |
| Reclassification of income tax effects from tax reform | — | — | 2,408 | (2,408) | — | — | — |
| Net decrease in noncontrolling interests in subsidiary | — | — | — | — | — | (11) | (11) |
| Balance at June 24, 2018 | \$ 283 | \$ — | \$ 14,528 | \$ (14,395) | \$ 416 | \$ 63 | \$ 479 |
| Balance at December 31, 2016 | \$ 289 | \$ — | \$ 13,195 | \$ (12,102) | \$ 1,382 | \$ 95 | \$ 1,477 |
| Net earnings | — | — | 1,744 | — | 1,744 | — | 1,744 |
| Other comprehensive income, net of tax | — | — | — | 465 | 465 | — | 465 |
| Repurchases of common stock | (4) | (168) | (828) | — | (1,000) | — | (1,000) |
| Dividends declared | — | — | (1,585) | — | (1,585) | — | (1,585) |
| Stock-based awards, ESOP activity and other | 1 | 168 | — | — | 169 | — | 169 |
| Net decrease in noncontrolling interests in subsidiary | — | — | — | — | — | (11) | (11) |
| Balance at June 25, 2017 | \$ 286 | \$ — | \$ 12,526 | \$ (11,637) | \$ 1,175 | \$ 84 | \$ 1,259 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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Lockheed Martin Corporation

Notes to Consolidated Financial Statements (unaudited)

NOTE 1 – BASIS OF PRESENTATION

We prepared these consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information, the instructions to Form 10-Q and Article 10 of U.S. Securities and Exchange Commission (SEC) Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements.

In the opinion of management, these consolidated financial statements reflect all adjustments that are of a normal recurring nature necessary for a fair presentation of our results of operations, financial condition and cash flows for the interim periods presented. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base these estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Our actual results may differ materially from these estimates. Significant estimates inherent in the preparation of our consolidated financial statements include, but are not limited to, accounting for sales and cost recognition, postretirement benefit plans, environmental receivables and liabilities, evaluation of goodwill and other assets for impairment, income taxes including deferred tax assets, fair value measurements and contingencies. The consolidated financial statements include the accounts of subsidiaries we control and variable interest entities if we are the primary beneficiary. We eliminate intercompany balances and transactions in consolidation.

We close our books and records on the last Sunday of the calendar quarter, which was on June 24 for the second quarter of 2018 and June 25 for the second quarter of 2017, to align our financial closing with our business processes. The consolidated financial statements and tables of financial information included herein are labeled based on that convention. This practice only affects interim periods as our fiscal year ends on December 31.

Effective January 1, 2018, we adopted Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, as amended (Topic 606) (commonly referred to as ASC 606), which changed the way we recognize revenue for certain contracts and significantly expanded disclosures about revenue recognition. In addition, effective January 1, 2018, we adopted ASU 2017-07, Compensation-Retirement Benefits, which changed the statement of earnings presentation of certain components of pension and other postretirement benefit plan expense. The amounts for all periods presented in this Form 10-Q have been adjusted to reflect the new methods of accounting. See “Note 12 – Recent Accounting Pronouncements” for more information regarding the adoption of these standards.

Other than the changes in our accounting policies related to revenue recognition and the classification of certain components of FAS pension and other postretirement benefit plan expense, we followed the accounting policies disclosed in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Form 10-K) filed with the SEC.

The results of operations for the interim periods presented are not necessarily indicative of results to be expected for the full year or future periods. Unless otherwise noted, we present all per share amounts cited in these consolidated financial statements on a “per diluted share” basis. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2017 Form 10-K.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICY UPDATES

As described in “Note 1 – Basis of Presentation” and “Note 12 – Recent Accounting Pronouncements,” effective January 1, 2018, we adopted ASC 606, which changed the way we recognize revenue for certain contracts. Accounting policies that were significantly affected by the adoption of ASC 606 are discussed below.

Revenue Recognition

The majority of our net sales are generated from long-term contracts with the U.S. Government and international customers (including foreign military sales (FMS) contracted through the U.S. Government) for the research, design, development, manufacture, integration and sustainment of advanced technology systems, products and services. We

provide our products and services under fixed-price and cost-reimbursable contracts.

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Lockheed Martin Corporation

Notes to Consolidated Financial Statements (unaudited) (continued)

Under fixed-price contracts we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less profit or could incur a loss. Some fixed-price contracts have a performance-based component under which we may earn incentive payments or incur financial penalties based on our performance.

Cost-reimbursable contracts provide for the payment of allowable costs incurred during performance of the contract plus a fee up to a ceiling based on the amount that has been funded. Typically, we enter into three types of cost-reimbursable contracts: cost-plus-award-fee, cost-plus-incentive-fee, and cost-plus-fixed-fee.

Cost-plus-award-fee contracts provide for an award fee that varies within specified limits based on the customer's assessment of our performance against a predetermined set of criteria, such as targets based on cost, quality, technical and schedule criteria. Cost-plus-incentive-fee contracts provide for reimbursement of costs plus a fee, which is adjusted by a formula based on the relationship of total allowable costs to total target costs (i.e., incentive based on cost) or reimbursement of costs plus an incentive to exceed stated performance targets (i.e., incentive based on performance). The fixed-fee in a cost-plus-fixed-fee contract is negotiated at the inception of the contract and that fixed-fee does not vary with actual costs.

We account for a contract after it has been approved by all parties to the arrangement, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

We assess each contract at its inception to determine whether it should be combined with other contracts. When making this determination, we consider factors such as whether two or more contracts were negotiated and executed at or near the same time or were negotiated with an overall profit objective. If combined, we treat the combined contracts as a single contract for revenue recognition purposes.

We evaluate the products or services promised in each contract at inception to determine whether the contract should be accounted for as having one or more performance obligations. The products and services in our contracts are typically not distinct from one another due to their complex relationships and the significant contract management functions required to perform under the contract. Accordingly, our contracts are typically accounted for as one performance obligation. In limited cases, our contracts have more than one distinct performance obligation, which occurs when we perform activities that are not highly complex or interrelated or involve different product lifecycles. Significant judgment is required in determining performance obligations, and these decisions could change the amount of revenue and profit recorded in a given period. We classify net sales as products or services on our consolidated statements of earnings based on the predominant attributes of the performance obligations.

We determine the transaction price for each contract based on the consideration we expect to receive for the products or services being provided under the contract. For contracts where a portion of the price may vary we estimate variable consideration at the most likely amount, which is included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur. We analyze the risk of a significant revenue reversal and if necessary constrain the amount of variable consideration recognized in order to mitigate this risk.

At the inception of a contract we estimate the transaction price based on our current rights and do not contemplate future modifications (including unexercised options) or follow-on contracts until they become legally enforceable. Contracts are often subsequently modified to include changes in specifications, requirements or price, which may create new or change existing enforceable rights and obligations. Depending on the nature of the modification, we consider whether to account for the modification as an adjustment to the existing contract or as a separate contract. Generally, modifications to our contracts are not distinct from the existing contract due to the significant integration and interrelated tasks provided in the context of the contract. Therefore, such modifications are accounted for as if they were part of the existing contract and recognized as a cumulative adjustment to revenue.

For contracts with multiple performance obligations, we allocate the transaction price to each performance obligation based on the estimated standalone selling price of the product or service underlying each performance obligation. The

standalone selling price represents the amount we would sell the product or service to a customer on a standalone basis (i.e., not bundled with any other products or services). Our contracts with the U.S. Government, including FMS contracts, are subject to the Federal Acquisition Regulations (FAR) and the price is typically based on estimated or actual costs plus a reasonable profit margin. As a result of these regulations, the standalone selling price of products or services in our contracts with the U.S. Government and FMS contracts are typically equal to the selling price stated in the contract. Therefore, we typically do not need to allocate (or reallocate) the transaction price to multiple performance obligations.

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Lockheed Martin Corporation

Notes to Consolidated Financial Statements (unaudited) (continued)

For non-U.S. Government contracts with multiple performance obligations, we evaluate whether the stated selling prices for the products or services represent their standalone selling prices. We primarily sell customized solutions unique to a customer's specifications. When it is necessary to allocate the transaction price to multiple performance obligations, we typically use the expected cost plus a reasonable profit margin to estimate the standalone selling price of each product or service. We occasionally sell standard products or services with observable standalone sales transactions. In these situations, the observable standalone sales transactions are used to determine the standalone selling price.

We recognize revenue as performance obligations are satisfied and the customer obtains control of the products and services. In determining when performance obligations are satisfied, we consider factors such as contract terms, payment terms and whether there is an alternative future use of the product or service. Substantially all of our revenue is recognized over a period of time as we perform under the contract because control of the work in process transfers continuously to the customer. For contracts with the U.S. Government and FMS contracts, this continuous transfer of control of the work in process to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit, and take control of any work in process. Our non-U.S. Government contracts, primarily international direct commercial contracts, typically do not include termination for convenience provisions. However, continuous transfer of control to our customer is supported as, if our customer were to terminate the contract for reasons other than our non-performance, we would have the right to recover damages which would include, among other potential damages, the right to payment for our work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to us.

For performance obligations to deliver products with continuous transfer of control to the customer, revenue is recognized based on the extent of progress towards completion of the performance obligation, generally using the percentage-of-completion cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer as we incur costs on our contracts. Under the percentage-of-completion cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs to complete the performance obligation(s). For performance obligations to provide services to the customer, revenue is recognized over a period of time based on costs incurred or the right to invoice method (in situations where the value transferred matches our billing rights) as our customer receives and consumes the benefits. For performance obligations in which control does not continuously transfer to the customer, we recognize revenue at the point in time in which each performance obligation is fully satisfied. This coincides with the point in time the customer obtains control of the product or service, which typically occurs upon customer acceptance or receipt of the product or service, given that we maintain control of the product or service until that point.

Backlog (i.e., unfulfilled or remaining performance obligations) represents the sales we expect to recognize for our products and services for which control has not yet transferred to the customer. For our cost-reimbursable and fixed-priced-incentive contracts, the estimated consideration we expect to receive pursuant to the terms of the contract may exceed the contractual award amount. The estimated consideration is determined at the outset of the contract and is continuously reviewed throughout the contract period. In determining the estimated consideration, we consider the risks related to the technical, schedule and cost impacts to complete the contract and an estimate of any variable consideration. Periodically, we review these risks and may increase or decrease backlog accordingly. As the risks on such contracts are successfully retired, the estimated consideration from customers may be reduced, resulting in a reduction of backlog without a corresponding recognition of sales. As of June 24, 2018, our ending backlog was \$105 billion. We expect to recognize approximately 40% over the next 12 months and approximately 65% over the next 24 months as revenue, with the remainder recognized thereafter.

For arrangements with the U.S. Government and FMS contracts, we generally do not begin work on contracts until funding is appropriated by the customer. Billing timetables and payment terms on our contracts vary based on a number of factors, including the contract type. Typical payment terms under fixed-price contracts with the U.S.

Government provide that the customer pays either performance-based payments (PBPs) based on the achievement of contract milestones or progress payments based on a percentage of costs we incur. For the majority of our international direct commercial contracts to deliver complex systems, we typically receive advance payments prior to commencement of work, as well as milestone payments that are paid in accordance with the terms of our contract as we perform. We recognize a liability for payments in excess of revenue recognized, which is presented as a contract liability on the balance sheet. The portion of payments retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer from our failure to adequately complete some or all of the obligations under the contract. Payments received from customers in advance of revenue recognition

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Lockheed Martin Corporation

Notes to Consolidated Financial Statements (unaudited) (continued)

are not considered to be significant financing components because they are used to meet working capital demands that can be higher in the early stages of a contract.

For fixed-price and cost-reimbursable contracts, we present revenues recognized in excess of billings as contract assets on the balance sheet. Amounts billed and due from our customers under both contract types are classified as receivables on the balance sheet.

Significant estimates and assumptions are made in estimating contract sales and costs, including the profit booking rate. At the outset of a long-term contract, we identify and monitor risks to the achievement of the technical, schedule and cost aspects of the contract, as well as variable consideration, and assess the effects of those risks on our estimates of sales and total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events) and costs (e.g., material, labor, subcontractor, overhead, general and administrative and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset or localization agreements, required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and cost aspects of the contract, which decreases the estimated total costs to complete the contract or may increase the variable consideration we expect to receive on the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase or our estimates of variable consideration we expect to receive decrease. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate. When estimates of total costs to be incurred on a contract exceed total estimates of the transaction price, a provision for the entire loss is determined at the contract level and is recorded in the period in which the loss is determined.

Comparability of our segment sales, operating profit and operating margin may be impacted favorably or unfavorably by changes in profit booking rates on our contracts for which we recognize revenue over a period of time using the percentage-of-completion cost-to-cost method to measure progress towards completion. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs to fulfill the performance obligations that reflect improved conditions on a particular contract. Conversely, conditions on a particular contract may deteriorate, resulting in an increase in the estimated total costs to fulfill the performance obligations and a reduction in the profit booking rate. Increases or decreases in profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes. Segment operating profit and margin may also be impacted favorably or unfavorably by other items, which may or may not impact sales. Favorable items may include the positive resolution of contractual matters, cost recoveries on severance and restructuring charges, insurance recoveries and gains on sales of assets. Unfavorable items may include the adverse resolution of contractual matters; restructuring charges, except for significant severance actions, which are excluded from segment operating results; reserves for disputes; certain asset impairments; and losses on sales of certain assets.

Our consolidated net adjustments not related to volume, including net profit booking rate adjustments and other matters, increased segment operating profit by approximately \$465 million and \$885 million during the quarter and six months ended June 24, 2018 and \$515 million and \$810 million during the quarter and six months ended June 25, 2017. These adjustments increased net earnings by approximately \$367 million (\$1.28 per share) and \$699 million (\$2.43 per share) during the quarter and six months ended June 24, 2018 and \$335 million (\$1.15 per share) and \$527 million (\$1.80 per share) during the quarter and six months ended June 25, 2017. We recognized net sales from performance obligations satisfied in prior periods of approximately \$540 million and \$955 million during the quarter and six months ended June 24, 2018 and \$540 million and \$920 million during the quarter and six months ended June 25, 2017, which primarily relate to changes in profit booking rates that impacted revenue.

We have a program, EADGE-T, to design, integrate, and install an air missile defense command, control, communications, computers – intelligence (C4I) system for an international customer that has experienced performance

matters and for which we have periodically accrued reserves. During the first quarter of 2017, we revised our estimated costs to complete the EADGE-T contract as a consequence of ongoing performance matters and recorded an additional charge of \$120 million (\$74 million or \$0.25 per share, after tax) at our Rotary and Mission Systems (RMS) business segment, which resulted in cumulative losses of approximately \$260 million on this program. As of June 24, 2018, cumulative losses remained at approximately \$260 million. We continue to monitor program requirements and our

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Notes to Consolidated Financial Statements (unaudited) (continued)

performance. At this time, we do not anticipate additional charges that would be material to our operating results or financial condition.

We have two commercial satellite programs at our Space business segment, for which we have experienced performance issues related to the development and integration of a modernized LM 2100 satellite platform. These commercial programs require the development of new satellite technology to enhance the LM 2100's power, propulsion and electronics, among other items. The enhanced LM 2100 satellite platform is expected to benefit other commercial and government satellite programs. We have periodically revised our estimated costs to complete these developmental commercial programs. We have recorded cumulative losses of approximately \$380 million through June 24, 2018. During the quarter and six months ended June 24, 2018, we recorded losses of approximately \$40 million (\$30 million, or \$0.10 per share, after tax) and \$75 million (\$56 million, or \$0.20 per share, after tax). While these losses reflect our estimated total losses on the programs, we will continue to incur unrecoverable general and administrative costs each period until we complete these programs. These programs remain developmental and further challenges in the delivery and integration of new satellite technology, anomalies discovered during system testing requiring repair or rework, further schedule delays and potential penalties could require that we record additional loss reserves which could be material to our operating results. As we did not meet the July 2018 delivery requirement on one of the programs, the customer could seek to exercise a termination right, but we think that the probability that this will occur is remote as the customer has an immediate need for the satellites. Were the customer to seek to exercise a termination right and be successful in this effort, we would have to refund the payments we have received and pay certain penalties. On the other program, we currently anticipate delivering the satellite before the date upon which the customer could seek to exercise a termination right although we may have to pay certain penalties and have sought to address this possibility in our reserves.

We are responsible for designing, developing and installing an upgraded turret for the Warrior Capability Sustainment Program. During the six months ended June 24, 2018, as a consequence of performance issues, we revised our estimated costs to complete the program and recorded a reserve of \$85 million (\$64 million, or \$0.22 per share, after tax) at our Missiles and Fire Control (MFC) business segment. As of June 24, 2018, we have recorded cumulative losses of approximately \$140 million on this program. We may continue to experience issues related to customer requirements and our performance under this contract and have to record additional reserves. However, based on the losses already recorded and our current estimate of the sales and costs to complete the program, at this time we do not anticipate that additional losses, if any, would be material.

Receivables, Net

Receivables, net represent our unconditional right to consideration under the contract and include amounts billed and currently due from customers. The amounts are stated at their net estimated realizable value. There were no significant impairment losses related to our receivables during the quarters and six months ended June 24, 2018 and June 25, 2017.

On occasion, our customers may seek deferred payment terms to purchase our products. In connection with these transactions, we may, at our customer's request, enter into arrangements for the non-recourse sale of customer receivables to unrelated third-party financial institutions. For accounting purposes, these transactions are not discounted and are treated as a sale of receivables as we have no continuing involvement. The sale proceeds from the financial institutions are reflected in our operating cash flows on the statement of cash flows. We sold customer receivables of \$124 million and \$227 million during the quarter and six months ended June 24, 2018 and \$365 million during both the quarter and six months ended June 25, 2017. There were no gains or losses related to sales of these receivables.

Contract Assets

Contract assets include unbilled amounts typically resulting from sales under contracts when the percentage-of-completion cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. The amounts may not exceed their estimated net realizable value. Contract assets are

classified as current based on our contract operating cycle.

