

# 2016 ANNUAL REPORT

LOCKHEED MARTIN CORPORATION



## FINANCIAL HIGHLIGHTS

In millions, except per share data	2016	2015	2014
Net Sales	<b>\$47,248</b>	\$40,536	\$39,946
Segment Operating Profit	<b>5,100</b>	4,978	5,116
Consolidated Operating Profit	<b>5,549</b>	4,712	5,012
Net Earnings From Continuing Operations	<b>3,753</b>	3,126	3,253
Net Earnings	<b>5,302</b>	3,605	3,614
Diluted Earnings Per Common Share			
Continuing Operations	<b>12.38</b>	9.93	10.09
Net Earnings	<b>17.49</b>	11.46	11.21
Cash Dividends Per Common Share	<b>6.77</b>	6.15	5.49
Average Diluted Common Shares Outstanding	<b>303</b>	315	322
Cash and Cash Equivalents	<b>\$ 1,837</b>	\$ 1,090	\$ 1,446
Total Assets	<b>47,806</b>	49,304	37,190
Total Debt, net	<b>14,282</b>	15,261	6,142
Total Equity	<b>1,606</b>	3,097	3,400
Common Shares Outstanding at Year-End	<b>289</b>	303	314
Net Cash Provided by Operating Activities	<b>\$ 5,189</b>	\$ 5,101	\$ 3,866

NOTE: For additional information regarding the amounts presented above see the Form 10-K portion of this Annual Report. A reconciliation of Segment Operating Profit to Consolidated Operating Profit is included on the page preceding the back cover of this Annual Report.

### On the Cover: The F-35 Lightning II

As the world's only 5th generation multi-variant, multi-role fighter, the F-35 Lightning II provides the U.S. Air Force, Marine Corps and Navy, along with at least 10 other countries, a qualitative advantage against the multitude of 21st century threats.

## DEAR FELLOW STOCKHOLDERS:

2016 was an outstanding year for Lockheed Martin.

We continued to put our customers at the center of all that we do. We concentrated on their priorities. We recognized their cost pressures. And we worked to anticipate how their needs might evolve in the years to come.

The strong financial results in all four quarters of 2016 substantiated our strategic approach and execution.

We achieved impressive results on a host of technological frontiers, as we advanced scientific discovery and offered affordable, innovative solutions to help our customers solve their complex challenges.

In addition, in 2016, we took action to ensure Lockheed Martin is well positioned for the future, by identifying emerging opportunities and adapting to new challenges we see developing around the world.

One of the most important ways we did this was by reshaping our portfolio. Most notably, we integrated our Sikorsky acquisition and realigned Mission Systems and Training into a new business area named Rotary and Mission Systems (RMS). RMS now has unrivalled integrated capabilities.

In another significant action to reshape our portfolio, we divested Lockheed Martin Information Systems & Global Solutions (IS&GS) in a tax-efficient manner. Stockholders who participated in the exchange offer received 50.5 percent equity in Leidos Holdings Inc., worth approximately \$2.8 billion, and we were able to retire approximately 9.4 million outstanding shares of our stock. We also received \$1.8 billion in cash in the transaction.

Because of such consequential actions, we have enhanced our focus on complex platform integration and capabilities to drive profitable growth over the long term.

Overall, this was a strong year for Lockheed Martin investors, as we delivered a total stockholder return of 18 percent.

## PRODUCED EXCEPTIONAL FINANCIAL RESULTS

In 2016, one of the most significant factors influencing our customers was budgetary pressure. In response, we worked across the corporation to deliver innovative solutions to help them meet their needs in an affordable way.

It is a tribute to the ingenuity and hard work of the men and women of Lockheed Martin that, even in this constrained environment, we were able to increase top-line sales in 2016, improve efficiency and profitability, and enhance our strong backlog.

### **Key financial results for 2016 included:**

- Sales of \$47.2 billion, up 17 percent versus 2015;
- Segment operating profit\* of \$5.1 billion;
- Segment margin\* of 11 percent;
- Diluted earnings per share of \$12.38 from continuing operations;
- New orders of \$46.9 billion, ending the year with a backlog of \$96.2 billion;
- Net earnings of approximately \$5.3 billion; and
- Cash from operations of \$5.2 billion.



*Marillyn A. Hewson, Chairman, President and Chief Executive Officer*



We successfully maintained our efforts to return cash to stockholders through dividends and share repurchases. In 2016, we paid out \$2 billion in dividends and increased our quarterly dividend by 10 percent in the third quarter. This marked the 14th consecutive year that the dividend rate has been increased by a double-digit percentage.

We repurchased 8.9 million shares for \$2.1 billion during the year. In total, we returned 100 percent of our free cash flow\* to stockholders in 2016.

We expect to generate at least \$15 billion in cash from operations over the next three years, after making required pension contributions in both 2018 and 2019.

## COMMITTED TO CUSTOMER MISSIONS

In 2016, we sought to meet or exceed customer needs in core programs across the company. The following examples highlight some of these achievements.

### ***Maintaining Air Superiority***

The F-35 Lightning II remained our company's largest program and growth engine. It represented 23 percent of our annual revenue and successfully reached multiple critical milestones in 2016. Production rates continued to grow, and we delivered a record number of 46 F-35 aircraft.

In the United States, the Air Force declared Initial Operational Capability for the F-35A, affirming its combat readiness. The U.S. Air Force will operate the world's largest F-35A fleet with more than 1,700 fifth-generation fighter aircraft.

### ***Reducing Costs of Production and Sustainment***

At the 2016 Farnborough International Airshow, we teamed with the U.S. Department of Defense to announce two initiatives to reduce F-35 production and sustainment costs. The first is a two-year extension of the Blueprint for Affordability for Production (BFA) program announced in 2014, and the second is the creation of a similar concept to reduce the operation and sustainment costs of the F-35 weapon system.

Through the F-35 BFA, the U.S. government-industry partnership is driving down F-35 unit recurring flyaway costs with the goal to achieve a target price of \$85 million for the aircraft by 2019 in then-year dollars. The initial BFA effort has reduced the unit recurring flyaway costs by millions, resulting in anticipated lifecycle savings of more than \$4 billion over the remaining production run of the F-35 program.

The second initiative, known as the Sustainment Cost Reduction Initiative, builds on this cost saving momentum. Lockheed Martin and our partners are investing up to \$250 million to reduce sustainment costs in order to save at least \$1 billion over a five-year period. We are committed to an ongoing effort to deliver an affordable aircraft to our U.S. military and allies.

Our efforts to reduce costs for customers extend beyond the F-35. For example, our Space Systems Company has addressed affordability primarily through outstanding performance. By coming in below cost on programs, it has equated to savings for our customers, and in many cases the customers have chosen to use those savings to add new work – providing more capabilities for the same price.



We continued to make progress toward our goals of 35 percent lower costs and 25 percent faster delivery on our modernized A2100 satellite platform, resulting in follow-on contracts for several important programs. We have also extended life on products built for our classified programs, which has provided customers with more flexibility to repurpose their funds.

***Integrating Strengths and Enhancing Synergies***

The successful integration of Sikorsky and the resulting teamwork have laid the groundwork to provide significant additional value for our customers.

As an example, we have made steady progress through the testing phase on the CH-53K King Stallion helicopter – the U.S. Marines’ Heavy Lift Replacement program. We further demonstrated our enhanced synergies when we unveiled an armed Black Hawk helicopter.

Throughout 2016, the RMS business area earned several significant wins. The U.S. Army awarded a contract to produce 35 UH-60M Black Hawks. The U.S. Navy also awarded RMS with contracts to expand the global Aegis fleet in the United States, Japan and the Republic of Korea and to upgrade the Navy’s shipboard

Surface Electronic Warfare Systems. In addition, RMS won a contract from the Australian government for the Future Submarine Combat System Program.

***Supporting Advanced Missile Capabilities and New Markets***

Because of the dynamic geopolitical environment, demand for our weapons systems and technologies increased in 2016.

For example, the United States and allied military forces upgraded their missile defense capabilities under a \$1.45 billion contract awarded to Lockheed Martin Missiles and Fire Control. The contract included PAC-3 and PAC-3 MSE missile deliveries for the U.S. Army, and Foreign Military Sales of PAC-3 interceptors, launcher-modification kits, associated equipment and spares for Qatar, the Republic of Korea, the Kingdom of Saudi Arabia, Taiwan and the United Arab Emirates.

We also were awarded additional funding to produce and deliver interceptors as part of a modification to the Missile Defense Agency’s Terminal High Altitude Area Defense (THAAD) contract. The capability of the THAAD missile system and the support we provide continue to open opportunities for international sales and growth.

***Our Leadership Team (from left to right):*** Bridget A. Lauderdale, Senior Vice President, Corporate Strategy & Business Development; Patricia L. Lewis, Senior Vice President, Human Resources; Rodney A. Makoske, Senior Vice President, Corporate Engineering, Technology and Operations; John C. Rood, Senior Vice President, Lockheed Martin International; Orlando D. Carvalho, Executive Vice President, Aeronautics; Dale P. Bennett, Executive Vice President, Rotary and Mission Systems; Richard F. Ambrose, Executive Vice President, Space Systems; Marillyn A. Hewson, Chairman, President and Chief Executive Officer; Bruce L. Tanner, Executive Vice President and Chief Financial Officer; Richard H. Edwards, Executive Vice President, Missiles and Fire Control; Maryanne R. Lavan, Senior Vice President, General Counsel and Corporate Secretary; Robert S. Rangel, Senior Vice President, Lockheed Martin Government Affairs; Jennifer M. Whitlow, Senior Vice President, Communications; and Leo S. Mackay, Senior Vice President, Internal Audit, Ethics and Sustainability.

To support the growing global demand for missile systems, we restarted our Tactical Missile System (TACMS) production line in Camden, Arkansas. This production restart yields greater flexibility and significant cost-savings on a program with a rich history of reliability, affordability and mission success.

In 2016, we won a contract from the U.S. Army, U.S. Marine Corps, Israel, Finland, Jordan and Singapore for the Guided Multiple Launch Rocket System (GMLRS). The U.S. Navy also awarded us a significant, sole-source contract for the continuation of the Long Range Anti-Ship Missile (LRASM) integration and test phase. In addition, we received follow-on production contracts for the Target Sight System (TSS), which is the turreted fire control sensor system for the U.S. Marine Corps' AH-1Z Viper attack helicopter.

### ***Reaching Farther and Deeper into Space***

In Space, we built and supported the successful launches of the OSIRIS-REx spacecraft for NASA, the WorldView-4 imaging satellite for DigitalGlobe and the GOES-R weather satellite for NOAA. In addition, our Commercial Launch Services business launched the EchoStar XIX high-speed Internet communications satellite for Hughes Network Systems.

In February 2016, we delivered the Orion deep space crew module to Kennedy Space Center, where it has undergone rigorous testing in preparation for its next test flight. Our team is working closely with our customers at NASA to make progress toward the launch of the first unmanned mission in 2018 and the first crewed mission as early as 2021. As we complete Orion's development phase and look forward to the transition into production, we have identified savings that could significantly reduce recurring manufacturing costs.

Moreover, the world watched in wonder as the Juno spacecraft completed its 1.7-billion-mile journey to Jupiter. On July 4, it executed a complex and high-stakes orbit insertion that will give NASA unprecedented insights into the largest planet in our solar system.

Our Global Positioning System (GPS) III program continued its impressive progress with eight satellites currently in production flow at our state-of-the-art facility in Denver. These next-generation satellites will improve position, navigation and timing services as well as provide advanced anti-jam capabilities yielding superior system security, accuracy and communications reliability. In September 2016, the U.S. Air Force awarded us a contract for the production of the ninth

and tenth satellites. In addition, by reducing risks and driving down supply chain costs, this latest contract reduced costs by nearly 50 percent compared to initial production satellites.

## **COMMITTED TO INNOVATION**

As we have demonstrated throughout our history, Lockheed Martin sets the standard for innovation and advancement. In 2016, we continued to develop new technologies and expand our capabilities, while meeting aggressive production goals.

Our innovation strategy included a focus on our customers' long-term requirements and the potential role of emerging technologies. This resulted in our increased concentration on high-potential areas such as hypersonics, directed energy and autonomy.

Innovation also meant taking today's products and capabilities, expanding their missions and making them more affordable. By anticipating and acting on what our customers will need in the future, we helped them stay on the leading edge of technology.

A great example of this was the recent live-fire test in conjunction with the U.S. Navy and U.S. Marine Corps to demonstrate the integrated capabilities of the F-35 to support Naval Integrated Fire Control-Counter Air. Working together with the Aegis Weapon System, an unmodified F-35B was able to detect an over-the-horizon threat and communicate that to Aegis, which then was able to engage and intercept the threat.

Our innovations and engineering achievements of 2016 are a reminder of what the Lockheed Martin team and our customers can achieve together, and they foreshadow the possibilities and progress to come.

## **WELL POSITIONED FOR PROFITABLE, LONG-TERM GROWTH**

The current focus on collective global defense has continued to intensify the need for interoperability among allies and increased demand in Europe, Asia and the Middle East for Lockheed Martin's products.

The largest area of growth is the F-35 fighter jet. International orders will approach 50 percent of all F-35 orders in the next five years. In 2016, the F-35 flew abroad impressing international observers in the Netherlands and in the United Kingdom. We also rolled out the first of Japan's 42 F-35As. We delivered the first two of Israel's 50 F-35As. And Italy took delivery of the

first of its 90 F-35As. In addition, Denmark selected the Lightning II as their next-generation fighter aircraft and confirmed their decision to acquire 27 F-35As.

Our company's second largest area of growth – both domestically and internationally – is missile defense, with greater opportunities to provide Aegis, PAC-3, THAAD and the Medium Extended Air Defense System (MEADS).

There are also ongoing contributions from the C-130J Super Hercules program. A total of 16 countries operated the C-130J in 2016, and France went on contract to become the 17th. We also delivered two KC-130J Super Hercules to the Kingdom of Saudi Arabia, helping enhance its existing legacy C-130 fleet. For six decades, this transport aircraft has continued to offer superior performance and new capabilities, with the range and flexibility for every theater of operations and evolving requirements.

We expect strong growth in our Sikorsky rotary wing business. Within five years, rotary-wing programs will be moving through their development phase and into production. These include the CH-53K heavy-lift aircraft for the U.S. Marine Corps, the Combat Rescue Helicopter for the Air Force, the U.S. Presidential Helicopter and the Canadian Maritime Helicopter.

## BUILDING ON OUR CORE VALUES

As we look back at the successes of 2016, we ultimately trace them to our core values – to *do what's right*, *respect others* and *perform with excellence*. These values shape our culture, drive our approach to business, encourage our outreach in the community, and inspire our commitment to sustainability and environmental stewardship. They are the key to the future.

At Lockheed Martin, we know our technologies and capabilities help promote peace and progress throughout the world. We are resolved to meet U.S. national security imperatives with innovation, affordability and efficiency.



In 2016, more than 14,000 STEM students boarded the Lockheed Martin Mars Experience Bus, a first-of-its-kind group virtual reality vehicle. Riders immersed themselves on the Red Planet with a simulated drive along its surface.

We are also proud to stand with our international partners to enhance their capabilities to protect the lives of citizens and build a brighter future.

In summary, 2016 was an outstanding year, and we look forward to building on these achievements as we do our part to continue to engineer a better tomorrow.

A handwritten signature in black ink that reads 'Mairlyn A. Hudson'.

Chairman, President, and  
Chief Executive Officer

*\*This letter includes references to segment operating profit, segment margin and free cash flow, which are non-GAAP financial measures. For reconciliations between our non-GAAP measures and the nearest GAAP measures, please refer to the page preceding the back cover of this Annual report. As non-GAAP financial measures are not intended to be considered in isolation or as a substitute for GAAP financial measures, you should carefully read the Form 10-K included in this Annual Report, which includes our consolidated financial statements prepared in accordance with GAAP. Additionally, this letter includes statements that, to the extent they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws, and are based on Lockheed Martin's current expectations and assumptions. For a discussion identifying important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see the Corporation's filings with the SEC including, but not limited to, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" in the Form 10-K portion of this Annual Report.*

# CORPORATE DIRECTORY

(As of February 9, 2017)

## BOARD OF DIRECTORS

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**Daniel F. Akerson**  
Retired Vice Chairman  
The Carlyle Group

**Nolan D. Archibald**  
Retired Chairman, President  
and Chief Executive Officer  
The Black & Decker Corporation

**Rosalind G. Brewer**  
Retired President and  
Chief Executive Officer  
Sam's Club (a division of  
Wal-Mart Stores, Inc.)

**David B. Burritt**  
Executive Vice President and  
Chief Financial Officer  
United States Steel Corporation

**Bruce A. Carlson**  
Retired General  
United States Air Force

**James O. Ellis, Jr.**  
Retired President and  
Chief Executive Officer  
Institute of Nuclear Power  
Operations

**Thomas J. Falk**  
Chairman and  
Chief Executive Officer  
Kimberly-Clark Corporation

**Ilene S. Gordon**  
Chairman, President and  
Chief Executive Officer  
Ingredion Incorporated

**Marilyn A. Hewson**  
Chairman, President and  
Chief Executive Officer  
Lockheed Martin Corporation

**James M. Loy**  
Senior Counselor  
The Cohen Group

**Joseph W. Ralston**  
Vice Chairman  
The Cohen Group

**Anne Stevens**  
Retired Chairman and  
Principal  
SA IT Services

## EXECUTIVE OFFICERS

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**Richard F. Ambrose**  
Executive Vice President  
Space Systems

**Dale P. Bennett**  
Executive Vice President  
Rotary and Mission Systems

**Orlando P. Carvalho**  
Executive Vice President  
Aeronautics

**Brian P. Colan**  
Vice President, Controller and  
Chief Accounting Officer

**Richard H. Edwards**  
Executive Vice President  
Missiles and Fire Control

**Marilyn A. Hewson**  
Chairman, President and  
Chief Executive Officer

**Maryanne R. Lavan**  
Senior Vice President,  
General Counsel and  
Corporate Secretary

**John W. Mollard**  
Vice President and Treasurer

**Bruce L. Tanner**  
Executive Vice President and  
Chief Financial Officer



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

**Form 10-K**

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

For the fiscal year ended December 31, 2016

Commission file number 1-11437

**LOCKHEED MARTIN CORPORATION**

(Exact name of registrant as specified in its charter)

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

**52-1893632**  
(I.R.S. Employer  
Identification No.)

**6801 Rockledge Drive, Bethesda, Maryland 20817-1877 (301/897-6000)**

(Address and telephone number of principal executive offices)

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$1 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

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

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 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  No

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

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  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant computed by reference to the last sales price of such stock, as of the last business day of the registrant's most recently completed second fiscal quarter, which was June 24, 2016, was approximately \$72.1 billion.

There were 290,315,668 shares of our common stock, \$1 par value per share, outstanding as of January 27, 2017.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of Lockheed Martin Corporation's 2017 Definitive Proxy Statement are incorporated by reference into Part III of this Form 10-K.

**Lockheed Martin Corporation**  
**Form 10-K**  
**For the Year Ended December 31, 2016**

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## PART I

### ITEM 1. Business.

#### General

We are a global security and aerospace company principally engaged in the research, design, development, manufacture, integration and sustainment of advanced technology systems, products and services. We also provide a broad range of management, engineering, technical, scientific, logistics, system integration and cybersecurity services. We serve both U.S. and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government. In 2016, 71% of our \$47.2 billion in net sales were from the U.S. Government, either as a prime contractor or as a subcontractor (including 59% from the Department of Defense (DoD)), 27% were from international customers (including foreign military sales (FMS) contracted through the U.S. Government) and 2% were from U.S. commercial and other customers. Our main areas of focus are in defense, space, intelligence, and homeland security.

We operate in an environment characterized by increasing complexity in global security and continuing economic pressures in the U.S. and globally. A significant component of our strategy in this environment is to focus on program execution, improving the quality and predictability of the delivery of our products and services, and placing security capability quickly into the hands of our U.S. and international customers at affordable prices. Recognizing that our customers are resource constrained, we are endeavoring to develop and extend our portfolio domestically in a disciplined manner with a focus on adjacent markets close to our core capabilities, as well as growing our international sales. We continue to focus on affordability initiatives. We also expect to continue to invest in technologies to fulfill new mission requirements for our customers and invest in our people so that we have the technical skills necessary to succeed without limiting our ability to return cash to our investors in the form of dividends and share repurchases.

We operate in four business segments: Aeronautics, Missiles and Fire Control (MFC), Rotary and Mission Systems (RMS) and Space Systems. We organize our business segments based on the nature of the products and services offered.

#### Recent Developments

##### *Divestiture of the Information Systems & Global Solutions Business*

On August 16, 2016, we completed the divestiture of our Information Systems & Global Solutions (IS&GS) business, which merged with a subsidiary of Leidos Holdings, Inc. (Leidos), in a Reverse Morris Trust transaction. This transaction represents the culmination of the strategic review of our government information technology (IT) business and our technical services business performed in 2015 to explore whether the IS&GS business could achieve greater growth and create more value for customers and stockholders outside of Lockheed Martin. The IS&GS business generated annual net sales of \$5.6 billion in 2015 and \$3.4 billion in 2016 through the August 16, 2016 divestiture date. As part of the transaction, we also completed an exchange offer that resulted in a reduction of our common stock outstanding by approximately 9.4 million shares (approximately 3%). Based on an opinion of outside tax counsel, subject to customary qualifications and based on factual representations, both the exchange offer and merger will qualify as tax-free transactions to us and our stockholders, except to the extent that cash was paid to our stockholders in lieu of fractional shares. Additionally, we received a one-time special cash payment of \$1.8 billion in connection with the divestiture of the IS&GS business. The operating results of the IS&GS business have been classified as discontinued operations for all periods presented. See “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements for additional information about the divestiture of the IS&GS business.

##### *AWE Management Limited*

On August 24, 2016, our ownership interest in the AWE Management Limited (AWE) venture increased from 33% to 51% in exchange for our assuming a more significant role in managing the operations of the venture. AWE operates the United Kingdom’s nuclear deterrent program and generated net sales of about \$1.5 billion and net earnings of about \$85 million in 2015. As a result of the increase in ownership interest, we now hold a 51% controlling interest in AWE. Accordingly, we are required to consolidate AWE. AWE continues to be aligned under our Space Systems business segment. Prior to August 24, 2016, we accounted for our investment in AWE using the equity method of accounting. See “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements for additional information about the consolidation of AWE.

## *Aeronautics*

In 2016, our Aeronautics business segment generated net sales of \$17.8 billion, which represented 38% of our total consolidated net sales. Aeronautics' customers include the military services and various other government agencies of the U.S. and other countries. In 2016, U.S. Government customers accounted for 66% and international customers accounted for 34% of Aeronautics' net sales. Net sales from Aeronautics' combat aircraft products and services represented 28% of our total consolidated net sales in both 2016 and 2015, and 26% in 2014.

Aeronautics is engaged in the research, design, development, manufacture, integration, sustainment, support and upgrade of advanced military aircraft, including combat and air mobility aircraft, unmanned air vehicles and related technologies. Aeronautics' major programs include:

- F-35 Lightning II Joint Strike Fighter – international multi-role, multi-variant, fifth generation stealth fighter;
- C-130 Hercules – international tactical airlifter;
- F-16 Fighting Falcon – low-cost, combat-proven, international multi-role fighter;
- F-22 Raptor – air dominance and multi-mission fifth generation stealth fighter; and
- C-5M Super Galaxy – strategic airlifter.

The F-35 program is our largest program, generating 23% of our total consolidated net sales, as well as 62% of Aeronautics' net sales in 2016. The F-35 program consists of development contracts, multiple production contracts, and sustainment activities. The development contracts are being performed concurrently with the production contracts. Concurrent performance of development and production contracts is used for complex programs to test aircraft, shorten the time to field systems and achieve overall cost savings. We expect the System Development and Demonstration portion of the development contracts will be substantially complete in 2017, with less significant efforts continuing into 2019. Production of the aircraft is expected to continue for many years given the U.S. Government's current inventory objective of 2,443 aircraft for the Air Force, Marine Corps and Navy; commitments from our eight international partners and three international customers; as well as expressions of interest from other countries. During 2016, we delivered 46 aircraft to our U.S. and international partners, resulting in total deliveries of 200 production aircraft as of December 31, 2016. We have 173 production aircraft in backlog as of December 31, 2016, including orders from our international partners. On November 2, 2016, the U.S. Government unilaterally definitized Low Rate Initial Production (LRIP) 9, which covers 57 aircraft. For additional information on the F-35 program, including a discussion of the unilateral contract action, see "Status of the F-35 Program" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Aeronautics produces and provides support and sustainment services for the C-130J Super Hercules, as well as upgrades and support services for the legacy C-130 Hercules worldwide fleet. We delivered 24 C-130J aircraft in 2016, including five to international customers. We have 88 aircraft in our backlog as of December 31, 2016 with advanced funding from customers for additional C-130J aircraft not currently in backlog. Our C-130J backlog extends into 2020.

Aeronautics currently produces F-16 aircraft for international customers with deliveries of new aircraft planned through 2017. Aeronautics also provides service-life extension, modernization and other upgrade programs for our customers' F-16 aircraft. We delivered 12 F-16 aircraft in 2016. As of December 31, 2016, we have eight F-16 aircraft in backlog with all deliveries expected in 2017. Although existing production contracts provide for deliveries of F-16 aircraft through late 2017, we continue to seek international opportunities to deliver additional aircraft beyond 2017. Aeronautics also provides service-life extension, modernization and other upgrade programs for our customers' F-16 aircraft, with existing contracts continuing for several years.

While production and deliveries of F-22 aircraft were completed in 2012, Aeronautics continues to provide modernization and sustainment activities for the U.S. Air Force's F-22 aircraft fleet. The modernization program comprises upgrading existing systems requirements, developing new systems requirements, adding capabilities and enhancing the performance of the weapon systems. The sustainment program consists of sustaining the weapon systems of the F-22 fleet, providing training systems, customer support, integrated support planning, supply chain management, aircraft modifications and heavy maintenance, systems engineering and support products.

Aeronautics provides sustainment services for the existing U.S. Air Force C-5 Galaxy fleet and modernization activities to convert 52 C-5 Galaxy aircraft to the C-5M Super Galaxy configuration. These modernization activities include the installation of new engines, landing gear and systems and other improvements that enable a shorter takeoff, a higher climb rate, an increased cargo load and longer flight range. As of December 31, 2016, we had delivered 41 C-5M aircraft under these modernization activities, including nine C-5M aircraft delivered in 2016. As of December 31, 2016, we have 11 C-5 aircraft in backlog with backlog extending into 2018.

In addition to the above aircraft programs, Aeronautics is involved in advanced development programs incorporating innovative design and rapid prototype applications. Our Advanced Development Programs (ADP) organization, also known as Skunk Works®, is focused on future systems, including unmanned aerial systems and next generation capabilities for advanced strike, intelligence, surveillance, reconnaissance, situational awareness and air mobility. We continue to explore technology advancement and insertion in our existing aircraft. We also are involved in numerous network-enabled activities that allow separate systems to work together to increase effectiveness and we continue to invest in new technologies to maintain and enhance competitiveness in military aircraft design, development and production.

### ***Missiles and Fire Control***

In 2016, our MFC business segment generated net sales of \$6.6 billion, which represented 14% of our total consolidated net sales. MFC's customers include the military services, principally the U.S. Army, and various government agencies of the U.S. and other countries, as well as commercial and other customers. In 2016, U.S. Government customers accounted for 61%, international customers accounted for 37% and U.S. commercial and other customers accounted for 2% of MFC's net sales.

MFC provides air and missile defense systems; tactical missiles and air-to-ground precision strike weapon systems; logistics; fire control systems; mission operations support, readiness, engineering support and integration services; manned and unmanned ground vehicles; and energy management solutions. MFC's major programs include:

- The Patriot Advanced Capability-3 (PAC-3) and Terminal High Altitude Area Defense (THAAD) air and missile defense programs. PAC-3 is an advanced defensive missile for the U.S. Army and international customers designed to intercept and eliminate incoming airborne threats using kinetic energy. THAAD is a transportable defensive missile system for the U.S. Government and international customers designed to engage targets both within and outside of the Earth's atmosphere.
- The Multiple Launch Rocket System (MLRS), Hellfire, Joint Air-to-Surface Standoff Missile (JASSM) and Javelin tactical missile programs. MLRS is a highly mobile, automatic system that fires surface-to-surface rockets and missiles from the M270 and High Mobility Artillery Rocket System platforms produced for the U.S. Army and international customers. Hellfire is an air-to-ground missile used on rotary and fixed-wing aircraft, which is produced for the U.S. Army, Navy, Marine Corps and international customers. JASSM is an air-to-ground missile launched from fixed-wing aircraft, which is produced for the U.S. Air Force and international customers. Javelin is a shoulder-fired anti-armor rocket system, which is produced for the U.S. Army, Marine Corps and international customers.
- The Apache, Sniper® and Low Altitude Navigation and Targeting Infrared for Night (LANTIRN®) fire control systems programs. The Apache fire control system provides weapons targeting capability for the Apache helicopter for the U.S. Army and international customers. Sniper is a targeting system for several fixed-wing aircraft and LANTIRN is a combined navigation and targeting system for several fixed-wing aircraft. Both Sniper and LANTIRN are produced for the U.S. Air Force and international customers.
- The Special Operations Forces Contractor Logistics Support Services (SOF CLSS) program provides logistics support services to the special operations forces of the U.S. military. In 2016 we submitted a bid for the Special Operations Forces Global Logistics Support Services (SOF GLSS) contract, which is a competitive follow-on contract to SOF CLSS. We anticipate an award decision on the follow-on contract in mid-2017.

### ***Rotary and Mission Systems***

In 2016, our RMS business segment, previously known as Mission Systems and Training (MST), generated net sales of \$13.5 billion, which represented 28% of our total consolidated net sales. RMS' customers include the military services, principally the U.S. Army and Navy, and various government agencies of the U.S. and other countries, as well as commercial and other customers. In 2016, U.S. Government customers accounted for 68%, international customers accounted for 28% and U.S. commercial and other customers accounted for 4% of RMS' net sales.

RMS provides design, manufacture, service and support for a variety of military and commercial helicopters; ship and submarine mission and combat systems; mission systems and sensors for rotary and fixed-wing aircraft; sea and land-based missile defense systems; radar systems; the Littoral Combat Ship (LCS); simulation and training services; and unmanned systems and technologies. In addition, RMS supports the needs of government customers in cybersecurity and delivers communications and command and control capabilities through complex mission solutions for defense applications.

On November 6, 2015, we acquired Sikorsky Aircraft Corporation (Sikorsky) and aligned it under our RMS business segment. Sikorsky is one of the world's largest helicopter companies and designs, manufactures, services and supports military and commercial helicopters. Additionally, Sikorsky offers full-spectrum aftermarket service and support solutions to commercial and military customers worldwide.

RMS' major programs include:

- The Black Hawk and Seahawk helicopters manufactured for U.S. and foreign governments.
- The Aegis Combat System serves as a fleet ballistic missile defense system for the U.S. Navy and international customers and is also a sea and land-based element of the U.S. missile defense system.
- The LCS, a surface combatant ship for the U.S. Navy designed to operate in shallow waters and the open ocean.
- The Advanced Hawkeye Radar System, an airborne early warning radar, which RMS provides for the E2-C/E2-D aircraft produced for the U.S. Navy and international customers.
- The Space Fence system, an advanced ground-based radar system for the U.S. Air Force designed to enhance the way objects in space are tracked and increase the ability to prevent collisions between such objects.
- The CH-53K development helicopter delivering the next generation heavy lift helicopter for the U.S. Marine Corps.
- The VH-92A helicopter manufactured for the U.S. Marine One transport mission.
- The TPQ-53 Radar System, a sensor that quickly locates and neutralizes mortar and rocket threats, produced for the U.S. Army and international customers.

### ***Space Systems***

In 2016, our Space Systems business segment generated net sales of \$9.4 billion, which represented 20% of our total consolidated net sales. Space Systems' customers include various U.S. government agencies and commercial customers. In 2016, U.S. Government customers accounted for 91%, international customers accounted for 5% and U.S. commercial and other customers accounted for 4% of Space Systems' net sales. Net sales from Space Systems' satellite products and services represented 13%, 15% and 16% of our total consolidated net sales in 2016, 2015 and 2014.

Space Systems is engaged in the research and development, design, engineering and production of satellites, strategic and defensive missile systems and space transportation systems. Space Systems provides network-enabled situational awareness and integrates complex space and ground global systems to help our customers gather, analyze and securely distribute critical intelligence data. Space Systems is also responsible for various classified systems and services in support of vital national security systems. Space Systems' other major programs include:

- The Trident II D5 Fleet Ballistic Missile, a program with the U.S. Navy for the only submarine-launched intercontinental ballistic missile currently in production in the U.S.
- The Orion Multi-Purpose Crew Vehicle (Orion), a spacecraft for the National Aeronautics and Space Administration (NASA) utilizing new technology for human exploration missions beyond low earth orbit.
- The Space Based Infrared System (SBIRS), which provides the U.S. Air Force with enhanced worldwide missile launch detection and tracking capabilities.
- The Advanced Extremely High Frequency (AEHF) system, the next generation of highly secure communications satellites for the U.S. Air Force.
- AWE venture, which operates the United Kingdom's nuclear deterrent program.
- Global Positioning System (GPS) III, a program to modernize the GPS satellite system for the U.S. Air Force.
- The Geostationary Operational Environmental Satellite R-Series (GOES-R), which is the National Oceanic and Atmospheric Association's next generation of meteorological satellites.
- The Mobile User Objective System (MUOS), a next-generation narrow-band satellite communication system for the U.S. Navy.

On August 24, 2016, we obtained a controlling interest in the AWE venture, and as a result, we are required to consolidate AWE. Previously, we accounted for our investment in AWE using the equity method of accounting. See "Note 3 – Acquisitions and Divestitures" included in our Notes to Consolidated Financial Statements for additional information about the consolidation of AWE. Operating profit for our Space Systems business segment also includes our share of earnings for our 50% ownership interest in United Launch Alliance (ULA).

### **Financial and Other Business Segment Information**

For additional information regarding our business segments, including comparative segment net sales, operating profit and related financial information for 2016, 2015, and 2014, see "Business Segment Results of Operations" in Management's Discussion and Analysis of Financial Condition and Results of Operations and "Note 5 – Information on Business Segments" included in our Notes to Consolidated Financial Statements.

## **Competition**

Our broad portfolio of products and services competes both domestically and internationally against products and services of other large aerospace and defense companies, as well as numerous smaller competitors. We often form teams with our competitors in efforts to provide our customers with the best mix of capabilities to address specific requirements. In some areas of our business, customer requirements are changing to encourage expanded competition and increasingly what would have previously been competed as a single large procurement is being broken into multiple smaller procurements. Principal factors of competition include the value of our products and services to the customer; technical and management capability; the ability to develop and implement complex, integrated system architectures; total cost of ownership; our demonstrated ability to execute and perform against contract requirements; and our ability to provide timely solutions. Technological advances in such areas as: additive manufacturing, cloud computing, advanced materials, autonomy, robotics, and big data and new business models such as commercial access to space are enabling new factors of competition for both traditional and non-traditional competitors.

The competition for international sales is generally subject to U.S. Government stipulations (e.g., export restrictions, market access, technology transfer, industrial cooperation and contracting practices). We may compete against U.S. and non-U.S. companies (or teams) for contract awards by international governments. International competitions also may be subject to different laws or contracting practices of international governments that may affect how we structure our bid for the procurement. In many international procurements, the purchasing government's relationship with the U.S. and its industrial cooperation programs are also important factors in determining the outcome of a competition. It is common for international customers to require contractors to comply with their industrial cooperation regulations, sometimes referred to as offset requirements, and we have entered into foreign offset agreements as part of securing some international business. For more information concerning offset agreements, see "Contractual Commitments and Off-Balance Sheet Arrangements" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

## **Patents**

We routinely apply for and own a substantial number of U.S. and international patents related to the products and services we provide. In addition to owning a large portfolio of intellectual property, we also license intellectual property to and from third parties. The U.S. Government has licenses in our patents that are developed in performance of government contracts and it may use or authorize others to use the inventions covered by these patents for government purposes. Unpatented research, development and engineering skills also make an important contribution to our business. Although our intellectual property rights in the aggregate are important to the operation of our business, we do not believe that any existing patent, license or other intellectual property right is of such importance that its loss or termination would have a material adverse effect on our business taken as a whole.

## **Raw Materials and Seasonality**

Some of our products require relatively scarce raw materials. Historically, we have been successful in obtaining the raw materials and other supplies needed in our manufacturing processes. We seek to manage raw materials supply risk through long-term contracts and by maintaining an acceptable level of the key materials in inventories.

Aluminum and titanium are important raw materials used in certain of our Aeronautics and Space Systems programs. Long-term agreements have helped enable a continued supply of aluminum and titanium. Carbon fiber is an important ingredient in composite materials used in our Aeronautics programs, such as the F-35 aircraft. We have been advised by some suppliers that pricing and the timing of availability of materials in some commodities markets can fluctuate widely. These fluctuations may negatively affect the price and availability of certain materials. While we do not anticipate material problems regarding the supply of our raw materials and believe that we have taken appropriate measures to mitigate these variations, if key materials become unavailable or if pricing fluctuates widely in the future, it could result in delay of one or more of our programs, increased costs or reduced operating profits.

No material portion of our business is considered to be seasonal. Various factors can affect the distribution of our sales between accounting periods, including the timing of government awards, the availability of government funding, product deliveries and customer acceptance.

## **Government Contracts and Regulations**

Our business is heavily regulated. We contract with numerous U.S. Government agencies and entities, principally all branches of the U.S. military and NASA. We also contract with similar government authorities in other countries and they

regulate our international efforts. Additionally, our commercial aircraft products are required to comply with U.S. and international regulations governing production and quality systems, airworthiness and installation approvals, repair procedures and continuing operational safety.

We must comply with, and are affected by, laws and regulations relating to the formation, administration and performance of U.S. Government and other governments' contracts. These laws and regulations, among other things:

- require certification and disclosure of all cost or pricing data in connection with certain types of contract negotiations;
- impose specific and unique cost accounting practices that may differ from U.S. generally accepted accounting principles;
- impose acquisition regulations, which may change or be replaced over time, that define allowable and unallowable costs, the allocability of costs, and otherwise govern our right to reimbursement under certain U.S. Government and foreign contracts;
- require specific security controls to protect U.S. Government controlled unclassified information and restrict the use and dissemination of information classified for national security purposes and the export of certain products, services and technical data; and
- require the review and approval of contractor business systems, defined in the regulations as: (i) Accounting System; (ii) Estimating System; (iii) Earned Value Management System, for managing cost and schedule performance on certain complex programs; (iv) Purchasing System; (v) Material Management and Accounting System, for planning, controlling and accounting for the acquisition, use, issuing and disposition of material; and (vi) Property Management System.

The U.S. Government and other governments may terminate any of our government contracts and subcontracts either at its convenience or for default based on our performance. If a contract is terminated for convenience, we generally are protected by provisions covering reimbursement for costs incurred on the contract and profit on those costs. If a contract is terminated for default, we generally are entitled to payments for our work that has been accepted by the U.S. Government or other governments; however, the U.S. Government and other governments could make claims to reduce the contract value or recover its procurement costs and could assess other special penalties. For more information regarding the U.S. Government's and other governments' right to terminate our contracts, see Item 1A – Risk Factors. For more information regarding government contracting laws and regulations, see Item 1A – Risk Factors as well as “Critical Accounting Policies – Contract Accounting / Sales Recognition” in Management's Discussion and Analysis of Financial Condition and Results of Operations. For more information on the risks of doing work internationally, see Item 1A – Risk Factors. Additionally, the U.S. Government may also enter into unilateral contract actions, which they recently did on the F-35 program. This can affect our ability to negotiate mutually agreeable contract terms.

