RAYTHEON CO/
Form 10-Q
July 28, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended July 3, 2016

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

For the transition period from to

Commission File Number 1-13699

RAYTHEON COMPANY
(Exact name of Registrant as Specified in its Charter)

Delaware	95-1778500
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

870 Winter Street, Waltham, Massachusetts 02451
(Address of Principal Executive Offices) (Zip Code)
(781) 522-3000
(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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of 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 and post such files). Yes ý No ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

Number of shares of common stock outstanding as of July 25, 2016 was 295,095,000.

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Cautionary Note Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of federal securities laws, including information regarding our financial outlook, future plans, objectives, business prospects, trends and anticipated financial performance, including with respect to our liquidity and capital resources, our capital expenditures, our bookings and backlog, our cash tax payments and tax reserves, our pension expense and funding, the impact of new accounting pronouncements, our unrecognized tax benefits, our expectations regarding customer contracts, our international sales, the impact of acquisitions and other business arrangements, and the impact and outcome of audits and legal and administrative proceedings, claims, investigations, and commitments and contingencies. You can identify these statements by the fact that they include words such as “will,” “believe,” “anticipate,” “expect,” “estimate,” “inter “plan,” or variations of these words, or similar expressions. These forward-looking statements are not statements of historical facts and represent only our current expectations regarding such matters. These statements inherently involve a wide range of known and unknown uncertainties. Our actual actions and results could differ materially from what is expressed or implied by these statements. Specific factors that could cause such a difference include, but are not limited to, those set forth under Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015 and other important factors disclosed previously and from time to time in our other filings with the Securities and Exchange Commission. Given these factors, as well as other variables that may affect our operating results, you should not rely on forward-looking statements, assume that past financial performance will be a reliable indicator of future performance, or use historical trends to anticipate results or trends in future periods. We expressly disclaim any obligation or intention to provide updates to the forward-looking statements and the estimates and assumptions associated with them.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
RAYTHEON COMPANY
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In millions, except per share amounts)	Jul 3, 2016	Dec 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$2,016	$2,328
Short-term investments	703	872
Contracts in process, net	6,249	5,564
Inventories	671	635
Prepaid expenses and other current assets	211	413
Total current assets	9,850	9,812
Property, plant and equipment, net	2,028	2,005
Goodwill	14,791	14,731
Other assets, net	2,429	2,733
Total assets	$29,098	$29,281
Liabilities, Redeemable Noncontrolling Interest and Equity		
Current liabilities		
Advance payments and billings in excess of costs incurred	$2,136	$2,193
Accounts payable	1,405	1,402
Accrued employee compensation	1,113	1,154
Other current liabilities	1,360	1,377
Total current liabilities	6,014	6,126
Accrued retiree benefits and other long-term liabilities	7,092	7,140
Long-term debt	5,333	5,330
Commitments and contingencies (Note 10)		
Redeemable noncontrolling interest (Note 8)	343	355
Equity		
Raytheon Company stockholders’ equity		
Common stock, par value, $0.01 per share, 1,450 shares authorized, 295 and 299 shares outstanding at July 3, 2016 and December 31, 2015, respectively	3	3
Additional paid-in capital	—	398
Accumulated other comprehensive loss	(6,899)	(7,176)
Retained earnings	17,212	16,903
Total Raytheon Company stockholders’ equity	10,316	10,128
Noncontrolling interests in subsidiaries	—	202
Total equity	10,316	10,330
Total liabilities, redeemable noncontrolling interest and equity	$29,098	$29,281

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In millions, except per share amounts)	Three Months Ended Jul 3, 2016	Three Months Ended Jun 28, 2015	Six Months Ended Jul 3, 2016	Six Months Ended Jun 28, 2015
Net sales				
Products	$5,037	$4,894	$9,826	$9,281
Services	998	954	1,972	1,855
Total net sales	6,035	5,848	11,798	11,136
Operating expenses				
Cost of sales—products	3,566	3,727	7,164	6,823
Cost of sales—services	814	798	1,616	1,535
General and administrative expenses	695	675	1,446	1,290
Total operating expenses	5,075	5,200	10,226	9,648
Operating income	960	648	1,572	1,488
Non-operating (income) expense, net				
Interest expense	58	59	116	117
Interest income	(4)	(2)	(8)	(6)
Other (income) expense, net	(1)	(1)	(3)	(3)
Total non-operating (income) expense, net	53	56	105	108
Income from continuing operations before taxes	907	592	1,467	1,380
Federal and foreign income taxes	202	90	358	324
Income from continuing operations	705	502	1,109	1,056
Income (loss) from discontinued operations, net of tax	(1)	1	—	1
Net income	704	503	1,109	1,057
Less: Net income (loss) attributable to noncontrolling interests in subsidiaries	(5)	(2)	(29)	1
Net income attributable to Raytheon Company	$709	$505	$1,138	$1,056
Basic earnings per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$2.39	$1.65	$3.81	$3.44
Income (loss) from discontinued operations, net of tax	—	—	—	—
Net income	2.39	1.65	3.81	3.44
Diluted earnings per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$2.38	$1.65	$3.81	$3.44
Income (loss) from discontinued operations, net of tax	—	—	—	—
Net income	2.38	1.65	3.81	3.44
Amounts attributable to Raytheon Company common stockholders:				
Income from continuing operations	$710	$504	$1,138	$1,055
Income (loss) from discontinued operations, net of tax	(1)	1	—	1
Net income	$709	$505	$1,138	$1,056

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Net income	$704	$503	$1,109	$1,057
Other comprehensive income (loss), before tax:				
Pension and other postretirement benefit plans, net:				
Amortization of prior service cost included in net periodic cost	1	—	2	2
Amortization of net actuarial loss included in net income	245	283	491	566
Loss due to settlements	3	—	3	—
Pension and other postretirement benefit plans, net	249	283	496	568
Foreign exchange translation	(13)	67	(46)	(2)
Cash flow hedges	4	7	8	—
Unrealized gains (losses) on investments and other, net	—	—	2	(6)
Other comprehensive income (loss), before tax	240	357	460	560
Income tax benefit (expense) related to items of other comprehensive income (loss)	(89)	(99)	(183)	(197)
Other comprehensive income (loss), net of tax	151	258	277	363
Total comprehensive income	855	761	1,386	1,420
Less: Comprehensive income (loss) attributable to noncontrolling interests in subsidiaries	(5)	(2)	(29)	1
Comprehensive income attributable to Raytheon Company	$860	$763	$1,415	$1,419

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)

Six Months Ended July 3, 2016 and June 28, 2015 (in millions)	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Total Raytheon Company stockholders' equity	Noncontrolling interests in subsidiaries[1]	Total equity
Balance at December 31, 2015	$ 3	$ 398	$ (7,176)	$ 16,903	$ 10,128	$ 202	$ 10,330
Net income				1,138	1,138	(15)	1,123
Other comprehensive income (loss), net of tax			277		277		277
Adjustment of redeemable noncontrolling interest to redemption value				9	9		9
Distributions and other activity related to noncontrolling interests				(205)	(205)	(187)	(392)
Dividends declared		2		(437)	(435)		(435)
Common stock plans activity		98			98		98
Share repurchases		(498)		(196)	(694)		(694)
Balance at July 3, 2016	$ 3	$ —	$ (6,899)	$ 17,212	$ 10,316	$ —	$ 10,316
Balance at December 31, 2014	$ 3	$ 1,309	$ (7,458)	$ 15,671	$ 9,525	$ 196	$ 9,721
Net income				1,056	1,056	5	1,061
Other comprehensive income (loss), net of tax			363		363		363
Adjustment of redeemable noncontrolling interest to redemption value				(5)	(5)		(5)
Distributions and other activity related to noncontrolling interests		(11)			(11)	(2)	(13)
Dividends declared				(408)	(408)		(408)
Common stock plans activity		132			132		132
Share repurchases		(596)			(596)		(596)
Balance at June 28, 2015	$ 3	$ 834	$ (7,095)	$ 16,314	$ 10,056	$ 199	$ 10,255

(1) Excludes redeemable noncontrolling interest which is not considered equity. See "Note 8: Forcepoint Joint Venture" for additional information.