Inventories

We record inventories at the lower of cost or estimated net realizable value. If events or changes in circumstances indicate that the utility of our inventories have diminished through damage, deterioration, obsolescence, changes in price

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Notes to Consolidated Financial Statements (unaudited) (continued)

or other causes, a loss is recognized in the period in which it occurs. We capitalize labor, material, subcontractor and overhead costs as work-in-process for contracts where control has not yet passed to the customer. In addition, we capitalize costs incurred to fulfill a contract in advance of contract award in inventories as work-in-process if we determine that contract award is probable. We determine the costs of other product and supply inventories by using the first-in first-out or average cost methods.

Contract Liabilities

Contract liabilities (formerly referred to as customer advances and amounts in excess of costs incurred) include advance payments and billings in excess of revenue recognized. Contract liabilities are classified as current based on our contract operating cycle and reported on a contract-by-contract basis, net of revenue recognized, at the end of each reporting period.

NOTE 3 – EARNINGS PER COMMON SHARE

The weighted average number of shares outstanding used to compute earnings per common share were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|---|---------------------|---------------------|---------------------|---------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Weighted average common shares outstanding for basic computations | 285.0 | 288.5 | 285.2 | 289.2 |
| Weighted average dilutive effect of equity awards | 2.1 | 2.7 | 2.3 | 2.8 |
| Weighted average common shares outstanding for diluted computations | 287.1 | 291.2 | 287.5 | 292.0 |

We compute basic and diluted earnings per common share by dividing net earnings by the respective weighted average number of common shares outstanding for the periods presented. Our calculation of diluted earnings per common share also includes the dilutive effects for the assumed vesting of outstanding restricted stock units (RSUs) and performance stock units (PSUs) and exercise of outstanding stock options based on the treasury stock method. There were no significant anti-dilutive equity awards during the quarters and six months ended June 24, 2018 or June 25, 2017.

NOTE 4 – INFORMATION ON BUSINESS SEGMENTS

We operate in four business segments: Aeronautics, MFC, RMS and Space. We organize our business segments based on the nature of the products and services offered.

Net sales of our business segments exclude intersegment sales as these activities are eliminated in consolidation. Operating profit of our business segments includes our share of earnings or losses from equity method investees as the operating activities of the equity method investees are closely aligned with the operations of our business segments. In addition, operating profit of our business segments includes total pension costs recoverable on U.S. Government contracts as determined in accordance with U.S. Government cost accounting standards (CAS). Operating profit of the business segments excludes the FAS/CAS operating adjustment; the U.S. GAAP financial accounting standards (FAS) non-service cost component for all postretirement benefit plans; expense for stock-based compensation; the effects of items not considered part of management's evaluation of segment operating performance, such as charges related to significant severance actions and certain asset impairments; gains or losses from significant divestitures; the effects of certain legal settlements; corporate costs not allocated to our business segments; and other miscellaneous corporate activities. These items are included in the reconciling item "Unallocated items" between operating profit from our business segments and our consolidated operating profit. See "Note 2 – Significant Accounting Policy Updates" for a discussion related to certain factors that may impact the comparability of net sales and operating profit of our business segments.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Summary operating results for each of our business segments were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|--|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | | | | |
| Aeronautics | \$5,321 | \$4,922 | \$9,719 | \$9,042 |
| Missiles and Fire Control | 2,085 | 1,784 | 3,762 | 3,333 |
| Rotary and Mission Systems | 3,566 | 3,414 | 6,789 | 6,541 |
| Space | 2,426 | 2,443 | 4,763 | 4,859 |
| Total net sales | \$13,398 | \$12,563 | \$25,033 | \$23,775 |
| Operating profit | | | | |
| Aeronautics | \$572 | \$567 | \$1,046 | \$1,006 |
| Missiles and Fire Control | 279 | 253 | 540 | 487 |
| Rotary and Mission Systems ^(a) | 341 | 271 | 652 | 399 |
| Space | 274 | 256 | 538 | 546 |
| Total business segment operating profit | 1,466 | 1,347 | 2,776 | 2,438 |
| Unallocated items | | | | |
| FAS/CAS operating adjustment ^(b) | 451 | 404 | 902 | 807 |
| Stock-based compensation | (60) | (57) | (98) | (101) |
| Severance and restructuring charges ^(c) | (96) | — | (96) | — |
| Other, net ^(d) | 34 | 22 | 36 | (26) |
| Total unallocated items | 329 | 369 | 744 | 680 |
| Total consolidated operating profit | \$1,795 | \$1,716 | \$3,520 | \$3,118 |
| Intersegment sales | | | | |
| Aeronautics | \$27 | \$40 | \$52 | \$65 |
| Missiles and Fire Control | 113 | 66 | 208 | 139 |
| Rotary and Mission Systems | 504 | 548 | 965 | 993 |
| Space | 48 | 19 | 93 | 45 |
| Total intersegment sales | \$692 | \$673 | \$1,318 | \$1,242 |

Operating profit at our RMS business segment for the six months ended June 25, 2017 includes a charge of \$120 million (\$74 million, or \$0.25 per share, after tax) recognized in the first quarter of 2017 for performance matters on the EADGE-T contract. See “Note 2 – Significant Accounting Policy Updates” (under the caption “Revenue Recognition”) for more information.

The FAS/CAS operating adjustment represents the difference between the service cost component of FAS pension expense and total pension costs recoverable on U.S. Government contracts as determined in accordance with U.S. Government CAS. For a detail of the FAS/CAS operating adjustment and the total net FAS/CAS pension adjustment, see the table below.

Unallocated items for the quarter and six months ended June 24, 2018 include severance and restructuring charges totaling \$96 million (\$76 million, or \$0.26 per share, after tax) associated with planned workforce reductions and the consolidation of certain operations at our RMS business segment. See “Note 11 – Other” (under the caption “Severance and Restructuring Charges”) for more information.

Other, net for the six months ended June 25, 2017 includes a \$64 million charge (\$40 million, or \$0.14 per share, after tax) recognized in the first quarter of 2017, which represents our portion of a non-cash asset impairment charge recorded by our equity method investee, Advanced Military Maintenance, Repair and Overhaul Center LLC (AMMROC). See “Note 11 – Other” (under the caption “Equity Method Investee Impairment”) for more information.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Our total net FAS/CAS pension adjustments for the quarters and six months ended June 24, 2018 and June 25, 2017, including the service and non-service cost components of FAS pension expense, were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|---|----------------|---------------|------------------|---------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Total FAS expense and CAS costs | | | | |
| FAS pension expense | \$(357) | \$(343) | \$(713) | \$(688) |
| Less: CAS pension cost | 609 | 562 | 1,217 | 1,124 |
| Net FAS/CAS pension adjustment | \$252 | \$219 | \$504 | \$436 |
| Service and non-service cost reconciliation | | | | |
| FAS pension service cost | \$(158) | \$(158) | \$(315) | \$(317) |
| Less: CAS pension cost | 609 | 562 | 1,217 | 1,124 |
| FAS/CAS operating adjustment | 451 | 404 | 902 | 807 |
| Non-operating FAS pension expense | (199) | (185) | (398) | (371) |
| Net FAS/CAS pension adjustment | \$252 | \$219 | \$504 | \$436 |

We recover CAS pension cost through the pricing of our products and services on U.S. Government contracts and, therefore, recognize CAS pension cost in each of our business segment's net sales and cost of sales. Our consolidated financial statements must present FAS pension and other postretirement benefit plan expense calculated in accordance with FAS requirements under U.S. GAAP. The operating portion of the net FAS/CAS pension adjustment represents the difference between the service cost component of FAS pension expense and CAS pension cost. The non-service FAS pension cost component is included in other non-operating expense, net on our consolidated statements of earnings. The net FAS/CAS pension adjustment increases or decreases CAS pension cost to equal total FAS pension cost (both service and non-service).

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Notes to Consolidated Financial Statements (unaudited) (continued)

Net sales by total products and services, contract type, customer category and geographic region for each of our business segments were as follows (in millions):

| | Quarter Ended June 24, 2018 | | | | |
|--------------------------------|-----------------------------|---------|---------|---------|----------|
| | Aeronautics | MISC | RMS | Space | Total |
| Net sales | | | | | |
| Products | \$4,511 | \$1,709 | \$2,904 | \$2,026 | \$11,150 |
| Services | 810 | 376 | 662 | 400 | 2,248 |
| Total net sales | \$5,321 | \$2,085 | \$3,566 | \$2,426 | \$13,398 |
| Net sales by contract type | | | | | |
| Fixed-price | \$3,906 | \$1,395 | \$2,450 | \$460 | \$8,211 |
| Cost-reimbursable | 1,415 | 690 | 1,116 | 1,966 | 5,187 |
| Total net sales | \$5,321 | \$2,085 | \$3,566 | \$2,426 | \$13,398 |
| Net sales by customer | | | | | |
| U.S. Government | \$3,444 | \$1,502 | \$2,608 | \$2,070 | \$9,624 |
| International ^(a) | 1,835 | 542 | 822 | 344 | 3,543 |
| U.S. commercial and other | 42 | 41 | 136 | 12 | 231 |
| Total net sales | \$5,321 | \$2,085 | \$3,566 | \$2,426 | \$13,398 |
| Net sales by geographic region | | | | | |
| United States | \$3,486 | \$1,543 | \$2,744 | \$2,082 | \$9,855 |
| Asia Pacific | 786 | 125 | 301 | 31 | 1,243 |
| Europe | 678 | 46 | 224 | 332 | 1,280 |
| Middle East | 320 | 364 | 143 | (19) | 808 |
| Other | 51 | 7 | 154 | — | 212 |
| Total net sales | \$5,321 | \$2,085 | \$3,566 | \$2,426 | \$13,398 |

| | Six Months Ended June 24, 2018 | | | | |
|--------------------------------|--------------------------------|---------|---------|---------|----------|
| | Aeronautics | MISC | RMS | Space | Total |
| Net sales | | | | | |
| Products | \$8,281 | \$3,062 | \$5,621 | \$3,948 | \$20,912 |
| Services | 1,438 | 700 | 1,168 | 815 | 4,121 |
| Total net sales | \$9,719 | \$3,762 | \$6,789 | \$4,763 | \$25,033 |
| Net sales by contract type | | | | | |
| Fixed-price | \$7,121 | \$2,507 | \$4,658 | \$860 | \$15,146 |
| Cost-reimbursable | 2,598 | 1,255 | 2,131 | 3,903 | 9,887 |
| Total net sales | \$9,719 | \$3,762 | \$6,789 | \$4,763 | \$25,033 |
| Net sales by customer | | | | | |
| U.S. Government | \$6,209 | \$2,590 | \$4,964 | \$3,940 | \$17,703 |
| International ^(a) | 3,412 | 1,096 | 1,603 | 800 | 6,911 |
| U.S. commercial and other | 98 | 76 | 222 | 23 | 419 |
| Total net sales | \$9,719 | \$3,762 | \$6,789 | \$4,763 | \$25,033 |
| Net sales by geographic region | | | | | |
| United States | \$6,307 | \$2,666 | \$5,186 | \$3,963 | \$18,122 |
| Asia Pacific | 1,540 | 223 | 625 | 54 | 2,442 |
| Europe | 1,186 | 115 | 379 | 758 | 2,438 |
| Middle East | 577 | 744 | 314 | (12) | 1,623 |
| Other | 109 | 14 | 285 | — | 408 |

Total net sales \$9,719 \$3,762 \$6,789 \$4,763 \$25,033

(a) International sales include FMS contracted through the U.S. Government and direct commercial sales to international governments and other international customers.

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Notes to Consolidated Financial Statements (unaudited) (continued)

| | Quarter Ended June 25, 2017 | | | | |
|--------------------------------|-----------------------------|---------|---------|---------|----------|
| | Aeronautics | MFC | RMS | Space | Total |
| Net sales | | | | | |
| Products | \$4,206 | \$1,452 | \$2,863 | \$2,101 | \$10,622 |
| Services | 716 | 332 | 551 | 342 | 1,941 |
| Total net sales | \$4,922 | \$1,784 | \$3,414 | \$2,443 | \$12,563 |
| Net sales by contract type | | | | | |
| Fixed-price | \$3,312 | \$1,258 | \$2,492 | \$592 | \$7,654 |
| Cost-reimbursable | 1,610 | 526 | 922 | 1,851 | 4,909 |
| Total net sales | \$4,922 | \$1,784 | \$3,414 | \$2,443 | \$12,563 |
| Net sales by customer | | | | | |
| U.S. Government | \$3,233 | \$1,059 | \$2,379 | \$2,105 | \$8,776 |
| International ^(a) | 1,655 | 687 | 929 | 325 | 3,596 |
| U.S. commercial and other | 34 | 38 | 106 | 13 | 191 |
| Total net sales | \$4,922 | \$1,784 | \$3,414 | \$2,443 | \$12,563 |
| Net sales by geographic region | | | | | |
| United States | \$3,267 | \$1,097 | \$2,485 | \$2,118 | \$8,967 |
| Asia Pacific | 694 | 114 | 343 | 36 | 1,187 |
| Europe | 599 | 82 | 245 | 288 | 1,214 |
| Middle East | 300 | 482 | 126 | 1 | 909 |
| Other | 62 | 9 | 215 | — | 286 |
| Total net sales | \$4,922 | \$1,784 | \$3,414 | \$2,443 | \$12,563 |

| | Six Months Ended June 25, 2017 | | | | |
|--------------------------------|--------------------------------|---------|---------|---------|----------|
| | Aeronautics | MFC | RMS | Space | Total |
| Net sales | | | | | |
| Products | \$7,840 | \$2,709 | \$5,511 | \$4,175 | \$20,235 |
| Services | 1,202 | 624 | 1,030 | 684 | 3,540 |
| Total net sales | \$9,042 | \$3,333 | \$6,541 | \$4,859 | \$23,775 |
| Net sales by contract type | | | | | |
| Fixed-price | \$6,228 | \$2,343 | \$4,728 | \$1,102 | \$14,401 |
| Cost-reimbursable | 2,814 | 990 | 1,813 | 3,757 | 9,374 |
| Total net sales | \$9,042 | \$3,333 | \$6,541 | \$4,859 | \$23,775 |
| Net sales by customer | | | | | |
| U.S. Government | \$5,916 | \$2,136 | \$4,674 | \$4,117 | \$16,843 |
| International ^(a) | 3,058 | 1,132 | 1,700 | 715 | 6,605 |
| U.S. commercial and other | 68 | 65 | 167 | 27 | 327 |
| Total net sales | \$9,042 | \$3,333 | \$6,541 | \$4,859 | \$23,775 |
| Net sales by geographic region | | | | | |
| United States | \$5,984 | \$2,201 | \$4,841 | \$4,144 | \$17,170 |
| Asia Pacific | 1,225 | 206 | 617 | 40 | 2,088 |
| Europe | 1,102 | 157 | 447 | 622 | 2,328 |
| Middle East | 635 | 752 | 236 | 53 | 1,676 |
| Other | 96 | 17 | 400 | — | 513 |
| Total net sales | \$9,042 | \$3,333 | \$6,541 | \$4,859 | \$23,775 |

(a)

International sales include FMS contracted through the U.S. Government and direct commercial sales to international governments and other international customers.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Total assets for each of our business segments were as follows (in millions):

| | June 24, 2018 | December 31, 2017 |
|---------------------------------|------------------|-------------------------|
| Assets | | |
| Aeronautics | \$8,283 | \$7,713 |
| Missiles and Fire Control | 4,812 | 4,577 |
| Rotary and Mission Systems | 18,495 | 18,292 |
| Space | 5,502 | 5,240 |
| Total business segment assets | 37,092 | 35,822 |
| Corporate assets ^(a) | 8,033 | 10,798 |
| Total assets | \$45,125 | \$46,620 |

^(a) Corporate assets primarily include cash and cash equivalents, deferred income taxes, environmental receivables, and investments held in a separate trust to fund certain of our non-qualified deferred compensation plans.

Our Aeronautics business segment includes our largest program, the F-35 Lightning II Joint Strike Fighter, an international multi-role, multi-variant, stealth fighter aircraft. Net sales for the F-35 program represented approximately 27% and 26% of our total consolidated net sales for the quarter and six months ended June 24, 2018 and 26% and 25% of our total consolidated net sales for the quarter and six months ended June 25, 2017.

NOTE 5 – CONTRACT ASSETS AND LIABILITIES

Contract assets include unbilled amounts typically resulting from sales under contracts when the percentage-of-completion cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. Contract liabilities (formerly referred to as customer advances and amounts in excess of costs incurred) include advance payments and billings in excess of revenue recognized. Contract assets and contract liabilities were as follows (in millions):

| | June 24, 2018 | December 31, 2017 |
|----------------------|---------------------|-------------------------|
| Contract assets | \$9,281 | \$7,992 |
| Contract liabilities | \$6,413 | \$7,028 |

Contract assets increased \$1.3 billion during the six months ended June 24, 2018, primarily due to the recognition of revenue related to the satisfaction or partial satisfaction of performance obligations during the six months ended June 24, 2018 for which we have not yet billed. There were no significant impairment losses related to our contract assets during the quarters and six months ended June 24, 2018 and June 25, 2017.

Contract liabilities decreased \$615 million during the six months ended June 24, 2018, primarily due to revenue recognized in excess of payments received on these performance obligations. During the quarter and six months ended June 24, 2018, we recognized \$731 million and \$2.6 billion of our contract liabilities at December 31, 2017 as revenue. During the quarter and six months ended June 25, 2017, we recognized \$789 million and \$2.4 billion of our contract liabilities at December 31, 2016 as revenue.