A portion of our business is classified by the U.S. Government and cannot be specifically described. The operating results of these classified contracts are included in our consolidated financial statements. The business risks associated with classified contracts historically have not differed materially from those of our other U.S. Government contracts. Our internal controls addressing the financial reporting of classified contracts are consistent with our internal controls for our non-classified contracts.

Our operations are subject to and affected by various federal, state, local and foreign environmental protection laws and regulations regarding the discharge of materials into the environment or otherwise regulating the protection of the environment. While the extent of our financial exposure cannot in all cases be reasonably estimated, the costs of environmental compliance have not had, and we do not expect that these costs will have, a material adverse effect on our earnings, financial position and cash flow, primarily because most of our environmental costs are allowable in establishing the price of our products and services under our contracts with the U.S. Government. For information regarding these matters, including current estimates of the amounts that we believe are required for remediation or cleanup to the extent that they are probable and estimable, see “Critical Accounting Policies – Environmental Matters” in Management's Discussion and Analysis of Financial Condition and Results of Operations and “Note 14 – Legal Proceedings, Commitments and Contingencies” included in our Notes to Consolidated Financial Statements. See also the discussion of environmental matters within Item 1A – Risk Factors.

## **Backlog**

At December 31, 2016, our backlog was \$96.2 billion compared with \$94.8 billion at December 31, 2015. Backlog at December 31, 2015 excludes \$4.8 billion related to the IS&GS business, which we divested in 2016. Backlog is converted into sales in future periods as work is performed or deliveries are made. Approximately \$34 billion, or 35%, of our backlog at December 31, 2016 is expected to be converted into sales in 2017.



Our backlog includes both funded (firm orders for our products and services for which funding has been both authorized and appropriated by the customer) and unfunded (firm orders for which funding has not been appropriated) amounts. We do not include unexercised options or potential orders under indefinite-delivery, indefinite-quantity agreements in our backlog. If any of our contracts with firm orders were to be terminated, our backlog would be reduced by the expected value of the unfilled orders of such contracts. Funded backlog was \$66.0 billion at December 31, 2016, as compared to \$67.6 billion at December 31, 2015. Funded backlog at December 31, 2015 excludes \$3.1 billion related to the IS&GS business, which we divested in 2016. For backlog related to each of our business segments, see “Business Segment Results of Operations” in Management’s Discussion and Analysis of Financial Condition and Results of Operations.

## **Research and Development**

We conduct research and development (R&D) activities under customer-sponsored contracts and with our own independent R&D funds. Our independent R&D costs include basic research, applied research, development, systems and other concept formulation studies. Generally, these costs are allocated among all contracts and programs in progress under U.S. Government contractual arrangements. Costs we incur under customer-sponsored R&D programs pursuant to contracts are included in net sales and cost of sales. Under certain arrangements in which a customer shares in product development costs, our portion of the unreimbursed costs is expensed as incurred in cost of sales. Independent R&D costs charged to cost of sales were \$988 million in 2016, \$817 million in 2015, and \$733 million in 2014. See “Research and development and similar costs” in “Note 1 – Significant Accounting Policies” included in our Notes to Consolidated Financial Statements.

## **Employees**

At December 31, 2016, we had approximately 97,000 employees, about 92% of whom were located in the U.S. Approximately 21% of our employees are covered by collective bargaining agreements with various unions. A number of our existing collective bargaining agreements expire in any given year. Historically, we have been successful in negotiating renewals to expiring agreements without any material disruption of operating activities. Management considers employee relations to be good.

## **Available Information**

We are a Maryland corporation formed in 1995 by combining the businesses of Lockheed Corporation and Martin Marietta Corporation. Our principal executive offices are located at 6801 Rockledge Drive, Bethesda, Maryland 20817. Our telephone number is (301) 897-6000 and our website home page is at [www.lockheedmartin.com](http://www.lockheedmartin.com). We make our website content available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference into this Annual Report on Form 10-K (Form 10-K).

Throughout this Form 10-K, we incorporate by reference information from parts of other documents filed with the U.S. Securities and Exchange Commission (SEC). The SEC allows us to disclose important information by referring to it in this manner.

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements for our annual stockholders’ meetings and amendments to those reports are available free of charge on our website, [www.lockheedmartin.com/investor](http://www.lockheedmartin.com/investor), as soon as reasonably practical after we electronically file the material with, or furnish it to, the SEC. In addition, copies of our annual report will be made available, free of charge, upon written request. The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy statements and other information regarding SEC registrants, including Lockheed Martin Corporation.

## **Forward-Looking Statements**

This Form 10-K contains statements that, to the extent they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws and are based on our current expectations and assumptions. The words “believe,” “estimate,” “anticipate,” “project,” “intend,” “expect,” “plan,” “outlook,” “scheduled,” “forecast” and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties.

Statements and assumptions with respect to future sales, income and cash flows, program performance, the outcome of litigation, anticipated pension cost and funding, environmental remediation cost estimates, planned acquisitions or dispositions of assets, or the anticipated consequences are examples of forward-looking statements. Numerous factors, including the risk factors described in the following section, could affect our forward-looking statements and actual performance.

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

#### **ITEM 1A. Risk Factors.**

An investment in our common stock or debt securities involves risks and uncertainties. We seek to identify, manage and mitigate risks to our business, but risk and uncertainty cannot be eliminated or necessarily predicted. The outcome of one or more of these risks could have a material effect on our operating results, financial position, or cash flows. You should carefully consider the following factors, in addition to the other information contained in this Annual Report on Form 10-K, before deciding to purchase our common stock or debt securities.

#### **We depend heavily on contracts with the U.S. Government for a substantial portion of our business.**

We derived 71% of our total net sales from the U.S. Government in 2016, including 59% from the Department of Defense (DoD). We expect to continue to derive most of our sales from work performed under U.S. Government contracts. Those contracts are conditioned upon the continuing availability of Congressional appropriations. Congress usually appropriates funds on a fiscal-year basis even though contract performance may extend over many years. Consequently, contracts are often partially funded initially and additional funds are committed only as Congress makes further appropriations. If we incur costs in excess of funds obligated on a contract, we may be at risk for reimbursement of those costs unless and until additional funds are obligated to the contract.

As discussed within the “Industry Considerations” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, the U.S. Government continues to face significant deficit reduction pressures and it is likely that discretionary spending by the U.S. Government will remain constrained for a number of years. Under such conditions, large or complex programs, which consist of multiple contracts and phases, are potentially subject to increased scrutiny.

There is also uncertainty regarding actions that may be taken by the new Presidential Administration in light of recent criticisms of the F-35 program and other large defense programs. President Trump has publicly expressed concerns over past cost overruns and delays in the program as well as overall program cost and has publicly requested that a competitor price out an alternative. Defense Secretary Mattis recently ordered a review of the program, including a comparison review of the F-35C carrier variant with a fourth generation alternative. Our Chairman, President and Chief Executive Officer has had discussions with President Trump on the importance of the F-35 program and our commitment to cut costs. However, we may continue to face pressure to reduce costs from the new Presidential Administration relating to the F-35 program and ongoing contract negotiations.

The F-35 is our largest program and represented 23% of our total net sales in 2016 and is expected to represent a higher percentage of our sales in future years. A decision to cut spending or reduce planned orders would have an adverse impact on our results of operations. Given the size and complexity of the F-35 program, we anticipate that there will be continual reviews related to aircraft performance, program schedule, cost, and requirements as part of the DoD, Congressional, and international partners’ oversight and budgeting processes. Current program challenges include, but are not limited to, supplier and partner performance, software development, level of cost associated with life cycle operations and sustainment and warranties, successfully negotiating and receiving funding for production contracts on a timely basis, executing future flight tests and findings resulting from testing and operating the aircraft. Additionally, the U.S. Government may also enter into unilateral contract actions, which they recently did on the F-35 program. This unilateral contract action obligates us to perform under terms and conditions imposed by the U.S. Government. Unilateral contract actions could negatively affect profit and cash flows, and establish a precedent for future contracts.

Based upon our diverse range of defense, homeland security and information technology products and services, we believe that this makes it less likely that cuts in any specific contract or program will have a long-term effect on our business. However, termination of multiple or large programs or contracts could adversely affect our business and future financial performance. Potential changes in funding priorities may afford new or additional opportunities for our businesses in terms of existing, follow-on or replacement programs. While we would expect to compete and be well positioned as the incumbent on existing programs, we may not be successful or the replacement programs may be funded at lower levels.

**We are subject to a number of procurement laws and regulations. Our business and our reputation could be adversely affected if we fail to comply with these laws.**

We must comply with and are affected by laws and regulations relating to the award, administration and performance of U.S. Government contracts. Government contract laws and regulations affect how we do business with our customers and impose certain risks and costs on our business. A violation of specific laws and regulations, by us, our employees, others working on our behalf, a supplier or a venture partner, could harm our reputation and result in the imposition of fines and penalties, the termination of our contracts, suspension or debarment from bidding on or being awarded contracts, loss of our ability to export products or services and civil or criminal investigations or proceedings.

In some instances, these laws and regulations impose terms or rights that are different from those typically found in commercial transactions. For example, the U.S. Government may terminate any of our government contracts and subcontracts either at its convenience or for default based on our performance. Upon termination for convenience of a fixed-price type contract, we normally are entitled to receive the purchase price for delivered items, reimbursement for allowable costs for work-in-process and an allowance for profit on the contract or adjustment for loss if completion of performance would have resulted in a loss.

Upon termination for convenience of a cost-reimbursable contract, we normally are entitled to reimbursement of allowable costs plus a portion of the fee. Allowable costs would include our cost to terminate agreements with our suppliers and subcontractors. The amount of the fee recovered, if any, is related to the portion of the work accomplished prior to termination and is determined by negotiation. We attempt to ensure that adequate funds are available by notifying the customer when its estimated costs, including those associated with a possible termination for convenience, approach levels specified as being allotted to its programs. As funds are typically appropriated on a fiscal-year basis and as the costs of a termination for convenience may exceed the costs of continuing a program in a given fiscal year, occasionally programs do not have sufficient funds appropriated to cover the termination costs were the government to terminate them for convenience. Under such circumstances, the U.S. Government could assert that it is not required to appropriate additional funding.

A termination arising out of our default may expose us to liability and have a material adverse effect on our ability to compete for future contracts and orders. In addition, on those contracts for which we are teamed with others and are not the prime contractor, the U.S. Government could terminate a prime contract under which we are a subcontractor, notwithstanding the quality of our services as a subcontractor. In the case of termination for default, the U.S. Government could make claims to reduce the contract value or recover its procurement costs and could assess other special penalties. However, under such circumstances we have rights and remedial actions under laws and the Federal Acquisition Regulation (FAR).

In addition, certain of our U.S. Government contracts span one or more base years and multiple option years. The U.S. Government generally has the right not to exercise option periods and may not exercise an option period for various reasons. However, the U.S. Government may exercise option periods, even for contracts for which it is expected that our costs may exceed the contract price or ceiling.

U.S. Government agencies, including the Defense Contract Audit Agency, the Defense Contract Management Agency and various agency Inspectors General, routinely audit and investigate government contractors. These agencies review a contractor's performance under its contracts, its cost structure, its business systems and compliance with applicable laws, regulations and standards. The U.S. Government has the ability to decrease or withhold certain payments when it deems systems subject to its review to be inadequate. Additionally, any costs found to be misclassified may be subject to repayment. We have unaudited and/or unsettled incurred cost claims related to past years, which places risk on our ability to issue final billings on contracts for which authorized and appropriated funds may be expiring.

If an audit or investigation uncovers improper or illegal activities, we may be subject to civil or criminal penalties and administrative sanctions, including reductions of the value of contracts, contract modifications or terminations, forfeiture of profits, suspension of payments, penalties, fines and suspension, or prohibition from doing business with the U.S. Government. In addition, we could suffer serious reputational harm if allegations of impropriety were made against us. Similar government oversight exists in most other countries where we conduct business.

**Our profitability and cash flow may vary based on the mix of our contracts and programs, our performance, our ability to control costs and evolving U.S. Government procurement policies.**

Our profitability and cash flow may vary materially depending on the types of government contracts undertaken, the nature of products produced or services performed under those contracts, the costs incurred in performing the work, the achievement of other performance objectives and the stage of performance at which the right to receive fees is determined, particularly under award and incentive-fee contracts.

Our backlog includes a variety of contract types that are intended to address changing risk and reward profiles as a program matures. Contract types include cost-reimbursable, fixed-price incentive-fee, fixed-price and time-and-materials contracts. Contracts for development programs with complex design and technical challenges are typically cost-reimbursable. Under cost-reimbursable contracts, we are reimbursed for allowable costs and paid a fee, which may be fixed or performance-based. In these cases, the associated financial risks primarily relate to a reduction in fees and the program could be cancelled if cost, schedule or technical performance issues arise.

Other contracts in backlog are for the transition from development to production (e.g., LRIP contracts), which includes the challenge of starting and stabilizing a manufacturing production and test line while the final design is being validated. These generally are cost-reimbursable or fixed-price incentive-fee contracts. Under a fixed-price incentive-fee contract, the allowable costs incurred are eligible for reimbursement but are subject to a cost-share arrangement, which affects profitability. Generally, if our costs exceed the contract target cost or are not allowable under the applicable regulations, we may not be able to obtain reimbursement for all costs and may have our fees reduced or eliminated.

There are also contracts for production, as well as operations and maintenance of the delivered products, that have the challenge of achieving a stable production and delivery rate, while maintaining operability of the product after delivery. These contracts are mainly fixed-price, although some operations and maintenance contracts are time-and-materials type. Under fixed-price contracts, we receive a fixed price regardless of the actual costs we incur. We have to absorb any costs in excess of the fixed price. Under time-and-materials contracts, we are paid for labor at negotiated hourly billing rates and for certain expenses.

The failure to perform to customer expectations and contract requirements may result in reduced fees or losses and affect our financial performance in that period. Under each type of contract, if we are unable to control costs, our operating results could be adversely affected, particularly if we are unable to justify an increase in contract value to our customers. Cost overruns or the failure to perform on existing programs also may adversely affect our ability to retain existing programs and win future contract awards.

The U.S. Government is currently pursuing and implementing policies that could negatively impact our profitability. Changes in procurement policy favoring more incentive-based fee arrangements, different award fee criteria or government contract negotiation offers based upon the customer's view of what our costs should be (as compared to our actual costs) may affect the predictability of our profit rates. The U.S. Government's unilateral contract action definitizing the LRIP 9 F-35 contract reflected differing U.S. Government and Lockheed Martin views as to costs, entitlement to performance-based payments and profitability and could negatively impact the profitability and cash flows of LRIP 9, LRIP 10 (which remains an undefinitized contract) and future production contracts. Our customers are subject to pressures that may result in a change in contract types referenced above earlier in a program's maturity than is traditional. An example of this is the use of fixed-price incentive-fee contracts for recent LRIP contracts on the F-35 program while the development contract is being performed concurrently. Our customers also may pursue non-traditional contract provisions in negotiation of contracts. For example, changes resulting from the F-35 development contract may need to be implemented on the production contracts (including the LRIP contracts), a concept referred to as concurrency, which may require us to pay for a portion of the concurrency costs. An example of customer budget pressures includes the U.S. Government requiring that bid and proposal costs be included in general and administrative costs, rather than charged directly to contracts in certain circumstances.

Other policies could negatively impact our working capital and cash flow. For example, the government has expressed a preference for requiring progress payments rather than performance based payments on new fixed-price contracts, which if implemented, delays our ability to recover a significant amount of costs incurred on a contract and thus affects the timing of our cash flows.

**Increased competition and bid protests in a budget-constrained environment may make it more difficult to maintain our financial performance and customer relationships.**

We are experiencing increased competition while, at the same time, our customers are facing budget constraints, trying to do more with less by cutting costs, identifying more affordable solutions, performing certain work internally rather than hiring a contractor, and reducing product development cycles. It is critical we maintain strong customer relationships and seek to understand the priorities of their requirements in this price competitive environment.

In international sales, we face substantial competition from both U.S. manufacturers and international manufacturers whose governments sometimes provide research and development assistance, marketing subsidies and other assistance for their products. Additionally, our competitors are also focusing on increasing their international sales to partially mitigate the

effect of reduced U.S. Government budgets. To remain competitive, we consistently must maintain strong customer relationships and provide superior performance, advanced technology solutions and service at an affordable cost and with the agility that our customers require to satisfy their mission objectives.

A substantial portion of our business is awarded through competitive bidding. The U.S. Government increasingly has relied upon competitive contract award types, including indefinite-delivery, indefinite-quantity and other multi-award contracts, which have the potential to create pricing pressure and increase our cost by requiring that we submit multiple bids and proposals. In addition, multi-award contracts require that we make sustained efforts to obtain task orders under the contract. The competitive bidding process entails substantial costs and managerial time to prepare bids and proposals for contracts that may not be awarded to us or may be split among competitors. Additionally, the former IS&GS programs we moved to RMS and Space Systems in the fourth quarter of 2015 and retained could experience increased pricing pressures which could have a negative impact on our ability to win future follow-on contracts. Following award, we may encounter significant expenses, delays, contract modifications or bid protests from unsuccessful bidders on new program awards. Unsuccessful bidders are more frequently protesting in the hope of being awarded a subcontract for a portion of the work in return for withdrawing the protest. Bid protests could result in significant expenses to us, contract modifications or even loss of the contract award. Even where a bid protest does not result in the loss of a contract award, the resolution can extend the time until the contract activity can begin and, as a result, delay our recognizing sales. We also may not be successful in our efforts to protest or challenge any bids for contracts that were not awarded to us and we could incur significant time and expense in such efforts.

**We are the prime contractor on most of our contracts and if our subcontractors, suppliers or teaming agreement or venture partners fail to perform their obligations, our performance and our ability to win future business could be harmed.**

For most of our contracts we rely on other companies to provide materials, major components and products, and to perform a portion of the services that we provide to our customers. Such arrangements may involve subcontracts, teaming arrangements, ventures or supply agreements with other companies upon which we rely (contracting parties). There is a risk that we may have disputes with our contracting parties, including disputes regarding the quality and timeliness of work performed, the workshare provided to that party, customer concerns about the other party's performance, our failure to extend existing task orders or issue new task orders, or our hiring the personnel of a subcontractor, teammate or venture partner or vice versa. In addition, changes in the economic environment, including defense budgets and constraints on available financing, may adversely affect the financial stability of our contracting parties and their ability to meet their performance requirements or to provide needed supplies on a timely basis as might their inability to perform profitably in the current highly competitive and budget constrained environment. A failure, for whatever reason, by one or more of our contracting parties to provide the agreed-upon supplies or perform the agreed-upon services on a timely basis, according to specifications, or at all may affect our ability to perform our obligations and require that we transition the work to other companies. Contracting party performance deficiencies may result in additional costs or delays in product deliveries and affect our operating results and could result in a customer terminating our contract for default or convenience. A default termination could expose us to liability and affect our ability to compete for future contracts and orders. Additionally, our efforts to increase the efficiency of our operations and improve the affordability of our products and services could negatively impact our ability to attract and retain suppliers.

**International sales may pose different risks.**

In 2016, 27% of our total net sales were from international customers. We have a strategy to grow international sales over the next several years, inclusive of sales of F-35 aircraft to our international partners and other countries. International sales are subject to numerous political and economic factors, regulatory requirements, significant competition, taxation, and other risks associated with doing business in foreign countries. Our exposure to such risks increased as a result of our acquisition of Sikorsky and our increased ownership interest in AWE and may further increase if our international sales grow as we anticipate.

Our international business is conducted through foreign military sales (FMS) contracted through the U.S. Government or by direct commercial sales (DCS) with international customers. In 2016, approximately 66% of our sales to international customers were FMS and about 34% were DCS. These transaction types differ as FMS transactions represent sales by the U.S. Government to international governments and our contract with the U.S. Government is subject to FAR. By contrast, DCS transactions represent sales directly to another international government or commercial customer. All sales to international customers are subject to U.S. and foreign laws and regulations, including, without limitation, regulations relating to anti-corruption, import-export control, technology transfer restrictions, taxation, repatriation of earnings, exchange

controls, the Foreign Corrupt Practices Act and other anti-corruption laws, and the anti-boycott provisions of the U.S. Export Administration Act. While we have stringent policies in place to comply with such laws and regulations, failure by us, our employees or others working on our behalf to comply with these laws and regulations could result in administrative, civil, or criminal liabilities, including suspension, debarment from bidding for or performing government contracts, or suspension of our export privileges, which could have a material adverse effect on us. We frequently team with international subcontractors and suppliers who are also exposed to similar risks.

While international sales, whether contracted as FMS or DCS, present risks that are different and potentially greater than those encountered in our U.S. business, DCS with international customers may impose even greater risks. DCS transactions involve commercial relationships with parties with whom we have less familiarity and where there may be significant cultural differences. Additionally, international procurement rules and regulations, contract laws and regulations, and contractual terms differ from those in the U.S. and are less familiar to us. International regulations may be interpreted by foreign courts less bound by precedent and with more discretion; these interpretations frequently have terms less favorable to us than the FAR. Export and import, tax and currency risk also may be increased for DCS with international customers. While these risks are potentially greater than those encountered in our U.S. business, we seek to price our products and services commensurate with the risk profile on DCS with international customers.

Our international business is highly sensitive to changes in regulations, political environments or security risks that may affect our ability to conduct business outside of the U.S., including those regarding investment, procurement, taxation and repatriation of earnings. Our international business also may be impacted by changes in foreign national priorities, foreign government budgets, global economic conditions, and fluctuations in foreign currency exchange rates. Sales of military products are also affected by defense budgets and U.S. foreign policy. Additionally, the timing of orders from our international customers can be less predictable than for our U.S. customers and may lead to fluctuations in the amount reported each year for our international sales.

In conjunction with defense procurements, some international customers require contractors to comply with industrial cooperation regulations, including entering into industrial cooperation agreements, sometimes referred to as offset agreements. Offset agreements may require in-country purchases, technology transfers, local manufacturing support, investments in foreign joint ventures and financial support projects as an incentive or as a condition to a contract award. In some countries, these offset agreements may require the establishment of a venture with a local company, which must control the venture. The costs to satisfy our offset obligations are included in the estimates of our total costs to complete the contract and may impact our profitability and cash flows. The ability to recover investments that we make is generally dependent upon the successful operation of ventures that we do not control and may involve products and services that are dissimilar to our business activities. In these and other situations, we could be liable for violations of law for actions taken by these entities such as laws related to anti-corruption, import and export, taxation, and anti-boycott restrictions. Offset agreements generally extend over several years and may provide for penalties in the event we fail to perform in accordance with the offset requirements which are typically subjective and can be outside our control.

### **Our business could be negatively affected by cyber or other security threats or other disruptions.**

We routinely experience various cybersecurity threats, threats to our information technology infrastructure, unauthorized attempts to gain access to our company sensitive information, denial-of-service attacks, threats to the security of our facilities and employees, and threats from terrorist acts, as do our customers, suppliers, subcontractors and venture partners. We may experience similar security threats at customer sites that we operate and manage.

The threats we face vary from attacks common to most industries to more advanced and persistent, highly organized adversaries who target us because we protect national security information. If we are unable to protect sensitive information, our customers or governmental authorities could question the adequacy of our threat mitigation and detection processes and procedures. Due to the evolving nature of these security threats, the impact of any future incident cannot be predicted.

Although we work cooperatively with our customers, suppliers, subcontractors, venture partners and acquisitions to seek to minimize the impact of cyber threats, other security threats, or business disruptions, we must rely on the safeguards put in place by these entities, which may affect the security of our information. These entities have varying levels of cybersecurity expertise and safeguards, and their relationships with government contractors, such as Lockheed Martin, may increase the likelihood that they are targeted by the same cyber threats we face.

The costs related to cyber or other security threats or disruptions may not be fully insured or indemnified by other means. Additionally, some cyber technologies we develop under contract for our customers, particularly those related to

homeland security, may raise potential liabilities related to intellectual property and civil liberties, including privacy concerns, which may not be fully insured or indemnified by other means. Occurrence of any of these events could adversely affect our internal operations, the services we provide to our customers, our future financial results, our reputation, or our stock price. Additionally, such events could result in the loss of competitive advantages derived from our research and development efforts or other intellectual property; early obsolescence of our products and services; or contractual penalties.

**If we fail to manage acquisitions, divestitures, equity investments and other transactions successfully or if acquired entities or equity investments fail to perform as expected, our financial results, business and future prospects could be harmed.**

In pursuing our business strategy, we routinely conduct discussions, evaluate companies, and enter into agreements regarding possible acquisitions, divestitures, ventures and equity investments. We seek to identify acquisition or investment opportunities that will expand or complement our existing products and services or customer base, at attractive valuations. We often compete with others for the same opportunities. To be successful, we must conduct due diligence to identify valuation issues and potential loss contingencies; negotiate transaction terms; complete and close complex transactions; integrate acquired companies and employees; and realize anticipated operating synergies efficiently and effectively. Acquisition, divestiture, venture and investment transactions often require substantial management resources and have the potential to divert our attention from our existing business. Unidentified or identified but un-indemnified pre-closing liabilities could affect our future financial results, particularly successor liability under procurement laws and regulations such as the False Claims Act or Truth in Negotiations Act, anti-corruption, tax, import-export and technology transfer laws which provide for civil and criminal penalties and the potential for debarment. We also may incur unanticipated costs or expenses, including post-closing asset impairment charges, expenses associated with eliminating duplicate facilities, employee retention, transaction-related or other litigation, and other liabilities. Any of the foregoing could adversely affect our business and results of operations.

Ventures, or noncontrolling equity investments, operate under shared control with other parties. Under the equity method of accounting for nonconsolidated ventures and investments, we recognize our share of the operating profit of these ventures in our results of operations. Our operating results may be affected by the performance of businesses over which we do not exercise control, which includes the inability to influence strategic decisions that may adversely affect our business, financial condition and results of operations. Our joint ventures face many of the same risks and uncertainties as we do. The most significant impact of our equity investments is in our Space Systems business segment where approximately 25% of its 2016 operating profit was derived from its share of earnings from equity method investees, particularly that in United Launch Alliance (ULA). Approximately 3% and 7% of our Aeronautics and RMS business segments' operating profit was derived from their shares of earnings from equity method investees, including their share in Advanced Military Maintenance, Repair and Overhaul Center LLC venture (AMMROC).

**The acquired Sikorsky business may underperform relative to our expectations, the transaction may cause our financial results to differ from our expectations or the expectations of the investment community and we may not be able to achieve anticipated cost savings or other anticipated synergies.**

On November 6, 2015, we completed the acquisition of Sikorsky. We believe that we will benefit from the integration of our products and technologies with those of the Sikorsky business and realize synergies and potential for long-term growth, as well as expanded capabilities and customer relationships as a result of the acquisition. However, we may not be able to capture anticipated synergies, tax benefits, cost savings, and business opportunities in the time frame anticipated, or at all. Changes to the Federal statutory tax rate could have an impact on the tax benefits we expect in connection with the acquisition. Due to the recent acquisition and valuation, the carrying value and fair value of our Sikorsky reporting unit are currently closely aligned. Therefore, any business deterioration, contract cancellations or terminations, or market pressures could cause our sales, earnings and cash flows to decline below current projections and could cause goodwill to be impaired. Additionally, Sikorsky may not perform as expected, or demand for its products may be adversely affected by global economic conditions, including oil and gas trends that are outside of their control.

**If we fail to maintain an effective system of internal controls over financial reporting there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.**

Effective internal controls are necessary for us to provide reliable and accurate financial statements and to effectively prevent fraud. As further described, in Part II Item 9A "Controls and Procedures" management has concluded that, because of a material weakness in internal controls within Sikorsky's processes (specifically, Sikorsky did not adequately identify,

design and implement appropriate process-level controls for its processes and appropriate information technology controls for its information technology systems), which we acquired on November 6, 2015 and which operates as a business unit of our RMS business segment, our disclosure controls and procedures were not effective as of December 31, 2016. We have and we will continue to enhance our controls at our Sikorsky business unit and we expect that the remediation of this material weakness will be completed prior to the end of fiscal year 2017. However, we cannot be certain that these measures will be successful or that we will be able to prevent future significant deficiencies or material weaknesses. Material inaccuracies in our financial statements would impair their value to management and our Board of Directors in making decisions as to the operation of our business, could impair our reputation and cause investors to lose confidence in our reported financial information, which could have a negative effect on investor confidence in our financial statements, the trading price of our stock and our access to capital.

**The divestiture of our Information Systems & Global Solutions business may not achieve the intended benefits and may expose us to potential risks and liabilities.**

We completed the divestiture of our IS&GS business on August 16, 2016, which merged with a subsidiary of Leidos Holdings Inc. (Leidos), in a Reverse Morris Trust transaction. As part of the transaction, we also completed an exchange offer that resulted in a reduction of our outstanding common stock. We undertook the divestiture because we believed that this business could achieve greater growth and create more value for customers and stockholders outside of Lockheed Martin and that we could benefit from greater strategic focus of our resources and management efforts. We may not benefit as expected from the increased focus on our core business, strategic programs and objectives made possible by the split-off or from the reduced exposure to a shorter product cycle services business. Additionally, the value of the transaction may also be reduced by potential liabilities related to post-closing adjustments and indemnities, which could adversely affect our results of operations.

**If the divestiture of our Information Systems & Global Solutions business or certain internal transactions undertaken in anticipation of the divestiture are determined to be taxable in whole or in part, we and our stockholders may incur significant tax liabilities.**

In connection with the divestiture of our IS&GS business, we obtained opinions of outside tax counsel that the merger and exchange offer will qualify as tax-free transactions to us and our stockholders, except to the extent that cash was paid to Lockheed Martin stockholders in lieu of fractional shares. We have not sought or obtained a ruling from the Internal Revenue Service (IRS) on each of the tax consequences of the transaction. An opinion of counsel is not binding on the IRS or the courts, which may disagree with the opinion. In addition, the tax opinions are subject to customary qualifications and based on factual representations. Even if the merger and exchange offer otherwise qualified as tax-free transactions, they may become taxable to us if certain events occur that affect either Lockheed Martin or Leidos. While Leidos has agreed not to take certain actions that could cause the transactions not to qualify as tax-free transactions and is generally obligated to indemnify us against any tax consequences if it breaches this agreement, the potential tax liabilities could have a material adverse effect on us if we were not entitled to indemnification or if the indemnification obligations were not fulfilled. If the merger or exchange offer were determined to be taxable, we could be subject to a substantial tax liability, and each U.S. holder of our common stock who participated in the exchange offer could be treated as exchanging the Lockheed Martin shares surrendered for Abacus shares in a taxable transaction.

**There can be no assurance that we will continue to increase our dividend or to repurchase shares of our common stock at current levels.**

The payment of cash dividends and share repurchases is subject to limitations under applicable law and the discretion of our Board of Directors and is determined in light of then current conditions, including earnings, other operating results and capital requirements. Decreases in asset values or increases in liabilities, including liabilities associated with benefit plans and assets and liabilities associated with taxes, can reduce stockholders' equity. A deficit in stockholders' equity could limit our ability to pay dividends and make share repurchases under Maryland Law in the future. In addition, the timing and amount of share repurchases under board approved share repurchase plans is within the discretion of management and will depend on many factors, including results of operations, capital requirements as well as applicable law.

**Our business involves significant risks and uncertainties that may not be covered by indemnity or insurance.**

A significant portion of our business relates to designing, developing and manufacturing advanced defense and technology products and systems. New technologies may be untested or unproven. Failure of some of these products and services could result in extensive loss of life or property damage. Accordingly, we also may incur liabilities that are unique to our products and services, including combat and air mobility aircraft, missile and space systems, command and control



systems, cybersecurity, homeland security and training programs. In some but not all circumstances, we may be entitled to certain legal protections or indemnifications from our customers, either through U.S. Government indemnifications under Public Law 85-804 or the Price-Anderson Act, qualification of our products and services by the Department of Homeland Security under the SAFETY Act provisions of the Homeland Security Act of 2002, contractual provisions or otherwise. We endeavor to obtain insurance coverage from established insurance carriers to cover these risks and liabilities. The amount of insurance coverage that we maintain may not be adequate to cover all claims or liabilities. Existing coverage may be cancelled while we remain exposed to the risk, and it is not possible to obtain insurance to protect against all operational risks and liabilities. For example, we are limited in the amount of insurance we can obtain to cover certain natural hazards, such as earthquakes. We have significant operations in geographic areas prone to this risk, such as Sunnyvale, California. Even if insurance coverage is available, we may not be able to obtain it at a price or on terms acceptable to us. Additionally, disputes with insurance carriers over coverage terms or the insolvency of one or more of our insurance carriers may significantly affect the amount or timing of our cash flows.

Substantial costs resulting from an accident; failure of or defect in our products or services; natural catastrophe or other incident; or liability arising from our products and services in excess of any legal protection, indemnity, and our insurance coverage (or for which indemnity or insurance is not available or not obtained) could adversely impact our financial condition, cash flows, or operating results. Any accident, failure of, or defect in our products or services, even if fully indemnified or insured, could negatively affect our reputation among our customers and the public and make it more difficult for us to compete effectively. It also could affect the cost and availability of adequate insurance in the future.

**Pension funding and costs are dependent on several economic assumptions which if changed may cause our future earnings and cash flow to fluctuate significantly as well as affect the affordability of our products and services.**

Many of our employees are covered by defined benefit pension plans, and we provide certain health care and life insurance benefits to eligible retirees. The impact of these plans on our U.S. generally accepted accounting principles (GAAP) earnings may be volatile in that the amount of expense we record for our postretirement benefit plans may materially change from year to year because those calculations are sensitive to funding levels as well as changes in several key economic assumptions, including interest rates, rates of return on plan assets, and other actuarial assumptions including participant longevity (also known as mortality), employee turnover, as well as the timing of cash funding. Changes in these factors, including actual returns on plan assets, may also affect our plan funding, cash flow and stockholders' equity. In addition, the funding of our plans and recovery of costs on our contracts, as described below, also may be subject to changes caused by legislative or regulatory actions. We have taken certain actions over the last few years to mitigate the impact the plans may have on our cash flows and earnings, including amendments made in June 2014 to a significant portion of our qualified and nonqualified defined benefit pension plans for non-union employees to freeze future retirement benefits. However, the impact of these actions on our cash flow and earnings may be less than anticipated or may be offset by other factors such as changes in actuarial assumptions and plan asset investment returns.

With regard to cash flow, we have made substantial cash contributions to our plans as required by the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act of 2006 (PPA). We generally are able to recover these contributions related to our plans as allowable costs on our U.S. Government contracts, including FMS, but there is a lag between when we contribute cash to our plans under pension funding rules and recover it under U.S. Government Cost Accounting Standards (CAS). Effective February 2012, the CAS rules were revised to harmonize the measurement and period assignment of the pension cost allocable to government contracts with the PPA (CAS Harmonization). In 2013, the cost impact of CAS Harmonization started being phased in with the goal of better aligning the CAS pension cost and ERISA funding requirements being fully achieved in 2017. The enactment of the Highway and Transportation Funding Act of 2014 and Bipartisan Budget Act of 2015 increased the interest rate assumption used to determine our CAS pension costs, which has the effect of lowering the recovery of pension contributions during the affected periods as it decreases our CAS pension costs.

For more information on how these factors could impact earnings, financial position, cash flow and stockholders' equity, see "Critical Accounting Policies – Postretirement Benefit Plans" in Management's Discussion and Analysis of Financial Conditions and Results of Operations and "Note 11 – Postretirement Plans" included in our Notes to Consolidated Financial Statements.

**Environmental costs could affect our future earnings as well as the affordability of our products and services.**

Our operations are subject to and affected by a variety of federal, state, local and foreign environmental protection laws and regulations. We are involved in environmental remediation at some of our facilities, some of our former facilities, and at

third-party-owned sites where we have been designated a potentially responsible party. In addition, we could be affected by future regulations imposed or claims asserted in response to concerns over climate change, other aspects of the environment or natural resources. We have an ongoing comprehensive sustainability program to reduce the effects of our operations on the environment.

We manage and have managed various U.S. Government-owned facilities, and portions of U.S. Government-owned facilities, on behalf of the U.S. Government. At such facilities, environmental compliance and remediation costs historically have been the responsibility of the U.S. Government. We have relied, and continue to rely with respect to past practices, upon U.S. Government funding to pay such costs, notwithstanding efforts by some U.S. Government representatives to limit this responsibility. Although the U.S. Government remains responsible for capital and operating costs associated with environmental compliance, responsibility for fines and penalties associated with environmental noncompliance typically is borne by either the U.S. Government or the contractor, depending on the contract and the relevant facts. Some environmental laws include criminal provisions. An environmental law conviction could affect our ability to be awarded future, or perform existing, U.S. Government contracts.

We have incurred and will continue to incur liabilities under various federal, state, local and foreign statutes for environmental protection and remediation. The extent of our financial exposure cannot in all cases be reasonably estimated at this time. Among the variables management must assess in evaluating costs associated with these cases and remediation sites generally are the status of site assessment, extent of the contamination, impacts on natural resources, changing cost estimates, evolution of technologies used to remediate the site, continually evolving governmental environmental standards and cost allowability issues, including varying efforts by the U.S. Government to limit allowability of our costs in resolving liability at third party-owned sites. For information regarding these matters, including current estimates of the amounts that we believe are required for remediation or cleanup to the extent probable and estimable, see “Critical Accounting Policies – Environmental Matters” in Management’s Discussion and Analysis of Financial Condition and Results of Operations and “Note 14 – Legal Proceedings, Commitments and Contingencies” of our consolidated financial statements.

**We are involved in a number of legal proceedings. We cannot predict the outcome of litigation and other contingencies with certainty.**

Our business may be adversely affected by the outcome of legal proceedings and other contingencies that cannot be predicted with certainty. As required by GAAP, we estimate loss contingencies and establish reserves based on our assessment of contingencies where liability is deemed probable and reasonably estimable in light of the facts and circumstances known to us at a particular point in time. Subsequent developments in legal proceedings may affect our assessment and estimates of the loss contingency recorded as a liability or as a reserve against assets in our financial statements. For a description of our current legal proceedings, see Item 3 – Legal Proceedings and “Note 14 – Legal Proceedings, Commitments and Contingencies” included in our Notes to Consolidated Financial Statements.

**Our success depends, in part, on our ability to develop new products and technologies and maintain a qualified workforce.**

Many of the products and services we provide are highly engineered and involve sophisticated technologies, with related complex manufacturing and system integration processes. Our customers’ requirements change and evolve regularly. Accordingly, our future performance depends, in part, on our ability to identify emerging technological trends, develop and manufacture innovative products and service and bring those offerings to market quickly at cost-effective prices.

Additionally, due to the specialized nature of our business, our future performance is highly dependent upon our ability to maintain a workforce with the requisite skills in multiple areas including: engineering, science, manufacturing, information technology, cybersecurity, business development and strategy and management. Our operating performance is also dependent upon personnel who hold security clearances and receive substantial training in order to work on certain programs or tasks. Additionally, as we expand our operations internationally, it is increasingly important to hire and retain personnel with relevant experience in local laws, regulations, customs, traditions and business practices.

We face a number of challenges that may affect personnel retention such as our endeavors to increase the efficiency of our operations and improve the affordability of our products and services such as workforce reductions and consolidating and relocating certain operations. Additionally as our workforce ages, our demographic continues to shift toward a higher proportion of employees nearing retirement. In June 2014, we amended certain of our defined benefit pension plans for non-union employees to freeze future retirement benefits, which may encourage retirement-eligible personnel to elect to retire earlier than anticipated. The freeze takes place in two stages and will be completed January 1, 2020.

