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 incorporation or organization)	(I.R.S. Employer Identification No.)
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.

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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Lockheed Martin Corporation
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.

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.

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.

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

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

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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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.

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

(a) 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.

(b) 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.

(c) 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.

(d) 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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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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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	MFC	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	MFC	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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	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

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.

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

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.

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	Level 2	Total	Level 1	Level 2
Assets						
Mutual funds	$1,067	$1,067	$—	$917	$917	$—
U.S. Government securities	93	—	93	116	—	116
Derivatives	17	—	17	23	—	23
Other securities	158	30	128	209	39	170
Liabilities						
Derivatives	101	—	101	106	—	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.

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)

(a) 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 $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.

(b) We reclassified the impact of the income tax effects related to the Tax Cuts and Jobs Act of 2017 (the Tax Act) 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

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			
		Adjustments for		
	Historical	ASC 606	ASU 2017-07	Adjusted
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			
		Adjustments for		
	Historical	ASC 606	ASU 2017-07	Adjusted
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		