NOTE 6 – INVENTORIES

Inventories consisted of the following (in millions):

| | June 24, 2018 | December 31, 2017 |
|--------------------------------|---------------------|-------------------------|
| Materials, spares and supplies | \$446 | \$563 |
| Work-in-process | 2,074 | 1,823 |
| Finished goods | 518 | 492 |

| | | |
|-------------------|---------|----------|
| Total inventories | \$3,038 | \$ 2,878 |
|-------------------|---------|----------|

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Notes to Consolidated Financial Statements (unaudited) (continued)

Costs incurred to fulfill a contract in advance of the contract being awarded are included in inventories as work-in-process if we determine that those costs relate directly to a contract or to an anticipated contract that we can specifically identify and contract award is probable, the costs generate or enhance resources that will be used in satisfying performance obligations, and the costs are recoverable (referred to as pre-contract costs). Pre-contract costs that are initially capitalized in inventory are generally recognized as cost of sales consistent with the transfer of products and services to the customer upon the receipt of the anticipated contract. All other pre-contract costs, including start-up costs, are expensed as incurred. As of June 24, 2018 and December 31, 2017, \$508 million and \$466 million of pre-contract costs were included in inventory.

NOTE 7 – POSTRETIREMENT BENEFIT PLANS

Our pretax net periodic benefit cost related to our qualified defined benefit pension plans and retiree medical and life insurance plans consisted of the following (in millions):

| | Quarters Ended | | Six Months Ended | |
|--|---------------------|---------------------|---------------------|---------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Qualified defined benefit pension plans | | | | |
| Service cost | \$158 | \$158 | \$315 | \$317 |
| Interest cost | 435 | 460 | 870 | 918 |
| Expected return on plan assets | (598) | (562) | (1,197) | (1,124) |
| Recognized net actuarial losses | 444 | 377 | 888 | 753 |
| Amortization of prior service credits | (82) | (90) | (163) | (176) |
| Total net periodic benefit cost | \$357 | \$343 | \$713 | \$688 |
| Retiree medical and life insurance plans | | | | |
| Service cost | \$4 | \$5 | \$9 | \$10 |
| Interest cost | 23 | 25 | 46 | 51 |
| Expected return on plan assets | (33) | (32) | (67) | (64) |
| Recognized net actuarial losses | 1 | 5 | 2 | 10 |
| Amortization of prior service costs | 3 | 4 | 7 | 7 |
| Total net periodic benefit (credit) cost | \$(2) | \$7 | \$(3) | \$14 |

We record the service cost component of net periodic benefit cost as part of cost of sales and the non-service cost components of net periodic benefit cost (i.e., interest cost, expected return on plan assets, net actuarial gains or losses, and amortization of prior service cost or credits) as part of other non-operating expense, net in the consolidated statements of earnings.

The recognized net actuarial losses and amortization of prior service (credits) costs in the table above, along with similar amounts related to our other postretirement benefit plans (\$15 million and \$29 million for the quarter and six months ended June 24, 2018 and \$13 million and \$27 million for the quarter and six months ended June 25, 2017), were reclassified from accumulated other comprehensive loss (AOCL) and recorded as a component of net periodic benefit cost for the periods presented. These costs totaled \$381 million (\$300 million, net of tax) and \$763 million (\$600 million, net of tax) during the quarter and six months ended June 24, 2018 and \$309 million (\$200 million, net of tax) and \$621 million (\$402 million, net of tax) during the quarter and six months ended June 25, 2017, which were recorded on our consolidated statements of comprehensive income as an increase to other comprehensive income. The funding of our qualified defined benefit pension plans is determined in accordance with the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act of 2006 (PPA), and in a manner consistent with CAS and Internal Revenue Code rules. During the quarter and six months ended June 24, 2018, we contributed \$2.0 billion and \$3.5 billion to our qualified defined benefit pension plans. There were no material

contributions to our qualified defined benefit pension plans during the quarter and six months ended June 25, 2017. We will make additional contributions of \$1.5 billion to our qualified defined benefit pension plans on or before September 15, 2018.

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Notes to Consolidated Financial Statements (unaudited) (continued)

NOTE 8 – LEGAL PROCEEDINGS AND CONTINGENCIES

We are a party to or have property subject to litigation and other proceedings that arise in the ordinary course of our business, including matters arising under provisions relating to the protection of the environment and are subject to contingencies related to certain businesses we previously owned. These types of matters could result in fines, penalties, compensatory or treble damages or non-monetary sanctions or relief. We believe the probability is remote that the outcome of each of these matters, including the legal proceedings described below, will have a material adverse effect on the corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our net earnings in any particular interim reporting period. Among the factors that we consider in this assessment are the nature of existing legal proceedings and claims, the asserted or possible damages or loss contingency (if estimable), the progress of the case, existing law and precedent, the opinions or views of legal counsel and other advisers, our experience in similar cases and the experience of other companies, the facts available to us at the time of assessment and how we intend to respond to the proceeding or claim. Our assessment of these factors may change over time as individual proceedings or claims progress.

Although we cannot predict the outcome of legal or other proceedings with certainty, where there is at least a reasonable possibility that a loss may have been incurred, GAAP requires us to disclose an estimate of the reasonably possible loss or range of loss or make a statement that such an estimate cannot be made. We follow a thorough process in which we seek to estimate the reasonably possible loss or range of loss, and only if we are unable to make such an estimate do we conclude and disclose that an estimate cannot be made. Accordingly, unless otherwise indicated below in our discussion of legal proceedings, a reasonably possible loss or range of loss associated with any individual legal proceeding cannot be estimated.

Legal Proceedings

As a result of our acquisition of Sikorsky Aircraft Corporation (Sikorsky), we assumed the defense of and any potential liability for two civil False Claims Act lawsuits pending in the U.S. District Court for the Eastern District of Wisconsin. In October 2014, the U.S. Government filed a complaint in intervention in the first suit, which was brought by qui tam relator Mary Patzer, a former Derco Aerospace (Derco) employee. In May 2017, the U.S. Government filed a complaint in intervention in the second suit, which was brought by qui tam relator Peter Cimma, a former Sikorsky Support Services, Inc. (SSSI) employee. In November 2017, the Court consolidated the cases into a single action for discovery and trial.

The U.S. Government alleges that Sikorsky and two of its wholly-owned subsidiaries, Derco and SSSI, violated the civil False Claims Act and the Truth in Negotiations Act in connection with a contract the U.S. Navy awarded to SSSI in June 2006 to support the Navy's T-34 and T-44 fixed-wing turboprop training aircraft. SSSI subcontracted with Derco, primarily to procure and manage spare parts for the training aircraft. The U.S. Government contends that SSSI overbilled the Navy on the contract as the result of Derco's use of prohibited cost-plus-percentage-of-cost pricing to add profit and overhead costs as a percentage of the price of the spare parts that Derco procured and then sold to SSSI. The U.S. Government also alleges that Derco's claims to SSSI, SSSI's claims to the Navy, and SSSI's yearly Certificates of Final Indirect Costs from 2006 through 2012 were false and that SSSI submitted inaccurate cost or pricing data in violation of the Truth in Negotiations Act for a sole-sourced, follow-on "bridge" contract. The U.S. Government's complaints assert common law claims for breach of contract and unjust enrichment.

The U.S. Government further alleged violations of the Anti-Kickback Act and False Claims Act based on a monthly "chargeback," through which SSSI billed Derco for the cost of certain SSSI personnel, allegedly in exchange for SSSI's permitting a pricing arrangement that was "highly favorable" to Derco. On January 12, 2018, the Corporation filed a partial motion to dismiss intended to narrow the U.S. Government's claims, including by seeking dismissal of the Anti-Kickback Act allegations. The Corporation also moved to dismiss Cimma as a party under the False Claims Act's first-to-file rule, which permits only the first relator to recover in a pending case. The District Court granted these motions, in part, on July 20, 2018, dismissing the Government's claims under the Anti-Kickback Act and dismissing Cimma as a party to the litigation.

Before the District Court's July 20, 2018 ruling, the U.S. Government sought damages of approximately \$52 million, subject to trebling, plus statutory penalties. We do not know what effect, if any, the ruling will have on the U.S. Government's calculation of damages. We believe that we have legal and factual defenses to the U.S. Government's remaining claims. Although we continue to evaluate our liability and exposure, we do not currently believe that it is

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Notes to Consolidated Financial Statements (unaudited) (continued)

probable that we will incur a material loss. If, contrary to our expectations, the U.S. Government prevails in this matter and proves damages at or near \$52 million and is successful in having such damages trebled, the outcome could have an adverse effect on our results of operations in the period in which a liability is recognized and on our cash flows for the period in which any damages are paid.

On April 24, 2009, we filed a declaratory judgment action against the New York Metropolitan Transportation Authority and its Capital Construction Company (collectively, the MTA) asking the U.S. District Court for the Southern District of New York to find that the MTA is in material breach of our agreement based on the MTA's failure to provide access to sites where work must be performed and the customer-furnished equipment necessary to complete the contract. The MTA filed an answer and counterclaim alleging that we breached the contract and subsequently terminated the contract for alleged default. The primary damages sought by the MTA are the costs to complete the contract and potential re-procurement costs. While we are unable to estimate the cost of another contractor to complete the contract and the costs of re-procurement, we note that our contract with the MTA had a total value of \$323 million, of which \$241 million was paid to us, and that the MTA is seeking damages of approximately \$190 million. We dispute the MTA's allegations and are defending against them. Additionally, following an investigation, our sureties on a performance bond related to this matter, who were represented by independent counsel, concluded that the MTA's termination of the contract was improper. Finally, our declaratory judgment action was later amended to include claims for monetary damages against the MTA of approximately \$95 million. This matter was taken under submission by the District Court in December 2014, after a five-week bench trial and the filing of post-trial pleadings by the parties. We continue to await a decision from the District Court. Although this matter relates to our former Information Systems & Global Solutions (IS&GS) business, we retained the litigation when we divested IS&GS in 2016.

Environmental Matters

We are involved in proceedings and potential proceedings relating to soil, sediment, surface water, and groundwater contamination, disposal of hazardous waste, and other environmental matters at several of our current or former facilities and at third-party sites where we have been designated as a potentially responsible party (PRP). A substantial portion of environmental costs will be included in our net sales and cost of sales in future periods pursuant to U.S. Government regulations. At the time a liability is recorded for future environmental costs, we record a receivable for estimated future recovery considered probable through the pricing of products and services to agencies of the U.S. Government, regardless of the contract form (e.g., cost-reimbursable, fixed-price). We continually evaluate the recoverability of our environmental receivables by assessing, among other factors, U.S. Government regulations, our U.S. Government business base and contract mix, our history of receiving reimbursement of such costs, and efforts by some U.S. Government representatives to limit such reimbursement. We include the portion of those environmental costs expected to be allocated to our non-U.S. Government contracts, or that is determined not to be recoverable under U.S. Government contracts, in our cost of sales at the time the liability is established.

At June 24, 2018 and December 31, 2017, the aggregate amount of liabilities recorded relative to environmental matters was \$910 million and \$920 million, most of which are recorded in other noncurrent liabilities on our consolidated balance sheets. We have recorded receivables totaling \$789 million and \$799 million at June 24, 2018 and December 31, 2017, most of which are recorded in other noncurrent assets on our consolidated balance sheets, for the estimated future recovery of these costs, as we consider the recovery probable based on the factors previously mentioned. We project costs and recovery of costs over approximately 20 years.

Environmental remediation activities usually span many years, which makes estimating liabilities a matter of judgment because of uncertainties with respect to assessing the extent of the contamination as well as such factors as changing remediation technologies and changing regulatory environmental standards. There are a number of former and present operating facilities that we are monitoring or investigating for potential future remediation. We perform quarterly reviews of the status of our environmental remediation sites and the related liabilities and receivables.

Additionally, in our quarterly reviews, we consider these and other factors in estimating the timing and amount of any

future costs that may be required for remediation activities, and record a liability when it is probable that a loss has occurred and the loss can be reasonably estimated. The amount of liability recorded is based on our estimate of the costs to be incurred for remediation at a particular site. We do not discount the recorded liabilities, as the amount and timing of future cash payments are not fixed or cannot be reliably determined. We reasonably cannot determine the extent of our financial exposure in all cases as, although a loss may be probable or reasonably possible, in some cases it is not possible at this time to estimate the loss or reasonably possible loss or range of loss.

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We also pursue claims for recovery of costs incurred or for contribution to site cleanup costs against other PRPs, including the U.S. Government, and are conducting remediation activities under various consent decrees, orders, and agreements relating to soil, groundwater, sediment, or surface water contamination at certain sites of former or current operations. Under agreements related to certain sites in California and New York, the U.S. Government reimburses us an amount equal to a percentage, specific to each site, of expenditures for certain remediation activities in the U.S. Government's capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

In addition to the proceedings and potential proceedings discussed above, California previously established a maximum level of the contaminant hexavalent chromium in drinking water of 10 parts per billion (ppb). This standard was successfully challenged by the California Manufacturers and Technology Association (CMTA) for failure to conduct the required economic feasibility analysis. In response to the court's ruling, the State Water Resources Control Board (State Board), a branch of the California Environmental Protection Agency, withdrew the hexavalent chromium standard from the published regulations, leaving only the 50 ppb standard for total chromium. The State Board has indicated it will work to re-establish a hexavalent chromium standard. If the standard for hexavalent chromium is re-established at 10 ppb or above, it will not have a material impact on our existing remediation costs in California. Further, the U.S. Environmental Protection Agency (U.S. EPA) is considering whether to regulate hexavalent chromium.

California is also reevaluating its existing drinking water standard of 6 ppb for perchlorate, and the U.S. EPA is taking steps to regulate perchlorate in drinking water. If substantially lower standards are adopted, in either California or at the federal level for perchlorate or for hexavalent chromium, we expect a material increase in our estimates for environmental liabilities and the related assets for the portion of the increased costs that are probable of future recovery in the pricing of our products and services for the U.S. Government. The amount that would be allocable to our non-U.S. Government contracts or that is determined not to be recoverable under U.S. Government contracts would be expensed, which may have a material effect on our earnings in any particular interim reporting period.

Letters of Credit, Surety Bonds and Third-Party Guarantees

We have entered into standby letters of credit and surety bonds issued on our behalf by financial institutions, and directly issued guarantees to third parties primarily relating to advances received from customers and the guarantee of future performance on certain contracts. Letters of credit and surety bonds generally are available for draw down in the event we do not perform. In some cases, we may guarantee the contractual performance of third parties such as venture partners. We had total outstanding letters of credit, surety bonds and third-party guarantees aggregating \$3.5 billion and \$3.3 billion at June 24, 2018 and December 31, 2017. Third-party guarantees do not include guarantees of subsidiaries and other consolidated entities.

At June 24, 2018 and December 31, 2017, third-party guarantees totaled \$790 million and \$750 million, of which approximately 64% and 62% related to guarantees of contractual performance of ventures to which we currently are or previously were a party. This amount represents our estimate of the maximum amount we would expect to incur upon the contractual non-performance of the venture, venture partners or divested businesses. Generally, we also have cross-indemnities in place that may enable us to recover amounts that may be paid on behalf of a venture partner. In determining our exposures, we evaluate the reputation, performance on contractual obligations, technical capabilities and credit quality of our current and former venture partners and the transferee under novation agreements all of which include a guarantee as required by the FAR. There were no material amounts recorded in our financial statements related to third-party guarantees or novation agreements.

United Launch Alliance

In connection with our 50% ownership interest of ULA, we and The Boeing Company (Boeing) are required to provide ULA an additional capital contribution if ULA is unable to make required payments under its inventory supply agreement with Boeing. As of June 24, 2018, ULA's total remaining obligation to Boeing under the inventory supply agreement was \$120 million. The parties have agreed to defer the remaining payment obligation, as it is more

than offset by other commitments to ULA. Accordingly, we do not expect to be required to make a capital contribution to ULA under this agreement.

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In addition, both we and Boeing have cross-indemnified each other for guarantees by us and Boeing of the performance and financial obligations of ULA under certain launch service contracts. We believe ULA will be able to fully perform its obligations, as it has done through June 24, 2018, and that it will not be necessary to make payments under the cross-indemnities or guarantees.

NOTE 9 – FAIR VALUE MEASUREMENTS

Assets and liabilities measured and recorded at fair value on a recurring basis consisted of the following (in millions):

| | June 24, 2018 | | December 31, 2017 | | |
|--|---------------|---------|-------------------|---------|---------|
| | Total | Level 1 | Total | Level 1 | Level 2 |
| Assets | | | | | |
| Mutual funds | \$1,067 | \$1,067 | \$917 | \$917 | \$— |
| U.S. Government securities | 93 | — | 93 | — | 116 |
| Derivatives | 17 | — | 1723 | — | 23 |
| Other securities | 158 | 30 | 12809 | 39 | 170 |
| Liabilities | | | | | |
| Derivatives | 101 | — | 101 | — | 106 |
| Assets measured at NAV ^(a) | | | | | |
| Other commingled funds | 18 | — | 19 | — | — |

^(a) Net Asset Value (NAV) is the total value of the fund divided by the number of the fund's shares outstanding.

Substantially all assets measured at fair value, other than derivatives, represent investments held in a separate trust to fund certain of our non-qualified deferred compensation plans and are recorded in other noncurrent assets on our consolidated balance sheets. The fair values of mutual funds and certain other securities are determined by reference to the quoted market price per unit in active markets multiplied by the number of units held without consideration of transaction costs. The fair values of U.S. Government and other securities are determined using pricing models that use observable inputs (e.g., interest rates and yield curves observable at commonly quoted intervals), bids provided by brokers or dealers or quoted prices of securities with similar characteristics. The fair values of derivative instruments, which consist of foreign currency exchange forward and interest rate swap contracts, primarily are determined based on the present value of future cash flows using model-derived valuations that use observable inputs such as interest rates, credit spreads and foreign currency exchange rates. We did not have any material transfers of assets or liabilities between levels of the fair value hierarchy during the six months ended June 24, 2018.