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

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)	Six Months Ended Jul 3, 2016	Jun 28, 2015
Cash flows from operating activities		
Net income	$1,109	$1,057
(Income) loss from discontinued operations, net of tax	—	(1)
Income from continuing operations	1,109	1,056
Adjustments to reconcile to net cash provided by (used in) operating activities from continuing operations, net of the effect of acquisitions and divestitures		
Depreciation and amortization	247	223
Stock-based compensation	89	87
Gain on sale of equity method investment	(158)	—
Deferred income taxes	(67)	(232)
Tax benefit from stock-based awards	—	(42)
Changes in assets and liabilities		
Contracts in process, net and advance payments and billings in excess of costs incurred	(734)	(795)
Inventories	(35)	(106)
Prepaid expenses and other current assets	155	29
Income taxes receivable/payable	64	92
Accounts payable	49	(99)
Accrued employee compensation	(43)	(117)
Other current liabilities	(76)	13
Accrued retiree benefits	445	408
Other, net	26	(86)
Net cash provided by (used in) operating activities from continuing operations	1,071	431
Net cash provided by (used in) operating activities from discontinued operations	—	1
Net cash provided by (used in) operating activities	1,071	432
Cash flows from investing activities		
Additions to property, plant and equipment	(237)	(143)
Proceeds from sales of property, plant and equipment	1	19
Additions to capitalized internal use software	(26)	(26)
Purchases of short-term investments	(472)	(148)
Sales of short-term investments	—	209
Maturities of short-term investments	599	774
Payments for purchases of acquired companies, net of cash received	(57)	(1,892)
Other	6	(15)
Net cash provided by (used in) investing activities	(186)	(1,222)
Cash flows from financing activities		
Dividends paid	(419)	(391)
Repurchases of common stock under share repurchase programs	(602)	(500)
Repurchases of common stock to satisfy tax withholding obligations	(92)	(96)
Acquisition of noncontrolling interest in RCCS LLC	(90)	—
Contribution from noncontrolling interest in Forcepoint	11	—
Tax benefit from stock-based awards	—	42
Sale of noncontrolling interest in Forcepoint	—	343
Other	(5)	(2)

Net cash provided by (used in) financing activities	(1,197)	(604)
Net increase (decrease) in cash and cash equivalents	(312)	(1,394)
Cash and cash equivalents at beginning of the year	2,328	3,222
Cash and cash equivalents at end of period	$2,016	$1,828

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

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RAYTHEON COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of Presentation
We prepared the accompanying unaudited consolidated financial statements of Raytheon Company and all wholly-owned, majority-owned or otherwise controlled subsidiaries on the same basis as our annual audited financial statements. We condensed or omitted certain information and footnote disclosures normally included in our annual audited financial statements, which we prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP). Our quarterly financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015. As used in this report, the terms “we,” “us,” “our,” “Raytheon” and the “Company” mean Raytheon Company and its subsidiaries, unless the context indicates another meaning.

In the opinion of management, our financial statements reflect all adjustments, which are of a normal recurring nature, necessary for presentation of financial statements for interim periods in accordance with U.S. GAAP and with the instructions to Form 10-Q in Article 10 of Securities and Exchange Commission Regulation S-X. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates, and any such differences may be material to our financial statements.

As previously announced, effective January 1, 2016, we reorganized certain product areas of our Integrated Defense Systems (IDS) and Intelligence, Information and Services (IIS) businesses to more efficiently leverage our capabilities. Additionally, also effective January 1, 2016, we reclassified, with respect to our IDS, IIS, Missile Systems (MS) and Space and Airborne Systems (SAS) businesses, acquisition accounting adjustments related to the amortization of acquired intangibles and adjustments to record acquired deferred revenue at fair value, such that they are no longer reported within the business segments and are instead reported in the Acquisition Accounting Adjustments line item. Prior to January 1, 2016, only those acquisition accounting adjustments associated with our Forcepoint™ business were reported in the Acquisition Accounting Adjustments line item. The amounts and presentation of our business segments, including corporate and eliminations for intersegment activity, set forth in this Form 10-Q reflect these changes. None of the changes impact our previously reported consolidated balance sheets, statements of operations or statements of cash flows. See "Note 14: Business Segment Reporting" for additional information.

Note 2: Accounting Standards
In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), which will replace numerous requirements in U.S. GAAP, including industry-specific requirements, and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented and the cumulative effect of applying the standard would be recognized at the earliest period shown, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. In July 2015, the FASB approved the deferral of the new standard's effective date by one year. The new standard is effective for annual reporting periods beginning after December 15, 2017. The FASB will permit companies to adopt the new standard early, but not before the original effective date of annual reporting periods beginning after December 15, 2016.

In 2014, we established a cross-functional implementation team consisting of representatives from across all of our business segments. We utilized a bottoms-up approach to analyze the impact of the standard on our contract portfolio by reviewing our current accounting policies and practices to identify potential differences that would result from applying the requirements of the new standard to our revenue contracts. In addition, we identified, and are in the process of implementing, appropriate changes to our business processes, systems and controls to support recognition and disclosure under the new standard. The implementation team has reported the findings and progress of the project to management and the Audit Committee on a frequent basis over the last two years.

We have been closely monitoring FASB activity related to the new standard, as well as working with various non-authoritative groups to conclude on specific interpretative issues. In the second quarter of 2016, we made progress toward completing our evaluation of the potential changes from adopting the new standard on our future financial reporting and disclosures. Our progress was aided by the FASB issuing ASU 2016-10, Identifying Performance Obligations and Licensing, which amended the current guidance on performance obligations and provided additional clarity on this topic, and the significant progress of the non-

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authoritative groups in concluding on specific interpretative issues. We also made significant progress on our contract reviews and detailed policy drafting in the second quarter of 2016. Based on our evaluation, we expect to early adopt the requirements of the new standard in the first quarter of 2017 and anticipate using the full retrospective transition method.