To the extent that we lose experienced personnel, it is critical that we develop other employees, hire new qualified personnel, and successfully manage the transfer of critical knowledge. Competition for personnel is intense, and we may not be successful in hiring or retaining personnel with the requisite skills or clearances. We increasingly compete with commercial technology companies outside of the aerospace and defense industry for qualified technical, cyber and scientific positions as the number of qualified domestic engineers is decreasing and the number of cyber professionals is not keeping up with demand. To the extent that these companies grow at a faster rate or face fewer cost and product pricing constraints, they may be able to offer more attractive compensation and other benefits to candidates or our existing employees. To the extent that the demand for skilled personnel exceeds supply, we could experience higher labor, recruiting or training costs in order to attract and retain such employees; we could experience difficulty in performing our contracts if we were unable to do so. We also must manage leadership development and succession planning throughout our business. While we have processes in place for management transition and the transfer of knowledge, the loss of key personnel, coupled with an inability to adequately train other personnel, hire new personnel or transfer knowledge, could significantly impact our ability to perform under our contracts.

Approximately 21% of our employees are covered by collective bargaining agreements with various unions. Historically, where employees are covered by collective bargaining agreements with various unions, we have been successful in negotiating renewals to expiring agreements without any material disruption of operating activities. This does not assure, however, that we will be successful in our efforts to negotiate renewals of our existing collective bargaining agreements in the future. If we encounter difficulties with renegotiations or renewals of collective bargaining arrangements or are unsuccessful in those efforts, we could incur additional costs and experience work stoppages. Union actions at suppliers can also affect us. Any delays or work stoppages could adversely affect our ability to perform under our contracts, which could negatively impact our results of operations, cash flows, and financial condition.

#### **Our estimates and projections may prove to be inaccurate.**

The accounting for some of our most significant activities is based on judgments and estimates, which are complex and subject to many variables. For example, accounting for sales using the percentage-of-completion method requires that we assess risks and make assumptions regarding schedule, cost, technical and performance issues for each of our thousands of contracts, many of which are long-term in nature. Additionally, we initially allocate the purchase price of acquired businesses based on a preliminary assessment of the fair value of identifiable assets acquired and liabilities assumed. For significant acquisitions we may use a one-year measurement period to analyze and assess a number of factors used in establishing the asset and liability fair values as of the acquisition date and could result in adjustments to asset and liability balances. Another example is the \$10.8 billion of goodwill assets recorded on our consolidated balance sheet as of December 31, 2016 from previous acquisitions, which represents approximately 23% of our total assets. These goodwill assets are subject to annual impairment testing and more frequent testing upon the occurrence of certain events or significant changes in circumstances that indicate goodwill may be impaired. If we experience changes or factors arise that negatively affect the expected cash flows of a reporting unit, we may be required to write off all or a portion of the reporting unit's related goodwill assets.

Future changes in U.S. or foreign tax laws, including those with retroactive effect, and audits by tax authorities could result in unanticipated increases in our tax expense and affect profitability and cash flows. For example, recent proposals to lower the U.S. corporate income tax rate would require us to reduce our net deferred tax assets upon enactment of new tax legislation, with a corresponding material, one-time, non-cash increase in income tax expense, but our income tax expense and payments would be materially reduced in subsequent years. Our net deferred tax assets as of December 31, 2016 and 2015 were \$6.6 billion and \$6.1 billion, based on a 35% Federal statutory income tax rate, and primarily relate to our postretirement benefit plans. If legislation reducing the Federal statutory income tax rate to 15% had been enacted at December 31, 2016, our net deferred tax assets would have been reduced by \$3.8 billion and we would have recorded a corresponding one-time, non-cash increase in income tax expense of \$3.8 billion. This additional expense would be less if the legislation phased in the tax rate reduction or if the final rate was higher than 15%. The amount of net deferred tax assets will change periodically based on several factors, including the measurement of our postretirement benefit plan obligations and actual cash contributions to our postretirement benefit plans.

Actual financial results could differ from our judgments and estimates. See "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations and "Note 1 – Significant Accounting Policies" included in our Notes to Consolidated Financial Statements for a complete discussion of our significant accounting policies and use of estimates.

#### **ITEM 1B. Unresolved Staff Comments.**

None.

## ITEM 2. Properties.

At December 31, 2016, we owned or leased building space (including offices, manufacturing plants, warehouses, service centers, laboratories and other facilities) at approximately 400 locations primarily in the U.S. Additionally, we manage or occupy various Government-owned facilities under lease and other arrangements.

At December 31, 2016, we had significant operations in the following locations:

- **Aeronautics** – Palmdale, California; Marietta, Georgia; Greenville, South Carolina; and Fort Worth, Texas.
- **Missiles and Fire Control** – Camden, Arkansas; Lexington, Kentucky; Ocala and Orlando, Florida; and Grand Prairie, Texas.
- **Rotary and Mission Systems** – Colorado Springs, Colorado; Stratford, Connecticut; Orlando, Florida; Moorestown/Mt. Laurel, New Jersey; Owego and Syracuse, New York; Akron, Ohio; Manassas, Virginia; and Mielec, Poland.
- **Space Systems** – Sunnyvale, California; Denver, Colorado; Albuquerque, New Mexico; Valley Forge, Pennsylvania; and Reading, England.
- **Corporate activities** – Bethesda, Maryland.

In connection with the increase in ownership interest of AWE Management Limited, we assumed 5.8 million square feet of Government-owned floor space. As a result of our divestiture of the IS&GS business, we reduced our owned and leased floor space by 3.4 million square feet.

The following is a summary of our square feet of floor space by business segment at December 31, 2016 (in millions):

	Owned	Leased	Government- Owned	Total
Aeronautics	5.8	2.4	14.5	22.7
Missiles and Fire Control	6.2	2.9	1.8	10.9
Rotary and Mission Systems	11.2	7.6	0.4	19.2
Space Systems	8.4	2.4	13.6	24.4
Corporate activities	2.7	1.0	—	3.7
Total	34.3	16.3	30.3	80.9

We believe our facilities are in good condition and adequate for their current use. We may improve, replace or reduce facilities as considered appropriate to meet the needs of our operations.

## ITEM 3. Legal Proceedings.

We are a party to or have property subject to litigation and other proceedings that arise in the ordinary course of our business, including matters arising under provisions relating to 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 these matters will have a material adverse effect on the Corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our net earnings in any particular interim reporting period. We cannot predict the outcome of legal or other proceedings with certainty. These matters include the proceedings summarized in “Note 14 – Legal Proceedings, Commitments and Contingencies” included in our Notes to Consolidated Financial Statements.

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

As a U.S. Government contractor, we are subject to various audits and investigations by the U.S. Government to determine whether our operations are being conducted in accordance with applicable regulatory requirements. U.S.

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

**ITEM 4. Mine Safety Disclosures.**

Not applicable.

#### **ITEM 4(a). Executive Officers of the Registrant.**

Our executive officers as of February 9, 2017 are listed below, with their ages on that date, positions and offices currently held, and principal occupation and business experience during at least the last five years. There were no family relationships among any of our executive officers and directors. All officers serve at the discretion of the Board of Directors.

##### **Richard F. Ambrose (age 58), Executive Vice President – Space Systems**

Mr. Ambrose has served as Executive Vice President of Space Systems since April 2013. He previously served as Vice President and Deputy, Space Systems from July 2012 to March 2013; and President, Information Systems & Global Solutions – Security from January 2011 to June 2012.

##### **Dale P. Bennett (age 60), Executive Vice President – Rotary and Mission Systems**

Mr. Bennett has served as Executive Vice President of Rotary and Mission Systems since December 2012. He previously served as President, Mission Systems & Sensors from August 2011 to December 2012.

##### **Orlando P. Carvalho (age 58), Executive Vice President – Aeronautics**

Mr. Carvalho has served as Executive Vice President of Aeronautics since March 2013. He previously served as Executive Vice President and General Manager, F-35 Program from March 2012 to March 2013; Vice President and Deputy, F-35 Program from August 2011 to March 2012.

##### **Brian P. Colan (age 56), Vice President, Controller and Chief Accounting Officer**

Mr. Colan has served as Vice President, Controller, and Chief Accounting Officer since August 2014. He previously served as Vice President and Controller, Missiles and Fire Control from January 2013 to August 2014; and Vice President and Controller, Electronic Systems from October 2011 to January 2013.

##### **Richard H. Edwards (age 60), Executive Vice President – Missiles and Fire Control**

Mr. Edwards has served as Executive Vice President of Missiles and Fire Control since December 2012. He previously served as Executive Vice President, Program and Technology Integration, Missiles and Fire Control from June 2012 to December 2012; and Vice President, Tactical Missiles and Combat Maneuver Systems from July 2005 to June 2012.

##### **Marillyn A. Hewson (age 63), Chairman, President and Chief Executive Officer**

Ms. Hewson has served as Chairman, President and Chief Executive Officer of Lockheed Martin since January 2014. Having served over 30 years at Lockheed Martin in roles of increasing responsibility, she held the positions of Chief Executive Officer and President from January 2013 to December 2013; President and Chief Operating Officer from November 2012 to December 2012; and Executive Vice President – Electronic Systems from January 2010 to November 2012.

##### **Maryanne R. Lavan (age 57), Senior Vice President, General Counsel and Corporate Secretary**

Ms. Lavan has served as Senior Vice President and General Counsel since June 2010 and Corporate Secretary since September 2010.

##### **John W. Mollard (age 59), Vice President and Treasurer**

Mr. Mollard has served as Vice President and Treasurer since April 2016. He previously served as Vice President, Corporate Financial Planning and Analysis from 2003 to April 2016.

##### **Bruce L. Tanner (age 57), Executive Vice President and Chief Financial Officer**

Mr. Tanner has served as Executive Vice President and Chief Financial Officer since September 2007.

## PART II

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

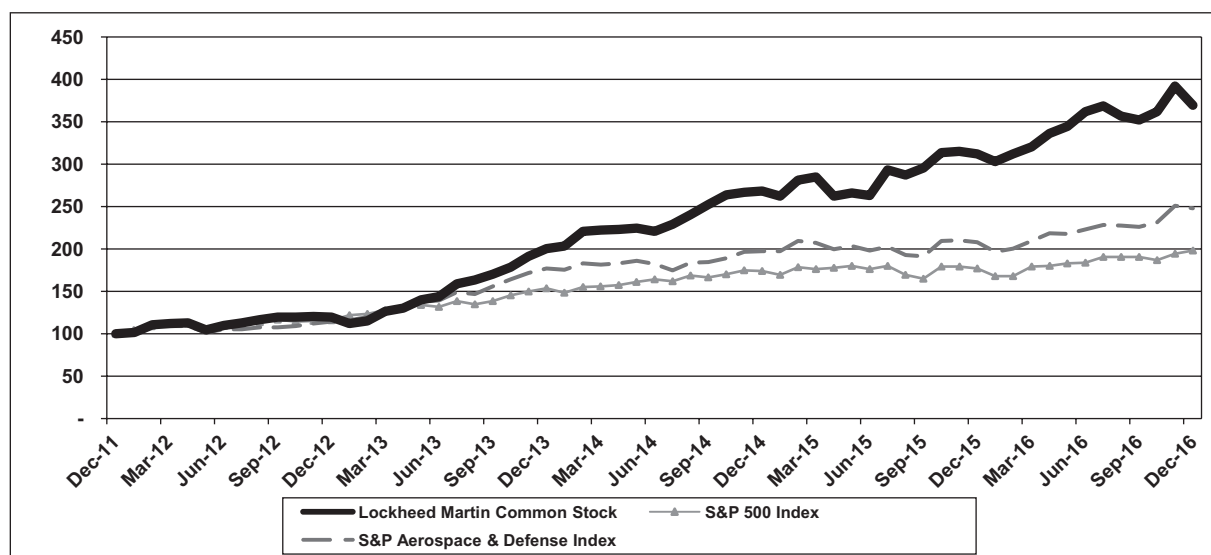
At January 27, 2017, we had 28,697 holders of record of our common stock, par value \$1 per share. Our common stock is traded on the New York Stock Exchange (NYSE) under the symbol LMT. Information concerning the high and low reported sales prices of Lockheed Martin common stock and dividends paid during the past two years is as follows:

#### Common Stock – Dividends Paid Per Share and Market Prices

Quarter	Dividends Paid Per Share		Stock Prices (High-Low)	
	2016	2015	2016	2015
First	<b>\$1.65</b>	\$1.50	<b>\$223.19 - \$200.47</b>	\$207.06 - \$186.01
Second	<b>1.65</b>	1.50	<b>245.37 - 218.34</b>	206.19 - 185.65
Third	<b>1.65</b>	1.50	<b>266.93 - 235.28</b>	213.34 - 181.91
Fourth	<b>1.82</b>	1.65	<b>269.90 - 228.50</b>	227.91 - 199.01
Year	<b>\$6.77</b>	\$6.15	<b>\$269.90 - \$200.47</b>	\$227.91 - \$181.91

#### Stockholder Return Performance Graph

The following graph compares the total return on a cumulative basis of \$100 invested in Lockheed Martin common stock on December 31, 2011 to the Standard and Poor’s (S&P) 500 Index and the S&P Aerospace & Defense (S&P Aero) Index.



The S&P Aero Index comprises Arconic Inc., General Dynamics Corporation, L3 Technologies, Inc., Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon Company, Rockwell Collins, Inc., Textron Inc., The Boeing Company, Transdigm Group Inc., and United Technologies Corporation. The stockholder return performance indicated on the graph is not a guarantee of future performance.

This graph is not deemed to be “filed” with the U.S. Securities and Exchange Commission or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934 (the Exchange Act), and should not be deemed to be incorporated by reference into any of our prior or subsequent filings under the Securities Act of 1933 or the Exchange Act.

## Purchases of Equity Securities

The following table provides information about our repurchases of our common stock registered pursuant to Section 12 of the Exchange Act during the quarter ended December 31, 2016.

Period <sup>(a)</sup>	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(b)</sup>	Amount Available for Future Share Repurchases Under the Plans or Programs <sup>(b)</sup>  (in millions)
September 26, 2016 – October 30, 2016	1,294,018	\$235.56	1,293,734	\$4,015
October 31, 2016 – November 27, 2016	712,100	\$254.42	711,974	\$3,834
November 28, 2016 – December 31, 2016	1,281,651	\$259.81	1,270,668	\$3,504
Total	3,287,769 <sup>(c)</sup>	\$249.09	3,276,376	

<sup>(a)</sup> We close our books and records on the last Sunday of each month to align our financial closing with our business processes, except for the month of December, as our fiscal year ends on December 31. As a result, our fiscal months often differ from the calendar months. For example, September 26, 2016 was the first day of our October 2016 fiscal month.

<sup>(b)</sup> In October 2010, our Board of Directors approved a share repurchase program pursuant to which we are authorized to repurchase our common stock in privately negotiated transactions or in the open market at prices per share not exceeding the then-current market prices. On September 22, 2016, our Board of Directors authorized a \$2.0 billion increase to the program. Under the program, management has discretion to determine the dollar amount of shares to be repurchased and the timing of any repurchases in compliance with applicable law and regulation. This includes purchases pursuant to Rule 10b5-1 plans. The program does not have an expiration date.

<sup>(c)</sup> During the quarter ended December 31, 2016, the total number of shares purchased included 11,393 shares that were transferred to us by employees in satisfaction of minimum tax withholding obligations associated with the vesting of restricted stock units. These purchases were made pursuant to a separate authorization by our Board of Directors and are not included within the program.



## ITEM 6. Selected Financial Data.

The operating results of the IS&GS business have been classified as discontinued operations for all periods presented and the assets and liabilities of the IS&GS business have been classified as assets and liabilities of discontinued operations for all periods presented. However, the cash flows generated by the IS&GS business have not been reclassified in our cash flow information as we retained the cash as part of the divestiture of the IS&GS business. See “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements for additional information about the divestiture of the IS&GS business.

<i>(In millions, except per share data)</i>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>Operating results</b>					
Net sales	<b>\$47,248</b>	\$40,536	\$39,946	\$39,243	\$40,573
Operating profit <sup>(a)(b)</sup>	<b>5,549</b>	4,712	5,012	4,066	3,748
Net earnings from continuing operations <sup>(a)(b)</sup>	<b>3,753</b>	3,126	3,253	2,701	2,297
Net earnings from discontinued operations <sup>(c)</sup>	<b>1,549</b>	479	361	280	448
Net earnings <sup>(b)</sup>	<b>5,302</b>	3,605	3,614	2,981	2,745
Earnings from continuing operations per common share					
Basic <sup>(a)(b)</sup>	<b>12.54</b>	10.07	10.27	8.42	7.10
Diluted <sup>(a)(b)</sup>	<b>12.38</b>	9.93	10.09	8.27	6.99
Earnings from discontinued operations per common share					
Basic	<b>5.17</b>	1.55	1.14	0.87	1.38
Diluted	<b>5.11</b>	1.53	1.12	0.86	1.36
Earnings per common share					
Basic <sup>(b)</sup>	<b>17.71</b>	11.62	11.41	9.29	8.48
Diluted <sup>(b)</sup>	<b>17.49</b>	11.46	11.21	9.13	8.36
<b>Cash dividends declared per common share</b>	<b>\$ 6.77</b>	\$ 6.15	\$ 5.49	\$ 4.78	\$ 4.15
<b>Balance sheet <sup>(d)</sup></b>					
Cash, cash equivalents and short-term investments <sup>(b)</sup>	<b>\$ 1,837</b>	\$ 1,090	\$ 1,446	\$ 2,617	\$ 1,898
Total current assets <sup>(c)</sup>	<b>15,108</b>	14,573	10,684	12,081	12,401
Goodwill <sup>(f)</sup>	<b>10,764</b>	10,695	7,964	7,698	7,697
Total assets <sup>(b)(c)(f)</sup>	<b>47,806</b>	49,304	37,190	36,352	38,890
Total current liabilities <sup>(c)</sup>	<b>12,542</b>	13,918	10,954	10,983	11,993
Total debt, net <sup>(g)</sup>	<b>14,282</b>	15,261	6,142	6,127	6,280
Total liabilities <sup>(b)(c)(g)</sup>	<b>46,200</b>	46,207	33,790	31,434	38,851
Total equity <sup>(b)</sup>	<b>1,606</b>	3,097	3,400	4,918	39
<b>Common shares in stockholders' equity at year-end</b>	<b>289</b>	303	314	319	321
<b>Cash flow information</b>					
Net cash provided by operating activities <sup>(b)(h)</sup>	<b>\$ 5,189</b>	\$ 5,101	\$ 3,866	\$ 4,546	\$ 1,561
Net cash used for investing activities <sup>(i)</sup>	<b>(985)</b>	(9,734)	(1,723)	(1,121)	(1,177)
Net cash provided by (used for) financing activities <sup>(j)</sup>	<b>(3,457)</b>	4,277	(3,314)	(2,706)	(2,068)
<b>Backlog <sup>(k)</sup></b>	<b>\$96,200</b>	\$94,800	\$74,500	\$76,300	\$75,600

(a) Our operating profit and net earnings from continuing operations and earnings per share from continuing operations were affected by severance charges of \$80 million (\$52 million or \$0.17 per share, after tax) in 2016; severance charges of \$82 million (\$53 million or \$0.17 per share, after tax) in 2015; severance charges of \$156 million (\$101 million or \$0.31 per share, after tax) in 2013. See “Note 15 – Restructuring Charges” included in our Notes to Consolidated Financial Statements for a discussion of 2016 and 2015 restructuring charges.

(b) The impact of our postretirement benefit plans can cause our operating profit, net earnings, cash flows and certain amounts recorded on our consolidated balance sheets to fluctuate. Accordingly, our earnings were affected by a FAS/CAS pension adjustment of \$902 million, \$400 million and \$317 million in 2016, 2015 and 2014 and \$(500) million and \$(832) million in 2013 and 2012. We made \$23 million in 2016 and \$5 million in 2015 of pension contributions (for our newly established Sikorsky plan), \$2.0 billion in 2014, \$2.25 billion in 2013 and \$3.6 billion in 2012 (for our legacy plans), and these contributions caused fluctuations in our operating cash flows and cash balance between each of those years. Fluctuations in our total assets, total liabilities and stockholders' equity between years 2012 to 2014 primarily were due to the annual measurement of the funded status of our postretirement benefit plans. See “Critical Accounting Policies – Postretirement Benefit Plans” in Management's Discussion and Analysis of Financial Condition and Results of Operations for more information.

(c) Our net earnings from discontinued operations includes a \$1.2 billion net gain in 2016 related to the divestiture of our IS&GS business.

- (d) Certain prior period amounts have been reclassified to conform to current year presentation.
- (e) Included in total current assets are assets of discontinued operations of \$1.0 billion in 2015, \$900 million in 2014, \$1.0 billion in 2013, and \$1.1 billion in 2012. Included in total current liabilities are liabilities of discontinued operations of \$900 million in each of the years 2015, 2014 and 2013 and \$1.0 billion in 2012. Included in total assets are assets of discontinued operations of \$4.1 billion in 2015, \$4.2 billion in 2014, \$3.9 billion in 2013, and \$4.0 billion in 2012. Included in total liabilities are liabilities of discontinued operations of \$1.2 billion in 2015, \$1.2 billion in 2014, \$1.2 billion in 2013, and \$1.3 billion in 2012.
- (f) The increase in our goodwill and total assets from 2014 to 2015 was primarily attributable to the Sikorsky acquisition, which resulted in an increase in goodwill and total assets as of December 31, 2015 of \$2.8 billion and \$11.7 billion, respectively.
- (g) The increase in our total debt and total liabilities from 2014 to 2015 was primarily a result of the debt incurred to fund the Sikorsky acquisition, as well as the issuance of debt in February of 2015 for general corporate purposes (see “Note 3 – Acquisitions and Divestitures” and “Note 10 – Debt” included in our Notes to Consolidated Financial Statements).
- (h) The fluctuations in our net cash provided by operating activities between years 2012 to 2016 were due to changes in pension contributions, working capital and tax payments made. See “Liquidity and Cash Flows” in Management’s Discussion and Analysis of Financial Condition and Results of Operations for more information.
- (i) The increase in our cash used for investing activities in 2015 was attributable to acquisitions of businesses, including the \$9.0 billion acquisition of Sikorsky in 2015, net of cash acquired (see “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements).
- (j) The increase in our cash provided by financing activities in 2015 was primarily a result of the debt incurred to fund the Sikorsky acquisition (see “Note 10 – Debt” included in our Notes to Consolidated Financial Statements). The increase in our cash used for financing activities in 2014 was due to decreased proceeds from stock option exercises; higher dividends paid and increased payments for repurchases of common stock. See “Liquidity and Cash Flows” in Management’s Discussion and Analysis of Financial Condition and Results of Operations for more information.
- (k) Backlog at December 31, 2016 and 2015 includes approximately \$14.7 billion and approximately \$15.6 billion related to Sikorsky and excludes backlog at December 31, 2015, 2014, 2013 and 2012 of \$4.8 billion, \$6.0 billion, \$6.3 billion and \$6.7 billion related to our IS&GS business, which we divested in 2016.

## **ITEM 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.**

### ***Business Overview***

We are a global security and aerospace company principally engaged in the research, design, development, manufacture, integration and sustainment of advanced technology systems, products and services. We also provide a broad range of management, engineering, technical, scientific, logistics, system integration and cybersecurity services. We serve both U.S. and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government. In 2016, 71% of our \$47.2 billion in net sales were from the U.S. Government, either as a prime contractor or as a subcontractor (including 59% from the Department of Defense (DoD)), 27% were from international customers (including foreign military sales (FMS) contracted through the U.S. Government) and 2% were from U.S. commercial and other customers. Our main areas of focus are in defense, space, intelligence, homeland security and information technology, including cybersecurity.

We operate in four business segments: Aeronautics, Missiles and Fire Control (MFC), Rotary and Mission Systems (RMS) and Space Systems. We organize our business segments based on the nature of products and services offered.

We operate in an environment characterized by both increasing complexity in global security and continuing economic pressures in the U.S. and globally. A significant component of our strategy in this environment is to focus on program execution, improving the quality and predictability of the delivery of our products and services and placing security capability quickly into the hands of our U.S. and international customers at affordable prices. Recognizing that our customers are resource constrained, we are endeavoring to develop and extend our portfolio domestically in a disciplined manner with a focus on adjacent markets close to our core capabilities, as well as growing our international sales. We continue to focus on affordability initiatives. We also expect to continue to invest in technologies to fulfill new mission requirements for our customers and invest in our people so that we have the technical skills necessary to succeed without limiting our ability to return substantially all of our free cash flow<sup>1</sup> to our investors in the form of dividends and share repurchases.

We expect 2017 net sales will increase in the mid-single digit range from 2016 levels. The projected growth is driven by increased production and sustainment volume on the F-35 program at Aeronautics as well as increased volume at MFC and RMS, partially offset by decreased volume at Space Systems. Operating profit margin is expected to decline from 2016 levels primarily driven by higher volume on the F-35 program, which is dilutive to our overall profit margin, contract mix at MFC, lower AWE Management Limited (AWE) earnings as a result of the non-cash gain recognized in 2016 related the consolidation of AWE, amortization of AWE intangible assets in 2017 and lower equity earnings at Space Systems. Accordingly, we expect 2017 segment operating profit margin will decline from our 2016 margin to just above 10%. Our outlook for 2017 assumes the U.S. Government continues to support and fund our key programs, consistent with the government fiscal year (GFY) 2017 budget. Changes in circumstances may require us to revise our assumptions, which could materially change our current estimate of 2017 net sales and operating profit margin. For additional information related to trends in net sales and operating profit at our business segments, see the “Business Segment Results of Operations” discussion below.

We expect the 2017 FAS/CAS pension adjustment to be approximately \$880 million, which incorporates a year end 2016 discount rate of 4.125%, a 25 basis point decrease from the end of 2015; an actual investment return during 2016 of approximately 5.0%; a 50 basis point reduction in our long-term rate of return assumption from 8.00% to 7.50%; and the revised longevity assumptions released on October 20, 2016 by the Society of Actuaries. We do not expect to make contributions to our legacy qualified defined benefit pension plans in 2017.

### ***Portfolio Shaping Activities***

We continuously strive to strengthen our portfolio of products and services to meet the current and future needs of our customers. We accomplish this in part by our independent research and development activities and through acquisition, divestiture and internal realignment activities.

We selectively pursue the acquisition of businesses and investments at attractive valuations that will expand or complement our current portfolio and allow access to new customers or technologies. We also may explore the divestiture of businesses that no longer meet our needs or strategy or that could perform better outside of our organization. In pursuing our business strategy, we routinely conduct discussions, evaluate targets and enter into agreements regarding possible acquisitions, divestitures, ventures and equity investments.

<sup>1</sup> We define free cash flow as cash from operations as determined under U.S. generally accepted accounting principles (GAAP), less capital expenditures as presented on our consolidated statements of cash flows.

## ***Business Developments***

### **Acquisition of Sikorsky Aircraft Corporation**

On November 6, 2015, pursuant to a Stock Purchase Agreement, dated as of July 19, 2015 by and between us and United Technologies Corporation (UTC) and certain wholly-owned subsidiaries of UTC, we completed the acquisition of Sikorsky Aircraft Corporation (Sikorsky) for \$9.0 billion, net of cash acquired. Sikorsky, a global company primarily engaged in the design, manufacture, service and support of military and commercial helicopters, has become a wholly-owned subsidiary of ours, aligned under the RMS business segment. We funded the acquisition with new debt issuances, commercial paper and cash on hand. We and UTC made a joint election under Section 338(h)(10) of the Internal Revenue Code, which treats the transaction as an asset purchase for tax purposes. Calculated using the Federal Statutory income tax rate, this election generates a cash tax benefit with an estimated net present value at the date of acquisition of \$1.9 billion for us and our stockholders. The 2015 financial results of the acquired Sikorsky business have been included in our consolidated results of operations from the November 6, 2015 acquisition date through December 31, 2015. Accordingly, the consolidated financial results for the year ended December 31, 2015 do not reflect a full year of Sikorsky's operations. See "Capital Structure, Resources and Other" included within "Liquidity and Cash Flows" discussion below and "Note 10 – Debt" included in our Notes to Consolidated Financial Statements for a discussion of the debt we incurred in connection with the Sikorsky acquisition.

### **Divestiture of the Information Systems & Global Solutions Business**

On August 16, 2016, we completed the previously announced divestiture of the IS&GS business, which merged with a subsidiary of Leidos, in a Reverse Morris Trust transaction (the "Transaction"). The Transaction was completed in a multi-step process pursuant to which we initially contributed the IS&GS business to Abacus Innovations Corporation (Abacus), a wholly-owned subsidiary of Lockheed Martin created to facilitate the Transaction, and the common stock of Abacus was distributed to participating Lockheed Martin stockholders through an exchange offer. Under the terms of the exchange offer, Lockheed Martin stockholders had the option to exchange shares of Lockheed Martin common stock for shares of Abacus common stock. At the conclusion of the exchange offer, all shares of Abacus common stock were exchanged for 9,369,694 shares of Lockheed Martin common stock held by Lockheed Martin stockholders that elected to participate in the exchange. The shares of Lockheed Martin common stock that were exchanged and accepted were retired, reducing the number of shares of our common stock outstanding by approximately 3%. Following the exchange offer, Abacus merged with a subsidiary of Leidos, with Abacus continuing as the surviving corporation and a wholly-owned subsidiary of Leidos. As part of the merger, each share of Abacus common stock was automatically converted into one share of Leidos common stock. We did not receive any shares of Leidos common stock as part of the Transaction and do not hold any shares of Leidos or Abacus common stock following the Transaction. Based on an opinion of outside tax counsel, subject to customary qualifications and based on factual representations, both the exchange offer and merger will qualify as tax-free transactions to Lockheed Martin and its stockholders, except to the extent that cash was paid to Lockheed Martin stockholders in lieu of fractional shares.

In connection with the Transaction, Abacus borrowed an aggregate principal amount of approximately \$1.84 billion under term loan facilities with third party financial institutions, the proceeds of which were used to make a one-time special cash payment of \$1.80 billion to Lockheed Martin and to pay associated borrowing fees and expenses. The entire special cash payment was used to repay debt, pay dividends and repurchase stock in the third and fourth quarters of 2016. The obligations under the Abacus term loan facilities were guaranteed by Leidos as part of the Transaction.

As a result of the Transaction, we recognized a net gain of approximately \$1.2 billion. The net gain represents the \$2.5 billion fair value of the shares of Lockheed Martin common stock exchanged and retired as part of the exchange offer, plus the \$1.8 billion one-time special cash payment, less the net book value of the IS&GS business of about \$3.0 billion at August 16, 2016 and other adjustments of about \$100 million. The final gain is subject to certain post-closing adjustments, including final working capital and tax adjustments, which we expect to complete in 2017.

We classified the operating results of the IS&GS business as discontinued operations in our financial statements in accordance with U.S. GAAP, as the divestiture of this business represented a strategic shift that had a major effect on our operations and financial results. However, the cash flows generated by the IS&GS business have not been reclassified in our consolidated statements of cash flows as we retained this cash as part of the Transaction.

### **Other**

On August 24, 2016, our ownership interest in the AWE venture increased by 18% in exchange for our assuming a more significant role in managing the operations of the venture. As a result of the increase, we now own a 51% interest in AWE

and control its operations and board of directors. Accordingly, we are required to consolidate AWE, which has been aligned under our Space Systems business segment since August 24, 2016. Space Systems' operating results include 100% of AWE's net sales and 51% of AWE's operating profit. Previously, we accounted for our investment in AWE using the equity method of accounting. Under the equity method, none of AWE's net sales and only 33% of AWE's net earnings were included in operating profit of the Space Systems business segment.

Additionally, we paid \$898 million during 2014 for acquisitions of businesses and investments in affiliates, net of cash acquired, primarily related to the following acquisitions:

- Systems Made Simple – a provider of health information technology solutions, which was included in our divestiture of the IS&GS business;
- Zeta Associates, Inc. – a designer of systems that enable collection, processing, safeguarding and dissemination of information for intelligence and defense communities, which is included in our Space Systems business segment; and
- Industrial Defender – a provider of cybersecurity solutions for control systems in the oil and gas, utility and chemical industries, which was included in our divestiture of the IS&GS business.

For additional information, see “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements.

### ***Industry Considerations***

#### **U.S. Government Funding Constraints**

The U.S. Government has not yet passed an annual budget for Government Fiscal Year (GFY) 2017. Accordingly, the U.S. Government is currently operating under a continuing resolution funding measure through April 28, 2017. Under this continuing resolution, partial-year funding at amounts consistent with appropriated levels for fiscal year 2016 are available, subject to certain restrictions, however, new spending initiatives are not authorized. Our key programs continue to be supported and funded despite the continuing resolution financing mechanism. However, during periods covered by continuing resolutions, or until regular annual appropriation bills are passed, we may experience delays in procurement of products and services due to lack of funding and those delays may affect our results of operations, financial position and cash flows.

During 2016, President Obama's Administration and both houses of Congress proposed budget plans for GFY 2017 that were broadly divergent in how they would be implemented, but set overall national defense spending limits at amounts consistent with the current limit imposed by the Bipartisan Budget Act of 2015. Significant differences remain in the various proposed budgets' funding sources and the potential use of overseas continuing operations funds for additional DoD-based budget. While we cannot predict budget resolution timing, we are hopeful that congressional deliberations can be concluded as soon as possible. A substantial delay would require an extension of the continuing resolution to enable continuation of government operations beyond April 28, 2017. While we think it is unlikely, a continuing resolution and its associated budget constraints could be extended for the full 2017 fiscal year should the varying budget positions remain unresolved. In the event of a full year continuing resolution, we would anticipate some level of impact against our 2017 orders and associated backlog level, but minimal impact to sales, earnings and cash flows in 2017 as a large portion of our backlog work is already funded from prior fiscal years, or we could face a government shutdown of unknown duration.

We anticipate there will continue to be a significant amount of debate and negotiations within the U.S. Government over defense spending for GFY 2017 and beyond. In the context of these negotiations, it is possible that existing cuts to government programs could be kept in place, replaced with different spending cuts, and/or replaced with a package of broader reforms to reduce the federal deficit. However, we continue to believe that our portfolio of products and services will continue to be well supported in a strategically focused allocation of budget resources.

#### **International Business**

A key component of our strategic plan is to grow our international sales. To accomplish this growth, we continue to focus on strengthening our relationships internationally through partnerships and joint technology efforts. We conduct business with international customers through each of our business segments.

In our Aeronautics business segment, there continues to be strong international interest in the F-35 program, which includes commitments from the U.S. Government and eight international partner countries and three international customers,

as well as expressions of interest from other countries. The U.S. Government and the eight partner countries continue to work together on the design, testing, production and sustainment of the F-35. The international commitment to the program continues to grow. For example, Denmark formally committed in 2016 to 27 F-35A variant aircraft. Japan received its first F-35A variant and two F-35A variant aircraft arrived in Israel. Additionally in 2016, Aeronautics received an undefinitized contract modification to the Low Rate Initial Production (LRIP) 10 advance acquisition contract, which included 35 international orders.

Other areas of international expansion at our Aeronautics business segment include the F-16 and C-130J programs. Aeronautics received a contract in 2016 with Korea for F-16 upgrades, extending work beyond 2020. The C-130J Super Hercules aircraft continued to draw interest from various international customers, including contracts in 2016 from France and Israel.

Our MFC business segment continues to generate significant international interest, most notably in the air and missile defense product line, which produces the Patriot Advanced Capability-3 (PAC-3) and Terminal High Altitude Area Defense (THAAD) systems. The PAC-3 is an advanced missile defense system designed to intercept incoming airborne threats. During 2016, we received orders for PAC-3 systems from Qatar, the Republic of Korea, the Kingdom of Saudi Arabia, Taiwan and the United Arab Emirates (UAE). THAAD is an integrated system designed to protect against short- and intermediate-range ballistic missiles. UAE is an international customer for THAAD, and other countries in the Middle East, Europe and the Asia-Pacific region have also expressed interest in our air and missile defense systems. Additionally, we continue to see international demand for our tactical missile and fire control products. In 2016, Poland became the first international customer for the Joint Air-to-Surface Standoff Missile-Extended Range (JASSM-ER), a long range, conventional air-to-ground, precision-guided standoff missile. Other MFC international customers include Japan, Germany, the Netherlands, Taiwan and Kuwait.

In our RMS business segment, we continue to experience international interest in the Aegis Ballistic Missile Defense System. We perform activities in the development, production, ship integration and test and lifetime support for ships of international customers such as Japan, Spain, Korea and Australia. We have an ongoing program in Canada for combat systems equipment upgrades on 12 Halifax-class frigates. In 2016, we were designated as the combat systems integrator for Australia's Future Submarine program. In our training and logistics solutions portfolio, we have active programs and pursuits in the United Kingdom, Saudi Arabia, Canada, Singapore and Australia. Our acquisition of Sikorsky adds a significant international component to the RMS business segment with an installed base of over 1,000 aircraft internationally. We have active development, production and sustainment support of the S-70i Black Hawk and MH-60 Seahawk aircraft to foreign military customers, including Chile, Australia, Denmark, Taiwan, Saudi Arabia, and Colombia. Commercial aircraft are sold to customers in the oil and gas industry, emergency medical evacuation, search and rescue fleets in over 30 countries, and VIP customers.

Our Space Systems business segment includes the operations of AWE, which operates the United Kingdom's nuclear deterrent program. The work at AWE covers the entire life cycle, from initial concept, assessment and design, through component manufacture and assembly, in-service support and decommissioning and disposal. In addition, Space Systems has international contracts with Saudi Arabia and Japan to design and manufacture geostationary communication satellites using the A2100 satellite platform.

### ***Status of the F-35 Program***

The F-35 program consists of development contracts, production contracts and sustainment activities. The development contracts are being performed concurrent with the production contracts. Concurrent performance of development and production contracts is used for complex programs to test aircraft, shorten the time to field systems, and achieve overall cost savings. We expect the System Development and Demonstration portion of the development contracts will be substantially complete in 2017, with less significant efforts continuing into 2019. Production of the aircraft is expected to continue for many years given the U.S. Government's current inventory objective of 2,443 aircraft for the U.S. Air Force, U.S. Marine Corps, and U.S. Navy; commitments from our eight international partners and three international customers; as well as expressions of interest from other countries.

On November 2, 2016, the U.S. Government unilaterally issued a contract (referred to as LRIP 9) to purchase 57 F-35 aircraft, including 42 F-35A conventional takeoff and landing variant (F-35A) aircraft at a production price that is 5.5% less than the production price for the F-35A variant in its previous contract to acquire F-35 aircraft (referred to as LRIP 8). The unilateral contract action obligates us to perform under terms and conditions imposed by the U.S. Government. At the time of the U.S. Government's decision to issue the unilateral contract, the parties had reached agreement in principle on

certain terms and conditions of the contract. However, certain key terms remained under negotiation, including the amount of cost to perform the contract, price and payment terms. We will continue to execute on the F-35 program and are evaluating our options and path forward. Although the amount at issue on the LRIP 9 contract is not a significant percentage of the overall contract value, the unilateral contract action could negatively affect profit and cash flows on the LRIP 9 and LRIP 10 (which remains undefinitized) contracts, and establish a precedent for future F-35 production contracts.

There is also uncertainty regarding actions that may be taken by the new Presidential Administration in light of recent criticisms of the F-35 program. President Trump has publicly expressed concerns over past cost overruns and delays in the program as well as overall program cost and has publicly requested that a competitor price out an alternative. Defense Secretary Mattis recently ordered a review of the program, including a comparison review of the F-35C carrier variant with a fourth generation alternative. Our Chairman, President and Chief Executive Officer has had discussions with President Trump on the importance of the F-35 program and our commitment to cut costs. However, we may continue to face pressure to reduce costs from the new Presidential Administration relating to the F-35 program and ongoing contract negotiations.