We use derivative instruments principally to reduce our exposure to market risks from changes in foreign currency exchange rates and interest rates. We do not enter into or hold derivative instruments for speculative trading purposes. We transact business globally and are subject to risks associated with changing foreign currency exchange rates. We enter into foreign currency hedges such as forward and option contracts that change in value as foreign currency exchange rates change. These contracts hedge forecasted foreign currency transactions in order to mitigate fluctuations in our earnings and cash flows associated with changes in foreign currency exchange rates. We designate foreign currency hedges as cash flow hedges. We also are exposed to the impact of interest rate changes primarily through our borrowing activities. For fixed rate borrowings, we may use variable interest rate swaps, effectively converting fixed rate borrowings to variable rate borrowings in order to reduce the amount of interest paid. These swaps are designated as fair value hedges. For variable rate borrowings, we may use fixed interest rate swaps, effectively converting variable rate borrowings to fixed rate borrowings in order to mitigate the impact of interest rate changes on earnings. These swaps are designated as cash flow hedges. We also may enter into derivative instruments that are not designated as hedges and do not qualify for hedge accounting, which are intended to mitigate certain economic exposures.

The aggregate notional amount of our outstanding interest rate swaps at both June 24, 2018 and December 31, 2017 was \$1.2 billion and the fair value was not significant. The aggregate notional amount of our outstanding foreign currency hedges at June 24, 2018 and December 31, 2017 was \$3.9 billion and \$4.1 billion and the fair value was not

significant. Derivative instruments did not have a material impact on net earnings and comprehensive income during the quarters and six months ended June 24, 2018 and June 25, 2017. Substantially all of our derivatives are designated for hedge accounting.

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In addition to the financial instruments listed in the table above, we hold other financial instruments, including debt. The estimated fair value of our outstanding debt was \$15.6 billion and \$16.8 billion at June 24, 2018 and December 31, 2017 (Level 2). The outstanding principal amount of debt was \$15.4 billion and \$15.5 billion, excluding unamortized discounts and issuance costs of \$1.2 billion at both June 24, 2018 and December 31, 2017.

NOTE 10 – STOCKHOLDERS’ EQUITY

Repurchases of Common Stock

During the six months ended June 24, 2018, we repurchased 1.9 million shares of our common stock for \$623 million, of which \$13 million was settled subsequent to the end of the second quarter. The total remaining authorization for future common share repurchases under our share repurchase program was \$2.9 billion as of June 24, 2018. As we repurchase our common shares, we reduce common stock for the \$1 of par value of the shares repurchased, with the excess purchase price over par value recorded as a reduction of additional paid-in capital. If additional paid-in capital is reduced to zero, we record the remainder of the excess purchase price over par value as a reduction of retained earnings. Due to the volume of repurchases and the prices at which these were made, additional paid-in capital was reduced to zero, with the remainder of the excess purchase price over par value of \$460 million and \$828 million recorded as a reduction of retained earnings during the six months ended June 24, 2018 and June 25, 2017.

Dividends

We declared cash dividends totaling \$572 million (\$2.00 per share) and \$1.1 billion (\$4.00 per share) during the quarter and six months ended June 24, 2018. We declared cash dividends totaling \$1.1 billion (\$3.64 per share) and \$1.6 billion (\$5.46 per share) during the quarter and six months ended June 25, 2017. The 2017 dividend amounts include the declaration of our 2017 third quarter dividend of \$1.82 per share, which totaled \$528 million. On June 28, 2018, subsequent to the end of our second quarter, we declared our 2018 third quarter dividend of \$2.00 per share.

Restricted Stock Unit Grants

During the six months ended June 24, 2018, we granted certain employees approximately 0.4 million RSUs with a grant date fair value of \$354.54 per RSU. The grant date fair value of these RSUs is equal to the closing market price of our common stock on the grant date less a discount to reflect the delay in payment of dividend-equivalent cash payments that are made only upon vesting, which is generally three years from the grant date. We recognize the grant date fair value of RSUs, less estimated forfeitures, as compensation expense ratably over the requisite service period, which is shorter than the vesting period if the employee is retirement eligible on the date of grant or will become retirement eligible before the end of the vesting period.

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Accumulated Other Comprehensive Loss

Changes in the balance of AOCL, net of tax, consisted of the following (in millions):

| | Postretirement Benefit Plans | Other, net | AOCL |
|---|---------------------------------|------------|------------|
| Balance at December 31, 2017 | \$ (12,559) | \$ 20 | \$(12,539) |
| Other comprehensive income before reclassifications | — | (62) | (62) |
| Amounts reclassified from AOCL | | | |
| Recognition of net actuarial losses ^(a) | 728 | — | 728 |
| Amortization of net prior service credits ^(a) | (128) | — | (128) |
| Other | — | 14 | 14 |
| Total reclassified from AOCL | 600 | 14 | 614 |
| Total other comprehensive income | 600 | (48) | 552 |
| Reclassification of income tax effects from tax reform ^(b) | (2,396) | (12) | (2,408) |
| Balance at June 24, 2018 | \$ (14,355) | \$ (40) | \$(14,395) |
| Balance at December 31, 2016 | \$ (11,981) | \$ (121) | \$(12,102) |
| Other comprehensive income before reclassifications | 3 | 53 | 56 |
| Amounts reclassified from AOCL | | | |
| Recognition of net actuarial losses ^(a) | 516 | — | 516 |
| Amortization of net prior service credits ^(a) | (114) | — | (114) |
| Other | — | 7 | 7 |
| Total reclassified from AOCL | 402 | 7 | 409 |
| Total other comprehensive income | 405 | 60 | 465 |
| Balance at June 25, 2017 | \$ (11,576) | \$ (61) | \$(11,637) |

Reclassifications from AOCL related to our postretirement benefit plans were recorded as a component of net periodic benefit cost for each period presented (see “Note 7 – Postretirement Benefit Plans”). These amounts include ^(a) \$300 million and \$200 million, net of tax, for the quarters ended June 24, 2018 and June 25, 2017, which are comprised of the recognition of net actuarial losses of \$364 million and \$258 million for the quarters ended June 24, 2018 and June 25, 2017 and the amortization of net prior service credits of \$(64) million and \$(58) million for the quarters ended June 24, 2018 and June 25, 2017.

We reclassified the impact of the income tax effects related to the Tax Cuts and Jobs Act of 2017 (the Tax Act) ^(b) from AOCL during the first quarter of 2018 to retained earnings by the same amount with zero impact to total equity. See ASU 2018-02 in “Note 12 – Recent Accounting Pronouncements” for additional information.

NOTE 11 – OTHER

Equity Method Investee Impairment

During the quarter ended March 26, 2017, equity earnings included a charge recorded of approximately \$64 million (\$40 million, or \$0.14 per share, after tax), which represented our portion of a non-cash asset impairment related to certain long-lived assets held by our equity method investee, AMMROC. As of June 24, 2018, our equity method investment in AMMROC totaled approximately \$560 million. We are continuing to monitor this investment in light of ongoing performance, business base and economic issues and we may have to record our portion of additional charges, or an impairment of our investment, or both, should the carrying value of our investment exceed its fair value. These charges could adversely affect our financial condition and results of operations.

Severance and Restructuring Charges

During the quarter ended June 24, 2018, we recorded charges totaling \$96 million (\$76 million, or \$0.26 per share, after tax) related to certain severance and restructuring actions at our RMS business segment. These charges consist of \$75 million of severance costs for the planned elimination of certain positions through either voluntary or involuntary

actions and \$21 million of asset impairment charges associated with our decision to consolidate certain operations. Upon separation, terminated employees will receive lump-sum severance payments primarily based on years of service, a

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majority of which we expect to pay by the end of 2018. These actions resulted from a strategic review of our RMS business segment and are intended to improve the efficiency of our operations and better align our organization and cost structure with changing economic conditions. We expect to recover a portion of the severance and restructuring charges through the pricing of our products and services to the U.S. Government and other customers in future periods, which will be included in RMS' operating results.

Income Taxes

Our effective income tax rates were 18.1% and 16.5% for the quarter and six months ended June 24, 2018, and 28.8% and 26.6% for the quarter and six months ended June 25, 2017. The lower rate for the quarter and six months ended June 24, 2018 is primarily due to the reduction of the federal statutory rate from 35% to 21% as a result of the Tax Act enacted in December 2017. The rates for both periods benefited from tax deductions for dividends paid to our defined contribution plans with an employee stock ownership plan feature, tax deductions for employee equity awards, and the research and development tax credit. The rate for the quarter and six months ended June 24, 2018 also benefited from the Tax Act's deduction for foreign derived intangible income. The rate for the quarter and six months ended June 25, 2017 benefited from tax deductions for U.S. manufacturing activities, which the Tax Act repealed for years after 2017. While we have substantially completed our provisional analysis of the income tax effects of the Tax Act as of December 31, 2017 and recorded a reasonable estimate in 2017 of such effects, actual effects may differ, possibly materially, due to, among other things, further refinement of our calculations, changes in interpretations and assumptions that we have made, additional guidance that may be issued by the U.S. Government, and actions and related accounting policy decisions we may take as a result of the Tax Act. We will complete our analysis of the impact of the Tax Act for 2017 over a one-year measurement period ending December 22, 2018, and any adjustments during this measurement period will be included in net earnings as an adjustment to income tax expense in the reporting period when such adjustments are determined. We have not identified any material change to the net one-time charge for the period ending December 31, 2017 related to the Tax Act.

NOTE 12 – RECENT ACCOUNTING PRONOUNCEMENTS**Recent Accounting Pronouncements Adopted**

Effective January 1, 2018, we adopted ASC 606, which replaces existing revenue recognition guidance and outlines a single set of comprehensive principles for recognizing revenue under GAAP. Among other things, ASC 606 requires entities to assess the products or services promised in contracts with customers at contract inception to determine the appropriate unit at which to record revenues, which is referred to as a performance obligation. Revenue is recognized when control of the promised products or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those products or services. Prior to the adoption of ASC 606, we recognized the majority of our revenues using the percentage-of-completion method of accounting. Based on the nature of products provided or services performed, revenue was recorded as costs were incurred (the percentage-of-completion cost-to-cost method) or as units were delivered (the percentage-of-completion units-of-delivery method). For most of our contracts, the customer obtains control or receives benefits as we perform on the contract. As a result, under ASC 606 revenue is recognized over a period of time utilizing the percentage-of-completion cost-to-cost method. This change generally results in an acceleration of revenue for contracts that were historically accounted for using the percentage-of-completion units-of-delivery method as revenues are now recognized earlier in the performance period as we incur costs. For more information on our policy for recognizing revenue under ASC 606, see "Note 2 – Significant Accounting Policy Updates." Significant programs impacted by these changes include the C-130J and C-5 programs in our Aeronautics business segment; tactical missile programs (Hellfire and Joint Air-to-Surface Standoff Missile (JASSM)), Patriot Advanced Capability-3 (PAC-3), and fire control programs (LANTIRN® and SNIPER®) in our MFC business segment; the Black Hawk and Seahawk helicopter programs in our RMS business segment; and commercial satellite programs in our Space business segment. We adopted ASC 606 using the full retrospective method, which means we applied the new standard to each prior year presented in our financial statements going back to January 1, 2016, with a cumulative effect adjustment to

retained earnings as of January 1, 2016 for contracts that were in process at that point in time. Accordingly, the amounts for all periods presented in this Form 10-Q have been adjusted to reflect the impacts of ASC 606.

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Effective January 1, 2018, we also adopted ASU 2017-07, which changed the income statement presentation of certain components of net periodic benefit cost related to defined benefit pension and other postretirement benefit plans. ASU 2017-07 requires entities to record only the service cost component of FAS pension and other postretirement benefit plan expense in operating profit and the non-service cost components of FAS pension and other postretirement benefit plan expense (i.e., interest cost, expected return on plan assets, net actuarial gains or losses, and amortization of prior service cost or credits) as part of non-operating expense. Previously, we recorded all components of net periodic benefit cost in operating profit as part of cost of sales. We adopted ASU 2017-07 using the retrospective method, which means we applied the new standard to each prior period presented in our financial statements going back to January 1, 2016.

The following tables summarize the effects of adopting ASC 606 and ASU 2017-07 on our consolidated statement of earnings for the quarter and six months ended June 25, 2017 (unaudited; in millions, except per share data):

| | Quarter Ended | | | Adjusted |
|--------------------------------------|---------------|---------|-----------------------------|-----------|
| | Historical | ASC 606 | Adjustments for ASU 2017-07 | |
| Net sales | | | | |
| Products | \$10,828 | \$(206) | \$ — | \$10,622 |
| Services | 1,857 | 84 | — | 1,941 |
| Total net sales | 12,685 | (122) | — | 12,563 |
| Cost of sales | | | | |
| Products | (9,751) | 189 | — | (9,562) |
| Services | (1,658) | (48) | — | (1,706) |
| Other unallocated, net | 149 | — | 212 | 361 |
| Total cost of sales | (11,260) | 141 | 212 | (10,907) |
| Gross profit | 1,425 | 19 | 212 | 1,656 |
| Other income, net | 60 | — | — | 60 |
| Operating profit | 1,485 | 19 | 212 | 1,716 |
| Interest expense | (160) | — | — | (160) |
| Other non-operating expense, net | (2) | — | (212) | (214) |
| Earnings before income taxes | 1,323 | 19 | — | 1,342 |
| Income tax expense | (381) | (6) | — | (387) |
| Net earnings | \$942 | \$13 | \$ — | \$955 |
| Earnings per common share | | | | |
| Basic | \$3.27 | \$0.04 | \$ — | \$3.31 |
| Diluted | \$3.23 | \$0.05 | \$ — | \$3.28 |
| Cash dividends paid per common share | \$1.82 | \$— | \$ — | \$1.82 |

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| | Six Months Ended | | | Adjusted |
|--------------------------------------|------------------|------------|----------------|-----------|
| | Historical | ASC 606 | ASU 2017-07 | |
| Net sales | | | | |
| Products | \$20,341 | \$(106) | \$ — | \$20,235 |
| Services | 3,401 | 139 | — | 3,540 |
| Total net sales | 23,742 | 33 | — | 23,775 |
| Cost of sales | | | | |
| Products | (18,438) | 132 | — | (18,306) |
| Services | (3,034) | (106) | — | (3,140) |
| Other unallocated, net | 308 | — | 425 | 733 |
| Total cost of sales | (21,164) | 26 | 425 | (20,713) |
| Gross profit | 2,578 | 59 | 425 | 3,062 |
| Other expense, net | 56 | — | — | 56 |
| Operating profit | 2,634 | 59 | 425 | 3,118 |
| Interest expense | (315) | — | — | (315) |
| Other non-operating expense, net | (1) | — | (425) | (426) |
| Earnings before income taxes | 2,318 | 59 | — | 2,377 |
| Income tax expense | (613) | (20) | — | (633) |
| Net earnings | \$1,705 | \$39 | \$ — | \$1,744 |
| Earnings per common share | | | | |
| Basic | \$5.90 | \$0.13 | \$ — | \$6.03 |
| Diluted | \$5.84 | \$0.13 | \$ — | \$5.97 |
| Cash dividends paid per common share | \$3.64 | \$— | \$ — | \$3.64 |

As a result of the increase in net earnings, our comprehensive income for the quarter and six months ended June 25, 2017 increased by \$13 million to \$1.2 billion and increased by \$39 million to \$2.2 billion.

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The following table summarizes the effects of adopting ASC 606 on our consolidated balance sheet as of December 31, 2017 (ASU 2017-07 had no impact on our consolidated balance sheet) (unaudited; in millions, except par value):

| | | Adjustments for | |
|--|------------|--------------------|-----------|
| | Historical | ASC 606 | Adjusted |
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents | \$2,861 | \$ — | \$2,861 |
| Receivables, net | 8,603 | (6,338) | 2,265 |
| Contract assets | — | 7,992 | 7,992 |
| Inventories | 4,487 | (1,609) | 2,878 |
| Other current assets | 1,510 | (1) | 1,509 |
| Total current assets | 17,461 | 44 | 17,505 |
| Property, plant and equipment, net | 5,775 | — | 5,775 |
| Goodwill | 10,807 | — | 10,807 |
| Intangible assets, net | 3,797 | — | 3,797 |
| Deferred income taxes | 3,111 | 45 | 3,156 |
| Other noncurrent assets | 5,570 | 10 | 5,580 |
| Total assets | \$46,521 | \$ 99 | \$46,620 |
| Liabilities and equity | | | |
| Current liabilities | | | |
| Accounts payable | \$1,467 | \$ — | \$1,467 |
| Contract liabilities ^(a) | 6,752 | 276 | 7,028 |
| Salaries, benefits and payroll taxes | 1,785 | — | 1,785 |
| Current maturities of long-term debt | 750 | — | 750 |
| Other current liabilities | 1,883 | — | 1,883 |
| Total current liabilities | 12,637 | 276 | 12,913 |
| Long-term debt, net | 13,513 | — | 13,513 |
| Accrued pension liabilities | 15,703 | — | 15,703 |
| Other postretirement benefit liabilities | 719 | — | 719 |
| Other noncurrent liabilities | 4,558 | (10) | 4,548 |
| Total liabilities | 47,130 | 266 | 47,396 |
| Stockholders' equity | | | |
| Common stock, \$1 par value per share | 284 | — | 284 |
| Additional paid-in capital | — | — | — |
| Retained earnings | 11,573 | (168) | 11,405 |
| Accumulated other comprehensive loss | (12,540) | 1 | (12,539) |
| Total stockholders' deficit | (683) | (167) | (850) |
| Noncontrolling interests in subsidiary | 74 | — | 74 |
| Total deficit | (609) | (167) | (776) |
| Total liabilities and equity | \$46,521 | \$ 99 | \$46,620 |

^(a) Formerly referred to as customer advances and amounts in excess of costs incurred.

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Lockheed Martin Corporation

Notes to Consolidated Financial Statements (unaudited) (continued)

The following table summarizes the effects of adopting ASC 606 on certain components within our net cash provided by operating activities for the six months ended June 25, 2017 (ASC 606 had no impact on total operating cash flows or cash flows from investing and financing activities) (unaudited; in millions):

| | Adjustments for | | |
|--|--------------------|---------|----------|
| | Historical | ASC 606 | Adjusted |
| Operating activities | | | |
| Net earnings | \$ 1,705 | \$ 39 | \$ 1,744 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | | |
| Depreciation and amortization | 581 | — | 581 |
| Stock-based compensation | 101 | — | 101 |
| Changes in assets and liabilities | | | |
| Receivables, net | (560) | (59) | (619) |
| Contract assets | — | (170) | (170) |
| Inventories | (271) | 233 | (38) |
| Accounts payable | 940 | — | 940 |
| Contract liabilities ^(a) | (316) | (72) | (388) |
| Postretirement benefit plans | 685 | — | 685 |
| Income taxes | 3 | — | 3 |
| Other, net | 342 | 29 | 371 |
| Net cash provided by operating activities | \$ 3,210 | \$ — | \$ 3,210 |

^(a) Formerly referred to as customer advances and amounts in excess of costs incurred.