The impact of adopting the new standard on our 2015 and 2016 total net sales and operating income is not expected to be material. We also do not expect a material impact to our consolidated balance sheet. The immaterial impact of adopting ASU 2014-09 primarily relates to the deferral of commissions on our commercial software arrangements, which previously were expensed as incurred but under the new standard will generally be capitalized and amortized over the period of contract performance, and policy changes related to the recognition of revenue and costs on our defense contracts to better align our policies with the new standard. The impact to our results is not material because the analysis of our contracts under the new revenue recognition standard supports the recognition of revenue over time under the cost-to-cost method for the majority of our contracts, which is consistent with our current revenue recognition model. Revenue on the majority of our contracts will continue to be recognized over time because of the continuous transfer of control to the customer. For U.S. government contracts, this continuous transfer of control 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. Similarly, for non-U.S. government contracts, the customer typically controls the work in process as evidenced either by contractual termination clauses or by our rights to payment for work performed to date to deliver products or services that do not have an alternative use to the company. Under the new standard, the cost-to-cost measure of progress continues to best depict the transfer of control of assets to the customer, which occurs as we incur costs. In addition, the number of our performance obligations under the new standard is not materially different from our contract segments under the existing standard. Lastly, the accounting for the estimate of variable amounts is not expected to be materially different compared to our current practice.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which amends the accounting for employee share-based payment transactions to require recognition of the tax effects resulting from the settlement of stock-based awards as income tax expense or benefit in the income statement in the reporting period in which they occur. In addition, the ASU requires that all tax-related cash flows resulting from share-based payments, including the excess tax benefits related to the settlement of stock-based awards, be classified as cash flows from operating activities in the statement of cash flows. The ASU also requires that cash paid by directly withholding shares for tax withholding purposes be classified as a financing activity in the statement of cash flows. In addition, the ASU allows companies to make an accounting policy election to either estimate the number of awards that are expected to vest, consistent with current U.S. GAAP, or account for forfeitures when they occur. The new standard is effective for annual reporting periods beginning after December 15, 2016 with early adoption permitted. We elected to early adopt the requirements of the amended standard in the first quarter of 2016. In accordance with U.S. GAAP, we adopted the amendment requiring recognition of excess tax benefits and tax deficiencies in the income statement prospectively beginning in the first quarter of 2016, which could result in fluctuations in our effective tax rate period over period depending on how many awards vest in a quarter as well as the volatility of our stock price. In addition, we elected to adopt the amendment related to the presentation of excess tax benefits within operating activities on the statement of cash flows prospectively beginning in the first quarter of 2016. We had previously classified cash paid for tax withholding purposes as a financing activity in the statement of cash flows, therefore there is no change related to this requirement. Furthermore, we elected to change our accounting policy to account for forfeitures when they occur for consistency with our government recovery accounting practices on a modified retrospective basis.

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 for most lease arrangements. The new standard is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted. We are currently evaluating the potential changes from this ASU to our future financial reporting and disclosures. We expect the standard to have a material impact on our assets and liabilities for the addition of right-of-use assets and lease liabilities, but we do not expect it to have a material impact to our results of operations or liquidity.

Other new pronouncements issued but not effective until after July 3, 2016 are not expected to have a material impact on our financial position, results of operations or liquidity.

Note 3: Changes in Estimates under Percentage of Completion Contract Accounting

We have a companywide standard and disciplined quarterly Estimate at Completion (EAC) process in which management reviews the progress and performance of our contracts. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress toward completion and the related program schedule, identified risks and opportunities, and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (e.g., the number and type of milestone events), technical requirements (e.g., a newly-developed product versus a mature product) and other contract requirements. Management must make assumptions and estimates regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (e.g., to estimate increases in wages and prices for materials and related support cost

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allocations), performance by our subcontractors, the availability and timing of funding from our customer, and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations, required under certain contracts. Based on this analysis, any quarterly adjustments to net sales, cost of sales and the related impact to operating income are recognized as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating income during the performance of individual contracts, if we determine we will be successful in mitigating risks surrounding the technical, schedule, and cost aspects of those contracts or in realizing related opportunities. Likewise, these adjustments may result in a decrease in operating income if we determine we will not be successful in mitigating these risks or in realizing related opportunities. Changes in estimates of net sales, cost of sales, and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a contract's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our contracts. When estimates of total costs to be incurred on a contract exceed total estimates of revenue to be earned, a provision for the entire loss on the contract is recognized in the period the loss is determined.

Net EAC adjustments had the following impact on our operating results:

	Three Months Ended		Six Months Ended	
(In millions, except per share amounts)	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Operating income	$134	$40	$155	$161
Income from continuing operations attributable to Raytheon Company	87	26	112	105
Diluted earnings per share (EPS) from continuing operations attributable to Raytheon Company	$0.29	$0.09	$0.38	$0.34

Note 4: Earnings Per Share (EPS)
We compute basic and diluted EPS using actual income from continuing operations attributable to Raytheon Company common stockholders, income (loss) from discontinued operations attributable to Raytheon Company common stockholders, net income attributable to Raytheon Company, and our actual weighted-average shares outstanding rather than the numbers presented within our unaudited consolidated financial statements, which are rounded to the nearest million. As a result, it may not be possible to recalculate EPS as presented in our unaudited consolidated financial statements. Furthermore, it may not be possible to recalculate EPS attributable to Raytheon Company common stockholders by adjusting EPS from continuing operations by EPS from discontinued operations.

We include all unvested stock awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, in the number of shares outstanding in our basic and diluted EPS calculations as they are considered participating securities. As a result, we have included all of our outstanding unvested restricted stock awards (RSAs), as well as restricted stock units (RSUs) and Long-term Performance Plan (LTPP) awards that meet the retirement eligible criteria in our calculation of basic and diluted EPS. We disclose EPS for common stock and unvested stock-based payment awards, and separately disclose distributed and undistributed earnings. Distributed earnings represent common stock dividends and dividends earned on unvested RSAs and stock-based payment awards of retirement eligible employees. Undistributed earnings represent earnings that were available for distribution but were not distributed. Common stock and unvested stock-based payment awards earn dividends equally. We reflect the redemption value adjustments for redeemable noncontrolling interests in the EPS calculation if redemption value is in excess of the fair value of noncontrolling interest.

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EPS from continuing operations attributable to Raytheon Company common stockholders and unvested stock-based payment awards was as follows:

	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.73	$ 0.68	$1.46	$ 1.35
Undistributed earnings	1.66	0.97	2.35	2.09
Total	$2.39	$ 1.65	$3.81	$ 3.44
Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.73	$ 0.68	$1.46	$ 1.35
Undistributed earnings	1.65	0.97	2.35	2.09
Total	$2.38	$ 1.65	$3.81	$ 3.44

Basic and diluted EPS from discontinued operations attributable to Raytheon Company common stockholders and unvested stock-based payment awards was a loss of less than $0.01 and earnings of less than $0.01 for the second quarters of 2016 and 2015, respectively, and earnings of less than $0.01 for the first six months of 2016 and 2015.

Income attributable to participating securities was as follows:

(In millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Income from continuing operations attributable to participating securities	$ 9	$ 7	$17	$ 18
Income (loss) from discontinued operations, net of tax attributable to participating securities(1)	—	—	—	—
Net income attributable to participating securities	$ 9	$ 7	$17	$ 18

(1) Income (loss) from discontinued operations, net of tax attributable to participating securities was a loss of less than $1 million and income of less than $1 million for the second quarters of 2016 and 2015, respectively, and income of less than $1 million for the first six months of 2016 and 2015.

The weighted-average shares outstanding for basic and diluted EPS were as follows:

(In millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Shares for basic EPS(1)	297.3	305.4	298.2	306.8
Dilutive effect of LTPP	0.3	0.3	0.4	0.4
Shares for diluted EPS	297.6	305.7	298.6	307.2

(1) Includes 3.8 million and 4.3 million participating securities for the three months ended July 3, 2016 and June 28, 2015, respectively, and 4.3 million and 5.2 million participating securities for the six months ended July 3, 2016 and June 28, 2015, respectively.