Operationally, the U.S. Government continues to complete various tests, including ship trials, mission system evaluations and weapons testing, and the F-35 aircraft fleet recently surpassed 80,000 flight hours. Progress also continues on the production of aircraft. In 2016, the program achieved a major milestone when the U.S. Air Force declared the F-35A variant ready for combat (also referred to as Initial Operating Capability (IOC)). The program continues to advance towards the U.S. Navy declaring the F-35C carrier variant ready for combat in 2018, as demonstrated by completing final carrier tests aboard the USS George Washington in 2016. Additionally, in 2016 we had initial deliveries of F-35 aircraft to Israel and Japan. As of December 31, 2016, we have delivered 200 production aircraft to our U.S. and international partners including delivery of the first F-35 aircraft completed at the Italian Final Assembly and Check-Out Facility, and we have 173 production aircraft in backlog, including orders from our international partners.

During aircraft inspections in 2016, debris was found in the fuel tank of an F-35A variant aircraft. It was determined the debris was caused by insulation shedding from tubing that is part of the system that provides cooling for the electronics and avionics and is located within the wing. Engineering assessments determined the tube assembly was wrapped using non-compliant insulation material. The non-compliant insulation was confined to only the F-35A variant aircraft. This issue affected 15 delivered aircraft and 42 aircraft in the factory. During the fourth quarter of 2016, modification work was completed to correct the issue on the 15 operational aircraft and flight operations have resumed. The issue was also corrected on many of the aircraft in the factory prior to delivery. The remaining affected aircraft will be corrected and delivered in 2017. This issue did not have a significant impact on our operating results or cash flows.

Given the size and complexity of the F-35 program, we anticipate that there will be continual reviews related to aircraft performance, program schedule, cost, and requirements as part of the DoD, Congressional, and international partners' oversight and budgeting processes. Current program challenges include, but are not limited to, supplier and partner performance, software development, level of cost associated with life cycle operations and sustainment and warranties, receiving funding for production contracts on a timely basis, executing future flight tests, findings resulting from testing, and operating the aircraft.

### ***Consolidated Results of Operations***

Since our operating cycle is primarily long term and involves many types of contracts for the design, development and manufacture of products and related activities with varying delivery schedules, the results of operations of a particular year, or year-to-year comparisons of sales and profits, may not be indicative of future operating results. The following discussions of comparative results among years should be reviewed in this context. All per share amounts cited in these discussions are presented on a "per diluted share" basis, unless otherwise noted.

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

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net sales	<b>\$ 47,248</b>	\$ 40,536	\$ 39,946
Cost of sales	<b>(42,186)</b>	(36,044)	(35,263)
Gross profit	<b>5,062</b>	4,492	4,683
Other income, net	<b>487</b>	220	329
Operating profit <sup>(a)</sup>	<b>5,549</b>	4,712	5,012
Interest expense	<b>(663)</b>	(443)	(340)
Other non-operating income, net	<b>—</b>	30	5
Earnings from continuing operations before income taxes	<b>4,886</b>	4,299	4,677
Income tax expense	<b>(1,133)</b>	(1,173)	(1,424)
Net earnings from continuing operations	<b>3,753</b>	3,126	3,253
Net earnings from discontinued operations	<b>1,549</b>	479	361
Net earnings	<b>\$ 5,302</b>	\$ 3,605	\$ 3,614
Diluted earnings per common share			
Continuing operations	<b>\$ 12.38</b>	\$ 9.93	\$ 10.09
Discontinued operations	<b>5.11</b>	1.53	1.12
Total diluted earnings per common share	<b>\$ 17.49</b>	\$ 11.46	\$ 11.21

(a) For the year ended December 31, 2015, operating profit includes \$45 million of operating loss at Sikorsky, which is less than 1% of consolidated operating profit in 2015. Sikorsky's operating loss is net of intangible amortization and adjustments required to account for the acquisition of this business in the fourth quarter of 2015.

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

## Net Sales

We generate sales from the delivery of products and services to our customers. Product sales are predominantly generated in each of our business segments and most of our service sales are generated in our RMS and Aeronautics business segments. Our consolidated net sales were as follows (in millions):

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Products	<b>\$ 40,365</b>	\$ 34,868	\$ 34,984
% of total net sales	<b>85.4%</b>	86.0%	87.6%
Services	<b>6,883</b>	5,668	4,962
% of total net sales	<b>14.6%</b>	14.0%	12.4%
Total net sales	<b>\$ 47,248</b>	\$ 40,536	\$ 39,946

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

### Product Sales

Product sales increased \$5.5 billion, or 16%, in 2016 as compared to 2015. The increase was primarily due to higher product sales of about \$3.7 billion at RMS and approximately \$1.8 billion at Aeronautics. The increase in product sales at RMS was primarily attributable to sales from Sikorsky, which was acquired in the fourth quarter of 2015. This increase was partially offset by lower net sales for training and logistics programs due to the divestiture of our Lockheed Martin Commercial Flight Training (LMCFT) business, which reported sales through the May 2, 2016 divestiture date. The increase at Aeronautics was primarily attributable to the F-35 program due to increased volume on aircraft production and the C-130 program due to increased aircraft deliveries.



Product sales decreased \$116 million, or less than 1%, in 2015 as compared to 2014. Lower product sales of about \$290 million at Space Systems and approximately \$250 million at MFC were partially offset by higher product sales of about \$300 million at RMS and approximately \$120 million at Aeronautics. The decrease in product sales at Space Systems was attributable to lower volume for government satellite programs (primarily Advanced Extremely High Frequency (AEHF)). Product sales at MFC decreased due to lower volume on air and missile defense systems programs (primarily PAC-3). The increase in product sales at RMS was primarily attributable to product sales from Sikorsky, which we acquired in the fourth quarter of 2015. Product sales at Aeronautics increased primarily due to higher volume on F-35 production contracts, as well as increased deliveries on our C-5 program; partially offset by fewer aircraft deliveries for our C-130 and F-16 programs and lower sustainment activities on our F-22 program.

### *Service Sales*

Service sales increased \$1.2 billion, or 21%, in 2016 as compared to 2015, primarily due to an increase in service sales of about \$700 million at RMS and approximately \$360 million at Aeronautics. The increase in service sales at RMS was primarily attributable to sales from Sikorsky, which was acquired in the fourth quarter of 2015. The increase in service sales at Aeronautics was primarily attributable to increased sustainment activities (primarily the F-35 and F-16 programs).

Service sales increased \$706 million, or 14%, in 2015 as compared to 2014. The increase in service sales was primarily attributable to higher service sales of approximately \$530 million at Aeronautics and about \$190 million at Space Systems. Higher service sales at Aeronautics were primarily due to increased sustainment activities (primarily the F-35 program). The increase in service sales at Space Systems was primarily due to service sales of entities acquired in the third quarter of 2014.

### **Cost of Sales**

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

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cost of sales – products	<b>\$(36,616)</b>	\$(31,091)	\$(30,983)
% of product sales	<b>90.7%</b>	89.2%	88.6%
Cost of sales – services	<b>(6,040)</b>	(4,824)	(4,184)
% of service sales	<b>87.8%</b>	85.1%	84.3%
Severance charges	<b>(80)</b>	(82)	—
Other unallocated, net	<b>550</b>	(47)	(96)
<b>Total cost of sales</b>	<b>\$(42,186)</b>	\$(36,044)	\$(35,263)

Due to the nature of percentage-of-completion accounting, changes in our cost of sales for both products and services are typically accompanied by changes in our net sales. The following discussion of material changes in our consolidated cost of sales for products and services should be read in tandem with the preceding discussion of changes in our consolidated net sales and our business segment results of operations. We have not identified any developing trends in cost of sales for products and services that would have a material impact on our future operations.

### *Product Costs*

Product costs increased approximately \$5.5 billion, or 18%, in 2016 as compared to 2015. The increase was primarily due to increased product costs of about \$3.6 billion at RMS and about \$1.6 billion at Aeronautics. The increase at RMS was primarily attributable to product costs generated by Sikorsky, which was acquired in the fourth quarter of 2015. The increase at Aeronautics was primarily attributable to increased volume on aircraft production for the F-35 program and increased aircraft deliveries on the C-130 program.

Product costs increased approximately \$108 million, or less than 1%, in 2015 as compared to 2014. Increased product costs of approximately \$445 million at RMS and about \$180 million at Aeronautics, were offset by decreases in product costs of approximately \$325 million at Space Systems and \$195 million at MFC. Increases in product costs at RMS were due primarily to the Sikorsky acquisition, including costs of Sikorsky products, intangible amortization and adjustments required

to account for the acquisition in the fourth quarter of 2015. Higher product costs at Aeronautics were attributable to the reasons stated above for higher product sales, as well as decreased risk retirements (primarily F-22). The changes in product costs at Space Systems and MFC were attributable to the reasons stated above for higher product sales.

### *Service Costs*

Service costs increased approximately \$1.2 billion, or 25%, in 2016 compared to 2015, primarily due to increased service costs of about \$670 million at RMS and approximately \$400 million at Aeronautics. The increase at RMS was primarily attributable to service costs generated by Sikorsky, which was acquired in the fourth quarter of 2015. The increase at Aeronautics was primarily attributable to increased sustainment activities (primarily the F-35 and the F-22 programs).

Service costs increased approximately \$640 million, or 15%, in 2015 compared to 2014. Higher service costs of approximately \$450 million at Aeronautics and about \$230 million at Space Systems were due to the reasons stated above for higher service sales. These increases in service costs were partially offset by a decrease in service costs of about \$80 million at MFC due primarily to lower service costs on various air and missile defense programs.

### *Restructuring Charges*

#### *2016 Actions*

During 2016, we recorded severance charges totaling approximately \$80 million related to our Aeronautics business segment. The charges consisted of severance costs associated with the planned elimination of certain positions through either voluntary or involuntary actions. Upon separation, terminated employees receive lump-sum severance payments primarily based on years of service, the majority of which are expected to be paid over the next several quarters. During 2016, we paid \$70 million in severance payments associated with these actions.

#### *2015 Actions*

During 2015, we recorded severance charges totaling \$82 million, of which \$67 million related to our RMS business segment and \$15 million related to businesses that were reported in our former IS&GS business prior to our fourth quarter 2015 program realignment. The charges consisted of severance costs associated with the planned elimination of certain positions through either voluntary or involuntary actions. Upon separation, terminated employees receive lump-sum severance payments primarily based on years of service, the majority of which are expected to be paid over the next several quarters. During 2016, we paid \$64 million in severance payments associated with these actions.

In connection with the Sikorsky acquisition, we assumed obligations related to certain restructuring actions committed to by Sikorsky in June 2015. Net of amounts we anticipate to recover through the pricing of our products and services to our customers, we incurred and paid \$40 million of costs in 2016 related to these actions.

We expect to recover a substantial amount of the restructuring charges through the pricing of our products and services to the U.S. Government and other customers in future periods, with the impact included in the respective business segment's results of operations.

### *Other Unallocated, Net*

Other unallocated, net primarily includes the FAS/CAS pension adjustment as described in the Business Segment Results of Operations section below, stock-based compensation and other corporate costs. These items are not allocated to the business segments and, therefore, are excluded from the cost of sales for products and services. Other unallocated, net was \$550 million of income in 2016, compared to expense of \$47 million in 2015 and \$96 million in 2014.

The fluctuation between each respective period was primarily attributable to the change in the FAS/CAS pension adjustment of \$902 million in 2016, \$400 million in 2015 and \$317 million in 2014, partially offset by fluctuations in other costs associated with various corporate items, none of which were individually significant. The changes in the FAS/CAS pension adjustment between the periods was primarily attributable to the increase in U.S. Government Cost Accounting Standards (CAS) pension cost due to the impact of phasing in CAS Harmonization. See "Critical Accounting Policies – Postretirement Benefit Plans" discussion below for more information on our CAS pension cost.

As a result of the divestiture of the IS&GS business, we retained all assets and obligations related to pension benefits earned by current and former IS&GS business salaried employees through the closing of the Transaction. Pension costs were

historically allocated to and included in the results of operations of the IS&GS business. In connection with the reclassification of the IS&GS business as discontinued operations, we reclassified the non-service portion of net pension costs related to IS&GS business salaried employee benefits (interest cost, actuarial gains and losses and expected return on plan assets) from cost of sales (and previously reported in the IS&GS business' operating profit) to other unallocated, net on our consolidated statements of earnings as corporate expenses because these costs will continue to be incurred by us subsequent to the Transaction. The service portion of net pension costs related to IS&GS business salaried employees that transferred to Leidos continued to be included in the operating results of the IS&GS business classified as discontinued operations because such costs will no longer be incurred by us subsequent to the Transaction. These net pension costs were \$54 million, \$71 million and \$59 million for the years ended December 31, 2016, 2015 and 2014.

In connection with the divestiture of the IS&GS business and reclassification of the IS&GS business to discontinued operations for all periods presented in the consolidated financial statements, certain corporate overhead costs incurred by us and previously allocated to the IS&GS business were reclassified from the IS&GS business results (which is recorded in net earnings from discontinued operations) to other unallocated, net in our consolidated statements of earnings. These overhead costs related to expenses for senior management, legal, human resources, finance, accounting, treasury, tax, information technology, communications, ethics and compliance, corporate employee benefits, incentives and stock-based compensation, shared services processing and administration and depreciation for corporate fixed assets, and were not directly attributable to the IS&GS business. During the years ended December 31, 2016, 2015 and 2014 we reclassified \$82 million, \$165 million and \$169 million of corporate overhead costs to other unallocated, net.

We allocate certain corporate overhead costs and defined benefit pension costs to our business segments because under U.S. Government contracting regulations such costs are allowable in establishing prices for contracts with the U.S. Government. Although the corporate overhead costs and defined benefit pension costs that were historically allocated to and included in the operating results of the IS&GS business have been reclassified to and included in the results of our continuing operations for financial reporting purposes, we will allocate similar costs incurred in future periods to our remaining business segments and expect to recover a substantial amount of these costs through the pricing of our products and services to the U.S. Government and other customers in future periods.

#### **Other Income, Net**

Other income, net primarily includes our share of earnings or losses from equity method investees and gains or losses for acquisitions and divestitures. Other income, net in 2016 was \$487 million, compared to \$220 million in 2015 and \$329 million in 2014. The increase in 2016, compared to 2015, was primarily attributable to the non-cash net gain of \$104 million associated with obtaining a controlling interest in AWE and approximately \$120 million of increased earnings generated by equity method investees as discussed in the "Business Segment Results of Operations" section below. Additionally, in 2015 we incurred a \$90 million non-cash impairment charge related to our decision in 2015 to divest our LMCFT business.

The decrease in 2015, compared to 2014, was primarily due to a \$90 million non-cash impairment charge related to our decision in 2015 to divest our LMCFT business and non-recoverable transaction costs of approximately \$38 million associated with the Sikorsky acquisition, partially offset by fluctuations in other various costs, none of which were individually significant. The asset impairment charge was partially offset by a net deferred tax benefit related to LMCFT of about \$80 million, which is recorded in income tax expense. Earnings from equity method investees in 2015 were comparable to 2014 (reflecting decreased earnings from equity method investees in our Space Systems business segment, offset by increased earnings from Sikorsky equity method investees).

#### **Interest Expense**

Interest expense in 2016 was \$663 million, compared to \$443 million in 2015 and \$340 million in 2014. The increases in interest expense in 2016 and 2015 relate to debt we incurred to fund the acquisition of Sikorsky, and the issuance of notes in February of 2015 for general corporate purposes. See "Capital Structure, Resources and Other" included within "Liquidity and Cash Flows" discussion below and "Note 10 – Debt" included in our Notes to Consolidated Financial Statements for a discussion of our debt.

#### **Other Non-Operating Income, Net**

Other non-operating income, net decreased \$30 million from 2015 to 2016 primarily due to a gain from the sale of an investment in 2015 which did not recur in 2016. Other non-operating income, net increased \$25 million from 2014 to 2015 due to a gain from the sale of an investment in 2015.

## **Income Tax Expense**

Our effective income tax rate from continuing operations was 23.2% for 2016, 27.3% for 2015, and 30.4% for 2014. The rates for all periods benefited from tax deductions for U.S. manufacturing activities, deductions for dividends paid to our defined contribution plans with an employee stock ownership plan feature, and the U.S. research and development (R&D) tax credit. The U.S. manufacturing deduction benefit for 2016, 2015, and 2014 reduced our effective tax rate by 2.4, 2.9, and 2.6 percentage points, respectively. The rate for 2016 also benefited from the nontaxable gain recorded in connection with the consolidation of AWE.

In addition, the rate for 2016 benefited from the additional tax benefits related to employee share-based payment awards, which are now recorded in earnings as income tax benefit or expense, effective with the adoption of an accounting standard update during the second quarter of 2016. As a result, we are required to report the impacts as though the accounting standard update had been adopted on January 1, 2016. Accordingly, we recognized additional income tax benefits of \$152 million during the year ended December 31, 2016, which reduced our effective income tax rate by 3.1 percentage points. The adjustment for the year ended December 31, 2016 includes second, third, and fourth quarter impacts and the reclassification of income tax benefits of \$104 million originally recognized in additional paid-in capital in the first quarter of 2016.

In 2016, the R&D tax credit reduced our effective tax rate by 2.2 percentage points. In December 2015, the R&D tax credit was permanently extended and reinstated, retroactive to the beginning of 2015, which reduced our effective income tax rate by 1.6 percentage points. In 2014, the R&D tax credit was temporarily reinstated for one year, retroactive to the beginning of 2014, which reduced our effective tax rate by 0.9 percentage point.

As a result of a decision in 2015 to divest our LMCFT business in 2016, we recorded an asset impairment charge of approximately \$90 million. This charge was partially offset by a net deferred tax benefit of about \$80 million. The net impact of the resulting tax benefit reduced our effective income tax rate by 1.2 percentage points in 2015.

Future changes in tax law could significantly impact our provision for income taxes, the amount of taxes payable, and our deferred tax asset and liability balances. Recent proposals to lower the U.S. corporate income tax rate would require us to reduce our net deferred tax assets upon enactment of new tax legislation, with a corresponding material, one-time, non-cash increase in income tax expense, but our income tax expense and payments would be materially reduced in subsequent years. Our net deferred tax assets as of December 31, 2016 and 2015 were \$6.6 billion and \$6.1 billion, based on a 35% the Federal statutory income tax rate, and primarily relate to our postretirement benefit plans. If legislation reducing the Federal statutory income tax rate to 15% had been enacted at December 31, 2016, our net deferred tax assets would have been reduced by \$3.8 billion and we would have recorded a corresponding one-time, non-cash increase in income tax expense of \$3.8 billion. This additional expense would be less if the legislation phased in the tax rate reduction or if the final rate was higher than 15%. The amount of net deferred tax assets will change periodically based on several factors, including the measurement of our postretirement benefit plan obligations and actual cash contributions to our postretirement benefit plans.

## **Net Earnings from Continuing Operations**

We reported net earnings from continuing operations of \$3.8 billion (\$12.38 per share) in 2016, \$3.1 billion (\$9.93 per share) in 2015 and \$3.3 billion (\$10.09 per share) in 2014. Both net earnings and earnings per share from continuing operations were affected by the factors mentioned above. Earnings per share also benefited from a net decrease of approximately 14 million common shares outstanding from December 31, 2015 to December 31, 2016 and approximately 11 million common shares outstanding from December 31, 2014 to December 31, 2015 as a result of share repurchases and the completion of the exchange offer, which were partially offset by share issuance under our stock-based awards and certain defined contribution plans.

## **Net Earnings from Discontinued Operations**

We reported net earnings from discontinued operations of \$1.5 billion (\$5.11 per share) in 2016, \$479 million (\$1.53 per share) in 2015 and \$361 million (\$1.12 per share) in 2014. Net earnings from discontinued operations in 2016 included a net gain of approximately \$1.2 billion recognized as a result of the divestiture of the IS&GS business.

## **Net Earnings**

We reported net earnings of \$5.3 billion (\$17.49 per share) in 2016, \$3.6 billion (\$11.46 per share) in 2015 and \$3.6 billion (\$11.21 per share) in 2014.

## Business Segment Results of Operations

We operate in four business segments: Aeronautics, MFC, RMS and Space Systems. We organize our business segments based on the nature of products and services offered. Net sales of our business segments exclude intersegment sales as these activities are eliminated in consolidation. The amounts, discussion and presentation of our business segments as set forth in this Annual Report on Form 10-K include the results of the acquired Sikorsky business from the November 6, 2015 acquisition date.

Operating profit of our business segments includes our share of earnings or losses from equity method investees because the operating activities of the equity method investees are closely aligned with the operations of our business segments. United Launch Alliance (ULA), which is part of our Space Systems business segment, is one of our largest equity method investees. Operating profit of our business segments excludes the FAS/CAS pension adjustment described below; 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 goodwill impairments (see "Note 1 – Significant Accounting Policies" included in our Notes to Consolidated Financial Statements) and significant severance actions (see "Note 15 – Restructuring Charges" included in our Notes to Consolidated Financial Statements); gains or losses from divestitures (see "Note 3 – Acquisitions and Divestitures" included in our Notes to Consolidated Financial Statements); 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.

Our business segments' results of operations include pension expense only as calculated under U.S. Government Cost Accounting Standards, which we refer to as CAS pension cost. We recover CAS pension cost through the pricing of our products and services on U.S. Government contracts and, therefore, the CAS pension cost is recognized in each of our business segments' net sales and cost of sales. Since our consolidated financial statements must present pension expense calculated in accordance with FAS requirements under U.S. generally accepted accounting principles (GAAP), which we refer to as FAS pension expense, the FAS/CAS pension adjustment increases or decreases the CAS pension cost recorded in our business segments' results of operations to equal the FAS pension expense. As a result, to the extent that CAS pension cost exceeds FAS pension expense, which occurred for 2016, 2015 and 2014, we have a favorable FAS/CAS pension adjustment.

The operating results in the following tables exclude businesses included in discontinued operations (see "Note 3 – Acquisitions and Divestitures" included in our Notes to Consolidated Financial Statements) for all years presented.

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

	2016	2015	2014
<b>Net sales</b>			
Aeronautics	\$17,769	\$15,570	\$14,920
Missiles and Fire Control	6,608	6,770	7,092
Rotary and Mission Systems	13,462	9,091	8,732
Space Systems	9,409	9,105	9,202
Total net sales	<b>\$47,248</b>	<b>\$40,536</b>	<b>\$39,946</b>
<b>Operating profit</b>			
Aeronautics	\$ 1,887	\$ 1,681	\$ 1,649
Missiles and Fire Control	1,018	1,282	1,344
Rotary and Mission Systems	906	844	936
Space Systems	1,289	1,171	1,187
Total business segment operating profit	<b>5,100</b>	4,978	5,116
Unallocated items			
FAS/CAS pension adjustment			
FAS pension expense <sup>(a)</sup>	(1,019)	(1,127)	(1,099)
Less: CAS pension cost <sup>(a)(b)</sup>	1,921	1,527	1,416
FAS/CAS pension adjustment <sup>(c)</sup>	902	400	317
Severance charges <sup>(a)(d)</sup>	(80)	(82)	—
Stock-based compensation	(149)	(133)	(154)
Other, net <sup>(e)(f)</sup>	(224)	(451)	(267)
Total unallocated, net	449	(266)	(104)
Total consolidated operating profit	<b>\$ 5,549</b>	<b>\$ 4,712</b>	<b>\$ 5,012</b>

<sup>(a)</sup> FAS pension expense, CAS pension costs and severance charges reflect the reclassification for discontinued operations presentation of benefits related to former IS&GS salaried employees (see “Note 11 – Postretirement Plans” included in our Notes to Consolidated Financial Statements).

<sup>(b)</sup> The higher CAS pension cost primarily reflects the impact of phasing in CAS Harmonization.

<sup>(c)</sup> We expect a FAS/CAS pension adjustment in 2017 of about \$880 million (see “Critical Accounting Policies – Postretirement Benefit Plans” discussion below).

<sup>(d)</sup> See “Consolidated Results of Operations – Restructuring Charges” discussion above for information on charges related to certain severance actions at our business segments. Severance charges for initiatives that are not significant are included in business segment operating profit.

<sup>(e)</sup> Other, net in 2015 includes a non-cash asset impairment charge of approximately \$90 million related to our decision to divest our LMCFT business (see “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements). This charge was partially offset by a net deferred tax benefit of about \$80 million, which is recorded in income tax expense. The net impact reduced net earnings by about \$10 million.

<sup>(f)</sup> Other, net in 2015 includes approximately \$38 million of non-recoverable transaction costs associated with the acquisition of Sikorsky.

The following segment discussions also include information relating to backlog for each segment. Backlog was approximately \$96.2 billion, \$94.8 billion and \$74.5 billion at December 31, 2016, 2015 and 2014. Backlog at December 31, 2015 and 2014 excludes approximately \$4.8 billion and \$6.0 billion of backlog related to our IS&GS business, which we divested in 2016. These amounts included both funded backlog (firm orders for which funding has been both authorized and appropriated by the customer) and unfunded backlog (firm orders for which funding has not yet been appropriated). Backlog does not include unexercised options or task orders to be issued under indefinite-delivery, indefinite-quantity contracts. Funded backlog was approximately \$66.0 billion at December 31, 2016.

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

We regularly provide customers with reports of our costs as the contract progresses. The cost information in the reports is accumulated in a manner specified by the requirements of each contract. For example, cost data provided to a customer for

a product would typically align to the subcomponents of that product (such as a wing-box on an aircraft) and for services would align to the type of work being performed (such as help-desk support). Our contracts generally are cost-based, which allows for the recovery of costs in the pricing of our products and services. Most of our contracts are bid and negotiated with our customers under circumstances in which we are required to disclose our estimated total costs to provide the product or service. This approach for negotiating contracts with our U.S. Government customers generally allows for the recovery of our costs. We also may enter into long-term supply contracts for certain materials or components to coincide with the production schedule of certain products and to ensure their availability at known unit prices.

Many of our contracts span several years and include highly complex technical requirements. At the outset of a contract, we identify and monitor risks to the achievement of the technical, schedule and cost aspects of the contract and assess the effects of those risks on our estimates of total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events) and costs (e.g., material, labor, subcontractor, overhead and the estimated costs to fulfill our industrial cooperation agreements required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and cost aspects of the contract which decreases the estimated total costs to complete the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate.

We have a number of programs that are designated as classified by the U.S. Government which cannot be specifically described. The operating results of these classified programs are included in our consolidated and business segment results and are subjected to the same oversight and internal controls as our other programs.

Our net sales are primarily derived from long-term contracts for products and services provided to the U.S. Government as well as FMS contracted through the U.S. Government. We account for these contracts, as well as product contracts with non-U.S. Government customers, using the percentage-of-completion method of accounting, which represent substantially all of our net sales. We derive our remaining net sales from contracts to provide services to non-U.S. Government customers, which we account for under the services method of accounting.

Under the percentage-of-completion method of accounting, we record sales on contracts based upon our progress towards completion on a particular contract as well as our estimate of the profit to be earned at completion. Cost-reimbursable contracts provide for the payment of allowable costs plus a fee. For fixed-priced contracts, net sales and cost of sales are recognized as products are delivered or as costs are incurred. Due to the nature of the percentage-of-completion method of accounting, changes in our cost of sales are typically accompanied by a related change in our net sales.

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

In addition, comparability of our segment sales, operating profit and operating margins may be impacted favorably or unfavorably by changes in profit booking rates on our contracts accounted for using the percentage-of-completion method of accounting. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs 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 complete 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 margins may also be impacted favorably or unfavorably by other items. Favorable items may include the positive resolution of contractual matters, cost recoveries on 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 as mentioned above which are excluded from segment operating results; reserves for disputes; asset impairments; and losses on sales of assets. Segment operating profit and items such as risk retirements, reductions of profit booking rates or other matters are presented net of state income taxes.

We have a contract to provide an integrated air and missile defense command, control, communications, computers – Integrated Surveillance & Reconnaissance (C4ISR) system to an international customer. In the first quarter of 2015, we revised our estimated costs to complete the program as a consequence of performance issues and recorded a reserve of

\$70 million. Since that time, we have continued to experience issues related to customer requirements and the implementation of this contract and have periodically accrued additional reserves. Consequently, we are continuing to monitor the scope, estimated costs, and viability of the program and the possibility of additional customer funding. It is possible that we may have to record additional loss reserves in future periods, which could be material to our operating results. However, we cannot make an estimate of the total expected costs at this time due to uncertainties inherent in the estimation process.

Our consolidated net adjustments not related to volume, including net profit booking rate adjustments and other matters, net of state income taxes, increased segment operating profit by approximately \$1.5 billion, \$1.7 billion and \$1.6 billion for 2016, 2015 and 2014. The decrease in our consolidated net adjustments in 2016 compared to 2015 was primarily due to a decrease in profit booking rate adjustments at our MFC and Space Systems business segments, partially offset by an increase at our RMS business segment. The increase in our consolidated net adjustments in 2015 compared to 2014 was primarily due to an increase in profit booking rate adjustments at our Space Systems and Aeronautics business segments, offset by a decrease in profit booking rate adjustments at our RMS and MFC business segments. The consolidated net adjustments for 2016 are inclusive of approximately \$530 million in unfavorable items, which include reserves for performance matters on an international program at RMS. The consolidated net adjustments for 2015 are inclusive of approximately \$550 million in unfavorable items, which include reserves for performance matters on an international program at RMS and on commercial satellite programs at Space Systems. The consolidated net adjustments for 2014 are inclusive of approximately \$535 million in unfavorable items, which include reserves recorded on certain training and logistics solutions programs at RMS and net warranty reserve adjustments for various programs (including JASSM and GMLRS) at MFC as described in the respective business segment's results of operations below.

## Aeronautics

Our Aeronautics business segment is engaged in the research, design, development, manufacture, integration, sustainment, support and upgrade of advanced military aircraft, including combat and air mobility aircraft, unmanned air vehicles and related technologies. Aeronautics' major programs include the F-35 Lightning II Joint Strike Fighter, C-130 Hercules, F-16 Fighting Falcon, C-5M Super Galaxy and F-22 Raptor. Aeronautics' operating results included the following (in millions):

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net sales	<b>\$17,769</b>	\$15,570	\$14,920
Operating profit	<b>1,887</b>	1,681	1,649
Operating margin	<b>10.6%</b>	10.8%	11.1%
Backlog at year-end	<b>\$34,200</b>	\$31,800	\$27,600

### *2016 compared to 2015*

Aeronautics' net sales in 2016 increased \$2.2 billion, or 14%, compared to 2015. The increase was attributable to higher net sales of approximately \$1.7 billion for the F-35 program due to increased volume on aircraft production and sustainment activities, partially offset by lower volume on development activities; and approximately \$290 million for the C-130 program due to increased deliveries (24 aircraft delivered in 2016 compared to 21 in 2015) and increased sustainment activities; and approximately \$250 million for the F-16 program primarily due to higher volume on aircraft modernization programs. The increases were partially offset by lower net sales of approximately \$55 million for the C-5 program due to decreased sustainment activities.

Aeronautics' operating profit in 2016 increased \$206 million, or 12%, compared to 2015. Operating profit increased approximately \$195 million for the F-35 program due to increased volume on aircraft production and sustainment activities and higher risk retirements; and by approximately \$60 million for aircraft support and maintenance programs due to higher risk retirements and increased volume. These increases were partially offset by lower operating profit of approximately \$65 million for the C-130 program due to contract mix and lower risk retirements. Adjustments not related to volume, including net profit booking rate adjustments, were approximately \$20 million higher in 2016 compared to 2015.

### *2015 compared to 2014*

Aeronautics' net sales in 2015 increased \$650 million, or 4%, compared to 2014. The increase was attributable to higher net sales of approximately \$1.4 billion for F-35 production contracts due to increased volume on aircraft production and sustainment activities; and approximately \$150 million for the C-5 program due to increased deliveries (nine aircraft



delivered in 2015 compared to seven delivered in 2014). The increases were partially offset by lower net sales of approximately \$350 million for the C-130 program due to fewer aircraft deliveries (21 aircraft delivered in 2015, compared to 24 delivered in 2014), lower sustainment activities and aircraft contract mix; approximately \$200 million due to decreased volume and lower risk retirements on various programs; approximately \$195 million for the F-16 program due to fewer deliveries (11 aircraft delivered in 2015, compared to 17 delivered in 2014); and approximately \$190 million for the F-22 program as a result of decreased sustainment activities.

Aeronautics' operating profit in 2015 increased \$32 million, or 2%, compared to 2014. Operating profit increased by approximately \$240 million for F-35 production contracts due to increased volume and risk retirements; and approximately \$40 million for the C-5 program due to increased risk retirements. These increases were offset by lower operating profit of approximately \$90 million for the F-22 program due to lower risk retirements; approximately \$70 million for the C-130 program as a result of the reasons stated above for lower net sales; and approximately \$80 million due to decreased volume and risk retirements on various programs. Adjustments not related to volume, including net profit booking rate adjustments and other matters, were approximately \$100 million higher in 2015 compared to 2014.

### *Backlog*

Backlog increased in 2016 compared to 2015 primarily due to higher orders on F-35 production and sustainment programs. Backlog increased in 2015 compared to 2014 primarily due to higher orders on F-35 and C-130 programs.

### *Trends*

We expect Aeronautics' 2017 net sales to increase in the low-double digit percentage range as compared to 2016 due to increased volume on the F-35 program. Operating profit is expected to increase at a slightly lower percentage range, driven by the increased volume on the F-35 program, partially offset by contract mix that results in a slight decrease in operating margins between years.

## **Missiles and Fire Control**

Our MFC business segment provides air and missile defense systems; tactical missiles and air-to-ground precision strike weapon systems; logistics; fire control systems; mission operations support, readiness, engineering support and integration services; manned and unmanned ground vehicles; and energy management solutions. MFC's major programs include PAC-3, THAAD, Multiple Launch Rocket System, Hellfire, JASSM, Javelin, Apache, Sniper<sup>®</sup>, Low Altitude Navigation and Targeting Infrared for Night (LANTIRN<sup>®</sup>) and Special Operations Forces Contractor Logistics Support Services (SOF CLSS). In 2016 we submitted a bid for the Special Operations Forces Global Logistics Support Services (SOF GLSS) contract, which is a competitive follow-on contract to SOF CLSS. We anticipate an award decision on the follow-on contract in mid-2017. MFC's operating results included the following (in millions):

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net sales	<b>\$ 6,608</b>	\$ 6,770	\$ 7,092
Operating profit	<b>1,018</b>	1,282	1,344
Operating margin	<b>15.4%</b>	18.9%	19.0%
Backlog at year-end	<b>\$14,700</b>	\$15,500	\$13,300

### *2016 compared to 2015*

MFC's net sales in 2016 decreased \$162 million, or 2%, compared to 2015. The decrease was attributable to lower net sales of approximately \$205 million for air and missile defense programs due to decreased volume (primarily THAAD); and lower net sales of approximately \$95 million due to lower volume on various programs. These decreases were partially offset by a \$75 million increase for tactical missiles programs due to increased deliveries (primarily Hellfire); and approximately \$70 million for fire control programs due to increased volume (SOF CLSS).

MFC's operating profit in 2016 decreased \$264 million, or 21%, compared to 2015. Operating profit decreased approximately \$145 million for air and missile defense programs due to lower risk retirements (PAC-3 and THAAD) and a reserve for a contractual matter; approximately \$45 million for tactical missiles programs due to lower risk retirements (Javelin); and approximately \$45 million for fire control programs due to lower risk retirements (Apache) and program mix. Adjustments not related to volume, including net profit booking rate adjustments and reserves, were about \$225 million lower in 2016 compared to 2015.

## 2015 compared to 2014

MFC's net sales in 2015 decreased \$322 million, or 5%, compared to the same period in 2014. The decrease was attributable to lower net sales of approximately \$345 million for air and missile defense programs due to fewer deliveries (primarily PAC-3) and lower volume (primarily THAAD); and approximately \$85 million for tactical missile programs due to fewer deliveries (primarily Guided Multiple Launch Rocket System (GMLRS)) and Joint Air-to-Surface Standoff Missile, partially offset by increased deliveries for Hellfire. These decreases were partially offset by higher net sales of approximately \$55 million for energy solutions programs due to increased volume.

MFC's operating profit in 2015 decreased \$62 million, or 5%, compared to 2014. The decrease was attributable to lower operating profit of approximately \$100 million for fire control programs due primarily to lower risk retirements (primarily LANTIRN and SNIPER); and approximately \$65 million for tactical missile programs due to lower risk retirements (primarily Hellfire and GMLRS) and fewer deliveries. These decreases were partially offset by higher operating profit of approximately \$75 million for air and missile defense programs due to increased risk retirements (primarily THAAD). Adjustments not related to volume, including net profit booking rate adjustments and other matters, were approximately \$60 million lower in 2015 compared to 2014.

### Backlog

Backlog decreased in 2016 compared to 2015 primarily due to lower orders on PAC-3, Hellfire, and JASSM. Backlog increased in 2015 compared to 2014 primarily due to higher orders on PAC-3, LANTIRN/Sniper and certain tactical missile programs, partially offset by lower orders on THAAD.

### Trends

We expect MFC's net sales to increase in the mid-single digit percentage range in 2017 as compared to 2016 driven primarily by our air and missile defense programs. Operating profit is expected to be flat or increase slightly. Accordingly, operating profit margin is expected to decline from 2016 levels as a result of contract mix and fewer risk retirements in 2017 compared to 2016.

## Rotary and Mission Systems

As previously described, on November 6, 2015, we acquired Sikorsky and aligned the Sikorsky business under our RMS business segment. The 2015 results of the acquired Sikorsky business have been included in our financial results from the November 6, 2015 acquisition date through December 31, 2015. As a result, our consolidated operating results and RMS business segment operating results for the year ended December 31, 2015 do not reflect a full year of Sikorsky operations.

Our RMS business segment provides design, manufacture, service and support for a variety of military and civil helicopters, ship and submarine mission and combat systems; mission systems and sensors for rotary and fixed-wing aircraft; sea and land-based missile defense systems; radar systems; the Littoral Combat Ship (LCS); simulation and training services; and unmanned systems and technologies. In addition, RMS supports the needs of government customers in cybersecurity and delivers communication and command and control capabilities through complex mission solutions for defense applications. RMS' major programs include Black Hawk and Seahawk helicopters, Aegis Combat System (Aegis), LCS, Space Fence, Advanced Hawkeye Radar System, TPQ-53 Radar System, CH-53K development helicopter, and VH-92A helicopter program. RMS' operating results included the following (in millions):

	2016	2015	2014
Net sales	\$13,462	\$ 9,091	\$ 8,732
Operating profit	906	844	936
Operating margin	6.7%	9.3%	10.7%
Backlog at year-end	\$28,400	\$30,100	\$13,300

## 2016 compared to 2015

RMS' net sales in 2016 increased \$4.4 billion, or 48%, compared to 2015. The increase was primarily attributable to higher net sales of approximately \$4.6 billion from Sikorsky, which was acquired on November 6, 2015. Net sales for 2015 include Sikorsky's results subsequent to the acquisition date, net of certain revenue adjustments required to account for the acquisition of this business. This increase was partially offset by lower net sales of approximately \$70 million for training

and logistics programs due to the divestiture of our LMCFT business, which reported sales through the May 2, 2016 divestiture date; and approximately \$65 million for ship and aviation systems programs due to decreased volume on various programs.