Effective January 1, 2018, we also adopted ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which provides entities an option to reclassify certain tax effects as a result of the Tax Act from accumulated other comprehensive income or loss to retained earnings. The adoption of ASU 2018-02 increased our AOCL at January 1, 2018 by \$2.4 billion with a corresponding increase to retained earnings by the same amount with zero impact to total equity. The reclassification was primarily related to the impact of U.S. tax reform on deferred tax assets associated with net actuarial losses (and prior service credits) resulting from our defined benefit pension and other postretirement benefit plans that were originally recorded in AOCL within equity. Those amounts were originally recorded net of deferred tax benefits based on the federal statutory income tax rate in effect at the time they were recorded. GAAP requires entities to remeasure deferred tax assets and liabilities as a result of a change in tax laws or rates, with the impacts reflected in earnings. Accordingly, in the fourth quarter of 2017, we remeasured the deferred tax assets associated with our AOCL using the lower U.S. corporate income tax rate under the Tax Act, with the impacts of the remeasurement recorded as a one-time charge to earnings. Prior to ASU 2018-02, GAAP required the original deferred tax amount recorded in accumulated other comprehensive income or loss, to remain at the old tax rate despite the fact that its related deferred tax asset or liability was remeasured as a result of the Tax Act. ASU 2018-02 allows entities to record a one-time reclassification of these tax effects between accumulated other comprehensive income or loss and retained earnings. We reclassify the impact of the income tax effects of tax reform from AOCL in the period in which they occur.

Recent Accounting Pronouncements Not Yet Adopted

In August 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-12, Derivatives and Hedging (Topic 815), which eliminates the requirement to separately measure and report hedge ineffectiveness. The guidance is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. We do not expect a significant impact to our consolidated assets and liabilities, net earnings, or cash flows as a result of adopting this new standard. We plan to adopt the new standard effective January 1, 2019.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize a right-of-use asset and lease liability on the balance sheet for most lease arrangements and expands disclosures about leasing arrangements for both lessees and lessors, among other items. The new standard is effective for public companies for fiscal years beginning after December 15, 2018, with early adoption permitted, and must be adopted using a modified

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Lockheed Martin Corporation

Notes to Consolidated Financial Statements (unaudited) (continued)

retrospective transition method. Currently, the new standard requires companies to apply the new lease requirements as of the beginning of the earliest period presented in the financial statements, which would be January 1, 2017 in our December 31, 2019 Form 10-K. However, the FASB has proposed a change that would allow companies to elect an optional transition method whereby companies could continue to apply existing lease guidance during the comparative periods and apply the new lease requirements through a cumulative-effect adjustment in the period of adoption rather than in the earliest period presented, which would result in an adjustment, if any, to our January 1, 2019 retained earnings balance in our December 31, 2019 Form 10-K without adjusting our historical financial statements for 2017 or 2018. We plan to adopt the new standard on January 1, 2019 and will evaluate the transition method if and when the FASB issues new guidance that permits the optional transition method.

We commenced our evaluation of the impact of the new lease accounting standard in late 2016 by evaluating its impact on selected contracts. With this baseline understanding, we developed a project plan to evaluate numerous contracts across our corporation, develop processes and tools to implement the new standard and identify and design changes to internal controls by January 1, 2019, which we continued to perform under this plan through the end of the second quarter of 2018. The majority of our existing lease arrangements are classified as operating leases, which we expect will continue to be classified as operating under the new standard. Upon adoption of the new standard, we will record a right-of-use asset and lease liability on our balance sheet for all of our lease arrangements. Based on our progress to date, we anticipate being able to estimate the impacts of adopting the new standard in our third quarter of 2018.

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Report of Independent Registered Public Accounting Firm
Board of Directors and Stockholders
Lockheed Martin Corporation

Results of Review of Interim Financial Statements

We have reviewed the accompanying consolidated balance sheet of Lockheed Martin Corporation (the Corporation) as of June 24, 2018, the related consolidated statements of earnings and comprehensive income for the quarters and six months ended June 24, 2018 and June 25, 2017 and consolidated statements of cash flows and equity for the six months ended June 24, 2018 and June 25, 2017, and the related notes (collectively referred to as the “consolidated interim financial statements”). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial statements for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Corporation as of December 31, 2017, the related consolidated statements of earnings, comprehensive income, cash flows and equity for the year then ended, and the related notes (not presented herein); and in our report dated February 6, 2018, we expressed an unqualified audit opinion on those consolidated financial statements. As described in Note 1 to the Corporation’s consolidated interim financial statements, on January 1, 2018, the Corporation adopted Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), as amended, using the full retrospective adoption method resulting in revision of the December 31, 2017 consolidated balance sheet. We have not audited and reported on the revised December 31, 2017 consolidated balance sheet reflecting the adoption of ASU No. 2014-09.

Basis for Review Results

These financial statements are the responsibility of the Corporation’s management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB. We conducted our review in accordance with the standards of the PCAOB. A review of interim financial statements consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/ Ernst & Young LLP
Tysons, Virginia
July 24, 2018

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

BUSINESS OVERVIEW

We are a global security and aerospace company principally engaged in the research, design, development, manufacture, integration and sustainment of advanced technology systems, products and services. We also provide a broad range of management, engineering, technical, scientific, logistics, system integration and cybersecurity services. We serve both U.S. and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government. During the six months ended June 24, 2018, 71% of our \$25.0 billion in net sales were from the U.S. Government, either as a prime contractor or as a subcontractor (including 60% from the Department of Defense (DoD)), 28% were from international customers (including foreign military sales (FMS) contracted through the U.S. Government) and 1% were from U.S. commercial and other customers. Our main areas of focus are in defense, space, intelligence, homeland security and information technology, including cybersecurity.

We currently expect 2018 net sales will increase in the mid-single digit range from 2017 levels. The projected growth is driven by increased production and sustainment volume on the F-35 program at Aeronautics as well as increased volume in tactical missiles programs and sensors and global sustainment at Missiles and Fire Control (MFC). Segment operating profit is expected to increase in the low-double digit range from 2017 levels driven primarily by improved performance at Rotary and Mission Systems (RMS). We expect that 2018 segment operating profit margin will also exceed our 2017 margin of 10.2%. Our outlook for 2018 assumes the U.S. Government continues to support and fund our key programs, consistent with the government fiscal year 2018 budget. Changes in circumstances may require us to revise our assumptions, which could materially change our current estimate of 2018 net sales and operating profit margin. For additional information related to trends in net sales and operating profit at our business segments, see the "Business Segment Results of Operations" discussion below.

We continue to expect the net 2018 FAS/CAS pension benefit to be approximately \$1.0 billion. We have contributed \$3.5 billion to our qualified defined benefit pension plans during the six months ended June 24, 2018 and will contribute an additional \$1.5 billion on or before September 15, 2018. As a result of these contributions, we do not expect any material qualified defined benefit cash funding will be required until 2021. We plan to fund these contributions using a mix of cash on hand and commercial paper. While we do not anticipate a need to do so, our capital structure and resources would allow us to issue new debt if circumstances change (see "Capital Structure, Resources and Other" discussion below).

The following discussion is a supplement to and should be read in conjunction with the accompanying consolidated financial statements and notes thereto and with our Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Form 10-K).

INDUSTRY CONSIDERATIONS

U.S. Government Funding

There have been no material updates with respect to U.S. Government budgetary actions that affect defense spending from what we reported in our Quarterly Report on Form 10-Q for the quarter ended March 25, 2018. We currently continue to await action with respect to the President's fiscal year (FY) 2019 budget proposal that was submitted to Congress on February 12, 2018, which includes a base budget for national defense of \$647 billion, inclusive of \$617 billion for the U.S. DoD. The base budget request for national defense is consistent with the revised spending limits established under the Bipartisan Budget Act of 2018 (BBA of 2018) and represents an increase of nearly \$17 billion over the FY 2018 funding level, most of which relates to increases in the DoD's budget. Congress must approve or revise the President's FY 2019 budget proposal through enactment of appropriations bills and other policy legislation, which would then require final approval from the President.

Currently, U.S. defense spending in FY 2020 and FY 2021 remains subject to statutory spending limits established by the Budget Control Act of 2011 (Budget Control Act). The Budget Control Act spending limits were modified for

fiscal years 2013 through 2019 by the American Taxpayer Relief Act of 2012, the Bipartisan Budget Act of 2013, the Bipartisan Budget Act of 2015, and most recently the BBA of 2018. However, these acts do not alter the spending limits beyond FY 2019. As currently enacted, the Budget Control Act limits defense spending to \$576 billion (including approximately \$550 billion for DoD) for fiscal year 2020 with a modest increase to \$590 billion (including approximately \$563 billion for DoD) in 2021. The President's defense budget estimates for FY 2020 and beyond exceed the spending limits established

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by the Budget Control Act. As a result, continued budget uncertainty and the risk of future sequestration cuts remain unless the Budget Control Act is repealed or significantly modified.

The investments and acquisitions we have made in recent years have sought to align our businesses with what we believe are the most critical national priorities and mission areas. However, the possibility remains that our programs could be materially reduced, extended, or terminated as a result of the U.S. Government's continuing assessment of priorities, changes in government priorities, the implementation of sequestration (particularly in those circumstances where sequestration is implemented across-the-board without regard to national priorities), or other budget cuts in lieu of sequestration. We anticipate there will continue to be a significant amount of debate and negotiations within the U.S. Government over federal and defense spending. In the context of these negotiations, it is possible that government programs could be modified, cut or replaced as part of broader reforms to reduce the federal deficit. However, we continue to believe that our portfolio of products and services will continue to be well supported in a strategically focused allocation of budget resources.

CONSOLIDATED RESULTS OF OPERATIONS

Effective January 1, 2018, we adopted Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, as amended (Topic 606) (commonly referred to as ASC 606), which changed the way we recognize revenue for certain contracts. In addition, effective January 1, 2018, we adopted ASU 2017-07, Compensation-Retirement Benefits, which changed the statement of earnings presentation of certain components of pension and other postretirement benefit plan expense. The amounts for all periods presented in this Form 10-Q have been adjusted to reflect the new methods of accounting. See "Note 12 – Recent Accounting Pronouncements" included in our Notes to Consolidated Financial Statements for more information regarding the adoption of these standards. Since our operating cycle is primarily long-term and involves many types of contracts for the design, development and manufacture of products and related activities with varying delivery schedules, the results of operations of a particular period, or period-to-period comparisons of sales and profits, may not be indicative of future operating results. The following discussions of comparative results among periods should be reviewed in this context. All per share amounts cited in these discussions are presented on a "per diluted share" basis, unless otherwise noted.

Our consolidated results of operations were as follows (in millions, except per share data):

| | Quarters Ended | | Six Months Ended | |
|-----------------------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | \$13,398 | \$12,563 | \$25,033 | \$23,775 |
| Cost of sales | (11,645) | (10,907) | (21,622) | (20,713) |
| Gross profit | 1,753 | 1,656 | 3,411 | 3,062 |
| Other income, net | 42 | 60 | 109 | 56 |
| Operating profit | 1,795 | 1,716 | 3,520 | 3,118 |
| Interest expense | (165) | (160) | (320) | (315) |
| Other non-operating expense, net | (210) | (214) | (420) | (426) |
| Earnings before income taxes | 1,420 | 1,342 | 2,780 | 2,377 |
| Income tax expense | (257) | (387) | (460) | (633) |
| Net earnings | \$1,163 | \$955 | \$2,320 | \$1,744 |
| Diluted earnings per common share | \$4.05 | \$3.28 | \$8.07 | \$5.97 |

Certain amounts reported in other income, net, primarily our share of earnings or losses from equity method investees, are included in the operating profit of our business segments. Accordingly, such amounts are included in the discussion of our business segment results of operations.

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Net Sales

We generate sales from the delivery of products and services to our customers. Our consolidated net sales were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|----------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Products | \$ 11,150 | \$ 10,622 | \$ 20,912 | \$ 20,235 |
| % of total net sales | 83.2 % | 84.5 % | 83.5 % | 85.1 % |
| Services | 2,248 | 1,941 | 4,121 | 3,540 |
| % of total net sales | 16.8 % | 15.5 % | 16.5 % | 14.9 % |
| Total net sales | \$ 13,398 | \$ 12,563 | \$ 25,033 | \$ 23,775 |

Substantially all of our contracts are accounted for using the percentage-of-completion cost-to-cost method. Under the percentage-of-completion cost-to-cost method, we record net sales on contracts over a period of time based upon our progress towards completion on a particular contract, as well as our estimate of the profit to be earned at completion. The following discussion of material changes in our consolidated net sales should be read in tandem with the subsequent discussion of changes in our consolidated cost of sales and our business segment results of operations because changes in our sales are typically accompanied by a corresponding change in our cost of sales due to the nature of the percentage-of-completion cost-to-cost method.

Product Sales

Product sales increased \$528 million, or 5%, during the quarter ended June 24, 2018 compared to the same period in 2017. The increase in product sales was primarily due to higher product sales of approximately \$305 million at Aeronautics and approximately \$260 million at MFC. These increases were partially offset by a decrease in product sales of approximately \$75 million at Space. Higher product sales at Aeronautics were primarily due to higher sales for F-35 production volume, partially offset by lower production volume for the C-5 program as the current modernization program nears completion. The increase in product sales at MFC was primarily attributable to increased volume on classified programs and air and missile defense programs (primarily Terminal High Altitude Area Defense (THAAD) and Patriot Advanced Capability-3 (PAC-3)). The decrease in product sales at Space was primarily attributable to lower volume on government satellite programs (primarily Advanced Extremely High Frequency systems (AEHF)), partially offset by higher volume for strategic and missile defense programs (primarily AWE Management Limited (AWE)).

Product sales increased \$677 million, or 3%, during the six months ended June 24, 2018 compared to the same period in 2017. The increase in product sales was primarily due to higher product sales of approximately \$440 million at Aeronautics and approximately \$355 million at MFC. These increases were partially offset by a decrease in product sales of approximately \$225 million at Space. Higher product sales at Aeronautics were primarily due to higher sales for F-35 production volume and higher volume on modernization contracts for the F-16 program, partially offset by lower production volume for the C-5 program as the current modernization program nears completion. The increase in product sales at MFC was primarily attributable to increased volume on classified programs, air and missile defense programs (primarily THAAD and PAC-3) and tactical missiles programs (primarily Long Range Stand Off (LRSO) missiles and Precision Fires). The decrease in product sales at Space was primarily attributable to lower volume on government satellite programs (primarily Space Based Infrared System (SBIRS) and AEHF) and commercial satellite programs, partially offset by higher volume for strategic and missile defense programs (primarily AWE).

Service Sales

Service sales increased \$307 million, or 16%, during the quarter ended June 24, 2018 compared to the same period in 2017. The increase in service sales was primarily due to higher service sales of approximately \$110 million at RMS, approximately \$95 million at Aeronautics and approximately \$55 million at Space. The increase in service sales at RMS was primarily due to higher volume for services related to integrated warfare systems and sensors (IWSS) and C6ISR (command, control, communications, computers, cyber, combat systems, intelligence, surveillance, and

reconnaissance) programs. The increase at Aeronautics was primarily attributable higher sustainment volume for the F-35 and F-22 programs. Higher service sales at Space were primarily due to increased volume on government satellite services.

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Service sales increased \$581 million, or 16%, during the six months ended June 24, 2018 compared to the same period in 2017. The increase in service sales was primarily due to higher service sales of approximately \$235 million at Aeronautics, approximately \$140 million at RMS and approximately \$130 million at Space. The increase in service sales at Aeronautics was primarily due to higher sustainment volume for the F-35 and F-22 programs, partially offset by lower sustainment activities for the C-130 program. The increase in service sales at RMS was primarily due to higher volume for services related to IWSS and C6ISR programs. Higher service sales at Space were primarily due to increased volume on government satellite services.

Cost of Sales

Cost of sales, for both products and services, consist of materials, labor, subcontracting costs, an allocation of indirect costs (overhead and general and administrative), as well as the costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required under certain contracts with international customers. For each of our contracts, we monitor the nature and amount of costs at the contract level, which form the basis for estimating our total costs to complete the contract. Our consolidated cost of sales were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|-------------------------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Cost of sales – products | \$(9,993) | \$(9,562) | \$(18,690) | \$(18,306) |
| % of product sales | 89.6 % | 90.0 % | 89.4 % | 90.5 % |
| Cost of sales – services | (1,967) | (1,706) | (3,656) | (3,140) |
| % of service sales | 87.5 % | 87.9 % | 88.7 % | 88.7 % |
| Severance and restructuring charges | (96) | — | (96) | — |
| Other unallocated, net | 411 | 361 | 820 | 733 |
| Total cost of sales | \$(11,645) | \$(10,907) | \$(21,622) | \$(20,713) |

The following discussion of material changes in our consolidated cost of sales for products and services should be read in tandem with the preceding discussion of changes in our consolidated net sales and our business segment results of operations. We have not identified any developing trends in cost of sales for products and services that would have a material impact on our future operations.