Note 5: Inventories

Inventories consisted of the following:

(In millions)	Jul 3, 2016	Dec 31, 2015

Materials and purchased parts	$ 68	$ 69
Work in process	587	551
Finished goods	16	15
Total	$ 671	$ 635

We capitalize costs incurred in advance of contract award or funding in inventories if we determine that contract award or funding is probable. To the extent these are precontract costs, start-up costs have been excluded. We included capitalized precontract costs and other deferred costs of $230 million and $225 million in inventories as work in process at July 3, 2016 and December 31, 2015, respectively.

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Note 6: Acquisitions and Goodwill
In pursuing our business strategies, we acquire and make investments in certain businesses that meet strategic and financial criteria.

In January 2016, our Forcepoint business acquired the Stonesoft next-generation firewall (NGFW) business, including the Sidewinder proxy firewall technology. Vista Equity Partners contributed 19.7% of the purchase price, which is reflected in contribution from noncontrolling interest in Forcepoint in our consolidated statements of cash flows. Stonesoft provides NGFW software and hardware solutions that focus on high-availability, centralized management of large networks and protection from advanced evasion techniques. The Sidewinder product provides proxy-based firewall software and hardware solutions, allowing for clear visibility and control of command filtering, protocol enforcement and application access. Stonesoft expands the cloud and hybrid capabilities of the Forcepoint TRITON® security platform. In connection with this acquisition, we have preliminarily recorded $51 million of goodwill, primarily related to expected synergies from combining operations and the value of the existing workforce, all of which is expected to be deductible for tax purposes, and $23 million of intangible assets, primarily related to technology and customer relationships, with a weighted-average life of 5 years. We expect to complete the purchase price allocation process in the second half of 2016 when we receive final valuation results and complete our review.

Pro-forma financial information has not been provided for this acquisition because it is not material.

A rollforward of goodwill by segment was as follows:

(In millions)	Integrated Defense Systems(1)	Intelligence, Information and Services(1)	Missile Systems	Space and Airborne Systems	Forcepoint(2)	Total
Balance at December 31, 2015	$ 1,704	$ 2,958	$ 4,154	$ 4,106	$ 1,809	$ 14,731
Acquisitions(3)	—	8	—	—	51	59
Effect of foreign exchange rates and other	—	1	—	—	—	1
Balance at July 3, 2016	$ 1,704	$ 2,967	$ 4,154	$ 4,106	$ 1,860	$ 14,791

(1) In connection with the January 1, 2016 reorganization of IDS and IIS, goodwill of $90 million was allocated to the IIS segment on a relative fair value basis and is reflected in the revised balances at December 31, 2015.

(2) At July 3, 2016, Forcepoint's fair value is estimated to exceed its net book value by approximately $300 million. As discussed in "Note 8: Forcepoint Joint Venture", we are required to determine Forcepoint's fair value on a quarterly basis due to the accounting related to the redeemable noncontrolling interest.

(3) In addition to the acquisition of the Stonesoft NGFW business during the first quarter of 2016, we finalized the purchase price allocation for Foreground Security at IIS, which resulted in an adjustment to goodwill of $8 million.

Note 7: Thales-Raytheon Systems Co. Ltd. (TRS) Joint Venture
In 2001, we formed the TRS joint venture with Thales S.A. The TRS joint venture arrangement involves three operating companies, one of which, Raytheon Command and Control Solutions LLC (RCCS LLC), previously called Thales-Raytheon Systems LLC, we control and consolidate, and the other two, Thales-Raytheon Systems Company S.A.S. (TRS SAS) and Thales-Raytheon Systems Air and Missile Defense Command and Control S.A.S. (TRS AMDC2), which we have accounted for using the equity method through our investment in TRS. All are reflected in our IDS segment results.

On December 24, 2015, Thales S.A. and Raytheon entered into a letter agreement relating to the joint venture agreement for the TRS joint venture, which contemplated that the parties would use their commercially reasonable efforts to amend the joint venture agreement on or before June 30, 2016 to reduce its existing scope of work. In the second quarter of 2016, Thales S.A. and Raytheon amended and restated the TRS joint venture agreement to reduce the existing joint venture arrangement to TRS AMDC2 only and limit its scope to NATO-only business opportunities involving air command and control systems, theatre missile defense and ballistic missile defense. Accordingly, TRS AMDC2 will continue to be a joint venture between Thales S.A. and Raytheon that will be accounted for using the equity method.

The amendment and restatement of the TRS joint venture agreement resulted in Raytheon acquiring Thales S.A.'s noncontrolling interest in RCCS LLC and selling our equity method investment in TRS SAS, resulting in a net cash payment to Thales S.A. of $90 million which was classified as a financing activity in our consolidated statements of cash flows. We recorded our acquisition of Thales S.A.'s noncontrolling interest in RCCS LLC at fair value, which resulted in a reduction to equity of $167 million before tax, $205 million after tax, and the sale of our equity method investment in TRS SAS at fair value, which resulted in a tax-free gain of $158 million that was recorded in operating income, consistent with the historical classification of equity method income for TRS SAS, at our IDS Segment.

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Note 8: Forcepoint Joint Venture

In May 2015, we created Forcepoint, a new cybersecurity joint venture company (with Vista Equity Partners), through a series of transactions by which we acquired Websense, Inc. from Vista Equity Partners and combined it with Raytheon Cyber Products, formerly part of our IIS segment. We then sold 19.7% of the equity interest in the combined company to Vista Equity Partners for $343 million.

The joint venture agreement between Raytheon and Vista Equity Partners provides Vista Equity Partners with certain rights to require Forcepoint to pursue an initial public offering at any time after four years and three months following the closing date of May 29, 2015, or pursue a sale of the company at any time after five years following the closing date. In either of these events, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint for cash at a price equal to fair value as determined under the joint venture agreement. Additionally, Vista Equity Partners has the ability to liquidate its ownership through a put option any time after two years following the closing date. In the event of a put option, Vista Equity Partners could require Raytheon to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint for cash at a price equal to fair value as determined under the joint venture agreement. Lastly, at any time after three years following the closing date, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint at a price equal to fair value as determined under the joint venture agreement.

Vista Equity Partners' interest in Forcepoint is presented as redeemable noncontrolling interest, outside of stockholders' equity, in our consolidated balance sheets. The redeemable noncontrolling interest is recognized at the greater of the estimated redemption value as of the balance sheet date, which was $343 million at July 3, 2016, or the carrying value, defined as the initial value adjusted for Vista Equity Partners' share of the cumulative impact of net income (loss) and other changes in accumulated other comprehensive income (loss), which was $323 million at July 3, 2016. Adjustments to the redemption value over the period from the date of acquisition to the date the redemption feature becomes puttable are immediately recorded to retained earnings.

A rollforward of redeemable noncontrolling interest was as follows:

	Six Months Ended	
(In millions)	Jul 3, 2016	Jun 28, 2015
Beginning balance	$355	$—
Sale of noncontrolling interest	—	343
Net income (loss)	(14)	(5)
Other comprehensive income (loss), net of tax[1]	—	—
Contribution from noncontrolling interest	11	—
Adjustment of noncontrolling interest to redemption value	(9)	5
Ending balance	$343	$343

(1) Other comprehensive income (loss), net of tax, was a loss of less than $1 million and income of less than $1 million for the six months ended July 3, 2016 and June 28, 2015, respectively.