RMS' operating profit in 2016 increased \$62 million, or 7%, compared to 2015. Operating profit increased approximately \$85 million for training and logistics programs due primarily to the divestiture of our LMCFT business which generated operating losses through its May 2, 2016 divestiture date; about \$60 million for our integrated warfare systems and sensors programs due to investments made in connection with a next generation radar technology program awarded during 2015; and approximately \$55 million for undersea systems programs due primarily to higher reserves for performance matters on an international program in 2015. These increases were partially offset by a decrease of \$70 million as a result of a higher operating loss from Sikorsky, inclusive of the unfavorable impacts of intangible asset amortization and other adjustments required to account for the acquisition of this business; about \$30 million for ship and aviation systems programs due primarily to performance on various programs; and about \$25 million for other matters. Adjustments not related to volume, including net profit booking rate adjustments and reserves, were about \$155 million higher in 2016 compared to 2015.

#### *2015 compared to 2014*

RMS' net sales in 2015 increased \$359 million, or 4%, compared to 2014. The increase was attributable to net sales of approximately \$400 million from Sikorsky, net of adjustments required to account for the acquisition of this business in the fourth quarter of 2015; and approximately \$220 million for integrated warfare systems and sensors programs, primarily due to the ramp-up of recently awarded programs (Space Fence). These increases were partially offset by lower net sales of approximately \$150 million for undersea systems programs due to decreased volume as a result of in-theater force reductions (primarily Persistent Threat Detection System); and approximately \$105 million for ship and aviation systems programs primarily due to decreased volume (Merlin Capability Sustainment Program).

RMS' operating profit in 2015 decreased \$92 million, or 10%, compared to 2014. Operating profit decreased by approximately \$75 million due to performance matters on an international program; approximately \$45 million for Sikorsky due primarily to intangible amortization and adjustments required to account for the acquisition of this business in the fourth quarter of 2015; and approximately \$15 million for integrated warfare systems and sensors programs, primarily due to investments made in connection with a recently awarded next generation radar technology program, partially offset by higher risk retirements (including Halifax Class Modernization). These decreases were partially offset by approximately \$20 million in increased operating profit for training and logistics services programs, primarily due to reserves recorded on certain programs in 2014 that were not repeated in 2015. Adjustments not related to volume, including net profit booking rate adjustments and other matters, were approximately \$100 million lower in 2015 compared to 2014.

#### *Backlog*

Backlog decreased in 2016 compared to 2015 primarily due to sales being recognized on several multi-year programs (primarily in Sikorsky) related to prior year awards. Backlog increased in 2015 compared to 2014 primarily due to the addition of Sikorsky's backlog, as well as higher orders on new program starts (such as Australian Defence Force Pilot Training System).

#### *Trends*

We expect RMS' 2017 net sales to increase in the low-single digit percentage range compared to 2016. Operating profit is expected to increase in the low-double-digit percentage range due to a reduction in certain purchase accounting adjustments that were attributable to the Sikorsky acquisition, resulting in higher operating profit margins between years.

### **Space Systems**

Our Space Systems business segment is engaged in the research and development, design, engineering and production of satellites, strategic and defensive missile systems and space transportation systems. Space Systems provides network-enabled situational awareness and integrates complex space and ground-based global systems to help our customers gather, analyze, and securely distribute critical intelligence data. Space Systems is also responsible for various classified systems and services in support of vital national security systems. Space Systems' major programs include the Trident II D5 Fleet Ballistic Missile (FBM), Orion, Space Based Infrared System (SBIRS), AEHF, GPS-III, Geostationary Operational Environmental Satellite R-Series (GOES-R), and The Mobile User Objective System (MUOS). Operating profit for our Space Systems business

segment includes AWE and our share of earnings for our investment in ULA, which provides expendable launch services to the U.S. Government. Space Systems' operating results included the following (in millions):

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net sales	<b>\$ 9,409</b>	\$ 9,105	\$ 9,202
Operating profit	<b>1,289</b>	1,171	1,187
Operating margin	<b>13.7%</b>	12.9%	12.9%
Backlog at year-end	<b>\$18,900</b>	\$17,400	\$20,300

#### *2016 compared to 2015*

Space Systems' net sales in 2016 increased \$304 million, or 3%, compared to 2015. The increase was attributable to net sales of approximately \$410 million from AWE following the consolidation of this business in the third quarter of 2016; and approximately \$150 million for commercial space transportation programs due to increased launch-related activities; and approximately \$70 million of higher net sales for various programs (primarily Fleet Ballistic Missiles) due to increased volume. These increases were partially offset by a decrease in net sales of approximately \$340 million for government satellite programs due to decreased volume (primarily SBIRS and MUOS) and the wind-down or completion of mission solutions programs.

Space Systems' operating profit in 2016 increased \$118 million, or 10%, compared to 2015. The increase was primarily attributable to a non-cash, pre-tax gain of approximately \$127 million related to the consolidation of AWE; and approximately \$80 million of increased equity earnings from joint ventures (primarily ULA). These increases were partially offset by a decrease of approximately \$105 million for government satellite programs due to lower risk retirements (primarily SBIRS, MUOS and mission solutions programs) and decreased volume. Adjustments not related to volume, including net profit booking rate adjustments, were approximately \$185 million lower in 2016 compared to 2015.

#### *2015 compared to 2014*

Space Systems' net sales in 2015 decreased \$97 million, or 1%, compared to 2014. The decrease was attributable to approximately \$335 million lower net sales for government satellite programs due to decreased volume (primarily AEHF) and the wind-down or completion of mission solutions programs; and approximately \$55 million for strategic missile and defense systems due to lower volume. These decreases were partially offset by higher net sales of approximately \$235 million for businesses acquired in 2014; and approximately \$75 million for the Orion program due to increased volume.

Space Systems' operating profit in 2015 decreased \$16 million, or 1%, compared to 2014. Operating profit increased approximately \$85 million for government satellite programs due primarily to increased risk retirements. This increase was offset by lower operating profit of approximately \$65 million for commercial satellite programs due to performance matters on certain programs; and approximately \$35 million due to decreased equity earnings in joint ventures. Adjustments not related to volume, including net profit booking rate adjustments and other matters, were approximately \$105 million higher in 2015 compared to 2014.

#### *Equity earnings*

Total equity earnings recognized by Space Systems (primarily ULA) represented approximately \$325 million, \$245 million and \$280 million, or 25%, 21% and 24% of this business segment's operating profit during 2016, 2015 and 2014.

#### *Backlog*

Backlog increased in 2016 compared to 2015 primarily due to the addition of AWE's backlog. Backlog decreased in 2015 compared to 2014 primarily due to lower orders for government satellite programs and the Orion program and higher sales on the Orion program.

#### *Trends*

We expect Space Systems' 2017 net sales to decrease in the mid-single digit percentage range as compared to 2016, driven by program lifecycles on government satellite programs, partially offset by the recognition of AWE net sales for a full year in 2017 versus a partial year in 2016 following the consolidation of AWE in the third quarter of 2016. Operating profit

is expected to decline in the low- to mid-double digit percentage range, primarily driven by sales volume, the one-time AWE non-cash gain in 2016, amortization of the AWE intangible assets in 2017, and lower equity earnings in 2017 compared to 2016. As a result operating profit margin is expected to decline from 2016 levels.

### ***Liquidity and Cash Flows***

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

We have generated strong operating cash flows, which have been the primary source of funding for our operations, capital expenditures, debt service and repayments, dividends, share repurchases and postretirement benefit plan contributions. Our strong operating cash flows enabled our Board of Directors to approve two key cash deployment initiatives in September 2016. First, we increased our fourth quarter dividend rate by 10% to \$1.82 per share. Second, the Board of Directors approved a \$2.0 billion increase to our share repurchase program. Inclusive of this increase, the total remaining authorization for future common share repurchases under our program was \$3.5 billion as of December 31, 2016.

During 2016, we received a one-time, tax-free special cash payment of approximately \$1.8 billion as a result of the divestiture of the IS&GS business in the third quarter of 2016. We used the proceeds to repay \$500 million of long-term notes at their scheduled maturity and paid \$484 million in dividends with a portion of this cash. The remainder was used for share repurchases.

We have accessed the capital markets opportunistically as we did in February 2015 when we issued \$2.25 billion of long-term debt and as needed as we did in November 2015 when we issued \$7.0 billion of long-term debt in connection with our acquisition of Sikorsky. We also used a combination of short-term debt financing, commercial paper and available cash to fund the Sikorsky acquisition, as discussed below in “Capital Structure, Resources and Other” and “Note 10 – Debt” included in our Notes to Consolidated Financial Statements. We expect our cash from operations will continue to be sufficient to support our operations and anticipated capital expenditures for the foreseeable future. However, we expect to continue to issue commercial paper backed by our revolving credit facility to manage the timing of our cash flows. As described in the “Capital Structure, Resources and Other” section below, we have financing resources available to fund potential cash outflows that are less predictable or more discretionary, should they occur. We also have access to credit markets, if needed, for liquidity or general corporate purposes, including, but not limited to, our revolving credit facility or the ability to issue commercial paper, and letters of credit to support customer advance payments and for other trade finance purposes such as guaranteeing our performance on particular contracts.

Cash received from customers, either from the payment of invoices for work performed or for advances in excess of costs incurred, is our primary source of cash. We generally do not begin work on contracts until funding is appropriated by the customer. However, we may determine to fund customer programs ourselves pending government appropriations and are doing so with increased frequency. If we incur costs in excess of funds obligated on the contract, we may be at risk for reimbursement of the excess costs.

Billing timetables and payment terms on our contracts vary based on a number of factors, including the contract type. We generally bill and collect cash more frequently under cost-reimbursable and time-and-materials contracts, which together represent approximately half of the sales we recorded in 2016, as we are authorized to bill as the costs are incurred or work is performed. A number of our fixed-price contracts may provide for performance-based payments, which allow us to bill and collect cash as we perform on the contract. The amount of performance-based payments and the related milestones are encompassed in the negotiation of each contract. The timing of such payments may differ from our incurrence of costs related to our contract performance, thereby affecting our cash flows.

The U.S. Government has indicated that it would consider progress payments as the baseline for negotiating payment terms on fixed-price contracts, rather than performance-based payments. In contrast to negotiated performance-based payment terms, progress payment provisions correspond to a percentage of the amount of costs incurred during the performance of the contract. While the total amount of cash collected on a contract is the same, performance-based payments have had a more favorable impact on the timing of our cash flows. In addition, our cash flows may be affected if the U.S. Government decides to withhold payments on our billings. While the impact of withholding payments delays the receipt of cash, the cumulative amount of cash collected during the life of the contract will not vary.

The majority of our capital expenditures for 2016 and those planned for 2017 are for equipment, facilities infrastructure and information technology. Expenditures for equipment and facilities infrastructure are generally incurred to support new and existing programs across all of our business segments. For example, we have projects underway in our Aeronautics business segment for facilities and equipment to support higher production of the F-35 combat aircraft, and we have projects underway to modernize certain of our facilities. We also incur capital expenditures for information technology to support programs and general enterprise information technology infrastructure, inclusive of costs for the development or purchase of internal-use software.

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

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cash and cash equivalents at beginning of year	<b>\$ 1,090</b>	\$ 1,446	\$ 2,617
Operating activities			
Net earnings	<b>5,302</b>	3,605	3,614
Non-cash adjustments	<b>(35)</b>	821	876
Changes in working capital	<b>(1,042)</b>	(846)	(372)
Other, net	<b>964</b>	1,521	(252)
Net cash provided by operating activities	<b>5,189</b>	5,101	3,866
Net cash used for investing activities	<b>(985)</b>	(9,734)	(1,723)
Net cash provided by (used for) financing activities	<b>(3,457)</b>	4,277	(3,314)
Net change in cash and cash equivalents	<b>747</b>	(356)	(1,171)
Cash and cash equivalents at end of year	<b>\$ 1,837</b>	\$ 1,090	\$ 1,446

## Operating Activities

### *2016 compared to 2015*

Net cash provided by operating activities increased \$88 million in 2016 compared to 2015 primarily due to a reduction in cash paid for income taxes, partially offset by an increase in cash paid for interest expense and an increase in cash used for working capital. The \$196 million increase in cash flows used for working capital (defined as receivables and inventories less accounts payable and customer advances and amounts in excess of costs incurred) was attributable to timing of cash receipts for receivables (primarily F-35 program), partially offset by timing of production and billing cycles affecting customer advances and progress payments applied to inventories (primarily C-130 program). See “Critical Accounting Policies – Postretirement Benefit Plans” (under the caption “Funding Considerations”) for discussion of future postretirement benefit plan funding. We made net income tax payments of \$1.3 billion and \$1.8 billion during the years ended December 31, 2016 and 2015, respectively. We made interest payments of approximately \$600 million and approximately \$375 million during the years ended December 31, 2016 and 2015, respectively.

We may determine to fund customer programs ourselves pending government appropriations. If we incur costs in excess of funds obligated on a contract, we are at risk for reimbursement of the excess costs. In 2014 and 2015, we received customer authorization and initial funding to begin producing F-35 aircraft to be acquired under LRIP 9 and 10 contracts, respectively. As a result of recent funding by the U.S. Government, our potential cash exposure and termination liability were not material at December 31, 2016. However, it may become material if government appropriations are delayed as was the case in the second and third quarters of 2016.

### *2015 compared to 2014*

Net cash provided by operating activities increased \$1.2 billion in 2015 compared to 2014 primarily due to lower pension contributions, partially offset by decreases in working capital and higher tax payments. The \$1.8 billion increase in cash flows related to other, net in the table above is primarily because we made no contributions to our heritage qualified defined benefit pension trust in 2015 compared to \$2.0 billion in 2014. We made \$5.0 million in contributions to our new Sikorsky bargained qualified defined benefit pension plan in 2015. The increase in cash flows related to other, net was offset by higher federal and foreign income tax payments, net of refunds received, of approximately \$210 million in 2015 compared to 2014 due primarily to the absence of refunds received in 2015 (prior year’s tax refunds were attributable to timing of discretionary pension contributions made during the fourth quarter of the respective previous years). The \$474 million decrease in cash flows related to working capital (defined as receivables and inventories less accounts payable

and customer advances and amounts in excess of costs incurred) was attributable to an increase in receivables due to timing of customer collections (primarily F-35 contracts) as well as timing of production and billing cycles affecting customer advances and progress payments applied to inventories (primarily C-130 program).

## **Investing Activities**

Net cash used for investing activities decreased \$8.7 billion in 2016 compared to the prior year, primarily due to \$9.0 billion of cash used for acquisition activities in 2015 that did not recur in 2016. Net cash used for investing activities increased \$8.0 billion in 2015 compared to 2014, primarily due to cash used for acquisition activities. Acquisition activities include both the acquisition of businesses and investments in affiliates. We had no acquisitions in 2016. In 2015 we paid \$9.0 billion for the Sikorsky acquisition, net of cash acquired. In 2014, we paid \$898 million for acquisition activities, primarily related to the acquisitions of Zeta, Systems Made Simple, and Industrial Defender (see “Note 3 – Acquisitions and Divestitures” included in our Notes to Consolidated Financial Statements).

Capital expenditures amounted to \$1.1 billion in 2016, \$939 million in 2015 and \$845 million in 2014. The majority of our capital expenditures were for equipment and facilities infrastructure that generally are incurred to support new and existing programs across all of our business segments. We also incur capital expenditures for information technology to support programs and general enterprise information technology infrastructure, inclusive of costs for the development or purchase of internal-use-software.

Additionally, in 2015, we received cash proceeds of approximately \$165 million related to three properties sold in California.

## **Financing Activities**

Net cash used for financing activities increased \$7.7 billion in 2016 compared to 2015 primarily due to proceeds from the issuance of long-term debt in 2015 which did not recur in 2016, the repayments of long-term debt in 2016, and higher dividend payments, partially offset by the proceeds from the one-time special cash payment of \$1.8 billion from the divestiture of the IS&GS business and a reduction in cash used for repurchases of common stock.

Net cash provided by financing activities increased \$7.6 billion in 2015 compared to 2014 primarily due to proceeds from new debt issuances, partially offset by increased repurchases of common stock and higher dividends paid.

In May 2016, we repaid \$452 million of long-term notes with a fixed interest rate of 7.65% according to their scheduled maturities.

In September 2016, we repaid \$500 million of long-term notes with a fixed interest rate of 2.13% according to their scheduled maturities.

In February 2015, we received net proceeds of \$2.21 billion for the issuance of \$2.25 billion of fixed interest-rate long-term notes. In November 2015, we borrowed \$7.0 billion of fixed interest-rate long-term notes and received net proceeds of \$6.9 billion (the November 2015 Notes). These proceeds were used to repay \$6.0 billion of outstanding borrowings under a 364-day revolving credit facility that was used to finance a portion of the purchase price for the Sikorsky acquisition. Additionally, in the fourth quarter of 2015, to partially finance the Sikorsky acquisition we borrowed and repaid approximately \$1.0 billion under our commercial paper program. See the “Capital Structure, Resources and Other” discussion below and “Note 10 – Debt” included in our Notes to Consolidated Financial Statements for more information about our debt financing activities.

We paid dividends totaling \$2.0 billion (\$6.77 per share) in 2016, \$1.9 billion (\$6.15 per share) in 2015 and \$1.8 billion (\$5.49 per share) in 2014. We have increased our quarterly dividend rate in each of the last three years, including a 10% increase in the quarterly dividend rate in the fourth quarter of 2016. We declared quarterly dividends of \$1.65 per share during each of the first three quarters of 2016 and \$1.82 per share during the fourth quarter of 2016; \$1.50 per share during each of the first three quarters of 2015 and \$1.65 per share during the fourth quarter of 2015; and \$1.33 per share during each of the first three quarters of 2014 and \$1.50 per share during the fourth quarter of 2014.

We paid \$2.1 billion, \$3.1 billion and \$1.9 billion to repurchase 8.9 million, 15.2 million and 11.5 million shares of our common stock during 2016, 2015 and 2014.

Cash received from the issuance of our common stock in connection with employee stock option exercises during 2016, 2015 and 2014 totaled \$106 million, \$174 million and \$308 million. The exercises resulted in the issuance of 1.2 million, 2.2 million and 3.7 million shares of our common stock.

### ***Capital Structure, Resources and Other***

At December 31, 2016, we held cash and cash equivalents of \$1.8 billion. As of December 31, 2016, approximately \$400 million of our cash and cash equivalents was held outside of the U.S. by foreign subsidiaries. Although those balances are generally available to fund ordinary business operations without legal or other restrictions, a significant portion is not immediately available to fund U.S. operations unless repatriated. Our intention is to permanently reinvest earnings from our foreign subsidiaries. While we do not intend to do so, if this cash had been repatriated at the end of 2016, we estimate that about \$64 million of U.S. federal income tax would have been due after considering foreign tax credits.

Our outstanding debt, net of unamortized discounts and issuance costs, amounted to \$14.3 billion at December 31, 2016 and mainly is in the form of publicly-issued notes that bear interest at fixed rates. As of December 31, 2016, we were in compliance with all covenants contained in our debt and credit agreements.

We actively seek to finance our business in a manner that preserves financial flexibility while minimizing borrowing costs to the extent practicable. We review changes in financial market and economic conditions to manage the types, amounts and maturities of our indebtedness. We may at times refinance existing indebtedness, vary our mix of variable-rate and fixed-rate debt or seek alternative financing sources for our cash and operational needs.

On occasion, customers may seek financing for the purchase of our products. In connection with these transactions, we may enter into arrangements along with our customers with unrelated third – party financial institutions to facilitate the non-recourse sale of customer receivables. For accounting purposes, these transactions are treated as a sale of receivables and the sale proceeds from the banks are reflected in our operating cash flows on the consolidated statements of cash flows. During 2016, there was no significant activity related to sales of customer receivables.

### **Revolving Credit Facilities**

On October 9, 2015, we entered into a new \$2.5 billion revolving credit facility (the 5-year Facility) with various banks. The 5-year Facility, was amended in October 2016 to extend its expiration date by one year from October 9, 2020 to October 9, 2021. The 5-year Facility is available for general corporate purposes. The undrawn portion of the 5-year Facility is also available to serve as a backup facility for the issuance of commercial paper. We may request and the banks may grant, at their discretion, an increase to the credit facility up to an additional \$500 million. There were no borrowings outstanding under the 5-year Facility as of and for the year ended December 31, 2016.

Borrowings under the 5-year Facility are unsecured and bear interest at rates based, at our option, on a Eurodollar Rate or a Base Rate, as defined in the 5-year Facility's agreement. Each bank's obligation to make loans under the 5-year Facility is subject to, among other things, our compliance with various representations, warranties and covenants, including covenants limiting our ability and certain of our subsidiaries' ability to encumber assets and a covenant not to exceed a maximum leverage ratio, as defined in the 5-year Facility agreement.

### **Long-Term Debt**

See "Note 10 – Debt" included in our Notes to Consolidated Financial Statements for information about our long-term debt.

We have an effective shelf registration statement on Form S-3 on file with the U.S. Securities and Exchange Commission to provide for the issuance of an indeterminate amount of debt securities.

### **Commercial Paper**

We have agreements in place with financial institutions to provide for the issuance of commercial paper backed by our \$2.5 billion credit facility. During 2016, we borrowed and fully repaid amounts under our commercial paper programs. There were no commercial paper borrowings outstanding as of December 31, 2016. However, we expect to continue to issue commercial paper backed by our credit facility to manage the timing of our cash flows.



## Total Equity

Our total equity was \$1.6 billion at December 31, 2016, a decrease of \$1.5 billion from December 31, 2015. The decrease was primarily due to the 9.4 million common shares tendered and retired in connection with the divestiture of our IS&GS business for \$2.5 billion; the repurchase of 8.9 million common shares for \$2.1 billion; and dividends declared of \$2.0 billion during the year. These decreases were partially offset by net earnings of \$5.3 billion and employee stock activity of \$399 million (including the impacts of stock option exercises, ESOP activity and stock-based compensation).

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. 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 \$1.7 billion recorded as a reduction of retained earnings in 2016.

## Contractual Commitments and Off-Balance Sheet Arrangements

At December 31, 2016, we had contractual commitments to repay debt, make payments under operating leases, settle obligations related to agreements to purchase goods and services and settle tax and other liabilities. Capital lease obligations were not material. Payments due under these obligations and commitments are as follows (in millions):

	Payments Due By Period				
	Total	Less Than 1 Year	Years 2 and 3	Years 4 and 5	After 5 Years
Long-term debt <sup>(a)</sup>	\$15,228	\$ —	\$ 1,650	\$ 2,150	\$11,428
Interest payments	10,602	630	1,245	1,120	7,607
Other liabilities	2,923	268	531	417	1,707
Operating lease obligations	762	179	281	181	121
Purchase obligations:					
Operating activities	38,357	20,060	13,271	3,484	1,542
Capital expenditures	229	168	54	7	—
Total contractual cash obligations	\$68,101	\$21,305	\$17,032	\$ 7,359	\$22,405

<sup>(a)</sup> Long-term debt includes scheduled principal payments only and excludes approximately \$13 million of debt issued by a consolidated joint venture, for which the debt is not guaranteed by us.

Amounts related to other liabilities represent the contractual obligations for certain long-term liabilities recorded as of December 31, 2016. Such amounts mainly include expected payments under non-qualified pension plans, environmental liabilities and deferred compensation plans.

Purchase obligations related to operating activities include agreements and contracts that give the supplier recourse to us for cancellation or nonperformance under the contract or contain terms that would subject us to liquidated damages. Such agreements and contracts may, for example, be related to direct materials, obligations to subcontractors and outsourcing arrangements. Total purchase obligations for operating activities in the preceding table include approximately \$33 billion related to contractual commitments entered into as a result of contracts we have with our U.S. Government customers. The U.S. Government generally would be required to pay us for any costs we incur relative to these commitments if they were to terminate the related contracts “for convenience” under the Federal Acquisition Regulation (FAR), subject to available funding. This also would be true in cases where we perform subcontract work for a prime contractor under a U.S. Government contract. The termination for convenience language also may be included in contracts with foreign, state and local governments. We also have contracts with customers that do not include termination for convenience provisions, including contracts with commercial customers.

Purchase obligations in the preceding table for capital expenditures generally include facilities infrastructure, equipment and information technology.

We also may enter 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. These agreements are designed to enhance the social and economic environment of the foreign country by requiring the contractor to promote investment in the country. Offset agreements may be satisfied through activities that do not require us to use cash, including transferring technology, providing manufacturing 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 also may be satisfied through our use of cash for such activities as purchasing supplies from in-country vendors, providing financial support for in-country projects, establishment of ventures with local companies and building or leasing facilities for in-country operations. 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 customer and typically require cash outlays that represent only a fraction of the original amount in the offset agreement. Satisfaction of our offset obligations are included in the estimates of our total costs to complete the contract and may impact our sales, profitability and cash flows. Our ability to recover investments on our consolidated balance sheet that we make to satisfy offset obligations is generally dependent upon the successful operation of ventures that we do not control and may involve products and services that are dissimilar to our business activities. At December 31, 2016, the notional value of remaining obligations under our outstanding offset agreements totaled approximately \$15 billion, which primarily relate to our Aeronautics, MFC and RMS business segments, most of which extend through 2044. To the extent we have entered into purchase obligations at December 31, 2016 that also satisfy offset agreements, those amounts are included in the preceding table. Offset programs usually extend over several years and may provide for penalties, estimated at approximately \$1.7 billion at December 31, 2016, in the event we fail to perform in accordance with offset requirements. While historically we have not been required to pay material penalties, resolution of offset requirements are often the result of negotiations and subjective judgments.

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 December 31, 2016, 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.

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 December 31, 2016, and that it will not be necessary to make payments under the cross-indemnities or guarantees.

We have entered into standby letters of credit, surety bonds and third-party guarantees with financial institutions and other 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. At December 31, 2016, we had the following outstanding letters of credit, surety bonds and third-party guarantees (in millions):

	<b>Commitment Expiration By Period</b>				
	<b>Total Commitment</b>	<b>Less Than 1 Year</b>	<b>Years 2 and 3</b>	<b>Years 4 and 5</b>	<b>After 5 Years</b>
Standby letters of credit <sup>(a)</sup>	\$2,661	\$1,232	\$ 893	\$363	\$173
Surety bonds	368	366	—	2	—
Third-party Guarantees	709	14	276	20	399
<b>Total commitments</b>	<b>\$3,738</b>	<b>\$1,612</b>	<b>\$1,169</b>	<b>\$385</b>	<b>\$572</b>

<sup>(a)</sup> Approximately \$850 million of standby letters of credit in the "Less Than 1 Year" category, \$554 million in the "Years 2 and 3" category and \$295 million in the "Years 4 and 5" category are expected to renew for additional periods until completion of the contractual obligation.

At December 31, 2016, third-party guarantees totaled \$709 million, of which approximately 56% 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 partners. In addition, we generally have cross-indemnities in place that may enable us to recover amounts that may be paid on behalf of a venture partner. We believe our current and former venture partners will be able to perform their obligations, as they have done through December 31, 2016, and that it will not be necessary to make payments under the guarantees. In determining our exposures, we evaluate the reputation, technical capabilities and credit quality of our current and former venture partners.

## ***Critical Accounting Policies***

### **Contract Accounting / Sales Recognition**

Substantially all of our net sales are accounted for using the percentage-of-completion method, which requires that significant estimates and assumptions be made in accounting for the contracts. Our remaining net sales are derived from contracts to provide services to non-U.S. Government customers, which we account for under a services accounting model.

We evaluate new or significantly modified contracts with customers other than the U.S. Government, to the extent the contracts include multiple elements, to determine if the individual deliverables should be accounted for as separate units of accounting. When we determine that accounting for the deliverables as separate units is appropriate, we allocate the contract value to the deliverables based on their relative estimated selling prices. The contracts or contract modifications we evaluate for multiple elements typically are long-term in nature and include the provision of both products and services. Based on the nature of our business, we generally account for components of such contracts using the percentage-of-completion accounting model or the services accounting model, as appropriate.

We classify net sales as products or services on our consolidated statements of earnings based on the predominant attributes of the underlying contract. Most of our long-term contracts are denominated in U.S. dollars, including contracts for sales of military products and services to international governments contracted through the U.S. Government.

#### ***Contract Types***

Our contracts generally record sales for both products and services under cost-reimbursable, fixed-price and time-and-materials contracts.

##### ***Cost-reimbursable contracts***

Cost-reimbursable contracts, which accounted for about 38%, 42%, and 41% of our total net sales in 2016, 2015, and 2014, 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. We generate revenue under two general types of cost-reimbursable contracts: cost-plus-award-fee/incentive-fee contracts, which represent a substantial majority of our cost-reimbursable contracts; and cost-plus-fixed-fee contracts.

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 (incentive based on cost) or reimbursement of costs plus an incentive to exceed stated performance targets (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.

##### ***Fixed-price***

Under fixed-price contracts, which accounted for about 61%, 57%, and 58% of our total net sales in 2016, 2015, and 2014, 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.

##### ***Percentage-of-Completion Method***

We record net sales and an estimated profit on a percentage-of-completion basis for cost-reimbursable and fixed-price contracts for product and services contracts with the U.S. Government.

The percentage-of-completion method for product contracts depends on the nature of the products provided under the contract. For example, for contracts that require us to perform a significant level of development effort in comparison to the total value of the contract and/or to deliver minimal quantities, sales are recorded using the cost-to-cost method to measure progress toward completion. Under the cost-to-cost method, we recognize sales and an estimated profit as costs are incurred based on the proportion that the incurred costs bear to total estimated costs. For contracts that require us to provide a

substantial number of similar items without a significant level of development, we record sales and an estimated profit on a percentage-of-completion basis using units-of-delivery as the basis to measure progress toward completing the contract. For contracts to provide services to the U.S. Government, sales are generally recorded using the cost-to-cost method.

Award and incentive fees, as well as penalties related to contract performance, are considered in estimating sales and profit rates on contracts accounted for under the percentage-of-completion method. Estimates of award fees are based on past experience and anticipated performance. We record incentives or penalties when there is sufficient information to assess anticipated contract performance. Incentive provisions that increase or decrease earnings based solely on a single significant event are not recognized until the event occurs.

Accounting for contracts using the percentage-of-completion method requires judgment relative to assessing risks, estimating contract sales and costs (including estimating award and incentive fees and penalties related to performance) and making assumptions for schedule and technical issues. Due to the number of years it may take to complete many of our contracts and the scope and nature of the work required to be performed on those contracts, the estimation of total sales and costs at completion is complicated and subject to many variables and, accordingly, is subject to change. When adjustments in estimated total contract sales or estimated total costs are required, any changes from prior estimates are recognized in the current period for the inception-to-date effect of such changes.

Our estimates of costs at completion of the contract are based on assumptions we make for variables such as labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (to estimate increases in wages and prices for materials), performance by our subcontractors and the availability and timing of funding from our customer, among other variables. When estimates of total costs to be incurred on a contract exceed total estimates of sales to be earned, a provision for the entire loss on the contract is recorded in the period in which the loss is determined.

Many of our contracts span several years and include highly complex technical requirements. At the outset of a contract, we identify and monitor risks to the achievement of the technical, schedule and cost aspects of the contract and assess the effects of those risks on our estimates of total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events) and costs (e.g., material, labor, subcontractor, overhead and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and cost aspects of the contract which decreases the estimated total costs to complete the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate.

In addition, comparability of our segment sales, operating profit and operating margins may be impacted favorably or unfavorably by changes in profit booking rates on our contracts accounted for using the percentage-of-completion method of accounting. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs 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 complete 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 margins may also be impacted favorably or unfavorably by other items. Favorable items may include the positive resolution of contractual matters, cost recoveries on 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 as mentioned above which are excluded from segment operating results; reserves for disputes; asset impairments; and losses on sales of assets. Segment operating profit and items such as risk retirements, reductions of profit booking rates or other matters are presented net of state income taxes.

### ***Services Method***

Under a fixed-price service contract, we are paid a predetermined fixed amount for a specified scope of work and generally have full responsibility for the costs associated with the contract and the resulting profit or loss. We record net sales under fixed-price service contracts to non-U.S. Government customers on a straight-line basis over the period of contract performance, unless evidence suggests that net sales are earned or the obligations are fulfilled in a different pattern. For cost-reimbursable contracts for services to non-U.S. Government customers that provide for award and incentive fees, we

record net sales as services are performed, exclusive of award and incentive fees. Award and incentive fees are recorded when they are fixed or determinable, generally at the date the amount is communicated to us by the customer. This approach results in the recognition of such fees at contractual intervals (typically every six months) throughout the contract and is dependent on the customer's processes for notification of awards and issuance of formal notifications. Costs for all service contracts are expensed as incurred.

### ***Other Contract Accounting Considerations***

The majority of our sales are driven by pricing based on costs incurred to produce products or perform services under contracts with the U.S. Government. Cost-based pricing is determined under the FAR. The FAR provides guidance on the types of costs that are allowable in establishing prices for goods and services under U.S. Government contracts. For example, costs such as those related to charitable contributions, interest expense and certain advertising and public relations activities are unallowable and, therefore, not recoverable through sales. In addition, we may enter into advance agreements with the U.S. Government that address the subjects of allowability and allocability of costs to contracts for specific matters. For example, most of the environmental costs we incur for environmental remediation related to sites operated in prior years are allocated to our current operations as general and administrative costs under FAR provisions and supporting advance agreements reached with the U.S. Government.

We closely monitor compliance with and the consistent application of our critical accounting policies related to contract accounting. Costs incurred and allocated to contracts are reviewed for compliance with U.S. Government regulations by our personnel and are subject to audit by the Defense Contract Audit Agency.

### **Postretirement Benefit Plans**

#### ***Overview***

Many of our employees participate in qualified and nonqualified defined benefit pension plans, retiree medical and life insurance plans and other postemployment plans (collectively, postretirement benefit plans – see “Note 11 – Postretirement Plans” included in our Notes to Consolidated Financial Statements). The majority of our accrued benefit obligations relate to our qualified defined benefit pension plans and retiree medical and life insurance plans. We recognize on a plan-by-plan basis the net funded status of these postretirement benefit plans under GAAP as either an asset or a liability on our consolidated balance sheets. There is a corresponding non-cash adjustment to accumulated other comprehensive loss, net of tax benefits recorded as deferred tax assets, in stockholders' equity. The GAAP funded status represents the difference between the fair value of each plan's assets and the benefit obligation of the plan. The GAAP benefit obligation represents the present value of the estimated future benefits we currently expect to pay to plan participants based on past service.

In June 2014, we amended certain of our qualified and nonqualified defined benefit pension plans for non-union employees to freeze future retirement benefits. The freeze will take effect in two stages. Beginning on January 1, 2016, the pay-based component of the formula used to determine retirement benefits was frozen so that future pay increases, annual incentive bonuses or other amounts earned for or related to periods after December 31, 2015 will not be used to calculate retirement benefits. On January 1, 2020, the service-based component of the formula used to determine retirement benefits will also be frozen so that participants will no longer earn further credited service for any period after December 31, 2019. When the freeze is complete, the majority of our salaried employees will have transitioned to an enhanced defined contribution retirement savings plan.

Notwithstanding these actions, the impact of these plans and benefits on our earnings may be volatile in that the amount of expense we record and the funded status for our postretirement benefit plans may materially change from year to year because those calculations are sensitive to funding levels as well as changes in several key economic assumptions, including interest rates, actual rates of return on plan assets and other actuarial assumptions including participant longevity and employee turnover, as well as the timing of cash funding.

#### ***Actuarial Assumptions***

The plan assets and benefit obligations are measured at the end of each year or more frequently, upon the occurrence of certain events such as a significant plan amendment, settlement or curtailment. The amounts we record are measured using actuarial valuations, which are dependent upon key assumptions such as discount rates, the expected long-term rate of return on plan assets, participant longevity, employee turnover and the health care cost trend rates for our retiree medical plans. The assumptions we make affect both the calculation of the benefit obligations as of the measurement date and the calculation of

net periodic benefit cost in subsequent periods. When reassessing these assumptions we consider past and current market conditions and make judgments about future market trends. We also consider factors such as the timing and amounts of expected contributions to the plans and benefit payments to plan participants.

We continue to use a single weighted average discount rate approach when calculating our benefit obligations related to our defined benefit pension plans resulting in 4.125% at December 31, 2016, compared to 4.375% at December 31, 2015 and 4.00% at December 31, 2014. We utilized a weighted average discount rate of 4.00% when calculating our benefit obligations related to our retiree medical plans at December 31, 2016, compared to 4.25% at December 31, 2015 and 3.75% at December 31, 2014. We evaluate several data points in order to arrive at an appropriate weighted average discount rate, including results from cash flow models, quoted rates from long-term bond indices and changes in long-term bond rates over the past year. As part of our evaluation, we calculate the approximate average yields on corporate bonds rated AA or better selected to match our projected postretirement benefit plan cash flows.

We utilized an expected long-term rate of return on plan assets of 7.50% at December 31, 2016, as compared to 8.00% at December 31, 2015 and December 31, 2014. We reduced our expected long-term rate of return assumption due to downward pressure on the equity and fixed income asset classes in our trust. An increasingly aging population and debt burden place downward pressure on already low interest rates and economic growth; suggesting the future return for our fixed-income may be lower than historical norms. Surges in equities since 2009 have led to a high valuation of the equity markets, suggesting the forward return may also be lower than historical norms. The long-term rate of return assumption represents the expected long-term rate of return on the funds invested or to be invested, to provide for the benefits included in the benefit obligations. This assumption is based on several factors including historical market index returns, the anticipated long-term allocation of plan assets, the historical return data for the trust funds, plan expenses and the potential to outperform market index returns. The difference between the long-term rate of return on plan assets assumption we select and the actual return on plan assets in any given year affects both the funded status of our benefit plans and the calculation of FAS pension expense in subsequent periods. Although the actual return in any specific year likely will differ from the assumption, the average expected return over a long-term future horizon should be approximately equal to the assumption. Any variance in a given year should not, by itself, suggest that the assumption should be changed. Patterns of variances are reviewed over time, and then combined with expectations for the future. As a result, changes in this assumption are less frequent than changes in the discount rate.

On October 20, 2016, the Society of Actuaries published revised longevity assumptions that refined its prior studies of longevity. We used the revised assumptions indicating a shortened longevity in our December 31, 2016 remeasurement of benefit obligation. The publication was a refinement to the assumptions the Society of Actuaries published in October 2014 and October 2015 that we previously adopted beginning year 2014.

Our stockholders' equity has been reduced cumulatively by \$12.0 billion from the annual year-end measurements of the funded status of postretirement benefit plans. The cumulative non-cash, after-tax reduction primarily represents net actuarial losses resulting from declines in discount rates, investment losses and updated longevity. A market-related value of our plan assets, determined using actual asset gains or losses over the prior three year period, is used to calculate the amount of deferred asset gains or losses to be amortized. These cumulative actuarial losses will be amortized to expense using the corridor method, where gains and losses are recognized to the extent they exceed 10% of the greater of plan assets or benefit obligations, over the average future service period of employees expected to receive benefits under the plans of approximately nine years as of December 31, 2016. This amortization period is expected to extend (approximately double) in 2020 when our non-union pension plan is completely frozen to use the average remaining life expectancy of the participants instead of average future service. During 2016, \$699 million of these amounts was recognized as a component of postretirement benefit plans expense and about \$800 million is expected to be recognized as expense in 2017.

The discount rate and long-term rate of return on plan assets assumptions we select at the end of each year are based on our best estimates and judgment. A change of plus or minus 25 basis points in the 4.125% discount rate assumption at December 31, 2016, with all other assumptions held constant, would have decreased or increased the amount of the qualified pension benefit obligation we recorded at the end of 2016 by approximately \$1.5 billion, which would result in an after-tax increase or decrease in stockholders' equity at the end of the year of approximately \$1.0 billion. If the 4.125% discount rate at December 31, 2016 that was used to compute the expected 2017 FAS pension expense for our qualified defined benefit pension plans had been 25 basis points higher or lower, with all other assumptions held constant, the amount of FAS pension expense projected for 2017 would be lower or higher by approximately \$120 million. If the 7.50% expected long-term rate of return on plan assets assumption at December 31, 2016 that was used to compute the expected 2017 FAS pension expense for our qualified defined benefit pension plans had been 25 basis points higher or lower, with all other assumptions held constant, the amount of FAS pension expense projected for 2017 would be lower or higher by approximately \$80 million.