Product Costs

Product costs increased \$431 million, or 5%, during the quarter ended June 24, 2018 compared to the same period in 2017, primarily due to higher product costs of approximately \$310 million at Aeronautics and approximately \$245 million at MFC. These increases were partially offset by lower product costs of approximately \$65 million at Space and approximately \$50 million at RMS. Higher product costs at Aeronautics were primarily due to higher F-35 production volume, partially offset by a decrease in product costs for the C-5 program due to lower production volume as the current modernization program nears completion. The increase in product costs at MFC was primarily attributable to higher volume on classified programs, a charge recorded for performance matters on the Warrior Capability Sustainment Program, which relates to designing, developing and installing an upgraded turret and higher volume on air and missile defense programs (primarily THAAD and PAC-3). The decrease in product costs at Space was primarily due to lower volume on government satellite programs (primarily AEHF) and commercial satellite programs, partially offset by higher volume for strategic and missile defense programs (primarily AWE). Lower product costs at RMS were primarily due to better program performance across the Sikorsky portfolio, partially offset by an increase in product cost for IWSS programs due to higher volume (primarily radar surveillance systems programs).

Product costs increased \$384 million, or 2%, during the six months ended June 24, 2018 compared to the same period in 2017. The increase in product costs was primarily due to higher product costs of approximately \$440 million at Aeronautics and approximately \$315 million at MFC, partially offset by lower product costs of approximately \$185 million at RMS and \$180 million at Space. Higher product costs at Aeronautics were primarily due to higher F-35 production volume and higher volume on modernization contracts for the F-16 program, partially offset by a

decrease in product costs for the C-5 program due to lower production volume as the current modernization program nears completion. The increase in product costs at MFC was primarily attributable to higher volume on classified programs and charges recorded for performance matters on the Warrior Capability Sustainment Program. The decrease in product costs at RMS is primarily attributable to a charge recorded in the first quarter of 2017 for performance matters on the EADGE-T contract

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and better program performance across the Sikorsky portfolio, partially offset by an increase in product cost for IWSS programs due to higher volume (primarily radar surveillance systems programs). Lower product costs at Space were primarily attributable to lower volume on government satellite programs (primarily AEHF) and commercial satellite programs, partially offset by higher volume for strategic and missile defense programs (primarily AWE).

Service Costs

Service costs increased \$261 million, or 15%, during the quarter ended June 24, 2018 compared to the same period in 2017. The increase in service costs was primarily due to higher service costs of approximately \$115 million at RMS and approximately \$80 million at Aeronautics. The increase in service costs at RMS was primarily due to higher volume for services related to IWSS and C6ISR programs. The increase in service costs at Aeronautics was primarily due to higher sustainment volume for the F-35 and F-22 programs.

Service costs increased \$516 million, or 16%, during the six months ended June 24, 2018 compared to the same period in 2017. The increase in service costs was primarily due to higher service costs of approximately \$200 million at Aeronautics, approximately \$165 million at RMS and approximately \$90 million at Space. The increase in service costs at Aeronautics was primarily due to higher sustainment volume for the F-35 and F-22 programs, partially offset by lower sustainment activities for the C-130 program. The increase in service costs at RMS was primarily due to higher volume for services related to IWSS and C6ISR programs. Higher service costs at Space were primarily due to increased volume on government satellite services.

Severance and Restructuring Charges

During the quarter ended June 24, 2018, we recorded charges totaling \$96 million (\$76 million, or \$0.26 per share, after tax) related to certain severance and restructuring actions at our RMS business segment. These charges consist of \$75 million of severance costs for the planned elimination of certain positions through either voluntary or involuntary actions and \$21 million of asset impairment charges associated with our decision to consolidate certain operations. Upon separation, terminated employees will receive lump-sum severance payments primarily based on years of service, a majority of which we expect to pay by the end of 2018. These actions resulted from a strategic review of our RMS business segment and are intended to improve the efficiency of our operations and better align our organization and cost structure with changing economic conditions. We expect to recover a portion of the severance and restructuring charges through the pricing of our products and services to the U.S. Government and other customers in future periods, which will be included in RMS' operating results.

Other Unallocated, Net

Other unallocated, net primarily includes the FAS/CAS operating adjustment (which represents the difference between CAS pension cost recorded in our business segments' results of operations and the service cost component of FAS pension expense), stock-based compensation expense and other corporate costs. These items are not allocated to the business segments and, therefore, are excluded from the cost of sales for products and services. Other unallocated, net was a net reduction to expense of \$411 million and \$820 million during the quarter and six months ended June 24, 2018 compared to \$361 million and \$733 million during the quarter and six months ended June 25, 2017. The increase in the net reduction to expense during the quarter and six months ended June 24, 2018 was primarily due to the change in the FAS/CAS operating adjustment (see "Business Segment Results of Operations" discussion below for more detail).

Other Income, Net

Other income, net primarily includes our share of earnings or losses from equity method investees. During the quarter and six months ended June 24, 2018, other income, net was \$42 million and \$109 million, compared to \$60 million and \$56 million during the quarter and six months ended June 25, 2017. The decrease for the quarter ended June 24, 2018 was primarily attributable to decreased earnings generated by equity method investees. The increase for the six months ended June 24, 2018 was primarily attributable to our portion of a non-cash asset impairment charge recorded in the first quarter of 2017 by our equity method investee, Advanced Military Maintenance, Repair and Overhaul Center LLC (AMMROC), of approximately \$64 million (\$40 million, or \$0.14 per share, after tax), partially offset by decreased earnings generated by equity method investees.

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Other Non-operating Expense, Net

Other non-operating expense, net primarily includes the non-service cost components of FAS pension and other postretirement benefit plan expense (i.e., interest cost, expected return on plan assets, net actuarial gains or losses, and amortization of prior service cost or credits) related to our postretirement benefit plans. Other non-operating expense, net during the quarter and six months ended June 24, 2018 was comparable to the same periods in 2017.

Income Tax Expense

Our effective income tax rates were 18.1% and 16.5% for the quarter and six months ended June 24, 2018, and 28.8% and 26.6% for the quarter and six months ended June 25, 2017. The lower rate for the quarter and six months ended June 24, 2018 is primarily due to the reduction of the federal statutory rate from 35% to 21% as a result of the Tax Act enacted in December 2017. The rates for both periods benefited from tax deductions for dividends paid to our defined contribution plans with an employee stock ownership plan feature, tax deductions for employee equity awards, and the research and development tax credit. The rate for the quarter and six months ended June 24, 2018 also benefited from the Tax Act's deduction for foreign derived intangible income. The rate for the quarter and six months ended June 25, 2017 benefited from tax deductions for U.S. manufacturing activities, which the Tax Act repealed for years after 2017. While we have substantially completed our provisional analysis of the income tax effects of the Tax Act as of December 31, 2017 and recorded a reasonable estimate in 2017 of such effects, actual effects may differ, possibly materially, due to, among other things, further refinement of our calculations, changes in interpretations and assumptions that we have made, additional guidance that may be issued by the U.S. Government, and actions and related accounting policy decisions we may take as a result of the Tax Act. We will complete our analysis of the impact of the Tax Act for 2017 over a one-year measurement period ending December 22, 2018, and any adjustments during this measurement period will be included in net earnings as an adjustment to income tax expense in the reporting period when such adjustments are determined. We have not identified any material change to the net one-time charge for the period ending December 31, 2017 related to the Tax Act.

Future changes in tax laws could significantly impact our provision for income taxes, the amount of taxes payable, our deferred tax asset and liability balances, and stockholders' equity. The amount of net deferred tax assets will change periodically based on several factors, including the measurement of our postretirement benefit plan obligations, actual cash contributions to our postretirement benefit plans, and future changes in tax laws.

Net Earnings

We reported net earnings of \$1.2 billion (\$4.05 per share) and \$2.3 billion (\$8.07 per share) during the quarter and six months ended June 24, 2018, compared to \$955 million (\$3.28 per share) and \$1.7 billion (\$5.97 per share) during the quarter and six months ended June 25, 2017. Both net earnings and earnings per share were affected by the factors mentioned above. Earnings per share also benefited from a net decrease of approximately 3.2 million shares outstanding from June 25, 2017 to June 24, 2018 as a result of share repurchases, partially offset by share issuance under our stock-based awards and certain defined contribution plans.

BUSINESS SEGMENT RESULTS OF OPERATIONS

Effective January 1, 2018, we adopted ASC 606, which changed the way we recognize revenue for certain contracts. We adopted this standard using the full retrospective method. Accordingly, the amounts for all periods presented in this Form 10-Q have been adjusted to reflect the new method of accounting. See "Note 12 – Recent Accounting Pronouncements" included in our Notes to Consolidated Financial Statements for more information regarding the adoption of this standard.

We operate in four business segments: Aeronautics, MFC, RMS and Space. We organize our business segments based on the nature of the products and services offered.

Net sales of our business segments exclude intersegment sales as these activities are eliminated in consolidation.

Operating profit of our business segments includes our share of earnings or losses from equity method investees as the operating activities of the equity method investees are closely aligned with the operations of our business segments. In addition, operating profit of our business segments includes total pension costs recoverable on U.S. Government contracts as determined in accordance with U.S. Government cost accounting standards (CAS). Operating profit of the

business segments excludes the FAS/CAS operating adjustment; the U.S. GAAP financial accounting standards (FAS)

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non-service cost component for all postretirement benefit plans; expense for stock-based compensation; the effects of items not considered part of management's evaluation of segment operating performance, such as charges related to significant severance actions and certain asset impairments; gains or losses from significant divestitures; the effects of certain legal settlements; corporate costs not allocated to our business segments; and other miscellaneous corporate activities. These items are included in the reconciling item "Unallocated items" between operating profit from our business segments and our consolidated operating profit. See "Note 2 – Significant Accounting Policy Updates" included in our Notes to Consolidated Financial Statements for a discussion related to certain factors that may impact the comparability of net sales and operating profit of our business segments.

Summary operating results for each of our business segments were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|--|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | | | | |
| Aeronautics | \$5,321 | \$4,922 | \$9,719 | \$9,042 |
| Missiles and Fire Control | 2,085 | 1,784 | 3,762 | 3,333 |
| Rotary and Mission Systems | 3,566 | 3,414 | 6,789 | 6,541 |
| Space | 2,426 | 2,443 | 4,763 | 4,859 |
| Total net sales | \$13,398 | \$12,563 | \$25,033 | \$23,775 |
| Operating profit | | | | |
| Aeronautics | \$572 | \$567 | \$1,046 | \$1,006 |
| Missiles and Fire Control | 279 | 253 | 540 | 487 |
| Rotary and Mission Systems ^(a) | 341 | 271 | 652 | 399 |
| Space | 274 | 256 | 538 | 546 |
| Total business segment operating profit | 1,466 | 1,347 | 2,776 | 2,438 |
| Unallocated items | | | | |
| FAS/CAS operating adjustment ^(b) | 451 | 404 | 902 | 807 |
| Stock-based compensation | (60) | (57) | (98) | (101) |
| Severance and restructuring charges ^(c) | (96) | — | (96) | — |
| Other, net ^(d) | 34 | 22 | 36 | (26) |
| Total unallocated items | 329 | 369 | 744 | 680 |
| Total consolidated operating profit | \$1,795 | \$1,716 | \$3,520 | \$3,118 |

Operating profit at our RMS business segment for the six months ended June 25, 2017 includes a charge of \$120 million (\$74 million, or \$0.25 per share, after tax) recognized in the first quarter of 2017 for performance matters on the EADGE-T contract. See "Note 2 – Significant Accounting Policy Updates" (under the caption "Revenue Recognition") included in our Notes to Consolidated Financial Statements for more information.

The FAS/CAS operating adjustment represents the difference between the service cost component of FAS pension expense and total pension costs recoverable on U.S. Government contracts as determined in accordance with U.S. Government CAS. For a detail of the FAS/CAS operating adjustment and the total net FAS/CAS pension adjustment, see the table below.

Unallocated items for the quarter and six months ended June 24, 2018 include severance and restructuring charges totaling \$96 million (\$76 million, or \$0.26 per share, after tax) associated with planned workforce reductions and the consolidation of certain operations at our RMS business segment. See "Note 11 – Other" (under the caption "Severance and Restructuring Charges") included in our Notes to Consolidated Financial Statements for more information.

Other, net for the six months ended June 25, 2017 includes a \$64 million charge (\$40 million, or \$0.14 per share, after tax) recognized in the first quarter of 2017, which represents our portion of a non-cash asset impairment charge recorded by our equity method investee, AMMROC. See "Note 11 – Other" (under the caption "Equity Method

Investee Impairment”) included in our Notes to Consolidated Financial Statements for more information.

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Our total net FAS/CAS pension adjustments for the quarters and six months ended June 24, 2018 and June 25, 2017, including the service and non-service cost components of FAS pension expense, were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|---|----------------|---------------|------------------|---------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Total FAS expense and CAS costs | | | | |
| FAS pension expense | \$(357) | \$(343) | \$(713) | \$(688) |
| Less: CAS pension cost | 609 | 562 | 1,217 | 1,124 |
| Net FAS/CAS pension adjustment | \$252 | \$219 | \$504 | \$436 |
| Service and non-service cost reconciliation | | | | |
| FAS pension service cost | \$(158) | \$(158) | \$(315) | \$(317) |
| Less: CAS pension cost | 609 | 562 | 1,217 | 1,124 |
| FAS/CAS operating adjustment | 451 | 404 | 902 | 807 |
| Non-operating FAS pension expense | (199) | (185) | (398) | (371) |
| Net FAS/CAS pension adjustment | \$252 | \$219 | \$504 | \$436 |

We recover CAS pension cost through the pricing of our products and services on U.S. Government contracts and, therefore, recognize CAS pension cost in each of our business segment's net sales and cost of sales. Our consolidated financial statements must present FAS pension and other postretirement benefit plan expense calculated in accordance with FAS requirements under U.S. GAAP. The operating portion of the net FAS/CAS pension adjustment represents the difference between the service cost component of FAS pension expense and CAS pension cost. The non-service FAS pension cost component is included in other non-operating expense, net on our consolidated statements of earnings. The net FAS/CAS pension adjustment increases or decreases CAS pension cost to equal total FAS pension cost (both service and non-service).

Management evaluates performance on our contracts by focusing on net sales and operating profit and not by type or amount of operating expense. Consequently, our discussion of business segment performance focuses on net sales and operating profit, consistent with our approach for managing the business. This approach is consistent throughout the life cycle of our contracts, as management assesses the bidding of each contract by focusing on net sales and operating profit and monitors performance on our contracts in a similar manner through their completion.

We regularly provide customers with reports of our costs as the contract progresses. The cost information in the reports is accumulated in a manner specified by the requirements of each contract. For example, cost data provided to a customer for a product would typically align to the subcomponents of that product (such as a wing-box on an aircraft) and for services would align to the type of work being performed (such as aircraft sustainment). Our contracts generally allow for the recovery of costs in the pricing of our products and services. Most of our contracts are bid and negotiated with our customers under circumstances in which we are required to disclose our estimated total costs to provide the product or service. This approach for negotiating contracts with our U.S. Government customers generally allows for recovery of our actual costs plus a reasonable profit margin. We also may enter into long-term supply contracts for certain materials or components to coincide with the production schedule of certain products and to ensure their availability at known unit prices.

Many of our contracts span several years and include highly complex technical requirements. At the outset of a contract, we identify and monitor risks to the achievement of the technical, schedule and cost aspects of the contract and assess the effects of those risks on our estimates of total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events) and costs (e.g., material, labor, subcontractor, overhead and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required

under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and cost aspects of the contract, which decreases the estimated total costs to complete the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the

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contract increase. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate.

Changes in net sales and operating profit generally are expressed in terms of volume. Changes in volume refer to increases or decreases in sales or operating profit resulting from varying production activity levels, deliveries or service levels on individual contracts. Volume changes in segment operating profit are typically based on the current profit booking rate for a particular contract.

Comparability of our segment sales, operating profit and operating margin may be impacted favorably or unfavorably by changes in profit booking rates on our contracts for which we recognize revenue over a period of time using the percentage-of-completion cost-to-cost method to measure progress towards completion. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs to fulfill the performance obligations that reflect improved conditions on a particular contract. Conversely, conditions on a particular contract may deteriorate, resulting in an increase in the estimated total costs to fulfill the performance obligations and a reduction in the profit booking rate. Increases or decreases in profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes. Segment operating profit and margin may also be impacted favorably or unfavorably by other items, which may or may not impact sales. Favorable items may include the positive resolution of contractual matters, cost recoveries on severance and restructuring charges, insurance recoveries and gains on sales of assets. Unfavorable items may include the adverse resolution of contractual matters; restructuring charges, except for significant severance actions, which are excluded from segment operating results; reserves for disputes; certain asset impairments; and losses on sales of certain assets.

We have a program, EADGE-T, to design, integrate, and install an air missile defense command, control, communications, computers – intelligence (C4I) system for an international customer that has experienced performance matters and for which we have periodically accrued reserves. During the first quarter of 2017, we revised our estimated costs to complete the EADGE-T contract as a consequence of ongoing performance matters and recorded an additional charge of \$120 million (\$74 million or \$0.25 per share, after tax) at our RMS business segment, which resulted in cumulative losses of approximately \$260 million on this program. As of June 24, 2018, cumulative losses remained at approximately \$260 million. We continue to monitor program requirements and our performance. At this time, we do not anticipate additional charges that would be material to our operating results or financial condition. We have two commercial satellite programs at our Space business segment, for which we have experienced performance issues related to the development and integration of a modernized LM 2100 satellite platform. These commercial programs require the development of new satellite technology to enhance the LM 2100's power, propulsion and electronics, among other items. The enhanced LM 2100 satellite platform is expected to benefit other commercial and government satellite programs. We have periodically revised our estimated costs to complete these developmental commercial programs. We have recorded cumulative losses of approximately \$380 million through June 24, 2018. During the quarter and six months ended June 24, 2018, we recorded losses of approximately \$40 million (\$30 million, or \$0.10 per share, after tax) and \$75 million (\$56 million, or \$0.20 per share, after tax). While these losses reflect our estimated total losses on the programs, we will continue to incur unrecoverable general and administrative costs each period until we complete these programs. These programs remain developmental and further challenges in the delivery and integration of new satellite technology, anomalies discovered during system testing requiring repair or rework, further schedule delays and potential penalties could require that we record additional loss reserves which could be material to our operating results. As we did not meet the July 2018 delivery requirement on one of the programs, the customer could seek to exercise a termination right, but we think that the probability that this will occur is remote as the customer has an immediate need for the satellites. Were the customer to seek to exercise a termination right and be successful in this effort, we would have to refund the payments we have received and pay certain penalties. On the other program, we currently anticipate delivering the satellite before the date upon which the customer could seek to exercise a termination right although we may have to pay certain penalties and have sought to address this possibility in our reserves.