Note 9: Derivatives and Other Financial Instruments

Derivatives—Our primary market exposures are to foreign exchange rates and interest rates, and we use certain derivative financial instruments to help manage these exposures. We execute these instruments with financial institutions that we judge to be credit-worthy, and the majority of our foreign currency forward contracts are denominated in currencies of major industrial countries. We do not hold or issue derivative financial instruments for trading or speculative purposes.

The fair value of asset derivatives included in other assets, net and liability derivatives included in other current liabilities in our consolidated balance sheets related to foreign currency contracts were $38 million and $47 million, respectively, at July 3, 2016 and $9 million and $29 million, respectively, at December 31, 2015. The fair values of these derivatives are Level 2 in the fair value hierarchy at July 3, 2016 and December 31, 2015 because they are determined based on a market approach utilizing externally quoted forward rates for similar contracts.

We use foreign currency forward contracts to fix the functional currency value of specific commitments, payments and receipts. The aggregate notional amount of the outstanding foreign currency forward contracts was $1,666 million and $1,076 million at July 3, 2016 and December 31, 2015, respectively. The net notional exposure of these contracts was approximately $261 million and $117 million at July 3, 2016 and December 31, 2015, respectively.

Our foreign currency forward contracts contain offset or netting provisions to mitigate credit risk in the event of counterparty default, including payment default and cross default. At July 3, 2016 and December 31, 2015, the fair value of our counterparty default exposure was less than $1 million and spread across numerous highly rated counterparties.

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There were no interest rate swaps outstanding at July 3, 2016 and December 31, 2015.

Other Financial Instruments—We invest in marketable securities in accordance with our short-term investment policy and cash management strategy. These marketable securities are classified as available-for-sale and are recorded at fair value as short-term investments in our consolidated balance sheets. These investments are deemed Level 2 assets under the fair value hierarchy at July 3, 2016 and December 31, 2015, as their fair value is determined under a market approach using valuation models that utilize observable inputs, including maturity date, issue date, settlement date and current rates. At July 3, 2016 and December 31, 2015, we had short-term investments of $703 million and $872 million, respectively, consisting of highly rated bank certificates of deposit with a minimum long-term debt rating of A or A2 and a minimum short-term debt rating of A-1 and P-1. As of July 3, 2016, our short-term investments had an average maturity of approximately five months. The amortized cost of these securities closely approximated their fair value at July 3, 2016 and December 31, 2015. There were no securities deemed to have other than temporary declines in value for the second quarter of 2016. In the second quarter and first six months of 2016, we recorded an unrealized loss on short-term investments of less than $1 million, net of tax, in accumulated other comprehensive loss (AOCL), and an unrealized gain on short-term investments of less than $1 million, net of tax, in AOCL, respectively. In the second quarter and first six months of 2015, we recorded an unrealized loss on short-term investments of less than $1 million, net of tax, in AOCL, and an unrealized gain on short-term investments of less than $1 million, net of tax, in AOCL, respectively. We did not have any sales of short-term investments in the second quarter and first six months of 2016. In the second quarter and first six months of 2015, we recorded sales of short-term investments of $74 million and $209 million, respectively, which resulted in gains of less than $1 million recorded in other (income) expense, net. For purposes of computing realized gains and losses on available-for-sale securities, we determine cost on a specific identification basis.

In addition to the financial instruments discussed above, we hold other financial instruments, including cash and cash equivalents, notes receivable and debt. The carrying amounts for cash and cash equivalents and notes receivable approximated their fair values. The carrying value of long-term debt was recorded at amortized cost. The estimated fair value of long-term debt was determined based on quoted prices in inactive markets, which falls within Level 2 of the fair value hierarchy. The carrying value and estimated fair value of long-term debt were as follows:

(In millions)	Jul 3, 2016	Dec 31, 2015
Carrying value of long-term debt	$5,333	$5,330
Fair value of long-term debt	6,168	5,826

In addition, we did not have any transfers of assets or liabilities between levels of the fair value hierarchy during the first six months of 2016.

Note 10: Commitments and Contingencies

Environmental Matters—We are involved in various stages of investigation and cleanup related to remediation of various environmental sites. Our estimate of the liability of total environmental remediation costs includes the use of a discount rate and takes into account that a portion of these costs is eligible for future recovery through the pricing of our products and services to the U.S. government. We consider such recovery probable based on government contracting regulations and our long history of receiving reimbursement for such costs, and accordingly have recorded the estimated future recovery of these costs from the U.S. government within contracts in process, net, in our consolidated balance sheets. Our estimates regarding remediation costs to be incurred were as follows:

(In millions, except percentages)	Jul 3, 2016	Dec 31, 2015
Total remediation costs—undiscounted	$219	$224
Weighted average discount rate	5.2 %	5.2 %
Total remediation costs—discounted	$151	$149

Recoverable portion	95	94

We also lease certain government-owned properties and generally are not liable for remediation of preexisting environmental contamination at these sites. As a result, we generally do not provide for these costs in our consolidated financial statements.

Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage and the unresolved extent of our responsibility, it is difficult to determine the ultimate outcome of environmental matters. However, we do not expect any additional liability to have a material adverse effect on our financial position, results of operations or liquidity.

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Financing Arrangements and Other—We issue guarantees, and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. These instruments expire on various dates through 2024. Additional guarantees of project performance for which there is no stated value also remain outstanding. The stated values outstanding consisted of the following:

(In millions)	Jul 3, 2016	Dec 31, 2015
Guarantees	$ 199	$ 213
Letters of credit	2,567	2,242
Surety bonds	255	264

Included in guarantees and letters of credit described above were $189 million and $47 million, respectively, at July 3, 2016, and $203 million and $187 million, respectively, at December 31, 2015, related to our joint venture in TRS. The joint venture agreement for the TRS joint venture was amended and restated in the second quarter of 2016, as discussed in "Note 7: Thales-Raytheon Systems Co. Ltd. (TRS) Joint Venture", reducing the scope of the joint venture to TRS AMDC2 only. We provide these guarantees and letters of credit to TRS AMDC2 and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. While we expect these entities to satisfy their loans and meet their project performance and other contractual obligations, their failure to do so may result in a future obligation to us. We periodically evaluate the risk of TRS AMDC2 and other affiliates failing to meet their obligations described above. At July 3, 2016, we believe the risk that TRS AMDC2 and other affiliates will not be able to meet their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at July 3, 2016. We had an estimated liability of $4 million and $8 million, respectively, at July 3, 2016 and December 31, 2015 related to these guarantees and letters of credit.

As discussed in "Note 8: Forcepoint Joint Venture", under the joint venture agreement between Raytheon Company and Vista Equity Partners, Raytheon may be required to purchase Vista Equity Partners' interest in Forcepoint.

We have entered into industrial cooperation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. At July 3, 2016, the aggregate amount of our offset agreements had an outstanding notional value of approximately $6.0 billion. These agreements are designed to return economic value to the foreign country by requiring us to engage in activities supporting local defense or commercial industries, promoting a balance of trade, developing in-country technology capabilities or addressing other local development priorities. Offset agreements may be satisfied through activities that do not require a direct cash payment, including transferring technology, providing manufacturing, training and other consulting support to in-country projects, and the purchase by third parties (e.g., our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for activities such as subcontracting with local partners, purchasing supplies from in-country vendors, providing financial support for in-country projects and making investments in local ventures. Such activities may also vary by country depending upon requirements as dictated by their governments. We typically do not commit to offset agreements until orders for our products or services are definitive. The amounts ultimately applied against our offset agreements are based on negotiations with the customers and typically require cash outlays that represent only a fraction of the notional value in the offset agreements. Offset programs usually extend over several or more years and may provide for penalties in the event we fail to perform in accordance with offset requirements. We have historically not been required to pay any such penalties.