Each year, differences between the actual plan asset return and the expected long-term rate of return on plan assets impacts the measurement of the following year's FAS expense. Every 100 basis points difference in return during 2016 between our actual return of 5.0% and our expected long-term rate of return of 8.0% impacted 2017 FAS pension expense by approximately \$20 million.

### ***Funding Considerations***

There were no contributions to our heritage qualified defined benefit pension plans in 2016 and 2015. We made contributions related to our heritage qualified defined benefit pension plans of \$2.0 billion in 2014 inclusive of amounts in excess of our required contributions. Funding of our qualified defined benefit pension plans is determined in a manner consistent with CAS and in accordance with the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act of 2006 (PPA). Our goal has been to fund the pension plans to a level of at least 80%, as determined under the PPA. The ERISA funded status is calculated on a different basis than under GAAP. As a result of the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21), which included a provision that changed the methodology for calculating the interest rate assumption used in determining the minimum funding requirements under the PPA, there was an increase in the interest rate assumption, which in turn lowered the minimum funding requirements. On August 8, 2014, the Highway and Transportation Funding Act of 2014 (HATFA) was enacted; and on November 2, 2015, the Bipartisan Budget Act of 2015; which extend the methodology put in place by MAP-21 to calculate the interest rate assumption so that the impact will begin to decrease in 2021 and phase out by 2024. This has the effect of lowering our minimum funding requirements during the affected periods from what they otherwise would have been. The ERISA funded status of our qualified defined benefit pension plans was about 87% and 90% as of December 31, 2016 and 2015. The GAAP funded status of our qualified defined benefit pension plans was about 70% and 73% at December 31, 2016 and 2015.

Contributions to our defined benefit pension plans are recovered over time through the pricing of our products and services on U.S. Government contracts, including FMS, and are recognized in our cost of sales and net sales. CAS govern the extent to which our pension costs are allocable to and recoverable under contracts with the U.S. Government, including FMS. We recovered \$2.0 billion in 2016, \$1.6 billion in 2015, and \$1.5 billion in 2014 as CAS pension costs. Effective February 27, 2012, CAS rules were revised to better align the recovery of pension costs, including prepayment credits, on U.S. Government contracts with the minimum funding requirements of the PPA (referred to as CAS Harmonization). Specifically, CAS Harmonization shortened the amortization period for allocating gains and losses to U.S. Government contracts from 15 to 10 years and requires the use of an interest rate to determine CAS pension cost consistent with the interest rate used to determine minimum pension funding requirements under the PPA. While the change in the amortization period was applicable beginning in 2013, there is a transition period for the impact of the change in the CAS liability measurement due to the revised interest rate that will be phased in with the full impact occurring in 2017. We expect the incremental impact of CAS Harmonization will increase successively through 2017, primarily due to the liability measurement transition period included in the amended rule. The enactment of the HATFA and Bipartisan Budget Act of 2015 also increased the interest rate assumption used to determine our CAS pension costs, which has the effect of lowering the recovery of pension contributions during the affected periods as it decreases our CAS pension costs.

Pension cost recoveries under CAS occur in different periods from when pension contributions are made under the PPA. Amounts contributed in excess of the CAS pension costs recovered under U.S. Government contracts are considered to be prepayment credits under the CAS rules. As of December 31, 2016, our prepayment credits were approximately \$7.7 billion as compared to \$9.0 billion at December 31, 2015. The recovery of CAS pension costs under U.S. Government contracts in excess of our contributions reduces the prepayment credit balance. The prepayment credit balance will also increase or decrease based on our actual investment return on plan assets.

### ***Trends***

We do not plan to make contributions to our heritage pension plans in 2017 because none are required using current assumptions, including investment returns on plan assets. However, we do plan to make contributions of approximately \$45 million in 2017 to our new Sikorsky bargained qualified defined benefit pension plan. Pension contributions to our heritage plans are expected to resume with contributions projected of about \$1.5 billion to \$2.0 billion in 2018 using current assumptions including investment returns on plan assets. We anticipate recovering almost \$2.3 billion of CAS pension cost in 2017 with a higher CAS recovery projected in 2018. Since the annual amount of CAS cost is more than our planned cash funding in each of these years, we will recover a portion of the \$7.7 billion of prepayment credits existing at December 31, 2016.

We expect our 2017 FAS pension expense to be \$1.4 billion, as compared to our 2016 FAS pension expense of \$1.0 billion, primarily due to the lower discount rate of 4.125% for 2017 versus 4.375% for 2016 and lower expected long-

term rate of return on plan assets of 7.50% at December 31, 2016 versus 8.00% at December 31, 2015. We expect a FAS/CAS pension adjustment in 2017 of about \$880 million, as compared to \$902 million in 2016. The increase in 2017 FAS pension expense is mostly offset by higher 2017 CAS pension costs, as compared to 2016, due to CAS Harmonization.

## **Environmental Matters**

We are a party to various agreements, proceedings and potential proceedings for environmental cleanup issues, including matters at various sites where we have been designated a potentially responsible party (PRP). At each of December 31, 2016 and 2015, the total amount of liabilities recorded on our consolidated balance sheet for environmental matters was \$1.0 billion. We have recorded receivables totaling \$870 million and \$858 million at December 31, 2016 and 2015 for the portion of environmental costs that are probable of future recovery in pricing of our products and services for agencies of the U.S. Government, as discussed below. The amount that is expected to be allocated to our non-U.S. Government contracts or that is determined to not be recoverable under U.S. Government contracts has been expensed through cost of sales. We project costs and recovery of costs over approximately 20 years.

We enter into agreements (e.g., administrative orders, consent decrees) that document the extent and timing of our environmental remediation obligation. We also are involved in environmental remediation activities at sites where formal agreements either do not exist or do not quantify the extent and timing of our obligation. Environmental cleanup activities usually span many years, which makes estimating the costs more judgmental due to, for example, changing remediation technologies. To determine the costs related to cleanup sites, we have to assess the extent of contamination, effects on natural resources, the appropriate technology to be used to accomplish the remediation and evolving governmental environmental standards.

We perform quarterly reviews of environmental remediation sites and record liabilities and receivables in the period it becomes probable that a liability has been incurred and the amounts can be reasonably estimated (see the discussion under “Environmental Matters” in “Note 1 – Significant Accounting Policies” and “Note 14 – Legal Proceedings, Commitments and Contingencies” included in our Notes to Consolidated Financial Statements). We consider the above factors in our quarterly estimates of the timing and amount of any future costs that may be required for remediation activities, which results in the calculation of a range of estimates for a particular environmental 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. Given the required level of judgment and estimation, it is likely that materially different amounts could be recorded if different assumptions were used or if circumstances were to change (e.g., a change in environmental standards or a change in our estimate of the extent of contamination).

The current standard in California for the maximum level of the contaminant hexavalent chromium in drinking water is 10 parts per billion (ppb). This standard is being challenged by the California Manufacturers and Technology Association (CMTA) as being lower than is required to protect public health. If the standard remains at 10 ppb, it will not have a material impact on our existing remediation costs in California. The U.S. EPA is considering whether to regulate hexavalent chromium.

In addition, California is reevaluating its existing drinking water standard of 6 ppb for perchlorate, and the U.S. Environmental Protection Agency (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 to not 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.

Under agreements reached with the U.S. Government, most of the amounts we spend for environmental remediation are allocated to our operations as general and administrative costs. Under existing government regulations, these and other environmental expenditures relating to our U.S. Government business, after deducting any recoveries received from insurance or other PRPs, are allowable in establishing prices of our products and services. As a result, most of the expenditures we incur are included in our net sales and cost of sales according to U.S. Government agreement or regulation, 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 recent efforts by some U.S. Government representatives to limit such reimbursement.

As disclosed above, we may record changes in the amount of environmental remediation liabilities as a result of our quarterly reviews of the status of our environmental remediation sites, which would result in a change to the corresponding



environmental receivable and a charge to earnings. For example, if we were to determine that the liabilities should be increased by \$100 million, the corresponding receivables would be increased by approximately \$87 million, with the remainder recorded as a charge to earnings. This allocation is determined annually, based upon our existing and projected business activities with the U.S. Government.

We cannot reasonably determine the extent of our financial exposure at all environmental sites with which we are involved. There are a number of former operating facilities we are monitoring or investigating for potential future remediation. In some cases, although a loss may be probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation activities because of uncertainties (e.g., assessing the extent of the contamination). During any particular quarter, such uncertainties may be resolved, allowing us to estimate and recognize the initial liability to remediate a particular former operating site. The amount of the liability could be material. Upon recognition of the liability, a portion will be recognized as a receivable with the remainder charged to earnings, which may have a material effect in any particular interim reporting period.

If we are ultimately found to have liability at those sites where we have been designated a PRP, we expect that the actual costs of remediation will be shared with other liable PRPs. Generally, PRPs that are ultimately determined to be responsible parties are strictly liable for site cleanup and usually agree among themselves to share, on an allocated basis, the costs and expenses for investigation and remediation. Under existing environmental laws, responsible parties are jointly and severally liable and, therefore, we are potentially liable for the full cost of funding such remediation. In the unlikely event that we were required to fund the entire cost of such remediation, the statutory framework provides that we may pursue rights of cost recovery or contribution from the other PRPs. The amounts we record do not reflect the fact that we may recover some of the environmental costs we have incurred through insurance or from other PRPs, which we are required to pursue by agreement and U.S. Government regulation.

## **Goodwill**

The assets and liabilities of acquired businesses are recorded under the acquisition method of accounting at their estimated fair values at the date of acquisition. Goodwill represents costs in excess of fair values assigned to the underlying identifiable net assets of acquired businesses.

Our goodwill balance was \$10.8 billion and \$10.7 billion at December 31, 2016 and 2015. We perform an impairment test of our goodwill at least annually in the fourth quarter or more frequently whenever events or changes in circumstances indicate the carrying value of goodwill may be impaired. Such events or changes in circumstances may include a significant deterioration in overall economic conditions, changes in the business climate of our industry, a decline in our market capitalization, operating performance indicators, competition, reorganizations of our business, U.S. Government budget restrictions or the disposal of all or a portion of a reporting unit. Our goodwill has been allocated to and is tested for impairment at a level referred to as the reporting unit, which is our business segment level or a level below the business segment. The level at which we test goodwill for impairment requires us to determine whether the operations below the business segment constitute a self-sustaining business for which discrete financial information is available and segment management regularly reviews the operating results.

We may use both qualitative and quantitative approaches when testing goodwill for impairment. For selected reporting units where we use the qualitative approach, we perform a qualitative evaluation of events and circumstances impacting the reporting unit to determine the likelihood of goodwill impairment. Based on that qualitative evaluation, if we determine it is more likely than not that the fair value of a reporting unit exceeds its carrying amount, no further evaluation is necessary. Otherwise we perform a quantitative two-step impairment test. We perform quantitative tests for most reporting units at least once every three years. However, for certain reporting units we may perform a quantitative impairment test every year.

Under step one of the quantitative two step impairment test, we compare the fair value of a reporting unit to its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is not impaired. If the carrying value of a reporting unit exceeds its fair value, we then perform step two of the quantitative impairment test and compare the implied value of the reporting unit's goodwill with the carrying value of its goodwill. The implied value of the reporting unit's goodwill is calculated by creating a hypothetical balance sheet as if the reporting unit had just been acquired. This balance sheet contains all assets and liabilities recorded at fair value (including any assumed intangible assets that may not have any corresponding carrying value in our balance sheet). The implied value of the reporting unit's goodwill is calculated by subtracting the fair value of the net assets from the fair value of the reporting unit. If the carrying value of the reporting unit's goodwill exceeds the implied value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

We estimate the fair value of each reporting unit using a combination of a discounted cash flow (DCF) analysis and market-based valuation methodologies such as comparable public company trading values and values observed in recent business acquisitions. Determining fair value requires the exercise of significant judgments, including the amount and timing of expected future cash flows, long-term growth rates, discount rates and relevant comparable public company earnings multiples and relevant transaction multiples. The cash flows employed in the DCF analyses are based on our best estimate of future sales, earnings and cash flows after considering factors such as general market conditions, U.S. Government budgets, existing firm orders, expected future orders, contracts with suppliers, labor agreements, changes in working capital, long term business plans and recent operating performance. The discount rates utilized in the DCF analysis are based on the respective reporting unit's weighted average cost of capital, which takes into account the relative weights of each component of capital structure (equity and debt) and represents the expected cost of new capital, adjusted as appropriate to consider the risk inherent in future cash flows of the respective reporting unit. The carrying value of each reporting unit includes the assets and liabilities employed in its operations, goodwill and allocations of amounts held at the business segment and corporate levels.

In the fourth quarter of 2016, we performed our annual goodwill impairment test for each of our reporting units. The results of our 2016 annual impairment tests of goodwill indicated that no impairment existed. The carrying value of our Sikorsky reporting unit includes goodwill of \$2.7 billion as of December 31, 2016. Currently, we estimate that the fair value of our Sikorsky reporting unit exceeds its carrying value by a margin of approximately 10%. We acquired Sikorsky in November 2015 and recorded the assets acquired and liabilities assumed at fair value. Due to the recent acquisition and valuation, the carrying value and fair value of our Sikorsky reporting unit are currently closely aligned. Therefore, any business deterioration, contract cancellations or terminations, or market pressures could cause our sales, earnings and cash flows to decline below current projections. Similarly, market factors utilized in the impairment analysis, including long-term growth rates, discount rates and relevant comparable public company earnings multiples and transaction multiples, could negatively impact the fair value of our reporting units. Based on our current assessment of these circumstances, we have determined that our Sikorsky reporting unit is at risk of a future goodwill impairment should there be deterioration of projected cash flows, negative changes in market factors or a significant increase in the carrying value of the reporting unit.

In the fourth quarter of 2015, we performed our annual goodwill impairment test for each of our reporting units. In connection with our fourth quarter 2015 program realignment, goodwill was reallocated between affected reporting units on a relative fair value basis. We performed goodwill impairment tests prior and subsequent to the realignment. The results of our 2015 annual impairment tests of goodwill indicated that no impairment existed.

Impairment assessments inherently involve management judgments regarding a number of assumptions such as those described above. Due to the many variables inherent in the estimation of a reporting unit's fair value and the relative size of our recorded goodwill, differences in assumptions could have a material effect on the estimated fair value of one or more of our reporting units and could result in a goodwill impairment charge in a future period.

## **Intangible Assets**

Intangible assets from acquired businesses are recognized at their estimated fair values at the date of acquisition and consist of customer programs, trademarks, customer relationships, technology and other intangible assets. Customer programs include values assigned to major programs of acquired businesses and represent the aggregate value associated with the customer relationships, contracts, technology and trademarks underlying the associated program and are amortized on a straight-line basis over a period of expected cash flows used to measure the fair value, which ranges from nine to 20 years. Acquired intangibles deemed to have indefinite lives are not amortized, but are subject to annual impairment testing. This testing compares carrying value to fair value and, when appropriate, the carrying value of these assets is reduced to fair value. Finite-lived intangibles are amortized to expense over the applicable useful lives, ranging from three to 20 years, based on the nature of the asset and the underlying pattern of economic benefit as reflected by future net cash inflows.

In the fourth quarter of 2016, we performed the annual impairment test for the Sikorsky indefinite-lived trademark intangible asset and the results indicated that no impairment existed. The carrying value of our Sikorsky reporting unit includes a trademark intangible asset of \$887 million as of December 31, 2016. Using the relief from royalty method, we estimated that the fair value of this intangible asset approximated its carrying value. As discussed above in the Goodwill section, the carrying value and fair value of our Sikorsky reporting unit are currently closely aligned due to the recent acquisition of Sikorsky. Therefore, any business deterioration, contract cancellations or terminations, or market pressures could cause our sales to decline below current projections. Based on our current assessment of these circumstances, we have determined that our Sikorsky trademark intangible asset is at risk of a future impairment.

## Recent Accounting Pronouncements

See “Note 1 – Significant Accounting Policies” included in our Notes to Consolidated Financial Statements for information under the caption “Recent Accounting Pronouncements” related to new accounting standards.

## ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk.

We maintain active relationships with a broad and diverse group of U.S. and international financial institutions. We believe that they provide us with sufficient access to the general and trade credit we require to conduct our business. We continue to closely monitor the financial market environment and actively manage counterparty exposure to minimize the potential impact from adverse developments with any single credit provider while ensuring availability of, and access to, sufficient credit resources.

Our main exposure to market risk relates to interest rates, foreign currency exchange rates and market prices on certain equity securities. Our financial instruments that are subject to interest rate risk principally include fixed-rate long-term debt. The estimated fair value of our outstanding debt was \$16.2 billion at December 31, 2016 and the outstanding principal amount was \$15.3 billion, excluding unamortized discounts and issuance costs of \$1.0 billion. A 10% change in the level of interest rates would not have a material impact on the fair value of our outstanding debt at December 31, 2016.

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. Our most significant foreign currency exposures relate to the British Pound Sterling, the Euro, the Canadian dollar and the Australian dollar. 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 indexed to LIBOR 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 classification of gains and losses resulting from changes in the fair values of derivatives is dependent on our intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives attributable to the effective portion of hedges are either reflected in earnings and largely offset by corresponding adjustments to the hedged items or reflected net of income taxes in accumulated other comprehensive loss until the hedged transaction is recognized in earnings. Changes in the fair value of the derivatives that are attributable to the ineffective portion of the hedges, or of derivatives that are not considered to be highly effective hedges, if any, are immediately recognized in earnings. The aggregate notional amount of our outstanding interest rate swaps at December 31, 2016 and 2015 was \$1.2 billion and \$1.5 billion. The aggregate notional amount of our outstanding foreign currency hedges at December 31, 2016 and 2015 was \$4.0 billion and \$4.1 billion. At December 31, 2016 and 2015, the net fair value of our derivative instruments was not material (see “Note 16 – Fair Value Measurements”) included in our Notes to Consolidated Financial Statements). A 10% appreciation or devaluation of the hedged currency as compared to the level of foreign exchange rates for currencies under contract at December 31, 2016 would not have a material impact on the aggregate net fair value of such contracts or our consolidated financial statements.

We evaluate the credit quality of potential counterparties to derivative transactions and only enter into agreements with those deemed to have acceptable credit risk at the time the agreements are executed. Our foreign currency exchange hedge portfolio is diversified across several banks. We periodically monitor changes to counterparty credit quality as well as our concentration of credit exposure to individual counterparties. We do not hold or issue derivative financial instruments for trading or speculative purposes.

We maintain a separate trust that includes investments to fund certain of our non-qualified deferred compensation plans. As of December 31, 2016, investments in the trust totaled \$1.2 billion and are reflected at fair value on our consolidated balance sheet in other noncurrent assets. The trust holds investments in marketable equity securities and fixed-income securities that are exposed to price changes and changes in interest rates. A portion of the liabilities associated with the deferred compensation plans supported by the trust is also impacted by changes in the market price of our common stock and certain market indices. Changes in the value of the liabilities have the effect of partially offsetting the impact of changes in the value of the trust. Both the change in the fair value of the trust and the change in the value of the liabilities are recognized on our consolidated statements of earnings in other unallocated, net and were not material for the year ended December 31, 2016.

**ITEM 8. Financial Statements and Supplementary Data.**

*Report of Ernst & Young LLP,  
Independent Registered Public Accounting Firm,  
on the Audited Consolidated Financial Statements*

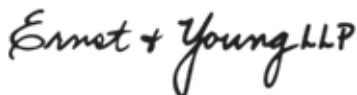
Board of Directors and Stockholders  
Lockheed Martin Corporation

We have audited the accompanying consolidated balance sheets of Lockheed Martin Corporation as of December 31, 2016 and 2015, and the related consolidated statements of earnings, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lockheed Martin Corporation at December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Lockheed Martin Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), and our report dated February 9, 2017 expressed an adverse opinion thereon.



McLean, Virginia  
February 9, 2017

**Lockheed Martin Corporation**  
**Consolidated Statements of Earnings**  
(in millions, except per share data)

	Years Ended December 31,		
	2016	2015	2014
<b>Net sales</b>			
Products	\$ 40,365	\$ 34,868	\$ 34,984
Services	6,883	5,668	4,962
Total net sales	47,248	40,536	39,946
<b>Cost of sales</b>			
Products	(36,616)	(31,091)	(30,983)
Services	(6,040)	(4,824)	(4,184)
Severance charges	(80)	(82)	—
Other unallocated, net	550	(47)	(96)
Total cost of sales	(42,186)	(36,044)	(35,263)
Gross profit	5,062	4,492	4,683
Other income, net	487	220	329
<b>Operating profit</b>	5,549	4,712	5,012
Interest expense	(663)	(443)	(340)
Other non-operating income, net	—	30	5
Earnings from continuing operations before income taxes	4,886	4,299	4,677
Income tax expense	(1,133)	(1,173)	(1,424)
Net earnings from continuing operations	3,753	3,126	3,253
Net earnings from discontinued operations	1,549	479	361
<b>Net earnings</b>	\$ 5,302	\$ 3,605	\$ 3,614
<b>Earnings per common share</b>			
Basic			
Continuing operations	\$ 12.54	\$ 10.07	\$ 10.27
Discontinued operations	5.17	1.55	1.14
Basic earnings per common share	\$ 17.71	\$ 11.62	\$ 11.41
Diluted			
Continuing operations	\$ 12.38	\$ 9.93	\$ 10.09
Discontinued operations	5.11	1.53	1.12
Diluted earnings per common share	\$ 17.49	\$ 11.46	\$ 11.21

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

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

	<b>Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net earnings	<b>\$ 5,302</b>	\$ 3,605	\$ 3,614
Other comprehensive (loss) income, net of tax			
Postretirement benefit plans			
Net other comprehensive loss recognized during the period, net of tax benefit of \$668 million in 2016, \$192 million in 2015 and \$1.5 billion in 2014	<b>(1,232)</b>	(351)	(2,870)
Amounts reclassified from accumulated other comprehensive loss, net of tax expense of \$382 million in 2016, \$464 million in 2015 and \$386 million in 2014	<b>699</b>	850	706
Reclassifications from divestiture of IS&GS business	<b>(134)</b>	—	—
Other, net	<b>9</b>	(73)	(105)
Other comprehensive (loss) income, net of tax	<b>(658)</b>	426	(2,269)
<b>Comprehensive income</b>	<b>\$ 4,644</b>	\$ 4,031	\$ 1,345

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

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

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 1,837	\$ 1,090
Receivables, net	8,202	7,254
Inventories, net	4,670	4,819
Other current assets	399	441
Assets of discontinued operations	—	969
Total current assets	15,108	14,573
Property, plant and equipment, net	5,549	5,389
Goodwill	10,764	10,695
Intangible assets, net	4,093	4,022
Deferred income taxes	6,625	6,068
Other noncurrent assets	5,667	5,396
Assets of discontinued operations	—	3,161
Total assets	\$ 47,806	\$ 49,304
<b>Liabilities and equity</b>		
Current liabilities		
Accounts payable	\$ 1,653	\$ 1,745
Customer advances and amounts in excess of costs incurred	6,776	6,703
Salaries, benefits and payroll taxes	1,764	1,707
Current maturities of long-term debt	—	956
Other current liabilities	2,349	1,859
Liabilities of discontinued operations	—	948
Total current liabilities	12,542	13,918
Long-term debt, net	14,282	14,305
Accrued pension liabilities	13,855	11,807
Other postretirement benefit liabilities	862	1,070
Other noncurrent liabilities	4,659	4,902
Liabilities of discontinued operations	—	205
Total liabilities	46,200	46,207
Stockholders' equity		
Common stock, \$1 par value per share	289	303
Additional paid-in capital	—	—
Retained earnings	13,324	14,238
Accumulated other comprehensive loss	(12,102)	(11,444)
Total stockholders' equity	1,511	3,097
Noncontrolling interests in subsidiary	95	—
Total equity	1,606	3,097
Total liabilities and equity	\$ 47,806	\$ 49,304

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



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

Years Ended December 31,

2016                      2015                      2014

	2016	2015	2014
<b>Operating activities</b>			
Net earnings	\$ 5,302	\$ 3,605	\$ 3,614
Adjustments to reconcile net earnings to net cash provided by operating activities			
Depreciation and amortization	1,215	1,026	994
Stock-based compensation	149	138	164
Deferred income taxes	(152)	(445)	(401)
Goodwill impairment charges	—	—	119
Severance charges	99	102	—
Gain on divestiture of IS&GS business	(1,242)	—	—
Gain on step acquisition of AWE	(104)	—	—
Changes in assets and liabilities			
Receivables, net	(811)	(256)	28
Inventories, net	(46)	(398)	77
Accounts payable	(188)	(160)	95
Customer advances and amounts in excess of costs incurred	3	(32)	(572)
Postretirement benefit plans	1,028	1,068	(880)
Income taxes	146	(48)	351
Other, net	(210)	501	277
Net cash provided by operating activities	<b>5,189</b>	5,101	3,866
<b>Investing activities</b>			
Capital expenditures	(1,063)	(939)	(845)
Acquisitions of businesses and investments in affiliates	—	(9,003)	(898)
Other, net	78	208	20
Net cash used for investing activities	<b>(985)</b>	(9,734)	(1,723)
<b>Financing activities</b>			
Special cash payment from divestiture of IS&GS business	1,800	—	—
Repurchases of common stock	(2,096)	(3,071)	(1,900)
Proceeds from stock option exercises	106	174	308
Dividends paid	(2,048)	(1,932)	(1,760)
Proceeds from the issuance of long-term debt	—	9,101	—
Repayments of long-term debt	(952)	—	—
Proceeds from borrowings under revolving credit facilities	—	6,000	—
Repayments of borrowings under revolving credit facilities	—	(6,000)	—
Other, net	(267)	5	38
Net cash (used for) provided by financing activities	<b>(3,457)</b>	4,277	(3,314)
Net change in cash and cash equivalents	747	(356)	(1,171)
Cash and cash equivalents at beginning of year	1,090	1,446	2,617
Cash and cash equivalents at end of year	<b>\$ 1,837</b>	\$ 1,090	\$ 1,446

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

**Lockheed Martin Corporation**  
**Consolidated Statements of Equity**  
(in millions, except per share data)

	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, 2013	\$ 319	\$ —	\$ 14,200	\$ (9,601)	\$ 4,918	\$ —	\$ 4,918
Net earnings	—	—	3,614	—	3,614	—	3,614
Other comprehensive loss, net of tax	—	—	—	(2,269)	(2,269)	—	(2,269)
Repurchases of common stock	(12)	(792)	(1,096)	—	(1,900)	—	(1,900)
Dividends declared (\$5.49 per share)	—	—	(1,762)	—	(1,762)	—	(1,762)
Stock-based awards and ESOP activity and other	7	792	—	—	799	—	799
Balance at December 31, 2014	314	—	14,956	(11,870)	3,400	—	3,400
Net earnings	—	—	3,605	—	3,605	—	3,605
Other comprehensive income, net of tax	—	—	—	426	426	—	426
Repurchases of common stock	(15)	(656)	(2,400)	—	(3,071)	—	(3,071)
Dividends declared (\$6.15 per share)	—	—	(1,923)	—	(1,923)	—	(1,923)
Stock-based awards and ESOP activity and other	4	656	—	—	660	—	660
Balance at December 31, 2015	303	—	14,238	(11,444)	3,097	—	3,097
Net earnings	—	—	5,302	—	5,302	—	5,302
Other comprehensive loss, net of tax	—	—	—	(658)	(658)	—	(658)
Shares exchanged and retired in connection with divestiture of IS&GS business	(9)	—	(2,488)	—	(2,497)	—	(2,497)
Repurchases of common stock	(9)	(395)	(1,692)	—	(2,096)	—	(2,096)
Dividends declared (\$6.77 per share)	—	—	(2,036)	—	(2,036)	—	(2,036)
Stock-based awards and ESOP activity and other	4	395	—	—	399	—	399
Increase in noncontrolling interests in subsidiary	—	—	—	—	—	95	95
Balance at December 31, 2016	\$ 289	\$ —	\$ 13,324	\$ (12,102)	\$ 1,511	\$ 95	\$ 1,606

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

**Lockheed Martin Corporation**  
**Notes to Consolidated Financial Statements**

**Note 1 – Significant Accounting Policies**

**Organization** – We are a global security and aerospace company principally engaged in the research, design, development, manufacture, integration and sustainment of advanced technology systems, products and services. We also provide a broad range of management, engineering, technical, scientific, logistics, system integration and cybersecurity services. We serve both U.S. and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government.

**Basis of presentation** – Our 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. Our receivables, inventories, customer advances and amounts in excess of costs incurred and certain amounts in other current liabilities primarily are attributable to long-term contracts or programs in progress for which the related operating cycles are longer than one year. In accordance with industry practice, we include these items in current assets and current liabilities. Unless otherwise noted, we present all per share amounts cited in these consolidated financial statements on a “per diluted share” basis. Certain prior period amounts have been reclassified to conform with current year presentation.

The discussion and presentation of the operating results of our business segments have been impacted by the following recent events.

On August 16, 2016, we completed the previously announced divestiture of the Information Systems & Global Solutions (IS&GS) business, which merged with a subsidiary of Leidos Holdings, Inc. (Leidos), in a Reverse Morris Trust transaction (the “Transaction”). This Transaction represents the culmination of the strategic review of our government information technology infrastructure services business and our technical services business performed in 2015 to explore whether the IS&GS business could achieve greater growth and create more value for customers and stockholders outside of Lockheed Martin. As a result of the divestiture, the operating results of the IS&GS business have been classified as discontinued operations in the consolidated statements of earnings for all periods presented and the assets and liabilities of the IS&GS business have been classified as assets and liabilities of discontinued operations in the consolidated balance sheet as of December 31, 2015. However, the cash flows of the IS&GS business have not been reclassified in our consolidated statements of cash flows as we retained the cash as part of the Transaction. See “Note 3 – Acquisitions and Divestitures” for additional information about the divestiture of the IS&GS business.

On August 24, 2016, our ownership interest in the AWE Management Limited (AWE) venture, which operates the United Kingdom’s nuclear deterrent program, increased by 18%. As a result of the increase, we now hold a 51% controlling interest in AWE and are required to consolidate the AWE venture in our consolidated financial statements. Accordingly, the operating results and cash flows of AWE have been included in our consolidated statements of earnings and consolidated statements of cash flows since August 24, 2016, the date we obtained a controlling interest, and the assets and liabilities of AWE are included in the consolidated balance sheet as of December 31, 2016. Previously, we accounted for our investment in AWE using the equity method of accounting. See “Note 3 – Acquisitions and Divestitures” for additional information about the change in ownership of AWE.

During the third quarter of 2016, the business segment formerly known as Mission Systems and Training (MST) was renamed Rotary and Missions Systems (RMS) to better reflect a broader range of products and capabilities subsequent to the acquisition of Sikorsky Aircraft Corporation (Sikorsky) in November 2015 and the realignment of certain programs from the former IS&GS business to RMS in the fourth quarter of 2015. While RMS was renamed to more accurately reflect the expanded portfolio, there was no additional change to the composition of the portfolio in connection with the name change. The information for this segment for all periods included in these consolidated financial statements has been labeled using the new name.

On November 6, 2015, we completed the acquisition of Sikorsky for \$9.0 billion, net of cash acquired, and aligned Sikorsky under our RMS business segment. The operating results and cash flows of Sikorsky have been included in our consolidated statements of earnings and consolidated statements of cash flows since the November 6, 2015 acquisition date. Additionally, the assets and liabilities of Sikorsky are included in our consolidated balance sheets as of December 31, 2016 and December 31, 2015. See “Note 3 – Acquisitions and Divestitures” for additional information about the acquisition of Sikorsky and related final purchase accounting.

During the fourth quarter of 2015, we realigned certain programs among our business segments. The amounts, discussion and presentation of our business segments for all periods presented in these consolidated financial statements reflect the program realignment.

**Use of estimates** – We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP). In doing so, we are required 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.

**Sales and earnings** – We record net sales and estimated profits for substantially all of our contracts using the percentage-of-completion method for cost-reimbursable and fixed-price contracts for products and services with the U.S. Government. Sales are recorded on all time-and-materials contracts as the work is performed based on agreed-upon hourly rates and allowable costs. We account for our services contracts with non-U.S. Government customers using the services method of accounting. We classify net sales as products or services on our consolidated statements of earnings based on the attributes of the underlying contracts.

*Percentage-of-Completion Method* – The percentage-of-completion method for product contracts depends on the nature of the products provided under the contract. For example, for contracts that require us to perform a significant level of development effort in comparison to the total value of the contract and/or to deliver minimal quantities, sales are recorded using the cost-to-cost method to measure progress toward completion. Under the cost-to-cost method of accounting, we recognize sales and an estimated profit as costs are incurred based on the proportion that the incurred costs bear to total estimated costs. For contracts that require us to provide a substantial number of similar items without a significant level of development, we record sales and an estimated profit on a percentage-of-completion basis using units-of-delivery as the basis to measure progress toward completing the contract. For contracts to provide services to the U.S. Government, sales are generally recorded using the cost-to-cost method.

Award and incentive fees, as well as penalties related to contract performance, are considered in estimating sales and profit rates on contracts accounted for under the percentage-of-completion method. Estimates of award fees are based on past experience and anticipated performance. We record incentives or penalties when there is sufficient information to assess anticipated contract performance. Incentive provisions that increase or decrease earnings based solely on a single significant event are not recognized until the event occurs.

Accounting for contracts using the percentage-of-completion method requires judgment relative to assessing risks, estimating contract sales and costs (including estimating award and incentive fees and penalties related to performance) and making assumptions for schedule and technical issues. Due to the number of years it may take to complete many of our contracts and the scope and nature of the work required to be performed on those contracts, the estimation of total sales and costs at completion is complicated and subject to many variables and, accordingly, is subject to change. When adjustments in estimated total contract sales or estimated total costs are required, any changes from prior estimates are recognized in the current period for the inception-to-date effect of such changes. When estimates of total costs to be incurred on a contract exceed estimates of total sales to be earned, a provision for the entire loss on the contract is recorded in the period in which the loss is determined.

Many of our contracts span several years and include highly complex technical requirements. At the outset of a contract, we identify and monitor risks to the achievement of the technical, schedule and cost aspects of the contract and assess the effects of those risks on our estimates of total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events) and costs (e.g., material, labor, subcontractor, overhead and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and cost aspects of the contract which decreases the estimated total costs to complete the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate.

In addition, comparability of our business segment sales, operating profit and operating margins may be impacted by changes in profit booking rates on our contracts accounted for using the percentage-of-completion method of accounting. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs 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 complete 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 margins may also be impacted favorably or unfavorably by other items. Favorable items may include the positive resolution of contractual matters, cost recoveries on 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 (such as those mentioned below in “Note 15 – Restructuring Charges”), which are excluded from segment operating results; reserves for disputes; asset impairments; and losses on sales of assets. Segment operating profit and items such as risk retirements, reductions of profit booking rates or other matters are presented net of state income taxes.

Our consolidated net adjustments not related to volume, including net profit booking rate adjustments and other matters, net of state income taxes, increased segment operating profit, by approximately \$1.5 billion in 2016, \$1.7 billion in 2015 and \$1.6 billion in 2014. These adjustments increased net earnings by approximately \$950 million (\$3.13 per share) in 2016, \$1.1 billion (\$3.50 per share) in 2015 and \$1.1 billion (\$3.41 per share) in 2014.

*Services Method* – For cost-reimbursable contracts for services to non-U.S. Government customers, we record net sales as services are performed, except for award and incentive fees. Award and incentive fees are recorded when they are fixed or determinable, generally at the date the amount is communicated to us by the customer. This approach results in the recognition of such fees at contractual intervals (typically every six months) throughout the contract and is dependent on the customer’s processes for notification of awards and issuance of formal notifications. Under fixed-price service contracts, we are paid a predetermined fixed amount for a specified scope of work and generally have full responsibility for the costs associated with the contract and the resulting profit or loss. We record net sales under fixed-price service contracts with non-U.S. Government customers on a straight-line basis over the period of contract performance, unless evidence suggests that net sales are earned or the obligations are fulfilled in a different pattern. Costs for all service contracts are expensed as incurred.

**Research and development and similar costs** – Except for certain arrangements described below, we account for independent research and development costs as part of the general and administrative costs that are allocated among all of our contracts and programs in progress under U.S. Government contractual arrangements and charged to cost of sales. Under certain arrangements in which a customer shares in product development costs, our portion of unreimbursed costs is expensed as incurred in cost of sales. Independent research and development costs charged to cost of sales totaled \$988 million in 2016, \$817 million in 2015 and \$733 million in 2014. Costs we incur under customer-sponsored research and development programs pursuant to contracts are included in net sales and cost of sales.

**Stock-based compensation** – Compensation cost related to all share-based payments is measured at the grant date based on the estimated fair value of the award. We generally recognize the compensation cost ratably over a three-year vesting period, net of estimated forfeitures. At each reporting date, the number of shares is adjusted to the number ultimately expected to vest.

**Income taxes** – We calculate our provision for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized based on the future tax consequences attributable to temporary differences that exist between the financial statement carrying amount of assets and liabilities and their respective tax bases, as well as from operating loss and tax credit carry-forwards. We measure deferred tax assets and liabilities using enacted tax rates that will apply in the years in which we expect the temporary differences to be recovered or paid.

We periodically assess our tax exposures related to periods that are open to examination. Based on the latest available information, we evaluate our tax positions to determine whether the position will more likely than not be sustained upon examination by the Internal Revenue Service (IRS) or other taxing authorities. If we cannot reach a more-likely-than-not determination, no benefit is recorded. If we determine that the tax position is more likely than not to be sustained, we record the largest amount of benefit that is more likely than not to be realized when the tax position is settled. We record interest and penalties related to income taxes as a component of income tax expense on our consolidated statements of earnings. Interest and penalties were not material.

**Cash and cash equivalents** – Cash equivalents include highly liquid instruments with original maturities of 90 days or less.

**Receivables** – Receivables include amounts billed and currently due from customers and unbilled costs and accrued profits primarily related to sales on long-term contracts that have been recognized but not yet billed to customers. Pursuant to contract provisions, agencies of the U.S. Government and certain other customers have title to, or a security interest in, assets related to such contracts as a result of advances, performance-based payments and progress payments. We reflect those advances and payments as an offset to the related receivables balance for contracts that we account for on a percentage-of-completion basis using the cost-to-cost method to measure progress towards completion.

On occasion, customers may seek financing for the purchase of our products. In connection with these transactions, we may enter into arrangements along with our customers with unrelated third-party financial institutions to facilitate the non-recourse sale of customer receivables. For accounting purposes, these transactions are treated as a sale of receivables and the sale proceeds from the banks are reflected in our operating cash flows on the statement of cash flows. During 2016, there was no significant activity related to sales of customer receivables.

**Inventories** – We record inventories at the lower of cost or estimated net realizable value. Costs on long-term contracts and programs in progress represent recoverable costs incurred for production or contract-specific facilities and equipment, allocable operating overhead, advances to suppliers and, in the case of contracts with the U.S. Government and substantially all other governments, research and development and general and administrative expenses. Pursuant to contract provisions, agencies of the U.S. Government and certain other customers have title to, or a security interest in, inventories related to such contracts as a result of advances, performance-based payments and progress payments. We reflect those advances and payments as an offset against the related inventory balances for contracts that we account for on a percentage-of-completion basis using units-of-delivery as the basis to measure progress toward completing the contract. We determine the costs of other product and supply inventories by the first-in first-out or average cost methods.