We are responsible for designing, developing and installing an upgraded turret for the Warrior Capability Sustainment Program. During the six months ended June 24, 2018, as a consequence of performance issues, we revised our estimated costs to complete the program and recorded a reserve of \$85 million (\$64 million, or \$0.22 per share, after tax) at our MFC business segment. As of June 24, 2018, we have recorded cumulative losses of approximately \$140 million on this program. We may continue to experience issues related to customer requirements and our performance under this contract and have to record additional reserves. However, based on the losses already recorded and our current estimate of the sales and costs to complete the program, at this time we do not anticipate that additional losses, if any, would be material.

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Our consolidated net adjustments not related to volume, including net profit booking rate adjustments and other matters, increased segment operating profit by approximately \$465 million and \$885 million during the quarter and six months ended June 24, 2018 and \$515 million and \$810 million during the quarter and six months ended June 25, 2017.

Aeronautics

Summary operating results for our Aeronautics business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | \$5,321 | \$4,922 | \$9,719 | \$9,042 |
| Operating profit | 572 | 567 | 1,046 | 1,006 |
| Operating margin | 10.7 % | 11.5 % | 10.8 % | 11.1 % |

Aeronautics' net sales during the quarter ended June 24, 2018 increased \$399 million, or 8%, compared to the same period in 2017. The increase was primarily attributable to higher net sales of approximately \$370 million for the F-35 program due to increased production volume, partially offset by lower volume on development activities; and about \$50 million for the F-22 program due to increased sustainment volume. These increases were partially offset by a decrease of approximately \$70 million for the C-5 program due to lower production volume as the current modernization program nears completion.

Aeronautics' operating profit during the quarter ended June 24, 2018 increased \$5 million, or 1%, compared to the same period in 2017. Operating profit increased approximately \$65 million for the F-35 program primarily due to increased volume on higher margin production contracts and new development activities, and better performance on sustainment. This increase was partially offset by a decrease of approximately \$40 million for the C-5 program due to lower risk retirements and lower production volume; and about \$20 million for the C-130 program due to lower volume and timing on sustainment programs. Adjustments not related to volume, including net profit booking rate adjustments, were \$50 million lower during the quarter ended June 24, 2018 compared to the same period in 2017.

Aeronautics' net sales during the first six months ended June 24, 2018 increased \$677 million, or 7%, compared to the same period in 2017. The increase was primarily attributable to higher net sales of approximately \$555 million for the F-35 program due to increased volume on production and sustainment, partially offset by lower volume on development activities; about \$70 million for the F-22 program due to increased sustainment volume; and about \$40 million for the F-16 program due to increased volume on modernization contracts. These increases were partially offset by a decrease of approximately \$95 million for the C-5 program due to lower production volume as the current modernization program nears completion; and about \$40 million for the C-130 program due to lower sustainment volume.

Aeronautics' operating profit during the first six months ended June 24, 2018 increased \$40 million, or 4%, compared to the same period in 2017. Operating profit increased approximately \$90 million for the F-35 program primarily due to increased volume on higher margin production contracts and new development activities, and better performance on sustainment. This increase was partially offset by a decrease of approximately \$30 million for the C-5 program due to lower risk retirements and lower volume; and about \$30 million for the C-130 program due to lower volume and timing on sustainment programs and lower risk retirements. Adjustments not related to volume, including net profit booking rate adjustments, were \$50 million lower during the first six months ended June 24, 2018 compared to the same period in 2017.

We currently expect Aeronautics' 2018 net sales to increase in the high-single digit percentage range as compared to 2017 driven by increased production and sustainment volume on the F-35 program. Operating profit is expected to increase in the low-single digit percentage range, resulting in slightly lower operating profit margins in 2018 as compared to 2017.

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Missiles and Fire Control

Summary operating results for our MFC business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | \$2,085 | \$1,784 | \$3,762 | \$3,333 |
| Operating profit | 279 | 253 | 540 | 487 |
| Operating margin | 13.4 % | 14.2 % | 14.4 % | 14.6 % |

MFC's net sales during the quarter ended June 24, 2018 increased \$301 million, or 17%, compared to the same period in 2017. The increase was primarily attributable to higher net sales of approximately \$95 million for increased volume on classified programs; about \$80 million for air and missile defense programs due to increased volume (primarily THAAD and PAC-3); about \$70 million for sensors and global sustainment programs due to increased volume (primarily LANTIRN[®] and SNIPER[®]); and about \$45 million for tactical missiles programs due to increased volume (primarily Precision Fires).

MFC's operating profit during the quarter ended June 24, 2018 increased \$26 million, or 10%, compared to the same period in 2017. Operating profit increased approximately \$35 million for sensors and global sustainment programs due to increased risk retirements and higher volume (primarily LANTIRN[®] and SNIPER[®]); and about \$35 million for air and missile defense programs due to increased risk retirements and higher volume (primarily THAAD and PAC-3). These increases were partially offset by a decrease of \$50 million for tactical missile programs primarily due to a charge recorded in the second quarter of 2018 of approximately \$65 million for performance matters on the Warrior Capability Sustainment Program, which relates to designing, developing and installing an upgraded turret. Adjustments not related to volume, including net profit booking rate adjustments, were comparable during the quarter ended June 24, 2018 to the same period in 2017.

MFC's net sales during the first six months ended June 24, 2018 increased \$429 million, or 13%, compared to the same period in 2017. The increase was primarily attributable to higher net sales of approximately \$165 million for increased volume on classified programs; about \$95 million for tactical missiles programs due to increased volume (primarily LRSO missiles and Precision Fires); about \$85 million for sensors and global sustainment programs due to increased volume (primarily LANTIRN[®] and SNIPER[®], and Apache); and about \$75 million for air and missile defense programs due to increased volume (primarily THAAD and PAC-3).

MFC's operating profit during the first six months ended June 24, 2018 increased \$53 million, or 11%, compared to the same period in 2017. Operating profit increased approximately \$50 million for sensors and global sustainment programs primarily due to increased risk retirements and higher volume (primarily LANTIRN[®] and SNIPER[®], and Apache); and about \$50 million for air and missile defense programs due to increased risk retirements and higher volume (primarily THAAD and PAC-3). These increases were partially offset by a decrease of \$60 million for tactical missiles programs due to charges of approximately \$85 million recorded in 2018 for performance matters on the Warrior Capability Sustainment Program. Adjustments not related to volume, including net profit booking rate adjustments, were \$50 million higher during the first six months ended June 24, 2018 compared to the same period in 2017.

We currently expect MFC's net sales to increase in the low-double digit percentage range in 2018 as compared to 2017 driven primarily by key contract awards and higher volume in tactical missile programs and sensors and global sustainment programs. Operating profit is expected to also increase in the low-double digit percentage range in 2018 as compared to 2017 driven by the increased volume and higher risk retirements. Operating profit margin for 2018 is expected to be slightly higher than 2017 levels.

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Rotary and Mission Systems

Summary operating results for our RMS business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | \$3,566 | \$3,414 | \$6,789 | \$6,541 |
| Operating profit | 341 | 271 | 652 | 399 |
| Operating margin | 9.6 % | 7.9 % | 9.6 % | 6.1 % |

RMS' net sales during the quarter ended June 24, 2018 increased \$152 million, or 4% compared to the same period in 2017. The increase was primarily attributable to higher net sales of approximately \$180 million for IWSS programs due to higher volume (primarily radar surveillance systems programs and Aegis); and about \$105 million for C6ISR programs due to higher volume on various programs. These increases were partially offset by a decrease in net sales of approximately \$105 million for Sikorsky helicopter programs. Sikorsky helicopter sales reflect lower volume for Black Hawk helicopters, partially offset by higher volume for CH-53K King Stallion helicopters.

RMS' operating profit during the quarter ended June 24, 2018 increased \$70 million, or 26% compared to the same period in 2017. Operating profit increased approximately \$40 million for IWSS programs due to increased risk retirements and higher volume (primarily radar surveillance systems programs and Aegis); and about \$30 million for C6ISR programs due to favorable cost performance and higher volume on various programs. Operating profit increased about \$10 million for Sikorsky helicopter programs due to favorable cost performance across the Sikorsky portfolio and better performance on the Multi-Year IX contract, which more than offset lower volume on the Multi-Year VIII contract. Adjustments not related to volume, including net profit booking rate adjustments, were about \$20 million lower during the quarter ended June 24, 2018 compared to the same period during 2017.

RMS' net sales during the first six months ended June 24, 2018 increased \$248 million, or 4% compared to the same period in 2017. The increase was primarily attributable to higher net sales of approximately \$275 million for IWSS programs due to higher volume (primarily radar surveillance systems programs and Aegis); about \$195 million for C6ISR programs due to higher volume on various programs; and about \$80 million for training and logistics solutions (TLS) programs due to higher volume on various programs. These increases were partially offset by a decrease in net sales of approximately \$295 million for Sikorsky helicopter programs. Sikorsky helicopter sales reflect lower volume for Black Hawk helicopters, partially offset by higher volume for CH-53K King Stallion helicopters.

RMS' operating profit during the first six months ended June 24, 2018 increased \$253 million, or 63% compared to the same period in 2017. Operating profit increased approximately \$150 million for C6ISR programs due to charges of \$120 million for performance matters on the EADGE-T contract, which were recorded in 2017 but did not recur in 2018 and due to favorable cost performance on various programs; about \$65 million for Sikorsky helicopter programs due to favorable cost performance across the Sikorsky portfolio and better performance on the Multi-Year IX contract, which more than offset lower volume on the Multi-Year VIII contract; and about \$40 million for IWSS programs due to increased risk retirements (primarily radar surveillance systems programs and Aegis). Adjustments not related to volume, including net profit booking rate adjustments, were \$90 million higher during the first six months ended June 24, 2018 compared to the same period during 2017.

We currently expect RMS' net sales to increase in the low-single digit percentage range as compared to 2017 driven primarily by higher volume in our IWSS, C6ISR, and TLS lines of business, partially offset by lower volume in our Sikorsky line of business. Operating profit is expected to increase in the mid-double digit percentage range in 2018 as compared to 2017 driven by the higher volume and performance improvements in the Sikorsky and C6ISR lines of business. Operating profit margin for 2018 is also expected to improve from 2017 levels.

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Space

Summary operating results for our Space business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|------------------|------------------|------------------|------------------|------------------|
| | June 24, 2018 | June 25, 2017 | June 24, 2018 | June 25, 2017 |
| Net sales | \$2,426 | \$2,443 | \$4,763 | \$4,859 |
| Operating profit | 274 | 256 | 538 | 546 |
| Operating margin | 11.3 % | 10.5 % | 11.3 % | 11.2 % |

Space's net sales during the quarter ended June 24, 2018 decreased \$17 million, or 1%, compared to the same period in 2017. The decrease was primarily attributable to lower net sales of approximately \$60 million for government satellite programs due to lower volume (primarily AEHF); and about \$20 million for commercial satellite programs due to lower volume. These decreases were partially offset by an increase of approximately \$65 million for strategic and missile defense programs due to higher volume (primarily AWE).

Space's operating profit during the quarter ended June 24, 2018 increased \$18 million, or 7%, compared to the same period in 2017. Operating profit increased approximately \$25 million for strategic and missile defense programs due to increased risk retirements (primarily Fleet Ballistic Missiles); and about \$25 million for commercial satellite programs, which reflect a lower amount of charges recorded for performance matters on certain programs. These increases were partially offset by a decrease of approximately \$30 million for government satellite programs due to lower risk retirements and lower volume (primarily AEHF). Adjustments not related to volume, including net profit booking rate adjustments, were about \$15 million higher during the quarter ended June 24, 2018 compared to the same period in 2017.

Space's net sales during the first six months ended June 24, 2018 decreased \$96 million, or 2%, compared to the same period in 2017. The decrease was primarily attributable to lower net sales of approximately \$160 million for government satellite programs due to lower volume (primarily SBIRS and AEHF); and about \$55 million for commercial satellite programs due to lower volume. These decreases were partially offset by an increase of approximately \$125 million for strategic and missile defense programs due to higher volume (primarily AWE).

Space's operating profit during the first six months ended June 24, 2018 decreased \$8 million, or 1%, compared to the same period in 2017. Operating profit decreased approximately \$35 million for government satellite programs due to lower risk retirements and lower volume (primarily SBIRS and AEHF). This decrease was partially offset by an increase of about \$25 million for commercial satellite programs, which reflect a lower amount of charges recorded for performance matters on certain programs. Adjustments not related to volume, including net profit booking rate adjustments, were \$15 million lower during the first six months ended June 24, 2018 compared to the same period in 2017.

Total equity earnings recognized by Space (primarily ULA) represented approximately \$50 million, or 18% and approximately \$135 million, or 25%, of Space's operating profit during the quarter and six months ended June 24, 2018, compared to approximately \$45 million, or 18% and approximately \$125 million, or 23%, during the quarter and six months ended June 25, 2017.

We currently expect Space's 2018 net sales to be comparable to 2017 levels. Operating profit in 2018 is expected to increase in the mid-single digit percentage range as compared to 2017 driven by improved program performance. As a result, operating profit margin in 2018 is expected to increase from 2017 levels.

FINANCIAL CONDITION

Liquidity and Cash Flows

We have a balanced cash deployment strategy to enhance stockholder value and position ourselves to take advantage of new business opportunities when they arise. Consistent with that strategy, we have continued to invest in our business, including capital expenditures, independent research and development and have made selective business acquisitions and investments, while returning cash to stockholders through dividends and share repurchases, and managing our debt levels, maturities and interest rates, and pension obligations.

We have generated strong operating cash flows, which have been the primary source of funding for our operations, capital expenditures, debt service and repayments, dividends, share repurchases and postretirement benefit plan

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contributions. The total remaining authorization for future common share repurchases under our share repurchase program was \$2.9 billion as of June 24, 2018.

We expect our cash from operations will continue to be sufficient to support our operations and anticipated capital expenditures for the foreseeable future. We also have access to credit markets, if needed, for liquidity or general corporate purposes, including, but not limited to, our revolving credit facility or the ability to issue commercial paper, and letters of credit to support customer advance payments and for other trade finance purposes such as guaranteeing our performance on particular contracts. See our “Capital Resources” section below for a discussion on financial resources available to us.

We contributed \$2.0 billion and \$3.5 billion to our qualified defined benefit pension plans during the quarter and six months ended June 24, 2018 and will contribute an additional \$1.5 billion on or before September 15, 2018. As a result of these contributions, we do not expect any material qualified defined benefit cash funding will be required in 2019 and 2020. We plan to fund these contributions and manage the timing of cash flows in 2018 using a mix of cash on hand and commercial paper. While we do not anticipate a need to do so, our capital structure and resources would allow us to issue new debt if circumstances change.

The following table provides a summary of our cash flow information followed by a discussion of the key elements (in millions):

| | Six Months Ended | |
|--|------------------|------------------|
| | June 24, 2018 | June 25, 2017 |
| Cash and cash equivalents at beginning of year | \$2,861 | \$1,837 |
| Operating activities | | |
| Net earnings | 2,320 | 1,744 |
| Non-cash adjustments | 760 | 682 |
| Changes in working capital | (1,057) | (275) |
| Other, net | (1,463) | 1,059 |
| Net cash provided by operating activities | 560 | 3,210 |
| Net cash used for investing activities | (329) | (439) |
| Net cash used for financing activities | (1,911) | (2,156) |
| Net change in cash and cash equivalents | (1,680) | 615 |
| Cash and cash equivalents at end of period | \$1,181 | \$2,452 |

Operating Activities

Net cash provided by operating activities decreased \$2.7 billion during the six months ended June 24, 2018 compared to the same period in 2017. The decrease in cash was primarily due to \$3.5 billion in contributions to our qualified defined benefit pension plans and a decrease in cash provided by changes in working capital of \$782 million, partially offset by net tax refunds of \$406 million and an increase in net earnings. The decrease in cash provided by changes in working capital was largely driven by the timing of revenue recognized in excess of cash collections (primarily Sikorsky and the F-35 program).

Investing Activities

Net cash used for investing activities decreased \$110 million during the six months ended June 24, 2018, compared to the same period in 2017 primarily due to approximately \$105 million of cash received as part of the final settlement of net working capital in connection with the 2016 divestiture of our Information Systems & Global Solutions business. Capital expenditures totaled \$480 million and \$448 million during the six months ended June 24, 2018 and June 25, 2017. The majority of our capital expenditures were for equipment and facilities infrastructure that generally are incurred to support new and existing programs across all of our business segments. We also incur capital expenditures for information technology to support programs and general enterprise information technology infrastructure, inclusive of costs for the development or purchase of internal-use software.

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Financing Activities

Net cash used for financing activities was \$1.9 billion during the six months ended June 24, 2018, compared to \$2.2 billion during the same period in 2017. Net cash used for financing activities during the six months ended June 24, 2018 and June 25, 2017 was primarily driven by dividend payments and share repurchases.

During the six months ended June 24, 2018 and June 25, 2017, we paid dividends totaling \$1.2 billion (\$4.00 per share) and \$1.1 billion (\$3.64 per share). In addition, we repurchased 1.9 million shares of our common stock during the six months ended June 24, 2018 for \$623 million, of which \$13 million was settled subsequent to the end of the second quarter. We repurchased 3.8 million shares of our common stock for \$1.0 billion during the six months ended June 25, 2017.

Capital Resources

At June 24, 2018, we held cash and cash equivalents of \$1.2 billion that was generally available to fund ordinary business operations without significant legal, regulatory, or other restrictions.

Our outstanding debt, net of unamortized discounts and issuance costs, was \$14.2 billion as of June 24, 2018 and mainly is in the form of publicly-issued notes that bear interest at fixed rates. As of June 24, 2018, we were in compliance with all covenants contained in our debt and credit agreements. There were no material changes during the quarter or six months ended June 24, 2018 to our contractual commitments as presented in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our 2017 Form 10-K that were outside the ordinary course of our business.