As a U.S. government contractor, we are subject to many levels of audit and investigation by the U.S. government relating to our contract performance and compliance with applicable rules and regulations. Agencies that oversee contract performance include: the Defense Contract Audit Agency (DCAA); the Defense Contract Management

Agency (DCMA); the Inspectors General of the U.S. Department of Defense (DoD) and other departments and agencies; the Government Accountability Office; the Department of Justice (DoJ); and Congressional Committees. From time to time, these and other agencies investigate or conduct audits to determine whether our operations are being conducted in accordance with applicable requirements. Such investigations and audits could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, the suspension of government export licenses or the suspension or debarment from future U.S. government contracting. U.S. government investigations often take years to complete and many result in no adverse action against us. Our final allowable incurred costs for each year are also subject to audit and have, from time to time, resulted in disputes between us and the U.S. government, with litigation resulting at the Court of Federal Claims (COFC) or the Armed Services Board of Contract Appeals (ASBCA) or their related courts of appeals. In addition, the DoJ has, from time to time, convened grand juries to investigate possible irregularities by us. We also provide products and services to customers outside of the U.S., and those sales are subject to local government laws, regulations and procurement policies and practices. Our compliance with such local government regulations or any applicable U.S. government regulations (e.g., the Foreign Corrupt Practices Act (FCPA) and International Traffic in Arms Regulations (ITAR)) may also be investigated or audited. Other than as specifically disclosed herein, we do not expect

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these audits, investigations or disputes to have a material effect on our financial position, results of operations or liquidity, either individually or in the aggregate.

In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against, or initiated by, us. We do not expect any of these proceedings to result in any additional liability or gains that would materially affect our financial position, results of operations or liquidity. In connection with certain of our legal matters, we may be entitled to insurance recovery for qualified legal costs. We do not expect any insurance recovery to have a material impact on the financial exposure that could result from these matters.

Product Warranty—We provide for product warranties in conjunction with certain product sales for which we recognize revenue upon delivery. These product warranty accruals were less than $30 million at both July 3, 2016 and December 31, 2015.

We account for warranty provision costs incurred under our long-term contracts using the cost-to-cost measure of progress as contracts costs, as the estimation of these costs is integral in determining the price of the related long-term contracts. The amounts above exclude these costs.

Note 11: Stockholders' Equity

The changes in shares of our common stock outstanding were as follows:

(In millions)	Six Months Ended Jul 3, 2016	Jun 28, 2015
Beginning balance	299.0	307.3
Stock plans activity	1.6	1.8
Share repurchases	(5.5)	(5.5)
Ending balance	295.1	303.6

From time to time, our Board of Directors authorizes the repurchase of shares of our common stock. In November 2013, our Board authorized the repurchase of up to $2.0 billion of our outstanding common stock. Our Board also authorized the repurchase of up to an additional $2.0 billion of our outstanding common stock in November 2015. At July 3, 2016, we had approximately $1.9 billion available under the 2015 repurchase program. Share repurchases will take place from time to time at management's discretion depending on market conditions.

Share repurchases also include shares surrendered by employees to satisfy tax withholding obligations in connection with RSAs, RSUs, stock options and LTPP awards issued to employees.

Repurchased shares are retired immediately upon repurchase. We account for treasury stock under the cost method. Upon retirement the excess over par value is charged against additional paid-in capital until reduced to zero, with the remainder recorded as a reduction to 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 $196 million recorded as a reduction to retained earnings in the six months ended July 3, 2016.

Our share repurchases were as follows:

(In millions)	Six Months Ended Jul 3, 2016		Jun 28, 2015	
	$	Shares	$	Shares
Shares repurchased under our share repurchase programs	$602	4.8	$500	4.6

Shares repurchased to satisfy tax withholding obligations	92	0.7	96	0.9
Total share repurchases	$694	5.5	$596	5.5

In March 2016, our Board of Directors authorized a 9.3% increase to our annual dividend payout rate from $2.68 to $2.93 per share. Our Board of Directors also declared dividends of $1.465 per share during the first six months of 2016, compared to dividends of $1.34 per share during the first six months of 2015. Dividends are subject to quarterly approval by our Board of Directors.

As further discussed in "Note 7: Thales-Raytheon Systems Co. Ltd. (TRS) Joint Venture", in the second quarter of 2016, we recorded our acquisition of Thales S.A.'s noncontrolling interest in RCCS LLC at fair value, which resulted in a reduction to retained earnings of $167 million before tax, $205 million after tax. The $38 million of deferred tax is due to the change in outside basis difference in RCCS LLC.

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Stock-based Compensation Plans

RSAs and RSUs—During the first six months of 2016, we granted 1.1 million RSAs and RSUs with a weighted-average grant-date fair value of $123.95, calculated under the intrinsic value method. These awards generally vest in equal installments on each of the second, third and fourth anniversary dates of the award's grant date.

LTPP—During the first six months of 2016, we granted RSUs subject to the 2016–2018 LTPP plan with an aggregate target award of 0.2 million units and a weighted-average grant-date fair value of $123.31. The performance goals for the 2016–2018 LTPP award are independent of each other and based on three metrics, as defined in the award agreements: return on invested capital (ROIC), weighted at 50%; total shareholder return (TSR) relative to a peer group, weighted at 25%; and cumulative free cash flow from continuing operations (CFCF), weighted at 25%. The ultimate award, which is determined at the end of the three-year cycle, can range from zero to 200% of the target award and includes dividend equivalents, which are not included in the aggregate target award numbers. The grant-date fair value is based upon the value determined under the intrinsic value method for the CFCF and ROIC portions of the award and the Monte Carlo simulation method for the TSR portion of the award.

Forcepoint Plans—In 2015, Forcepoint established long-term incentive plans that provide for awards of unit appreciation rights and profits interests in the joint venture to Forcepoint management and key employees. Awards are approved by the Board of Forcepoint. These awards vest over a specified period of time and settlement is subject to a liquidity event defined as either a change in control or an initial public offering of the joint venture. In certain limited circumstances other vesting conditions may apply and the expense attributable to these vesting conditions was $2 million for both the second quarter and first six months of 2016. At July 3, 2016, there were 131 thousand combined units and/or profits interests authorized for award under these plans.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes gains and losses associated with pension and other postretirement benefits (PRB), foreign exchange translation adjustments, effective portion of gains and losses on derivative instruments qualified as cash flow hedges, and unrealized gains (losses) on available-for-sale investments. The computation of other comprehensive income (loss) and its components are presented in the consolidated statements of comprehensive income.