**Property, plant and equipment** – We record property, plant and equipment at cost. We provide for depreciation and amortization on plant and equipment generally using accelerated methods during the first half of the estimated useful lives of the assets and the straight-line method thereafter. The estimated useful lives of our plant and equipment generally range from 10 to 40 years for buildings and five to 15 years for machinery and equipment. No depreciation expense is recorded on construction in progress until such assets are placed into operation. Depreciation expense related to plant and equipment was \$747 million in 2016, \$716 million in 2015 and \$713 million in 2014.

We review the carrying amounts of long-lived assets for impairment if events or changes in the facts and circumstances indicate that their carrying amounts may not be recoverable. We assess impairment by comparing the estimated undiscounted future cash flows of the related asset grouping to its carrying amount. If an asset is determined to be impaired, we recognize an impairment charge in the current period for the difference between the fair value of the asset and its carrying amount.

**Capitalized software** – We capitalize certain costs associated with the development or purchase of internal-use software. The amounts capitalized are included in other noncurrent assets on our consolidated balance sheets and are amortized on a straight-line basis over the estimated useful life of the resulting software, which ranges from two to six years. As of December 31, 2016 and 2015, capitalized software totaled \$427 million and \$473 million, net of accumulated amortization of \$1.9 billion in each of the years. No amortization expense is recorded until the software is ready for its intended use. Amortization expense related to capitalized software was \$136 million in 2016, \$161 million in 2015 and \$194 million in 2014.

**Goodwill** – The assets and liabilities of acquired businesses are recorded under the acquisition method of accounting at their estimated fair values at the date of acquisition. Goodwill represents costs in excess of fair values assigned to the underlying identifiable net assets of acquired businesses.

We perform an impairment test of our goodwill at least annually in the fourth quarter and more frequently whenever certain events or changes in circumstances indicate the carrying value of goodwill may be impaired. Such events or changes in circumstances may include a significant deterioration in overall economic conditions, changes in the business climate of our industry, a decline in our market capitalization, operating performance indicators, competition, reorganizations of our business or the disposal of all or a portion of a reporting unit. Our goodwill has been allocated to and is tested for impairment at a level referred to as the reporting unit, which is our business segment level or a level below the business segment. The level at which we test goodwill for impairment requires us to determine whether the operations below the business segment constitute a business for which discrete financial information is available and segment management regularly reviews the operating results.

We may use both qualitative and quantitative approaches when testing goodwill for impairment. Under the qualitative approach, for selected reporting units we perform a qualitative evaluation of events and circumstances impacting the

reporting unit to determine the likelihood of goodwill impairment. Based on that qualitative evaluation, if we determine it is more likely than not that the fair value of a reporting unit exceeds its carrying amount, no further evaluation is necessary. Otherwise, we perform a quantitative two-step impairment test. For certain reporting units we only perform a quantitative impairment test.

Under step one of the quantitative impairment test, we compare the fair value of each reporting unit to its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is not impaired. If the carrying value of a reporting unit exceeds its fair value, we then perform step two of the quantitative impairment test and compare the implied value of the reporting unit's goodwill with the carrying value of its goodwill. The implied value of the reporting unit's goodwill is calculated by creating a hypothetical balance sheet as if the reporting unit had just been acquired. This balance sheet contains all assets and liabilities recorded at fair value (including any intangible assets that may not have any corresponding carrying value in our balance sheet). The implied value of the reporting unit's goodwill is calculated by subtracting the fair value of the net assets from the fair value of the reporting unit. If the carrying value of the reporting unit's goodwill exceeds the implied value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

We estimate the fair value of each reporting unit using a combination of a discounted cash flow (DCF) analysis and market-based valuation methodologies such as comparable public company trading values and values observed in recent business acquisitions. Determining fair value requires the exercise of significant judgments, including judgments about the amount and timing of expected future cash flows, long-term growth rates, discount rates and relevant comparable public company earnings multiples and relevant transaction multiples. The cash flows employed in the DCF analyses are based on our best estimate of future sales, earnings and cash flows after considering factors such as general market conditions, U.S. Government budgets, existing firm orders, expected future orders, contracts with suppliers, labor agreements, changes in working capital, long-term business plans and recent operating performance. The discount rates utilized in the DCF analysis are based on the respective reporting unit's weighted average cost of capital, which takes into account the relative weights of each component of capital structure (equity and debt) and represents the expected cost of new capital, adjusted as appropriate to consider the risk inherent in future cash flows of the respective reporting unit.

In the fourth quarter of 2016, we performed our annual goodwill impairment test for each of our reporting units. The results of our 2016 annual impairment tests of goodwill indicated that no impairment existed.

In the fourth quarter of 2015, we performed our annual goodwill impairment test for each of our reporting units. During the fourth quarter of 2015, we realigned certain programs between our business segments in connection with our strategic review of our government IT and technical services businesses. As part of the realignment, goodwill was reallocated between affected reporting units on a relative fair value basis. We performed goodwill impairment tests prior and subsequent to the realignment. The results of our 2015 annual impairment tests of goodwill indicated that no impairment existed.

In the fourth quarter of 2014, we completed our annual goodwill impairment test for each of our reporting units. The results of these tests indicated that the estimated fair values of our reporting units exceeded their carrying values, with the exception of our Technical Services reporting unit within our IS&GS business. The impact of market pressures such as lower in-theater support as troop levels are drawn down and increased re-competition on existing contracts that are awarded primarily on the basis of price adversely impacted the fair value of this reporting unit. As a result, we compared the implied value of that reporting unit's goodwill with the carrying value of its goodwill, and since the carrying value exceeded the implied value, we recorded a non-cash impairment charge of \$119 million in the fourth quarter of 2014 equal to that differential. The impairment charge of \$119 million was reclassified in connection with the divestiture of the IS&GS business and reclassification of the IS&GS business to discontinued operations.

**Intangible assets** – Intangible assets from acquired businesses are recognized at their estimated fair values at the date of acquisition and consist of customer programs, trademarks, customer relationships, technology and other intangible assets. Customer programs include values assigned to major programs of acquired businesses and represent the aggregate value associated with the customer relationships, contracts, technology and trademarks underlying the associated program and are amortized on a straight-line basis over a period of expected cash flows used to measure the fair value, which ranges from nine to 20 years. Acquired intangibles deemed to have indefinite lives are not amortized, but are subject to annual impairment testing. This testing compares carrying value to fair value and, when appropriate, the carrying value of these assets is reduced to fair value. Finite-lived intangibles are amortized to expense over the applicable useful lives, ranging from three to 20 years, based on the nature of the asset and the underlying pattern of economic benefit as reflected by future net cash inflows.

**Customer advances and amounts in excess of cost incurred** – We receive advances, performance-based payments and progress payments from customers that may exceed costs incurred on certain contracts, including contracts with agencies of the U.S. Government. We classify such advances, other than those reflected as a reduction of receivables or inventories as discussed above, as current liabilities.

**Postretirement benefit plans** – Many of our employees are covered by defined benefit pension plans and we provide certain health care and life insurance benefits to eligible retirees (collectively, postretirement benefit plans). GAAP requires that the amounts we record related to our postretirement benefit plans be computed, based on service to date, using actuarial valuations that are based in part on certain key economic assumptions we make, including the discount rate, the expected long-term rate of return on plan assets and other actuarial assumptions including participant longevity (also known as mortality) estimates, health care cost trend rates and employee turnover, each as appropriate based on the nature of the plans.

A market-related value of our plan assets, determined using actual asset gains or losses over the prior three year period, is used to calculate the amount of deferred asset gains or losses to be amortized. These asset gains or losses, along with those resulting from adjustments to our benefit obligation, will be amortized to expense using the corridor method, where gains and losses are recognized to the extent they exceed 10% of the greater of plan assets or benefit obligations, over the average future service period of employees expected to receive benefits under the plans of approximately 9 years as of December 31, 2016. This amortization period is expected to extend (approximately double) in 2020 when our non-union pension plan is frozen to use the average remaining life expectancy of the participants instead of average future service.

We recognize on a plan-by-plan basis the funded status of our postretirement benefit plans under GAAP as either an asset recorded within other noncurrent assets or a liability recorded within noncurrent liabilities on our consolidated balance sheets. There is a corresponding non-cash adjustment to accumulated other comprehensive loss, net of tax benefits recorded as deferred tax assets, in stockholders' equity. The GAAP funded status is measured as the difference between the fair value of the plan's assets and the benefit obligation of the plan. The funded status under the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act of 2006 (PPA), is calculated on a different basis than under GAAP.

**Environmental matters** – We record a liability for environmental matters when it is probable that a liability has been incurred and the amount 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. Our environmental liabilities are recorded on our consolidated balance sheets within other liabilities, both current and noncurrent. We expect to include a substantial portion of environmental costs in our net sales and cost of sales in future periods pursuant to U.S. Government agreement or regulation. 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 continuously 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 recent 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 to not be recoverable under U.S. Government contracts, in our cost of sales at the time the liability is established. Our environmental receivables are recorded on our consolidated balance sheets within other assets, both current and noncurrent. We project costs and recovery of costs over approximately 20 years.

**Investments in marketable securities** – Investments in marketable securities consist of debt and equity securities and are classified as trading securities. As of December 31, 2016 and 2015, the fair value of our trading securities totaled \$1.2 billion and \$1.1 billion and was included in other noncurrent assets on our consolidated balance sheets. Our trading securities are held in a separate trust, which includes investments to fund our deferred compensation plan liabilities. Net gains on trading securities in 2016 were \$66 million, net losses on trading securities in 2015 were \$11 million and net gains on trading securities in 2014 were \$65 million. Gains and losses on these investments are included in other unallocated, net within cost of sales on our consolidated statements of earnings in order to align the classification of changes in the market value of investments held for the plan with changes in the value of the corresponding plan liabilities.

**Equity method investments** – Investments where we have the ability to exercise significant influence, but do not control, are accounted for under the equity method of accounting and are included in other noncurrent assets on our consolidated balance sheets. Significant influence typically exists if we have a 20% to 50% ownership interest in the investee. Under this method of accounting, our share of the net earnings or losses of the investee is included in operating profit in other income, net on our consolidated statements of earnings since the activities of the investee are closely aligned



with the operations of the business segment holding the investment. We evaluate our equity method investments for impairment whenever events or changes in circumstances indicate that the carrying amounts of such investments may be impaired. If a decline in the value of an equity method investment is determined to be other than temporary, a loss is recorded in earnings in the current period. As of December 31, 2016 and 2015, our equity method investments totaled \$1.4 billion and \$1.3 billion, which primarily are composed of our Space Systems business segment's investment in United Launch Alliance (ULA), see "Note 14 – Legal Proceedings, Commitments and Contingencies", and our Aeronautics and RMS business segments' investments in the Advanced Military Maintenance, Repair and Overhaul Center (AMMROC) venture. Our share of net earnings related to our equity method investees was \$443 million in 2016, \$320 million in 2015 and \$327 million in 2014, of which approximately \$325 million, \$245 million and \$280 million related to our Space Systems business segment.

**Derivative financial instruments** – 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.

We record derivatives at their fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on our intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives attributable to the effective portion of hedges are either reflected in earnings and largely offset by corresponding adjustments to the hedged items or reflected net of income taxes in accumulated other comprehensive loss until the hedged transaction is recognized in earnings. Changes in the fair value of the derivatives that are attributable to the ineffective portion of the hedges or of derivatives that are not considered to be highly effective hedges, if any, are immediately recognized in earnings. The aggregate notional amount of our outstanding interest rate swaps at December 31, 2016 and 2015 was \$1.2 billion and \$1.5 billion. The aggregate notional amount of our outstanding foreign currency hedges at December 31, 2016 and 2015 was \$4.0 billion and \$4.1 billion. Derivative instruments did not have a material impact on net earnings and comprehensive income during 2016, 2015 and 2014. Substantially all of our derivatives are designated for hedge accounting. See "Note 16 – Fair Value Measurements" for more information on the fair value measurements related to our derivative instruments.

**Recent Accounting Pronouncements** – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, as amended (Topic 606) (the ASU), which will change the way we recognize revenue and significantly expand the disclosure requirements for revenue arrangements. In July 2015, the FASB approved a one-year deferral of the effective date of the ASU to 2018 for public companies, with an option that would permit companies to adopt the ASU in 2017. Further amendments and technical corrections were made to the ASU during 2016. This ASU may be adopted using the full retrospective method, whereby the ASU would be applied to each prior year presented and the cumulative effect of applying the ASU would be recognized at the beginning of the earliest year presented or the modified retrospective method, whereby the cumulative effect of applying the ASU would be recognized at the beginning of the year of adoption. We will adopt the requirements of the new standard effective January 1, 2018 using the full retrospective transition method.

As the ASU will supersede substantially all existing revenue guidance affecting us under GAAP, it could impact revenue and cost recognition on thousands of contracts across all of our business segments, as well as, our business processes and our information technology systems. As a result, our evaluation of the effect of the ASU will extend through 2017. We have closely monitored the standard setting process, including amendments and technical corrections to the ASU following its issuance in May 2014 and participated in aerospace and defense forums to understand the impact of the ASU on our industry.

We commenced our evaluation of the impact of the ASU in late 2014, by evaluating its impact on selected contracts at each of our business segments. With this baseline understanding, we developed a project plan to evaluate thousands of contracts across our business segments, develop processes and tools to dual report financial results under both GAAP and the

ASU and assess the internal control structure in order to adopt the ASU on January 1, 2018. We have periodically briefed our Audit Committee on our progress made towards adoption. Based on our evaluation to date, we anticipate being able to estimate the impacts of adopting the ASU in the second half of 2017.

We recognize the majority of our revenue using the percentage-of-completion method of accounting, whereby revenue is recognized as we progress on the contract. For contracts with a significant amount of development and/or requiring the delivery of a minimal number of units, revenue and profit is recognized using the percentage-of-completion cost-to-cost method to measure progress. For example, we use this method in Aeronautics for the F-35 program; in MFC for the THAAD program; in RMS for the Littoral Combat Ship and Aegis Combat System programs; and in Space Systems for government satellite programs. For contracts that require us to produce a substantial number of similar items without a significant level of development, we record revenue and profit using the percentage-of-completion units-of-delivery as the basis for measuring progress on the contract. For example, we use this method in Aeronautics for the C-130J and C-5 programs; in MFC for tactical missile programs (i.e., Hellfire, JASSM), PAC-3 programs and fire control programs (i.e., LANTIRN, Sniper); in RMS for Black Hawk and Seahawk helicopter programs; and in Space Systems for commercial satellite programs. For contracts to provide services to the U.S. Government, revenue is generally recorded using the percentage-of-completion cost-to-cost method.

Under the ASU, revenue will be recognized as the customer obtains control of the goods and services promised in the contract (i.e., performance obligations). Given the nature of our products and terms and conditions in our contracts, in particular those with the U. S. Government (including FMS contracts), the customer obtains control as we perform on the contract. Therefore, we expect to recognize revenue over time for almost all of our contracts using a method similar to our current percentage-of-completion cost-to-cost method. Accordingly, adoption of the ASU will primarily impact our contracts where revenue is currently recognized using the percentage-of-completion units-of-delivery method, with the resulting impact being revenue will be recognized earlier in the performance period as we incur costs, as opposed to when units are delivered. This change will also impact our balance sheet presentation with an expected decrease in inventories, an increase in contract assets (i.e., unbilled receivables) and a net increase to retained earnings to primarily reflect the impact of converting units-of-delivery contracts to the cost-to-cost method for recognizing revenue and profits.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other (Topic 350), which will simplify the goodwill impairment calculation, by eliminating Step 2 from the current goodwill impairment test. The new standard does not change how a goodwill impairment is identified. We will continue to perform our quantitative goodwill impairment test by comparing the fair value of each reporting unit to its carrying amount, but if we are required to recognize a goodwill impairment charge, under the new standard the amount of the charge will be calculated by subtracting the reporting unit's fair value from its carrying amount. Under the current standard, if we are required to recognize a goodwill impairment charge, Step 2 requires us to calculate the implied value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination and the amount of the charge is calculated by subtracting the reporting unit's implied fair value of goodwill from its actual goodwill balance. The standard should be applied prospectively from the date of adoption. We are currently evaluating when we will adopt the ASU and the expected impact to related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which increases transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements for both lessees and lessors. The ASU is effective January 1, 2019 for public companies, with early adoption permitted. The ASU will be applied using a modified retrospective approach to the beginning of the earliest period presented in the financial statements. We are currently evaluating when we will adopt the ASU and the expected impact to our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which changed the accounting for certain aspects of employee share-based payments. The ASU requires companies to recognize additional tax benefits or expenses related to the vesting or settlement of employee share-based awards (the difference between the actual tax benefit and the tax benefit initially recognized for financial reporting purposes) as income tax benefit or expense in earnings, rather than in additional paid-in capital, in the reporting period in which they occur. The ASU also requires companies to classify cash flows resulting from employee share-based payments, including the additional tax benefits or expenses related to the vesting or settlement of share-based awards, as cash flows from operating activities rather than financing activities. Although this change will reduce some of the administrative complexities of tracking share-based awards, it will increase the volatility of our income tax expense and cash flows from operations. The new standard is effective for annual reporting periods beginning after December 15, 2016, with early adoption permitted. We early adopted the ASU during the second quarter of 2016 and are therefore required to report the impacts as though the ASU had been adopted on January 1, 2016. Accordingly, we recognized additional income tax

benefits as an increase to earnings of \$152 million (\$0.50 per share) during the year ended December 31, 2016. Additionally, we recognized additional income tax benefits as an increase to operating cash flows of \$152 million during the year ended December 31, 2016. The new accounting standard did not impact any periods prior to January 1, 2016, as we applied the changes in the ASU on a prospective basis.

In September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805), which simplifies the accounting for adjustments made to preliminary amounts recognized in a business combination by eliminating the requirement to retrospectively account for those adjustments. Instead, adjustments will be recognized in the period in which the adjustments are determined, including the effect on earnings of any amounts that would have been recorded in previous periods if the accounting had been completed at the acquisition date. We adopted the ASU on January 1, 2016 and are prospectively applying the ASU to business combination adjustments identified after the date of adoption.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740), which simplifies the presentation of deferred income taxes and requires that deferred tax assets and liabilities, as well as any related valuation allowance, be classified as noncurrent in our consolidated balance sheets. We applied the provisions of the ASU retrospectively and reclassified approximately \$1.6 billion from current to noncurrent assets and approximately \$140 million from current to noncurrent liabilities in our consolidated balance sheet as of December 31, 2015.

## Note 2 – Earnings Per Share

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

	2016	2015	2014
Weighted average common shares outstanding for basic computations	299.3	310.3	316.8
Weighted average dilutive effect of equity awards	3.8	4.4	5.6
Weighted average common shares outstanding for diluted computations	303.1	314.7	322.4

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 and exercise of outstanding stock options based on the treasury stock method.

There were no anti-dilutive equity awards for the years ended December 31, 2016, 2015 and 2014.

## Note 3 – Acquisitions and Divestitures

### Acquisitions

#### *Acquisition of Sikorsky Aircraft Corporation*

On November 6, 2015, we completed the acquisition of Sikorsky Aircraft Corporation and certain affiliated companies (collectively “Sikorsky”) from United Technologies Corporation (UTC) and certain of UTC’s subsidiaries. The purchase price of the acquisition was \$9.0 billion, net of cash acquired. As a result of the acquisition, Sikorsky became a wholly-owned subsidiary of ours. Sikorsky is a global company primarily engaged in the research, design, development, manufacture and support of military and commercial helicopters. Sikorsky’s products include military helicopters such as the Black Hawk, Seahawk, CH-53K, H-92; and commercial helicopters such as the S-76 and S-92. The acquisition enables us to extend our core business into the military and commercial rotary wing markets, allowing us to strengthen our position in the aerospace and defense industry. Further, this acquisition will expand our presence in commercial and international markets. Sikorsky has been aligned under our RMS business segment.

To fund the \$9.0 billion acquisition price, we utilized \$6.0 billion of proceeds borrowed under a temporary 364-day revolving credit facility (the 364-day Facility), \$2.0 billion of cash on hand and \$1.0 billion from the issuance of commercial paper. In the fourth quarter of 2015, we repaid all outstanding borrowings under the 364-day Facility with the proceeds from the issuance of \$7.0 billion of fixed interest-rate long-term notes in a public offering (the November 2015 Notes). In the fourth quarter of 2015, we also repaid the \$1.0 billion in commercial paper borrowings (see “Note 10 – Debt”).

### Allocation of Purchase Price to Assets Acquired and Liabilities Assumed

We accounted for the acquisition of Sikorsky as a business combination, which requires us to record the assets acquired and liabilities assumed at fair value. The amount by which the purchase price exceeds the fair value of the net assets acquired is recorded as goodwill. During the fourth quarter of 2016, we completed our appraisals and determined the fair values of the assets acquired and liabilities assumed upon acquisition of Sikorsky. As a result of the completed valuation the significant adjustments to the carrying amounts were as follows: Goodwill, trademarks intangible assets and customer programs intangible assets increased by about \$78 million, \$71 million and \$57 million and inventories, net was decreased by about \$185 million. The measurement period adjustments did not result in a significant adjustment to amortization expense for intangible assets during 2016.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the acquisition date, including the refinements described in the previous paragraph (in millions):

Cash and cash equivalents	\$ 75
Receivables, net	1,924
Inventories, net	1,632
Other current assets	46
Property, plant and equipment	649
Goodwill	2,842
Intangible assets:	
Customer programs	3,184
Trademarks	887
Other noncurrent assets	572
Deferred income taxes, noncurrent	256
<b>Total identifiable assets and goodwill</b>	<b>12,067</b>
Accounts payable	(565)
Customer advances and amounts in excess of costs incurred	(1,197)
Salaries, benefits, and payroll taxes	(105)
Other current liabilities	(430)
Customer contractual obligations <sup>(a)</sup>	(507)
Other noncurrent liabilities	(185)
<b>Total liabilities assumed</b>	<b>(2,989)</b>
<b>Total consideration</b>	<b>\$ 9,078</b>

<sup>(a)</sup> Recorded in other noncurrent liabilities on our consolidated balance sheets.

Intangible assets related to customer programs were recognized for each major helicopter and aftermarket program and represent the aggregate value associated with the customer relationships, contracts, technology and tradenames underlying the associated program. These intangible assets will be amortized on a straight-line basis over a weighted-average useful life of approximately 15 years. The useful life is based on a period of expected cash flows used to measure the fair value of each of intangible assets.

Customer contractual obligations represent liabilities on certain development programs where the expected costs exceed the expected sales under contract. We measured these liabilities based on the price to transfer the obligation to a market participant at the measurement date, assuming that the liability will remain outstanding in the marketplace. Based on the estimated net cash outflows of the developmental programs plus a reasonable contracting profit margin required to transfer the contracts to market participants, we recorded assumed liabilities of \$507 million. These liabilities will be liquidated in accordance with the underlying economic pattern of the contractual obligations, as reflected by the estimated future net cash outflows incurred on the associated contracts. From the acquisition date through the year ended December 31, 2016, we recognized approximately \$130 million in sales related to customer contractual obligations. Estimated liquidation of the customer contractual obligation is approximated as follows: \$110 million in 2017, \$70 million in 2018, \$70 million in 2019, \$60 million in 2020, \$40 million in 2021 and \$27 million thereafter.

The fair values of the assets acquired and liabilities assumed were determined using income, market and cost valuation methodologies. The fair value measurements were estimated using significant inputs that are not observable in the market and thus represent a Level 3 measurement as defined in Accounting Standards Codification (ASC) 820, *Fair Value Measurement*. The income approach was primarily used to value the customer programs and trademarks intangible assets.

The income approach indicates value for an asset or liability based on the present value of cash flow projected to be generated over the remaining economic life of the asset or liability being measured. Both the amount and the duration of the cash flows are considered from a market participant perspective. Our estimates of market participant net cash flows considered historical and projected pricing, remaining developmental effort, operational performance including company-specific synergies, aftermarket retention, product life cycles, material and labor pricing, and other relevant customer, contractual and market factors. Where appropriate, the net cash flows are adjusted to reflect the uncertainties associated with the underlying assumptions, as well as the risk profile of the net cash flows utilized in the valuation. The adjusted future cash flows are then discounted to present value using an appropriate discount rate. Projected cash flow is discounted at a required rate of return that reflects the relative risk of achieving the cash flows and the time value of money. The market approach is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. Valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. The cost approach, which estimates value by determining the current cost of replacing an asset with another of equivalent economic utility, was used, as appropriate, for property, plant and equipment. The cost to replace a given asset reflects the estimated reproduction or replacement cost, less an allowance for loss in value due to depreciation.

The purchase price allocation resulted in the recognition of \$2.8 billion of goodwill, all of which is expected to be amortizable for tax purposes. Substantially all of the goodwill was assigned to our RMS business. The goodwill recognized is attributable to expected revenue synergies generated by the integration of our products and technologies with those of Sikorsky, costs synergies resulting from the consolidation or elimination of certain functions, and intangible assets that do not qualify for separate recognition, such as the assembled workforce of Sikorsky.

Determining the fair value of assets acquired and liabilities assumed requires the exercise of significant judgments, including the amount and timing of expected future cash flows, long-term growth rates and discount rates. The cash flows employed in the DCF analyses are based on our best estimate of future sales, earnings and cash flows after considering factors such as general market conditions, customer budgets, existing firm orders, expected future orders, contracts with suppliers, labor agreements, changes in working capital, long term business plans and recent operating performance. Use of different estimates and judgments could yield different results.

#### *Impact to 2015 Financial Results*

Sikorsky's 2015 financial results have been included in our consolidated financial results only for the period from the November 6, 2015 acquisition date through December 31, 2015. As a result, our consolidated financial results for the year ended December 31, 2015 do not reflect a full year of Sikorsky's results. From the November 6, 2015 acquisition date through December 31, 2015, Sikorsky generated net sales of approximately \$400 million and operating loss of approximately \$45 million, inclusive of intangible amortization and adjustments required to account for the acquisition.

We incurred approximately \$38 million of non-recoverable transaction costs associated with the Sikorsky acquisition in 2015 that were expensed as incurred. These costs are included in other income, net on our consolidated statements of earnings. We also incurred approximately \$48 million in costs associated with issuing the \$7.0 billion November 2015 Notes used to repay all outstanding borrowings under the 364-day Facility used to finance the acquisition. The financing costs were recorded as a reduction of debt and will be amortized to interest expense over the term of the related debt.

#### *Supplemental Pro Forma Financial Information (unaudited)*

The following table presents summarized unaudited pro forma financial information as if Sikorsky had been included in our financial results for the entire years in 2015 and 2014 (in millions):

	<b>2015</b>	<b>2014</b>
Net sales	\$ 45,366	\$ 47,369
Net earnings	3,534	3,475
Basic earnings per common share	11.39	10.97
Diluted earnings per common share	11.23	10.78

The unaudited supplemental pro forma financial data above has been calculated after applying our accounting policies and adjusting the historical results of Sikorsky with pro forma adjustments, net of tax, that assume the acquisition occurred on January 1, 2014. Significant pro forma adjustments include the recognition of additional amortization expense related to acquired intangible assets and additional interest expense related to the short-term debt used to finance the acquisition. These

adjustments assume the application of fair value adjustments to intangibles and the debt issuance occurred on January 1, 2014 and are approximated as follows: amortization expense of \$125 million and \$150 million in 2015 and 2014, respectively; and interest expense of \$40 million and \$50 million in 2015 and 2014, respectively. In addition, significant nonrecurring adjustments include the elimination of a \$72 million pension curtailment loss, net of tax, recognized in 2015 and the elimination of a \$58 million income tax charge related to historic earnings of foreign subsidiaries recognized by Sikorsky in 2015.

The unaudited supplemental pro forma financial information also reflects an increase in interest expense, net of tax, of approximately \$110 million and approximately \$120 million in 2015 and 2014, respectively. The increase in interest expense is the result of assuming the November 2015 Notes were issued on January 1, 2014. Proceeds of the November 2015 Notes were used to repay all outstanding borrowings under the 364-day Facility used to finance a portion of the purchase price of Sikorsky, as contemplated at the date of acquisition.

The unaudited supplemental pro forma financial information does not reflect the realization of any expected ongoing cost or revenue synergies relating to the integration of the two companies. Further, the pro forma data should not be considered indicative of the results that would have occurred if the acquisition, related financing and associated notes issuance and repayment of the 364-day Facility had been consummated on January 1, 2014, nor are they indicative of future results.

#### *AWE Management Limited*

On August 24, 2016, our ownership interest in the AWE venture increased by 18% in exchange for our assuming a more significant role in managing the operations of the venture. As a result of the increase in ownership interest, we now hold a 51% controlling interest in AWE. Accordingly, we are required to consolidate AWE, which has been aligned under our Space Systems business segment. Space Systems' operating results includes 100% of AWE's net sales and 51% of AWE's operating profit since August 24, 2016. Previously, we accounted for our investment in AWE using the equity method of accounting. Under the equity method, none of AWE's net sales and only 33% of AWE's net earnings were included in operating profit of the Space Systems business segment.

We accounted for this transaction as a "step acquisition" (as defined by U.S. GAAP), which requires us to consolidate and record the assets and liabilities of AWE at fair value. Accordingly, we recorded intangible assets of \$243 million related to customer relationships, \$32 million of net liabilities, and noncontrolling interests of \$107 million. The intangible assets are being amortized over a period of eight years in accordance with the underlying pattern of economic benefit reflected by the future net cash flows. In 2016, we recognized a non-cash net gain of \$104 million associated with obtaining a controlling interest in AWE, which consisted of a \$127 million pretax gain recognized in the operating results of our Space Systems business segment and \$23 million of tax-related items at our corporate office. The gain represents the fair value of our 51% interest in AWE, less the carrying value of our previously held investment in AWE and deferred taxes. The gain was recorded in other income, net in the consolidated statements of earnings. The fair value of AWE (including the intangible assets), our controlling interest, and the noncontrolling interests were determined using the income approach.

#### *Other acquisitions*

We paid \$898 million in 2014 for acquisitions of businesses and investments in affiliates, net of cash acquired, primarily related to the acquisitions of Zeta, Systems Made Simple and Industrial Defender. In August 2014, we completed the acquisition of all interests in Zeta, a designer of systems that enable collection, processing, safeguarding and dissemination of information for intelligence and defense communities, which is included in our Space Systems business segment. In connection with the acquisition of Zeta, we recorded goodwill of approximately \$290 million, related to expected synergies from combining operations and value of the existing workforce. The recorded goodwill is not deductible for tax purposes. Additionally, in connection with the acquisition of Zeta, we recorded other intangible assets of approximately \$100 million, primarily related to customer relationships and technologies, which will be amortized over a weighted average period of 10 years. Also during 2014, we completed the acquisitions of interests in Systems Made Simple, a provider of health information technology solutions, and Industrial Defender, a provider of cybersecurity solutions for control systems in the oil and gas, utility and chemical industries. Both businesses were included in our former IS&GS business. We recorded goodwill of approximately \$370 million and intangible assets of approximately \$125 million related to these acquisitions, which were reclassified to discontinued operations in connection with the divestiture of IS&GS.

## Divestiture of the Information Systems & Global Solutions Business

On August 16, 2016, we completed the previously announced divestiture of the IS&GS business, which merged with a subsidiary of Leidos, in a Reverse Morris Trust transaction (the "Transaction"). The Transaction was completed in a multi-step process pursuant to which we initially contributed the IS&GS business to Abacus Innovations Corporation (Abacus), a wholly owned subsidiary of Lockheed Martin created to facilitate the Transaction, and the common stock of Abacus was distributed to participating Lockheed Martin stockholders through an exchange offer. Under the terms of the exchange offer, Lockheed Martin stockholders had the option to exchange shares of Lockheed Martin common stock for shares of Abacus common stock. At the conclusion of the exchange offer, all shares of Abacus common stock were exchanged for 9,369,694 shares of Lockheed Martin common stock held by Lockheed Martin stockholders that elected to participate in the exchange. The shares of Lockheed Martin common stock that were exchanged and accepted were retired, reducing the number of shares of our common stock outstanding by approximately 3%. Following the exchange offer, Abacus merged with a subsidiary of Leidos, with Abacus continuing as the surviving corporation and a wholly-owned subsidiary of Leidos. As part of the merger, each share of Abacus common stock was automatically converted into one share of Leidos common stock. We did not receive any shares of Leidos common stock as part of the Transaction and do not hold any shares of Leidos or Abacus common stock following the Transaction. Based on an opinion of outside tax counsel, subject to customary qualifications and based on factual representations, the exchange offer and merger will qualify as tax-free transactions to Lockheed Martin and its stockholders, except to the extent that cash was paid to Lockheed Martin stockholders in lieu of fractional shares.

In connection with the Transaction, Abacus borrowed an aggregate principal amount of approximately \$1.84 billion under term loan facilities with third party financial institutions, the proceeds of which were used to make a one-time special cash payment of \$1.80 billion to Lockheed Martin and to pay associated borrowing fees and expenses. The entire special cash payment was used to repay debt, pay dividends and repurchase stock during the third and fourth quarters of 2016. The obligations under the Abacus term loan facilities were guaranteed by Leidos as part of the Transaction.

As a result of the Transaction, we recognized a net gain of approximately \$1.2 billion. The net gain represents the \$2.5 billion fair value of the shares of Lockheed Martin common stock exchanged and retired as part of the exchange offer, plus the \$1.8 billion one-time special cash payment, less the net book value of the IS&GS business of about \$3.0 billion at August 16, 2016 and other adjustments of about \$100 million. The final gain is subject to certain post-closing adjustments, including final working capital, indemnification, and tax adjustments, which we expect to complete in 2017.

We classified the operating results of our IS&GS business as discontinued operations in our consolidated financial statements in accordance with U.S. GAAP, as the divestiture of this business represented a strategic shift that had a major effect on our operations and financial results. However, the cash flows generated by the IS&GS business have not been reclassified in our consolidated statements of cash flows as we retained this cash as part of the Transaction.

The carrying amounts of major classes of the IS&GS business assets and liabilities that were classified as assets and liabilities of discontinued operations as of December 31, 2015 are as follows (in millions):

Receivables, net	\$ 807
Inventories, net	143
Other current assets	19
Property, plant and equipment, net	101
Goodwill	2,881
Intangible assets	125
Other noncurrent assets	54
<b>Total assets of the disposal group</b>	<b>\$ 4,130</b>
Accounts payable	\$ (229)
Customer advances and amounts in excess of costs incurred	(285)
Salaries, benefits and payroll taxes	(209)
Other current liabilities	(225)
Deferred income taxes	(145)
Other noncurrent liabilities	(60)
<b>Total liabilities of the disposal group</b>	<b>\$(1,153)</b>

The operating results of IS&GS that have been reflected within net earnings from discontinued operations are as follows (in millions):

	<b>Year Ended December 31,</b>		
	<b>2016<sup>(a)</sup></b>	<b>2015</b>	<b>2014</b>
Net sales	<b>\$ 3,410</b>	\$ 5,596	\$ 5,654
Cost of sales	<b>(2,953)</b>	(4,868)	(4,963)
Goodwill impairment charges	—	—	(119)
Severance charges	<b>(19)</b>	(20)	—
Gross profit	<b>438</b>	708	572
Other income, net	<b>16</b>	16	8
Operating profit	<b>454</b>	724	580
Other non-operating income, net	—	—	1
Earnings from discontinued operations before income taxes	<b>454</b>	724	581
Income tax expense	<b>(147)</b>	(245)	(220)
Net gain on divestiture of discontinued operations	<b>1,242</b>	—	—
Net earnings from discontinued operations	<b>\$ 1,549</b>	\$ 479	\$ 361

<sup>(a)</sup> Operating results for the year ended December 31, 2016 reflect operating results prior to the August 16, 2016 divestiture date, not the full year as shown for the prior years.

The operating profit reflected above does not represent the IS&GS business's historical operating profit, as the results reported within net earnings from discontinued operations only include costs that were directly attributable to the IS&GS business and exclude certain overhead costs that were previously allocated to the IS&GS business for each period. For instance, certain corporate overhead costs and certain defined benefit pension costs that were historically allocated to and included in the operating results of the IS&GS business have been reclassified and included in the results of our continuing operations because we will continue to incur these costs subsequent to the divestiture of the IS&GS business.

Certain corporate overhead costs incurred by us and previously allocated to the IS&GS business were reclassified from the IS&GS business to other unallocated, net in our consolidated statements of earnings. These overhead costs were primarily related to expenses for senior management, legal, human resources, finance, accounting, treasury, tax, information technology, communications, ethics and compliance, corporate employee benefits, incentives and stock-based compensation, shared services processing and administration and depreciation for corporate fixed assets, and were not directly attributable to the IS&GS business. We reclassified \$82 million in 2016, \$165 million in 2015 and \$169 million in 2014 of corporate overhead costs to other unallocated, net. Additionally, we retained all assets and obligations related to the pension benefits earned by current and former IS&GS business salaried employees through the divestiture of the IS&GS business. As a result, the non-service portion of net pension costs (interest cost, actuarial gains and losses and expected return on plan assets) for these plans was reclassified from the operating results of the IS&GS business and reported as a reduction to the FAS/CAS pension adjustment. The service portion of pension costs related to IS&GS business salaried employees that transferred to Leidos continued to be included in the operating results of the IS&GS business classified as discontinued operations because such costs will no longer be incurred by us subsequent to the divestiture of the IS&GS business. These net pension costs were \$54 million in 2016, \$71 million in 2015 and \$59 million in 2014.

Significant severance charges related to the IS&GS business were historically recorded at the Lockheed Martin corporate office. These charges have been reclassified into the operating results of the IS&GS business, classified as discontinued operations, and excluded from the operating results of our continuing operations. The amount of severance charges reclassified were \$19 million in 2016 and \$20 million in 2015.

Financial information related to the IS&GS business's cash flows, such as depreciation and amortization, capital expenditures, and other non-cash items, included in our consolidated statements of cash flows was not significant.

## **Other Divestitures**

During 2016, we completed the sale of our Lockheed Martin Commercial Flight Training (LMCFT) business, which was classified as held for sale in the fourth quarter of 2015. Other, net in 2015 includes a non-cash asset impairment charge of approximately \$90 million. This charge was partially offset by a net deferred tax benefit of about \$80 million, which is



recorded in income tax expense. The net impact reduced net earnings by about \$10 million. LMCFT's financial results are not material and there was no significant impact on our consolidated financial results as a result of completing the sale of our LMCFT business. Accordingly, LMCFT's financial results are not classified in discontinued operations.

#### Note 4 – Goodwill and Acquired Intangibles

Changes in the carrying amount of goodwill by segment were as follows (in millions):

	Aeronautics	MFC	RMS	Space Systems	Total
Balance at December 31, 2014 <sup>(a)</sup>	\$171	\$2,181	\$4,022	\$1,590	\$ 7,964
Sikorsky acquisition	—	—	2,764	—	2,764
Other	—	17	(48)	(2)	(33)
Balance at December 31, 2015	171	2,198	6,738	1,588	10,695
Purchase accounting adjustments	—	—	78	—	78
Other	—	62	(68)	(3)	(9)
Balance at December 31, 2016	\$171	\$2,260	\$6,748	\$1,585	\$10,764

<sup>(a)</sup> Includes reclassifications of goodwill among our business segments as a result of our program realignment, which occurred during the fourth quarter of 2015 (see "Note 1 – Significant Accounting Policies").

The gross carrying amounts and accumulated amortization of our acquired intangible assets consisted of the following (in millions):

	2016			2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Finite-Lived:						
Customer programs	\$3,184	\$(273)	\$2,911	\$3,127	\$(38)	\$3,089
Customer relationships	359	(92)	267	137	(59)	78
Other	111	(83)	28	111	(72)	39
Total finite-lived intangibles	3,654	(448)	3,206	3,375	(169)	3,206
Indefinite-Lived:						
Trademarks	887	—	887	816	—	816
Total acquired intangibles	\$4,541	\$(448)	\$4,093	\$4,191	\$(169)	\$4,022

Acquired finite-lived intangible assets are amortized to expense primarily on a straight-line basis over the following estimated useful lives: customer programs, from nine to 20 years; customer relationships, from four to 10 years; technology, from five to seven years; trademarks, from two to five years; and other intangibles, from three to 10 years.