At June 24, 2018, we had a \$2.5 billion revolving credit facility (the 5-year Facility) with various banks that is available for general corporate purposes and expires on October 9, 2022. The undrawn portion of the 5-year Facility is also available to serve as a backup facility for the issuance of commercial paper. We may request and the banks may grant, at their discretion, an increase in the borrowing capacity under the 5-year Facility of up to an additional \$500 million. There were no borrowings outstanding under the 5-year Facility at June 24, 2018.

We have agreements in place with financial institutions to provide for the issuance of commercial paper. During the quarter ended June 24, 2018, we borrowed and fully repaid amounts under our commercial paper program. There were no commercial paper borrowings outstanding as of June 24, 2018. However, we may, as conditions warrant, continue to issue commercial paper backed by our credit facility to manage the timing of cash flows and to fund a portion of our qualified defined benefit pension contributions in 2018.

On occasion, our customers may seek deferred payment terms to purchase our products. In connection with these transactions, we may, at our customer’s request, enter into arrangements for the non-recourse sale of customer receivables to unrelated third-party financial institutions. For accounting purposes, these transactions are not discounted and are treated as a sale of receivables as we have no continuing involvement. The sale proceeds from the financial institutions are reflected in our operating cash flows on the statement of cash flows. We sold customer receivables of \$124 million and \$227 million during the quarter and six months ended June 24, 2018 and \$365 million during both the quarter and six months ended June 25, 2017. There were no gains or losses related to sales of these receivables.

Our total equity was \$479 million at June 24, 2018, an increase of \$1.3 billion from December 31, 2017. The increase was primarily attributable to net earnings of \$2.3 billion and amortization of \$600 million in pension and other postretirement benefit plan expense and gains. These increases were partially offset by dividends declared of \$1.1 billion and the repurchase of 1.9 million shares for \$623 million, of which \$13 million was settled subsequent to the end of the second quarter. As we repurchase our common shares, we reduce common stock for the \$1 of par value of the shares repurchased, with the excess purchase price over par value recorded as a reduction of additional paid-in capital. If additional paid-in capital is reduced to zero, we record the remainder of the excess purchase price over par value as a reduction of retained earnings. Due to the volume of repurchases made under our share repurchase program, additional paid-in capital was reduced to zero, with the remainder of the excess purchase price over par value of \$460 million recorded as a reduction of retained earnings during the six months ended June 24, 2018.

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OTHER MATTERS

Status of the F-35 Program

The F-35 program primarily consists of production contracts, sustainment activities, and new development efforts. Production of the aircraft is expected to continue for many years given the U.S. Government's current inventory objective of 2,456 aircraft for the U.S. Air Force, U.S. Marine Corps, and U.S. Navy; commitments from our eight international partners and three international customers; as well as expressions of interest from other countries. During the first six months of 2018, the F-35 program completed several milestones both domestically and internationally. The U.S. Government continued testing the aircraft including ship trials, mission and weapons systems evaluations, and the F-35 fleet recently surpassed 140,000 flight hours. In April, we completed the System Development and Demonstration (SDD) flight testing portion of the development contract and began the next phase of development in support of phased capability improvements and modernization of the F-35 air system. This next phase of development work is being performed separately from the basic SDD contract as part of the Joint Program Office's Continuous Capability Development and Delivery (C2D2) strategy.

Several milestones were also achieved with our international customers. First, the initial Italian built F-35B was delivered to the Italian Ministry of Defense. Second, the first operational Japan Air Self-Defense Force (JASDF) F-35A arrived in Japan after undergoing extensive maintenance and training in the U.S. Third, we completed the first F-35A aircraft for the Republic of Korea Air Force (ROKAF), which was delivered to Luke Air Force Base, Arizona, where ROKAF pilots and maintainers will begin training. Fourth, the Israeli Air Force completed its first F-35 combat mission. Finally, the first four F-35B short take-off and vertical landing aircraft arrived in the United Kingdom as it prepares for Initial Operating Capability (IOC) later this year.

On June 11, we delivered the 300th production F-35 aircraft, demonstrating the F-35 program's continued progress and longevity. The first 300 F-35 aircraft delivered to U.S. and international customers include 197 F-35A variants, 75 F-35B variants and 28 F-35C variants. As of June 24, 2018, we have delivered 305 production aircraft to our U.S. and international partners, and we have 196 production aircraft in backlog, including orders from our international partners.

Given the size and complexity of the F-35 program, we anticipate that there will be continual reviews related to aircraft performance, program schedule, cost, and requirements as part of the DoD, Congressional, and international partners' oversight and budgeting processes. Current program challenges include, but are not limited to, supplier and partner performance, software development, level of cost associated with life cycle operations and sustainment and warranties, receiving funding for production contracts on a timely basis, executing future flight tests, findings resulting from testing and operating the aircraft. The U.S. Government continues to take aggressive negotiating positions regarding these challenges. Nonetheless, the U.S. Government is considering a potential "Block Buy" for multiple F-35 LRIP lots to provide greater production efficiency, stability and savings.

Contingencies

See "Note 8 – Legal Proceedings and Contingencies" included in our Notes to Consolidated Financial Statements for information regarding our contingent obligations, including off-balance sheet arrangements.

Critical Accounting Policies

Effective January 1, 2018, we adopted ASC 606, which changed the way we recognize revenue for certain contracts. See "Note 2 – Significant Accounting Policy Updates" included in our Notes to Consolidated Financial Statements for changes to our critical accounting policies as a result of adopting ASC 606. Other than changes to our revenue recognition policy as a result of adopting ASC 606 there have been no significant changes to the critical accounting policies disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2017 Annual Report on Form 10-K.

Goodwill

The carrying value of our Sikorsky reporting unit included goodwill of \$2.7 billion as of June 24, 2018. As of December 31, 2017, we estimated that the fair value of our Sikorsky reporting unit exceeded its carrying value by a margin of approximately 25%, after adjusting for the positive impact of lower statutory tax rates due to the passage of

the Tax Act on December 22, 2017. We acquired Sikorsky in November 2015 and recorded the assets acquired and liabilities

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assumed at fair value. Due to the acquisition and valuation, the carrying value and fair value of our Sikorsky reporting unit are currently closely aligned. Therefore, any business deterioration, contract cancellations or terminations, or negative changes in market factors could cause our sales, earnings and cash flows to decline below current projections. Similarly, market factors utilized in the impairment analysis, including long-term growth rates, discount rates and relevant comparable public company earnings multiples and transaction multiples, could negatively impact the fair value of our reporting units. Based on our assessment of these circumstances, we have determined that goodwill at our Sikorsky reporting unit is at risk for impairment should there be deterioration of projected cash flows, negative changes in market factors or a significant increase in the carrying value of the reporting unit.

Intangible assets

The carrying value of our Sikorsky indefinite-lived trademark intangible asset was \$887 million as of June 24, 2018. As of December 31, 2017, we estimated that the fair value of this intangible asset exceeded its carrying value by a margin of approximately 20%, after adjusting for the positive impact of lower statutory tax rates due to the passage of the Tax Act on December 22, 2017. Additionally, our Sikorsky business has finite-lived customer program intangible assets with carrying values of \$2.6 billion as of June 24, 2018. The carrying value and fair value of Sikorsky's intangible assets are currently closely aligned due to the November 2015 acquisition and valuation of Sikorsky. Therefore, any business deterioration, contract cancellations or terminations, or negative changes in market factors could cause our sales to decline below current projections. Based on our assessment of these circumstances, we have determined that our Sikorsky intangible assets are at risk for impairment should there be any business deterioration, contract cancellations or terminations, or negative changes in market factors.

Recent Accounting Pronouncements

See "Note 12 – Recent Accounting Pronouncements" included in our Notes to Consolidated Financial Statements for information related to new accounting standards.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

As disclosed in "Item 7A. Quantitative and Qualitative Disclosures About Market Risk" of our Annual Report on Form 10-K for the year ended December 31, 2017, we transact business globally and are subject to risks associated with changing foreign currency exchange rates. We enter into foreign currency hedges such as forward and option contracts that change in value as foreign currency exchange rates change. Our other exposures to market risk have not changed materially since December 31, 2017. See "Note 9 – Fair Value Measurements" included in our Notes to Consolidated Financial Statements for additional discussion.

ITEM 4. Controls and Procedures

We performed an evaluation of the effectiveness of our disclosure controls and procedures as of June 24, 2018. The evaluation was performed with the participation of senior management of each business segment and key corporate functions, under the supervision of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Based on this evaluation, the CEO and CFO concluded that our disclosure controls and procedures were operating and effective as of June 24, 2018.

There were no changes in our internal control over financial reporting during the quarter ended June 24, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Forward-Looking Statements

This Form 10-Q contains statements that, to the extent they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws, and are based on our current expectations and assumptions. The words "believe," "estimate," "anticipate," "project," "intend," "expect," "plan," "outlook," "scheduled," "forecast" and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties. Actual results may differ materially due to factors such as:

- our reliance on contracts with the U.S. Government, which are conditioned upon the availability of funding and can be terminated by the U.S. Government for convenience, and our ability to negotiate favorable contract terms;

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budget uncertainty; affordability initiatives; the risk of future sequestration under the Budget Control Act of 2011 or other budget cuts;

- risks related to the development, production, sustainment, performance, schedule, cost and requirements of complex and technologically advanced programs including our largest, the F-35 program;

economic, industry, business and political conditions including their effects on governmental policy (including trade policy and sanctions);

our success expanding into and doing business in adjacent markets and internationally; the differing risks posed by international sales, including those involving commercial relationships with unfamiliar customers and different cultures; our ability to recover investments, which is frequently dependent upon the successful operation of ventures that we do not control; and changes in foreign national priorities, and foreign government budgets;

the competitive environment for our products and services, including increased pricing pressures, competition from outside the aerospace and defense industry, and increased bid protests;

planned production rates for significant programs; compliance with stringent performance and reliability standards; materials availability;

the performance and financial viability of key suppliers, teammates, ventures, venture partners, subcontractors and customers;

the timing and customer acceptance of product deliveries;

our ability to continue to innovate and develop new products and to attract and retain key personnel and transfer knowledge to new personnel; the impact of work stoppages or other labor disruptions;

the impact of cyber or other security threats or other disruptions to our businesses;

our ability to implement and continue capitalization changes such as share repurchases and dividend payments, pension funding as well as the pace and effect of any such capitalization changes;

our ability to recover certain costs under U.S. Government contracts and changes in contract mix;

the accuracy of our estimates and projections;

movements in interest rates and other changes that may affect pension plan assumptions, equity, the level of the FAS/CAS adjustment and actual returns on pension plan assets;

realizing the anticipated benefits of acquisitions or divestitures, ventures, teaming arrangements or internal reorganizations, and our efforts to increase the efficiency of our operations and improve the affordability of our products and services;

risk of an impairment of goodwill, investments or other long-term assets, including the potential impairment of goodwill, intangible assets and inventory recorded as a result of the acquisition of the Sikorsky business and the potential impairment of our equity investment in Advanced Military Maintenance, Repair and Overhaul Center LLC (AMMROC);

the adequacy of our insurance and indemnities;

the effect of changes in (or the interpretation of): legislation, regulation or policy, including those applicable to procurement (including aggressive government positions seeking intellectual property and broad license rights to use and have others use such intellectual property), cost allowability or recovery, accounting, taxation (including the impact of the Tax Cuts and Jobs Act), or export; and

the outcome of legal proceedings, bid protests, environmental remediation efforts, government investigations or government allegations that we have failed to comply with law, other contingencies and U.S. Government identification of deficiencies in our business systems.

These are only some of the factors that may affect forward-looking statements contained in this Form 10-Q. For a discussion identifying additional important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see our filings with the U.S. Securities and Exchange Commission (SEC) including, but not limited to, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 and subsequent Quarterly Reports on Form 10-Q. Our filings may be accessed through the Investor Relations page of our

website, www.lockheedmartin.com/investor, or through the website maintained by the SEC at www.sec.gov. Our actual financial results likely will be different from those projected due to the inherent nature of projections. Given these uncertainties, forward-looking statements should not be relied on in making investment decisions. The forward-looking statements contained in this Form 10-Q speak only as of the date of its filing. Except where required by applicable law, we expressly disclaim a duty to provide updates to forward-looking statements after the date of this Form 10-Q to reflect subsequent events, changed circumstances, changes in expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Form 10-Q are intended to be subject to the safe harbor protection provided by the federal securities laws.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We are a party to or have property subject to litigation and other proceedings that arise in the ordinary course of our business, including matters arising under provisions relating to protection of the environment, and are subject to contingencies related to certain businesses we previously owned. These types of matters could result in fines, penalties, compensatory or treble damages or non-monetary sanctions or relief. We believe the probability is remote that the outcome of these matters will have a material adverse effect on the corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our net earnings in any particular interim reporting period. We cannot predict the outcome of legal or other proceedings with certainty. These matters include the proceedings summarized in “Note 8 – Legal Proceedings and Contingencies” included in our Notes to Consolidated Financial Statements and “Note 14 – Legal Proceedings, Commitments and Contingencies” in our Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Form 10-K) filed with the U.S. Securities and Exchange Commission.

We are subject to federal, state, local and foreign requirements for protection of the environment, including those for discharge of hazardous substances and remediation of contaminated sites. As a result, we are a party to or have our property subject to various lawsuits or proceedings involving environmental protection matters. Due in part to their complexity and pervasiveness, such requirements have resulted in us being involved with related legal proceedings, claims and remediation obligations. The extent of our financial exposure cannot in all cases be reasonably estimated at this time. For information regarding these matters, including current estimates of the amounts that we believe are required for remediation or clean-up to the extent estimable, see “Note 8 – Legal Proceedings and Contingencies” included in our Notes to Consolidated Financial Statements. See also “Critical Accounting Policies – Environmental Matters” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Note 14 – Legal Proceedings, Commitments and Contingencies”, each in our 2017 Form 10-K for a description of previously reported matters.

As a U.S. Government contractor, we are subject to various audits and investigations by the U.S. Government to determine whether our operations are being conducted in accordance with applicable regulatory requirements. U.S. Government investigations of us, whether relating to government contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, suspension, proposed debarment, debarment from eligibility for future U.S. Government contracting or suspension of export privileges. Suspension or debarment could have a material adverse effect on us because of our dependence on contracts with the U.S. Government. U.S. Government investigations often take years to complete and many result in no adverse action against us. We also provide products and services to customers outside of the U.S., which are subject to U.S. and foreign laws and regulations and foreign procurement policies and practices. Our compliance with local regulations or applicable U.S. Government regulations also may be audited or investigated.

ITEM 1A. Risk Factors

While we attempt to identify, manage and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. “Item 1A. Risk Factors” of our 2017 Form 10-K describes some of the risks and uncertainties associated with our business, including U.S. Government funding, as further described in the “Industry Considerations” section of “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Form 10-Q. These risks and uncertainties have the potential to materially affect our business, results of operations, financial condition, cash flows, projected results and future prospects. We do not believe that there have been any material changes to the risk factors disclosed in our 2017 Form 10-K.

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ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no sales of unregistered equity securities during the quarter ended June 24, 2018.

The following table provides information about our repurchases of our common stock that is registered pursuant to Section 12 of the Securities Exchange Act of 1934 during the quarter ended June 24, 2018.

| Period ^(a) | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ^(b) | Amount Available for Future Share Repurchases Under the Plans or Programs ^(b) (in millions) |
|---------------------------------|----------------------------------|------------------------------|---|--|
| March 26, 2018 – April 29, 2018 | 352,986 | \$ 338.67 | 352,857 | \$ 3,084 |
| April 30, 2018 – May 27, 2018 | 281,149 | \$ 316.60 | 280,828 | \$ 2,995 |
| May 28, 2018 – June 24, 2018 | 369,222 | \$ 311.72 | 368,475 | \$ 2,880 |
| Total | 1,003,357 | ^(c) \$ 322.57 | 1,002,160 | |

We close our books and records on the last Sunday of each month to align our financial closing with our business processes, except for the month of December, as our fiscal year ends on December 31. As a result, our fiscal months often differ from the calendar months. For example, June 24, 2018 was the last day of our June 2018 fiscal month.

In October 2010, our Board of Directors approved a share repurchase program pursuant to which we are authorized to repurchase our common stock in privately negotiated transactions or in the open market at prices per share not exceeding the then-current market prices. From time to time, our Board of Directors authorizes increases to our share repurchase program. The total remaining authorization for future common share repurchases under our share repurchase program was \$2.9 billion as of June 24, 2018. Under the program, management has discretion to determine the dollar amount of shares to be repurchased and the timing of any repurchases in compliance with applicable law and regulation. This includes purchases pursuant to Rule 10b5-1 plans. The program does not have an expiration date.

During the quarter ended June 24, 2018, the total number of shares purchased included 1,197 shares that were transferred to us by employees in satisfaction of tax withholding obligations associated with the vesting of restricted stock units and performance stock units. These purchases were made pursuant to a separate authorization by our Board of Directors and are not included within the program.

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ITEM 6. Exhibits

Exhibit No. Description

| | |
|---------|---|
| 10.1 | <u>Amendment No. 1 to Lockheed Martin Corporation Executive Severance Plan, as amended and restated effective December 1, 2016.</u> |
| 10.2 | <u>Lockheed Martin Corporation Amended and Restated Directors Equity Plan (incorporated by reference to Exhibit 10.1 of Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on April 26, 2018).</u> |
| 15 | <u>Acknowledgment of Independent Registered Public Accounting Firm.</u> |
| 31.1 | <u>Certification of Marillyn A. Hewson pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | <u>Certification of Bruce L. Tanner pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32 | <u>Certification of Marillyn A. Hewson and Bruce L. Tanner pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Lockheed Martin Corporation
(Registrant)

Date: July 24, 2018 By: /s/ Brian P. Colan
Brian P. Colan
Vice President and Controller
(Duly Authorized Officer and Chief Accounting Officer)