Accumulated other comprehensive income (loss) consisted of the following activity during the first six months of 2016 and 2015:

(In millions)	Pension and PRB plans, net[1]	Foreign exchange translation	Cash flow hedges[2]	Unrealized gains (losses) on investments and other, net[3]	Total
Balance at December 31, 2015	$(7,088)	$ (60)	$ (16)	$ (12)	$(7,176)
Before tax amount	496	(46)	8	2	460
Tax (expense) or benefit	(178)	—	(4)	(1)	(183)
Net of tax amount	318	(46)	4	1	277
Balance at July 3, 2016	$(6,770)	$ (106)	$ (12)	$ (11)	$(6,899)
Balance at December 31, 2014	$(7,432)	$ (3)	$ (14)	$ (9)	$(7,458)
Before tax amount	568	(2)	—	(6)	560
Tax (expense) or benefit	(199)	—	—	2	(197)
Net of tax amount	369	(2)	—	(4)	363
Balance at June 28, 2015	$(7,063)	$ (5)	$ (14)	$ (13)	$(7,095)

(1) The pension and PRB plans, net, is shown net of tax benefits of $3,646 million and $3,824 million at July 3, 2016 and December 31, 2015, respectively.

(2) The cash flow hedges are shown net of tax benefits of $6 million and $10 million at July 3, 2016 and December 31, 2015, respectively.

(3) The unrealized gains (losses) on investments and other, net are shown net of tax benefits of $3 million and $4 million at July 3, 2016 and December 31, 2015, respectively.

Material amounts reclassified out of AOCL were related to amortization of net actuarial loss associated with our pension and PRB plans and were $491 million and $566 million before tax in the first six months of 2016 and 2015, respectively. This component of AOCL is included in the calculation of net periodic pension expense (income) (see "Note 12: Pension and Other Employee Benefits" for additional details).

We expect approximately $8 million of after-tax net unrealized losses on our cash flow hedges at July 3, 2016 to be reclassified into earnings at then-current values over the next twelve months as the underlying hedged transactions occur.

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Note 12: Pension and Other Employee Benefits

We have pension plans covering the majority of our employees, including certain employees in foreign countries (Pension Benefits). Our primary pension obligations relate to our domestic Internal Revenue Service (IRS) qualified pension plans. In addition, we provide certain health care and life insurance benefits to retired employees and to eligible employees upon retirement through PRB plans.

We also sponsor nonqualified defined benefit and defined contribution plans to provide benefits in excess of qualified plan limits. We have set aside certain assets in a separate trust, which we expect to be used to pay for trust obligations. The fair value of marketable securities held in trust, which are considered Level 1 assets under the fair value hierarchy, consisted of the following:

(In millions)	Jul 3, 2016	Dec 31, 2015
Marketable securities held in trust	$530	$ 525

Included in marketable securities held in trust in the table above was $335 million and $337 million at July 3, 2016 and December 31, 2015, respectively, related to the nonqualified defined contribution plans. The liabilities related to the nonqualified defined contribution plans were $338 million and $337 million at July 3, 2016 and December 31, 2015, respectively.

The components of net periodic pension expense (income) were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Service cost	$123	$131	$246	$261
Interest cost	273	262	545	523
Expected return on plan assets	(380)	(385)	(759)	(769)
Amounts reflected in net funded status	16	8	32	15
Amortization of prior service cost included in net periodic pension expense	1	1	2	3
Recognized net actuarial loss	245	283	490	565
Loss due to settlements	—	—	3	—
Amounts reclassified during the period	246	284	495	568
Net periodic pension expense (income)	$262	$292	$527	$583

Net periodic pension expense (income) includes income of $1 million and $2 million from foreign Pension Benefits plans in the second quarters of 2016 and 2015, respectively, and income of $2 million and $3 million in the first six months of 2016 and 2015, respectively.

Net periodic PRB expense was $3 million and $2 million in the second quarters of 2016 and 2015, respectively, and $7 million and $5 million in the first six months of 2016 and 2015, respectively.

Long-term pension and PRB liabilities were as follows:

(In millions)	Jul 3, 2016	Dec 31, 2015
Long-term pension liabilities	$6,433	$6,474
Long-term PRB liabilities	348	352
Total long-term pension and PRB liabilities	$6,781	$6,826

We made the following contributions to our pension and PRB plans:

(In millions)	Six Months Ended Jul 3, 2016	Jun 28, 2015
Required pension contributions	$79	$ 170
PRB contributions	10	10

We did not make any discretionary contributions to our pension plans during the first six months of 2016 and 2015; however, we periodically evaluate whether to make discretionary contributions.

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Note 13: Income Taxes
We are subject to income taxes in the U.S. and numerous foreign jurisdictions. We have participated in the IRS Compliance Assurance Process (CAP) program since 2011. All IRS examinations of our tax years prior to 2014 are closed. We continue to participate in the CAP program for the 2014, 2015 and 2016 tax years. We are also under audit by multiple state and foreign tax authorities.

There has been no material change in our unrecognized tax benefit since December 31, 2015.

Note 14: Business Segment Reporting
Our reportable segments, organized based on capabilities and technologies, are: Integrated Defense Systems (IDS); Intelligence, Information and Services (IIS); Missile Systems (MS); Space and Airborne Systems (SAS); and Forcepoint. Segment total net sales and operating income generally include intersegment sales and profit recorded at cost plus a specified fee, which may differ from what the selling entity would be able to obtain on sales to external customers. Eliminations includes intersegment sales and profit eliminations. Corporate operating income includes expenses that represent unallocated costs and certain other corporate costs not considered part of management's evaluation of reportable segment operating performance.

As previously announced, effective January 1, 2016, we reorganized certain product areas of our IDS and IIS businesses to more efficiently leverage our capabilities. Additionally, also effective January 1, 2016, we reclassified, with respect to our IDS, IIS, MS and SAS businesses, acquisition accounting adjustments related to the amortization of acquired intangibles and adjustments to record acquired deferred revenue at fair value, such that they are no longer reported within the business segments and are instead reported in the Acquisition Accounting Adjustments line item. Prior to January 1, 2016, only those acquisition accounting adjustments associated with our Forcepoint business were reported in the Acquisition Accounting Adjustments line item. The amounts and presentation of our business segments, including corporate and eliminations for intersegment activity, set forth in this Form 10-Q reflect these changes.

Segment financial results were as follows:

Total Net Sales (in millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Integrated Defense Systems	$1,399	$1,565	$2,736	$2,872
Intelligence, Information and Services	1,642	1,594	3,135	3,055
Missile Systems	1,656	1,559	3,376	3,032
Space and Airborne Systems	1,547	1,416	2,997	2,774
Forcepoint	138	57	274	81
Eliminations	(326)	(333)	(673)	(668)
Total business segment sales	6,056	5,858	11,845	11,146
Acquisition Accounting Adjustments	(21)	(10)	(47)	(10)
Total	$6,035	$5,848	$11,798	$11,136

Intersegment Sales (in millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Integrated Defense Systems	$16	$ 18	$33	$ 36
Intelligence, Information and Services	165	159	332	309

Missile Systems	33	33	68	66
Space and Airborne Systems	109	119	234	250
Forcepoint	3	4	6	7
Total	$326	$ 333	$673	$ 668

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Operating Income (in millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Integrated Defense Systems	$375	$202	$522	$385
Intelligence, Information and Services	124	122	224	417
Missile Systems	223	184	415	391
Space and Airborne Systems	203	195	376	377
Forcepoint	7	(1)	21	(1)
Eliminations	(34)	(36)	(67)	(69)
Total business segment operating income	898	666	1,491	1,500
Acquisition Accounting Adjustments	(51)	(32)	(109)	(46)
FAS/CAS Adjustment	109	49	214	98
Corporate	4	(35)	(24)	(64)
Total	$960	$648	$1,572	$1,488

Intersegment Operating Income (in millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Integrated Defense Systems	$1	$ 2	$1	$ 3
Intelligence, Information and Services	16	15	32	29
Missile Systems	3	3	6	7
Space and Airborne Systems	10	12	22	24
Forcepoint	4	4	6	6
Total	$34	$ 36	$67	$ 69

The FAS/CAS Adjustment, which is reported as a separate line in our segment results above, represents the difference between our pension and PRB expense or income under Financial Accounting Standards (FAS) in accordance with U.S. GAAP and our pension and PRB expense under U.S. government Cost Accounting Standards (CAS). The results of each segment only include pension and PRB expense under CAS that we generally recover through the pricing of our products and services to the U.S. government. The components of the FAS/CAS Adjustment were as follows:

FAS/CAS Adjustment Income (Expense) (in millions)	Three Months Ended		Six Months Ended	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
FAS/CAS Pension Adjustment	$108	$ 48	$213	$ 96
FAS/CAS PRB Adjustment	1	1	1	2
FAS/CAS Adjustment	$109	$ 49	$214	$ 98

Total assets for each of our business segments were as follows:

Total Assets (in millions)	Jul 3, 2016	Dec 31, 2015
Integrated Defense Systems(1)	$4,311	$4,132
Intelligence, Information and Services(1)	4,371	4,380
Missile Systems(1)	6,893	6,561
Space and Airborne Systems(1)	6,526	6,416

Forcepoint(1)	2,495	2,486
Corporate	4,502	5,306
Total	$29,098	$29,281

(1) Total assets includes intangible assets. Related amortization expense is included in Acquisition Accounting Adjustments.

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With respect to the unaudited consolidated financial information of Raytheon Company for the six months ended July 3, 2016 and June 28, 2015, PricewaterhouseCoopers LLP (PricewaterhouseCoopers) reported that it has applied limited procedures in accordance with professional standards for a review of such information. Its report dated July 28, 2016, appearing below, states that the firm did not audit and does not express an opinion on that unaudited consolidated financial information. Accordingly, the degree of reliance on its report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (Securities Act) for its report on the unaudited consolidated financial information because that report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers within the meaning of Sections 7 and 11 of the Securities Act.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Raytheon Company:

We have reviewed the accompanying consolidated balance sheet of Raytheon Company and its subsidiaries as of July 3, 2016, and the related consolidated statements of operations and of comprehensive income for the three-month and six-month periods ended July 3, 2016 and June 28, 2015 and the consolidated statements of equity and of cash flows for the six-month periods ended July 3, 2016 and June 28, 2015. This interim financial information is the responsibility of the Company’s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information 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 Public Company Accounting Oversight Board (United States), 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.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated interim financial information, the Company changed the manner in which it accounts for the income tax effects of share-based payment transactions in 2016.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2015, and the related consolidated statements of operations, of comprehensive income, of equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 10, 2016, which included a paragraph that described the change in the manner of classification of deferred taxes, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2015, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Boston, Massachusetts

July 28, 2016

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We develop technologically advanced and integrated products, services and solutions in our core markets: sensing; effects; command, control, communications, computers, cyber and intelligence; mission support; and cybersecurity. We serve both domestic and international customers, primarily as a prime contractor or subcontractor on a broad portfolio of defense and related programs for government customers.

As previously announced, effective January 1, 2016, we reorganized certain product areas of our Integrated Defense Systems (IDS) and Intelligence, Information and Services (IIS) businesses to more efficiently leverage our capabilities. Additionally, also effective January 1, 2016, we reclassified, with respect to our IDS, IIS, Missile Systems (MS) and Space and Airborne Systems (SAS) businesses, acquisition accounting adjustments related to the amortization of acquired intangibles and adjustments to record acquired deferred revenue at fair value, such that they are no longer reported within the business segments and are instead reported in the Acquisition Accounting Adjustments line item. Prior to January 1, 2016, only those acquisition accounting adjustments associated with our Forcepoint business were reported in the Acquisition Accounting Adjustments line item. The amounts and presentation of our business segments, including corporate and eliminations for intersegment activity, set forth in this Form 10-Q reflect these changes. None of the changes impact our previously reported consolidated balance sheets, statements of operations or statements of cash flows. See "Note 14: Business Segment Reporting" for additional information.

We operate in five segments: IDS; IIS; MS; SAS; and Forcepoint. For a more detailed description of our segments, see "Business Segments" within Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2015.

In the second quarter of 2016, Thales S.A. and Raytheon amended and restated the Thales-Raytheon Systems Co. Ltd. (TRS) joint venture agreement to reduce the existing joint venture arrangement to Thales-Raytheon Systems Air and Missile Defense Command and Control S.A.S. (TRS AMDC2) only and limit its scope to NATO-only business opportunities involving air command and control systems, theatre missile defense and ballistic missile defense. The amendment and restatement of the TRS joint venture agreement resulted in Raytheon acquiring Thales S.A.'s noncontrolling interest in Raytheon Command and Control Solutions LLC (RCCS LLC), previously called Thales-Raytheon Systems LLC, and selling our equity method investment in Thales-Raytheon Systems Company S.A.S. (TRS SAS), which resulted in a non-cash tax-free gain of $158 million that was recorded in operating income through a reduction in cost of sales, and a net cash payment to Thales S.A. of $90 million. See "Note 7: Thales-Raytheon Systems Co. Ltd. (TRS) Joint Venture" for additional information. As a result, going forward IDS' results will no longer include the equity method income on TRS SAS, which was $11 million, $12 million and $7 million in 2015, 2014 and 2013, respectively. In addition, our earnings per share (EPS) will no longer be impacted by the noncontrolling interest in RCCS LLC, which had the impact of decreasing net income attributable to Raytheon Company by $10 million, $14 million and $17 million in 2015, 2014 and 2013, respectively.

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015 and our unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q.

CONSOLIDATED RESULTS OF OPERATIONS

As described in our Cautionary Note Regarding Forward-Looking Statements on page 3 of this Form 10-Q, our interim period results of operations and period-to-period comparisons of such results, particularly at a segment level, may not be indicative of our future operating results. Additionally, we use a fiscal calendar, which may result in differences in the number of work days in the current and comparable prior interim period and could affect period-to-period comparisons. The following discussions of comparative results among periods, including the discussion of segment results, should be viewed in this context.

Total Net Sales

The composition of external net sales by products and services for IDS, IIS, MS, SAS and Forcepoint for the second quarter of 2016 was relatively consistent with the year ended December 31, 2015, which is shown in the table below.

External Net Sales by Products and Services (% of segment total external net sales)

	IDS	IIS	MS	SAS	Forcepoint
Products	90 %	45 %	100 %	95 %	95 %
Services	10 %	55 %	— %	5 %	5 %

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(In millions, except percentages)	Three Months Ended		% of Total Net Sales	
	Jul 3, 2016	Jun 28, 2015	Jul 3, 2016	Jun 28, 2015
Net sales				
Products	$5,037	$4,894	83.5 %	83.7 %
Services	998	954	16.5 %	16.3 %
Total net sales	$6,035	$5,848	100.0%	100.0%

Total Net Sales - Second Quarter of 2016 vs. Second Quarter of 2015—The increase in total net sales of $187 million in the