Amortization expense from continuing operations for acquired finite-lived intangible assets was \$284 million, \$68 million and \$20 million in 2016, 2015 and 2014. Estimated future amortization expense is as follows: \$318 million in 2017; \$298 million in 2018; \$285 million in 2019; \$263 million in 2020; \$256 million in 2021 and \$1,786 million thereafter.

#### Note 5 – Information on Business Segments

We operate in four business segments: Aeronautics, Missiles and Fire Control (MFC), Rotary and Mission Systems (RMS) and Space Systems. We organize our business segments based on the nature of products and services offered.

Following is a brief description of the activities of our business segments:

- **Aeronautics** – Engaged in the research, design, development, manufacture, integration, sustainment, support and upgrade of advanced military aircraft, including combat and air mobility aircraft, unmanned air vehicles and related technologies.
- **Missiles and Fire Control** – Provides air and missile defense systems; tactical missiles and air-to-ground precision strike weapon systems; logistics; fire control systems; mission operations support, readiness, engineering support and integration services; manned and unmanned ground vehicles; and energy management solutions.

- **Rotary and Mission Systems** – Provides design, manufacture, service and support for a variety of military and civil helicopters; ship and submarine mission and combat systems; mission systems and sensors for rotary and fixed-wing aircraft; sea and land-based missile defense systems; radar systems; the Littoral Combat Ship; simulation and training services; and unmanned systems and technologies. In addition, RMS supports the needs of customers in cybersecurity and delivers communications and command and control capability through complex mission solutions for defense applications. The 2015 results of the acquired Sikorsky business have been included in our consolidated results of operations from the November 6, 2015 acquisition date through December 31, 2015. Accordingly, the consolidated results of operations for the year ended December 31, 2015 do not reflect a full year of Sikorsky operations.
- **Space Systems** – Engaged in the research and development, design, engineering and production of satellites, strategic and defensive missile systems and space transportation systems. Space systems provides network-enabled situational awareness and integrates complex space and ground-based global systems to help our customers gather, analyze and securely distribute critical intelligence data. Space Systems is also responsible for various classified systems and services in support of vital national security systems. The results of AWE have been included in our consolidated results of operations from August 24, 2016, when we obtained controlling interest through December 31, 2016. Accordingly, the consolidated results of operations for the year ended December 31, 2016 do not reflect a full year of AWE operations. Operating profit for our Space Systems business segment also includes our share of earnings for our investment in ULA, which provides expendable launch services to the U.S. Government.

The financial information in the following tables includes the results of businesses we have acquired during the past three years (see “Note 3 – Acquisitions and Divestitures”) from their respective dates of acquisition. The business segment operating results in the following tables exclude businesses included in discontinued operations (see “Note 3 – Acquisitions and Divestitures”) for all years presented. 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. United Launch Alliance (ULA), which is part of our Space Systems business segment, is our primary equity method investee. Operating profit of our business segments excludes the FAS/CAS pension adjustment described below; 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 (see “Note 15 – Restructuring Charges”) and goodwill impairments; gains or losses from 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 1 – Significant Accounting Policies” under the caption “Use of Estimates” for a discussion related to certain factors that may impact the comparability of net sales and operating profit of our business segments.

Our business segments’ results of operations include pension expense only as calculated under U.S. Government Cost Accounting Standards (CAS), which we refer to as CAS pension cost. We recover CAS pension cost through the pricing of our products and services on U.S. Government contracts and, therefore, the CAS pension cost is recognized in each of our business segments’ net sales and cost of sales. Since our consolidated financial statements must present pension expense calculated in accordance with the financial accounting standards (FAS) requirements under GAAP, which we refer to as FAS pension expense, the FAS/CAS pension adjustment increases or decreases the CAS pension cost recorded in our business segments’ results of operations to equal the FAS pension expense.

## Selected Financial Data by Business Segment

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

	2016	2015	2014
<b>Net sales</b>			
Aeronautics	<b>\$17,769</b>	\$15,570	\$14,920
Missiles and Fire Control	<b>6,608</b>	6,770	7,092
Rotary and Mission Systems	<b>13,462</b>	9,091	8,732
Space Systems	<b>9,409</b>	9,105	9,202
Total net sales	<b>\$47,248</b>	\$40,536	\$39,946
<b>Operating profit</b>			
Aeronautics	<b>\$ 1,887</b>	\$ 1,681	\$ 1,649
Missiles and Fire Control	<b>1,018</b>	1,282	1,344
Rotary and Mission Systems	<b>906</b>	844	936
Space Systems	<b>1,289</b>	1,171	1,187
Total business segment operating profit	<b>5,100</b>	4,978	5,116
Unallocated items			
FAS/CAS pension adjustment			
FAS pension expense <sup>(a)</sup>	<b>(1,019)</b>	(1,127)	(1,099)
Less: CAS pension cost <sup>(a) (b)</sup>	<b>1,921</b>	1,527	1,416
FAS/CAS pension adjustment	<b>902</b>	400	317
Severance charges <sup>(a) (c)</sup>	<b>(80)</b>	(82)	—
Stock-based compensation	<b>(149)</b>	(133)	(154)
Other, net <sup>(d), (e)</sup>	<b>(224)</b>	(451)	(267)
Total unallocated items	<b>449</b>	(266)	(104)
Total consolidated operating profit	<b>\$ 5,549</b>	\$ 4,712	\$ 5,012

<sup>(a)</sup> FAS pension expense, CAS pension costs and severance charges reflect the reclassification for discontinued operations presentation of benefits related to former IS&GS salaried employees (see “Note 11 – Postretirement Plans”).

<sup>(b)</sup> The higher CAS pension cost primarily reflects the impact of phasing in CAS Harmonization.

<sup>(c)</sup> See “Note 15 – Restructuring Charges” for information on charges related to certain severance actions at our business segments. Severance charges for initiatives that are not significant are included in business segment operating profit.

<sup>(d)</sup> Other, net in 2015 includes a non-cash asset impairment charge of approximately \$90 million related to our decision in 2015 to divest our LMCFT business (see “Note 3 – Acquisitions and Divestitures”). This charge was partially offset by a net deferred tax benefit of about \$80 million, which is recorded in income tax expense. The net impact reduced net earnings by about \$10 million.

<sup>(e)</sup> Other, net in 2015 includes approximately \$38 million of non-recoverable transaction costs associated with the acquisition of Sikorsky.

**Selected Financial Data by Business Segment (continued)**

	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Intersegment sales</b>			
Aeronautics	\$ 137	\$ 102	\$ 103
Missiles and Fire Control	305	315	256
Rotary and Mission Systems	1,816	1,533	1,245
Space Systems	110	146	137
Total intersegment sales	<b>\$2,368</b>	\$2,096	\$1,741
<b>Depreciation and amortization</b>			
Aeronautics	\$ 299	\$ 317	\$ 322
Missiles and Fire Control	105	99	99
Rotary and Mission Systems	476	211	167
Space Systems	212	220	232
Total business segment depreciation and amortization	<b>1,092</b>	847	820
Corporate activities	75	98	107
Total depreciation and amortization <sup>(a)</sup>	<b>\$1,167</b>	\$ 945	\$ 927
<b>Capital expenditures</b>			
Aeronautics	\$ 358	\$ 387	\$ 283
Missiles and Fire Control	167	120	142
Rotary and Mission Systems	271	169	164
Space Systems	183	172	172
Total business segment capital expenditures	<b>979</b>	848	761
Corporate activities	75	60	66
Total capital expenditures <sup>(b)</sup>	<b>\$1,054</b>	\$ 908	\$ 827

<sup>(a)</sup> Total depreciation and amortization in the table above excludes \$48 million, \$81 million and \$67 million for the years ended December 31, 2016, 2015 and 2014 related to the former IS&GS business segment. These amounts are included in depreciation and amortization in our consolidated statements of cash flows as we did not reclassify our cash flows to exclude the IS&GS business segment. See “Note 3 – Acquisitions and Divestitures” for more information.

<sup>(b)</sup> Total capital expenditures in the table above excludes \$9 million, \$31 million and \$18 million for the years ended December 31, 2016, 2015 and 2014 related to the former IS&GS business segment. These amounts are included in capital expenditures in our consolidated statements of cash flows as we did not reclassify our cash flows to exclude the IS&GS business segment. See “Note 3 – Acquisitions and Divestitures” for more information.

## Selected Financial Data by Business Segment (continued)

### Net Sales by Customer Category

Net sales by customer category were as follows (in millions):

	2016	2015	2014
<b>U.S. Government</b>			
Aeronautics	\$11,714	\$11,195	\$10,704
Missiles and Fire Control	4,026	4,150	4,509
Rotary and Mission Systems	9,187	6,961	6,752
Space Systems	8,543	8,845	8,921
Total U.S. Government net sales	\$33,470	\$31,151	\$30,886
<b>International <sup>(a)</sup></b>			
Aeronautics	\$ 5,973	\$ 4,328	\$ 4,183
Missiles and Fire Control	2,444	2,449	2,421
Rotary and Mission Systems	3,798	2,016	1,921
Space Systems	488	218	89
Total international net sales	\$12,703	\$ 9,011	\$ 8,614
<b>U.S. Commercial and Other</b>			
Aeronautics	\$ 82	\$ 47	\$ 33
Missiles and Fire Control	138	171	162
Rotary and Mission Systems	477	114	59
Space Systems	378	42	192
Total U.S. commercial and other net sales	\$ 1,075	\$ 374	\$ 446
Total net sales	\$47,248	\$40,536	\$39,946

<sup>(a)</sup> International sales include foreign military sales contracted through the U.S. Government, direct commercial sales with international governments and commercial and other sales to international customers.

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 23% of our total consolidated net sales during each of 2016 and 2015, and 20% during 2014.

Total assets and customer advances and amounts in excess of costs incurred for each of our business segments were as follows (in millions):

	2016	2015
<b>Assets <sup>(a)</sup></b>		
Aeronautics	\$ 7,896	\$ 6,618
Missiles and Fire Control	4,000	4,027
Rotary and Mission Systems	18,367	19,187
Space Systems	5,250	4,861
Total business segment assets	35,513	34,693
Assets of discontinued operations	—	4,130
Corporate assets <sup>(b)</sup>	12,293	10,481
Total assets	\$47,806	\$49,304
<b>Customer advances and amounts in excess of costs incurred</b>		
Aeronautics	\$ 2,133	\$ 2,045
Missiles and Fire Control	1,517	1,766
Rotary and Mission Systems	2,590	2,415
Space Systems	536	477
Total customer advances and amounts in excess of costs incurred	\$ 6,776	\$ 6,703

<sup>(a)</sup> We have no long-lived assets with material carrying values located in foreign countries.

<sup>(b)</sup> Corporate assets primarily include cash and cash equivalents, deferred income taxes, environmental receivables and investments held in a separate trust.

**Note 6 – Receivables, net**

Receivables, net consisted of the following (in millions):

	<b>2016</b>	<b>2015</b>
U.S. Government		
Amounts billed	\$ 792	\$ 1,205
Unbilled costs and accrued profits	6,877	5,243
Less: customer advances and progress payments	(1,346)	(1,193)
<b>Total U.S. Government receivables, net</b>	<b>6,323</b>	<b>5,255</b>
Other governments and commercial		
Amounts billed	546	704
Unbilled costs and accrued profits	1,847	1,888
Less: customer advances	(514)	(593)
<b>Total other governments and commercial receivables, net</b>	<b>1,879</b>	<b>1,999</b>
<b>Total receivables, net</b>	<b>\$ 8,202</b>	<b>\$ 7,254</b>

We expect to bill substantially all of the December 31, 2016 unbilled costs and accrued profits during 2017.

**Note 7 – Inventories, net**

Inventories, net consisted of the following (in millions):

	<b>2016</b>	<b>2015</b>
Work-in-process, primarily related to long-term contracts and programs in progress	\$ 7,864	\$ 8,081
Spare parts, used aircraft and general stock materials	833	1,030
Other inventories	719	740
<b>Total inventories</b>	<b>9,416</b>	<b>9,851</b>
Less: customer advances and progress payments	(4,746)	(5,032)
<b>Total inventories, net</b>	<b>\$ 4,670</b>	<b>\$ 4,819</b>

Work-in-process inventories at December 31, 2016 and 2015 included general and administrative costs of \$529 million and \$565 million. General and administrative costs incurred and recorded in inventories totaled \$3.3 billion in 2016, \$2.7 billion in 2015 and \$2.5 billion in 2014. General and administrative costs charged to cost of sales from inventories totaled \$3.3 billion in 2016, \$2.8 billion in 2015 and \$2.5 billion in 2014.

**Note 8 – Property, Plant and Equipment, net**

Property, plant and equipment, net consisted of the following (in millions):

	<b>2016</b>	<b>2015</b>
Land	\$ 127	\$ 112
Buildings	6,385	6,007
Machinery and equipment	7,389	7,261
Construction in progress	976	886
<b>Total property, plant and equipment</b>	<b>14,877</b>	<b>14,266</b>
Less: accumulated depreciation and amortization	(9,328)	(8,877)
<b>Total property, plant and equipment, net</b>	<b>\$ 5,549</b>	<b>\$ 5,389</b>

## Note 9 – Income Taxes

Our provision for federal and foreign income tax expense for continuing operations consisted of the following (in millions):

	2016	2015	2014
Federal income tax expense (benefit):			
Current	\$1,327	\$1,573	\$1,770
Deferred	(231)	(473)	(351)
Total federal income tax expense	1,096	1,100	1,419
Foreign income tax expense (benefit):			
Current	56	39	13
Deferred	(19)	34	(8)
Total foreign income tax expense	37	73	5
Total income tax expense	\$1,133	\$1,173	\$1,424

State income taxes are included in our operations as general and administrative costs and, under U.S. Government regulations, are allowable costs in establishing prices for the products and services we sell to the U.S. Government. Therefore, a substantial portion of state income taxes is included in our net sales and cost of sales. As a result, the impact of certain transactions on our operating profit and of other matters presented in these consolidated financial statements is disclosed net of state income taxes. Our total net state income tax expense was \$112 million for 2016, \$106 million for 2015, and \$149 million for 2014.

Our reconciliation of the 35% U.S. federal statutory income tax rate to actual income tax expense for continuing operations is as follows (dollars in millions):

	2016		2015		2014	
	Amount	Rate	Amount	Rate	Amount	Rate
Income tax expense at the U.S. federal statutory tax rate	\$1,710	35.0%	\$1,505	35.0%	\$1,637	35.0%
Adoption of stock-based compensation ASU	(152)	(3.1)	—	—	—	—
U.S. manufacturing deduction benefit	(117)	(2.4)	(123)	(2.9)	(124)	(2.6)
Research and development tax credit	(107)	(2.2)	(70)	(1.6)	(63)	(1.3)
Tax deductible dividends	(92)	(1.9)	(87)	(2.0)	(82)	(1.8)
Other, net	(109)	(2.2)	(52)	(1.2)	56	1.1
Income tax expense	\$1,133	23.2%	\$1,173	27.3%	\$1,424	30.4%

In 2016, we early adopted the accounting standard update for employee share-based payment awards. Accordingly, we recognized additional income tax benefits of \$152 million during the year ended December 31, 2016. The 2016 income tax rate also benefited from the nontaxable gain recorded in connection with the consolidation of AWE.

We recognized tax benefits of \$107 million in 2016, \$70 million in 2015, and \$63 million in 2014 from U.S. research and development (R&D) tax credits, including benefits attributable to prior periods. In December 2015, the R&D tax credit was permanently extended and reinstated, retroactive to the beginning of 2015, which reduced income tax expense by approximately \$70 million. In 2014, the R&D tax credit was temporarily reinstated for one year, retroactive to the beginning of 2014, which reduced income tax expense by approximately \$45 million.

We receive a tax deduction for dividends paid on shares of our common stock held by certain of our defined contribution plans with an employee stock ownership plan feature. The amount of the tax deduction has increased as we increased our dividend over the last three years, partially offset by a decline in the number of shares in these plans.

As a result of a decision in 2015 to divest our LMCFT business (see “Note 3 – Acquisitions and Divestitures), we recorded an asset impairment charge of approximately \$90 million. This charge was partially offset by a net deferred tax benefit of about \$80 million. The net impact of the resulting tax benefit reduced the effective income tax rate by 1.2 percentage points in 2015.

We participate in the IRS Compliance Assurance Process program. Examinations of the years 2015 and 2016 remain under IRS review.

The primary components of our federal and foreign deferred income tax assets and liabilities at December 31 were as follows (in millions):

	2016	2015
Deferred tax assets related to:		
Accrued compensation and benefits	\$1,012	\$ 919
Pensions <sup>(a)</sup>	5,197	4,462
Other postretirement benefit obligations	302	375
Contract accounting methods	878	1,039
Foreign company operating losses and credits	30	62
Other	327	418
Valuation allowance <sup>(b)</sup>	(15)	(73)
Deferred tax assets, net	7,731	7,202
Deferred tax liabilities related to:		
Goodwill and purchased intangibles	378	274
Property, plant and equipment	346	457
Exchanged debt securities and other <sup>(c)</sup>	418	408
Deferred tax liabilities	1,142	1,139
Net deferred tax assets	\$6,589	\$6,063

<sup>(a)</sup> The increase in 2016 was primarily due to the reduction in the discount rate used to measure our postretirement benefit plans (see “Note 11 – Postretirement Plans”).

<sup>(b)</sup> A valuation allowance was provided against certain foreign company deferred tax assets arising from carryforwards of unused tax benefits.

<sup>(c)</sup> Includes deferred taxes associated with the exchange of debt securities in prior years.

As of December 31, 2016 and 2015, our liabilities associated with unrecognized tax benefits are not material.

We and our subsidiaries file income tax returns in the U.S. Federal jurisdiction and various foreign jurisdictions. With few exceptions, the statute of limitations is no longer open for U.S. Federal or non-U.S. income tax examinations for the years before 2013, other than with respect to refunds.

U.S. income taxes and foreign withholding taxes have not been provided on earnings of \$386 million, \$310 million, and \$249 million that have not been distributed by our non-U.S. companies as of December 31, 2016, 2015, and 2014. Our intention is to permanently reinvest these earnings, thereby indefinitely postponing their remittance to the U.S. If these earnings had been remitted, we estimate that the additional income taxes after foreign tax credits would have been approximately \$64 million in 2016, \$49 million in 2015, and \$52 million in 2014.

Our federal and foreign income tax payments, net of refunds received, were \$1.3 billion in 2016, \$1.8 billion in 2015, and \$1.5 billion in 2014. Our 2014 net payments reflect a \$200 million refund from the IRS primarily attributable to our tax-deductible discretionary pension contributions during the fourth quarter of 2013.



## Note 10 – Debt

Our long-term debt consisted of the following (in millions):

	December 31,	
	2016	2015
<b>Notes</b>		
2.13% and 7.65% due 2016	\$ —	\$ 952
1.85% due 2018	750	750
4.25% due 2019	900	900
2.50% due 2020	1,250	1,250
3.35% due 2021	900	900
3.10% due 2023	500	500
2.90% due 2025	750	750
3.55% due 2026	2,000	2,000
3.60% due 2035	500	500
4.50% and 6.15% due 2036	1,152	1,152
4.85% due 2041	600	600
4.07% due 2042	1,336	1,336
3.80% due 2045	1,000	1,000
4.70% due 2046	2,000	2,000
Other notes with rates from 5.50% to 8.50%, due 2023 to 2040	1,656	1,706
Total debt	15,294	16,296
Less: unamortized discounts and issuance costs	(1,012)	(1,035)
Total debt, net	14,282	15,261
Less: current portion	—	(956)
Long-term debt, net	\$14,282	\$14,305

### Revolving Credit Facilities

On October 9, 2015, we entered into a new \$2.5 billion revolving credit facility (the 5-year Facility) with various banks and concurrently terminated our existing \$1.5 billion revolving credit facility, which was scheduled to expire in August 2019. The 5-year Facility was amended in October 2016 to extend its expiration date by one year from October 9, 2020 to October 9, 2021. The 5-year Facility is available for general corporate purposes. The undrawn portion of the 5-year Facility is also available to serve as a backup facility for the issuance of commercial paper. We may request and the banks may grant, at their discretion, an increase in the borrowing capacity under the 5-year Facility of up to an additional \$500 million. During 2016, we borrowed and fully repaid amounts under our commercial paper programs. There were no borrowings outstanding under the 5-year Facility as of years ended December 31, 2016 and 2015.

In contemplation of our acquisition of Sikorsky, on October 9, 2015, we also entered into a 364-day revolving credit facility (the 364-day Facility, and together with the 5-year Facility, the Facilities) with various banks that provided \$7.0 billion of funding for general corporate purposes, including the acquisition of Sikorsky. Concurrent with the consummation of the Sikorsky acquisition, we borrowed \$6.0 billion under the 364-day Facility. On November 23, 2015, we repaid all outstanding borrowings under the 364-day Facility with proceeds received from an issuance of new debt (see below) and terminated any remaining commitments of the lenders under the 364-day Facility.

Borrowings under the 5-year Facility bear interest at rates based, at our option, on a Eurodollar Rate or a Base Rate, as defined in the 5-year Facility's agreement. Each bank's obligation to make loans under the 5-year Facility is subject to, among other things, our compliance with various representations, warranties, and covenants, including covenants limiting our ability and certain of our subsidiaries' ability to encumber assets and a covenant not to exceed a maximum leverage ratio, as defined in the 5-year Facility agreement. As of December 31, 2016 and 2015, we were in compliance with all covenants contained in the 5-year Facility agreement, as well as in our debt agreements.

### Long-Term Debt

In September 2016, we repaid \$500 million of long-term notes with a fixed interest rate of 2.13% according to their scheduled maturities.

In May 2016, we repaid \$452 million of long-term notes with a fixed interest rate of 7.65% according to their scheduled maturities. We also had related variable interest rate swaps with a notional amount of \$450 million mature, which did not have a significant impact on net earnings or comprehensive income.

We made interest payments of approximately \$600 million, approximately \$375 million and approximately \$325 million during the years ended December 31, 2016, 2015 and 2014, respectively.

On November 23, 2015, we issued \$7.0 billion of notes (the November 2015 Notes) in a registered public offering. We received net proceeds of \$6.9 billion from the offering, after deducting discounts and debt issuance costs, which are being amortized as interest expense over the life of the debt. The November 2015 Notes consist of:

- \$750 million maturing in 2018 with a fixed interest rate of 1.85% (the 2018 Notes);
- \$1.25 billion maturing in 2020 with a fixed interest rate of 2.50% (the 2020 Notes);
- \$500 million maturing in 2023 with a fixed interest rate of 3.10% (the 2023 Notes);
- \$2.0 billion maturing in 2026 with a fixed interest rate of 3.55% (the 2026 Notes);
- \$500 million maturing in 2036 with a fixed interest rate of 4.50% (the 2036 Notes); and
- \$2.0 billion maturing in 2046 with a fixed interest rate of 4.70% (the 2046 Notes).

We may, at our option, redeem some or all of the November 2015 Notes and unpaid interest at any time by paying the principal amount of notes being redeemed plus any make-whole premium and accrued and unpaid interest to the date of redemption. Interest is payable on the 2018 Notes and the 2020 Notes on May 23 and November 23 of each year; on the 2023 Notes and the 2026 Notes on January 15 and July 15 of each year; and on the 2036 Notes and the 2046 Notes on May 15 and November 15 of each year. The November 2015 Notes rank equally in right of payment with all of our existing unsecured and unsubordinated indebtedness. The proceeds of the November 2015 Notes were used to repay \$6.0 billion of borrowings under our 364-day Facility and for general corporate purposes.

On February 20, 2015, we issued \$2.25 billion of notes (the February 2015 Notes) in a registered public offering. We received net proceeds of \$2.21 billion from the offering, after deducting discounts and debt issuance costs, which are being amortized as interest expense over the life of the debt. The February 2015 Notes consist of \$750 million maturing in 2025 with a fixed interest rate of 2.90%, \$500 million maturing in 2035 with a fixed interest rate of 3.60% and \$1.0 billion maturing in 2045 with a fixed interest rate of 3.80%. We may, at our option, redeem some or all of the notes at any time by paying the principal amount of notes being redeemed plus any make-whole premium and accrued and unpaid interest to the date of redemption. Interest on the notes is payable on March 1 and September 1 of each year. These notes rank equally in right of payment with all of our existing unsecured and unsubordinated indebtedness. The proceeds of the February 2015 Notes were used for general corporate purposes.

## **Commercial Paper**

We have agreements in place with financial institutions to provide for the issuance of commercial paper. In connection with the Sikorsky acquisition, in the fourth quarter of 2015 we borrowed and repaid approximately \$1.0 billion under our commercial paper programs. There were no commercial paper borrowings outstanding as of December 31, 2016 and 2015. If we were to issue commercial paper in the future, the borrowings would be supported by the 5-year Facility.

## **Note 11 – Postretirement Plans**

### **Defined Benefit Pension Plans and Retiree Medical and Life Insurance Plans**

Many of our employees are covered by qualified defined benefit pension plans and we provide certain health care and life insurance benefits to eligible retirees (collectively, postretirement benefit plans). We also sponsor nonqualified defined benefit pension plans to provide for benefits in excess of qualified plan limits. Non-union employees hired after December 2005 do not participate in our qualified defined benefit pension plans, but are eligible to participate in a qualified defined contribution plan in addition to our other retirement savings plans. They also have the ability to participate in our retiree medical plans, but we do not subsidize the cost of their participation in those plans as we do with employees hired before January 1, 2006. Over the last few years, we have negotiated similar changes with various labor organizations such that new union represented employees do not participate in our defined benefit pension plans. In June 2014, we amended certain of our qualified and nonqualified defined benefit pension plans for non-union employees to freeze future retirement benefits. The calculation of retirement benefits under the affected defined benefit pension plans is determined by a formula that takes into account the participants' years of credited service and average compensation. The freeze will take effect in two stages.

Beginning on January 1, 2016, the pay-based component of the formula used to determine retirement benefits was frozen so that future pay increases, annual incentive bonuses or other amounts earned for or related to periods after December 31, 2015 are not used to calculate retirement benefits. On January 1, 2020, the service-based component of the formula used to determine retirement benefits will also be frozen so that participants will no longer earn further credited service for any period after December 31, 2019. When the freeze is complete, the majority of our salaried employees will have transitioned to an enhanced defined contribution retirement savings plan. As part of the November 6, 2015 acquisition of Sikorsky, we established a new defined benefit pension plan for Sikorsky's union workforce that provides benefits for their prospective service with us. The Sikorsky salaried employees participate in a defined contribution plan. We did not assume any legacy pension liability from UTC.

We have made contributions to trusts established to pay future benefits to eligible retirees and dependents, including Voluntary Employees' Beneficiary Association trusts and 401(h) accounts, the assets of which will be used to pay expenses of certain retiree medical plans. We use December 31 as the measurement date. Benefit obligations as of the end of each year reflect assumptions in effect as of those dates. Net periodic benefit cost is based on assumptions in effect at the end of the respective preceding year.

The rules related to accounting for postretirement benefit plans under GAAP require us to recognize on a plan-by-plan basis the funded status of our postretirement benefit plans as either an asset or a liability on our consolidated balance sheets. There is a corresponding non-cash adjustment to accumulated other comprehensive loss, net of tax benefits recorded as deferred tax assets, in stockholders' equity. The funded status is measured as the difference between the fair value of the plan's assets and the benefit obligation of the plan.

The net periodic benefit cost recognized each year included the following (in millions):

	Qualified Defined Benefit Pension Plans <sup>(a)</sup>			Retiree Medical and Life Insurance Plans		
	2016	2015	2014	2016	2015	2014
Service cost	\$ 827	\$ 836	\$ 841	\$ 24	\$ 21	\$ 22
Interest cost	1,861	1,791	1,912	119	110	123
Expected return on plan assets	(2,666)	(2,734)	(2,693)	(138)	(147)	(146)
Recognized net actuarial losses	1,359	1,599	1,173	34	43	23
Amortization of net prior service (credit) cost <sup>(b)</sup>	(362)	(365)	(134)	22	4	4
<b>Total net periodic benefit cost</b>	<b>\$ 1,019</b>	<b>\$ 1,127</b>	<b>\$ 1,099</b>	<b>\$ 61</b>	<b>\$ 31</b>	<b>\$ 26</b>

<sup>(a)</sup> Total net periodic benefit cost associated with our qualified defined benefit plans represents pension expense calculated in accordance with GAAP (FAS pension expense). We are required to calculate pension expense in accordance with both GAAP and CAS rules, each of which results in a different calculated amount of pension expense. The CAS pension cost is recovered through the pricing of our products and services on U.S. Government contracts and, therefore, is recognized in net sales and cost of sales for products and services. We include the difference between FAS pension expense and CAS pension cost, referred to as the FAS/CAS pension adjustment, as a component of other unallocated, net on our consolidated statements of earnings. The FAS/CAS pension adjustment, which was \$902 million in 2016, \$400 million in 2015, and \$317 million in 2014, effectively adjusts the amount of CAS pension cost in the business segment operating profit so that pension expense recorded on our consolidated statements of earnings is equal to FAS pension expense. FAS pension expense and CAS pension costs reflect the reclassification for discontinued operations presentation of benefits related to former IS&GS salaried employees.

<sup>(b)</sup> Net of the reclassification for discontinued operations presentation of pension benefits related to former IS&GS salaried employees (\$14 million in 2016, \$24 million in 2015 and \$17 million in 2014).

The following table provides a reconciliation of benefit obligations, plan assets and unfunded status related to our qualified defined benefit pension plans and our retiree medical and life insurance plans (in millions):

	Qualified Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
	2016	2015	2016	2015
<b>Change in benefit obligation</b>				
Beginning balance	\$ 43,702	\$ 45,882	\$ 2,883	\$ 3,034
Service cost	827	836	24	21
Interest cost	1,861	1,791	119	110
Benefits paid	(2,172)	(2,055)	(222)	(307)
Actuarial losses (gains)	1,402	(1,988)	(135)	(170)
New longevity assumptions <sup>(a)</sup>	(687)	(834)	(53)	(77)
Plan amendments and acquisitions <sup>(b)</sup>	110	31	(32)	157
Service cost related to discontinued operations	21	39	—	—
Medicare Part D subsidy	—	—	4	14
Participants' contributions	—	—	61	101
Ending balance	\$ 45,064	\$ 43,702	\$ 2,649	\$ 2,883
<b>Change in plan assets</b>				
Beginning balance at fair value	\$ 32,096	\$ 34,673	\$ 1,813	\$ 1,932
Actual return on plan assets	1,470	(527)	95	(27)
Benefits paid	(2,172)	(2,055)	(222)	(307)
Company contributions	23	5	36	100
Medicare Part D subsidy	—	—	4	14
Participants' contributions	—	—	61	101
Ending balance at fair value	\$ 31,417	\$ 32,096	\$ 1,787	\$ 1,813
Unfunded status of the plans	\$ (13,647)	\$ (11,606)	\$ (862)	\$ (1,070)

<sup>(a)</sup> We adopted new longevity assumptions originally published by the Society of Actuaries in October 2014. The Society of Actuaries refined their original publication in October 2015 and again in October 2016.

<sup>(b)</sup> Includes special termination benefits of \$27 million for qualified pension and \$9 million for retiree medical recognized in 2016 related to former IS&GS salaried employees. The November 2015 acquisition of Sikorsky increased our qualified defined benefit pension obligations by about \$30 million.

The following table provides amounts recognized on our consolidated balance sheets related to our qualified defined benefit pension plans and our retiree medical and life insurance plans (in millions):

	Qualified Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
	2016	2015	2016	2015
Prepaid pension asset	\$ 208	\$ 201	\$ —	\$ —
Accrued postretirement benefit liabilities	(13,855)	(11,807)	(862)	(1,070)
Accumulated other comprehensive loss (pre-tax) related to:				
Net actuarial losses	20,184	19,632	447	627
Prior service (credit) cost <sup>(a)</sup>	(2,896)	(3,565)	96	167
Total <sup>(b)</sup>	\$ 17,288	\$ 16,067	\$ 543	\$ 794

<sup>(a)</sup> Pre-tax amounts of \$210 million for qualified pension prior service credits and \$9 million for retiree medical prior service costs were recognized from the divestiture of our IS&GS business (combined \$134 million, net of tax).

<sup>(b)</sup> Accumulated other comprehensive loss related to postretirement benefit plans, after tax, of \$12.0 billion and \$11.3 billion at December 31, 2016 and 2015 (see "Note 12 – Stockholders' Equity") includes \$17.3 billion (\$11.2 billion after tax) and \$16.1 billion (\$10.4 billion after tax) for qualified defined benefit pension plans, \$543 million (\$351 million after tax) and \$794 million (\$514 million after tax) for retiree medical and life insurance plans and \$677 million (\$448 million after tax) and \$620 million (\$408 million after tax) for other plans.

The accumulated benefit obligation (ABO) for all qualified defined benefit pension plans was \$44.9 billion and \$43.5 billion at December 31, 2016 and 2015, of which \$44.8 billion and \$43.4 billion related to plans where the ABO was in excess of plan assets. The ABO represents benefits accrued without assuming future compensation increases to plan participants. Certain key information related to our qualified defined benefit pension plans as of December 31, 2016 and 2015 is as follows (in millions):

	2016	2015
<b>Plans where ABO was in excess of plan assets</b>		
Projected benefit obligation	\$ 44,946	\$ 43,575
Less: fair value of plan assets	31,091	31,768
Unfunded status of plans <sup>(a)</sup>	(13,855)	(11,807)
<b>Plans where ABO was less than plan assets</b>		
Projected benefit obligation	118	127
Less: fair value of plan assets	326	328
Funded status of plans <sup>(b)</sup>	\$ 208	\$ 201

(a) Represents accrued pension liabilities, which are included on our consolidated balance sheets.

(b) Represents prepaid pension assets, which are included on our consolidated balance sheets in other noncurrent assets.

We also sponsor nonqualified defined benefit plans to provide benefits in excess of qualified plan limits. The aggregate liabilities for these plans at December 31, 2016 and 2015 were \$1.2 billion, which also represent the plans' unfunded status. We have set aside certain assets totaling \$460 million and \$421 million as of December 31, 2016 and 2015 in a separate trust which we expect to be used to pay obligations under our nonqualified defined benefit plans. In accordance with GAAP, those assets may not be used to offset the amount of the benefit obligation similar to the postretirement benefit plans in the table above. The unrecognized net actuarial losses at December 31, 2016 and 2015 were \$642 million and \$632 million. The unrecognized prior service credit at December 31, 2016 was \$74 million and was \$95 million at December 31, 2015. The expense associated with these plans totaled \$125 million in 2016, \$117 million in 2015 and \$115 million in 2014. We also sponsor a small number of other postemployment plans and foreign benefit plans. The aggregate liability for the other postemployment plans was \$63 million and \$70 million as of December 31, 2016 and 2015. The expense for the other postemployment plans, as well as the liability and expense associated with the foreign benefit plans, was not material to our results of operations, financial position or cash flows. The actuarial assumptions used to determine the benefit obligations and expense associated with our nonqualified defined benefit plans and postemployment plans are similar to those assumptions used to determine the benefit obligations and expense related to our qualified defined benefit pension plans and retiree medical and life insurance plans as described below.

The following table provides the amounts recognized in other comprehensive income (loss) related to postretirement benefit plans, net of tax, for the years ended December 31, 2016, 2015 and 2014 (in millions):

	Incurred but Not Yet Recognized in Net Periodic Benefit Cost			Recognition of Previously Deferred Amounts		
	2016	2015	2014	2016	2015	2014
	<i>Gains (losses)</i>			<i>(Gains) losses</i>		
<b>Actuarial gains and losses</b>						
Qualified defined benefit pension plans	\$(1,236)	\$(291)	\$(5,505)	\$ 879	\$1,034	\$ 758
Retiree medical and life insurance plans	94	46	(160)	22	28	15
Other plans	(62)	21	(245)	37	47	33
	(1,204)	(224)	(5,910)	938	1,109	806
	<i>Credit (cost)</i>			<i>(Credit) cost <sup>(a)</sup></i>		
<b>Net prior service credit and cost</b>						
Qualified defined benefit pension plans	(54)	(18)	2,959	(235)	(235)	(87)
Retiree medical and life insurance plans	27	(102)	(3)	14	2	3
Other plans	(1)	(7)	84	(9)	(10)	(5)
	(28)	(127)	3,040	(230)	(243)	(89)
	\$(1,232)	\$(351)	\$(2,870)	\$ 708	\$ 866	\$ 717

(a) Reflects the reclassification for discontinued operations presentation of benefits related to former IS&GS salaried employees (\$9 million in 2016, \$16 million in 2015 and \$11 million in 2014). In addition, we recognized \$134 million of prior service credits from the divestiture of our IS&GS business, which were reclassified as discontinued operations.

We expect that approximately \$1.2 billion, or about \$800 million net of tax, of actuarial losses and net prior service credit related to postretirement benefit plans included in accumulated other comprehensive loss at the end of 2016 to be recognized in net periodic benefit cost during 2017. Of this amount, \$1.1 billion, or \$743 million net of tax, relates to our qualified defined benefit plans and is included in our expected 2017 pension expense of \$1.4 billion.

### Actuarial Assumptions

The actuarial assumptions used to determine the benefit obligations at December 31 of each year and to determine the net periodic benefit cost for each subsequent year, were as follows:

	Qualified Defined Benefit Pension Plans			Retiree Medical and Life Insurance Plans		
	2016	2015	2014	2016	2015	2014
Weighted average discount rate	4.125%	4.375%	4.00%	4.00%	4.25%	3.75%
Expected long-term rate of return on assets	7.50%	8.00%	8.00%	7.50%	8.00%	8.00%
Rate of increase in future compensation levels (for applicable bargained pension plans)	4.50%	4.50%	4.30%			
Health care trend rate assumed for next year				8.75%	9.00%	8.50%
Ultimate health care trend rate				5.00%	5.00%	5.00%
Year that the ultimate health care trend rate is reached				2032	2032	2029

The decrease in the discount rate from December 31, 2015 to December 31, 2016 resulted in an increase in the projected benefit obligations of our qualified defined benefit pension plans of approximately \$1.4 billion at December 31, 2016. The increase in the discount rate from December 31, 2014 to December 31, 2015 resulted in a decrease in the projected benefit obligations of our qualified defined benefit pension plans of approximately \$2.1 billion at December 31, 2015.

The long-term rate of return assumption represents the expected long-term rate of earnings on the funds invested, or to be invested, to provide for the benefits included in the benefit obligations. That assumption is based on several factors including historical market index returns, the anticipated long-term allocation of plan assets, the historical return data for the trust funds, plan expenses and the potential to outperform market index returns.

### Plan Assets

**Investment policies and strategies** – Lockheed Martin Investment Management Company (LMIMCo), our wholly-owned subsidiary, has the fiduciary responsibility for making investment decisions related to the assets of our postretirement benefit plans. LMIMCo's investment objectives for the assets of these plans are (1) to minimize the net present value of expected funding contributions; (2) to ensure there is a high probability that each plan meets or exceeds our actuarial long-term rate of return assumptions; and (3) to diversify assets to minimize the risk of large losses. The nature and duration of benefit obligations, along with assumptions concerning asset class returns and return correlations, are considered when determining an appropriate asset allocation to achieve the investment objectives.

Investment policies and strategies governing the assets of the plans are designed to achieve investment objectives within prudent risk parameters. Risk management practices include the use of external investment managers; the maintenance of a portfolio diversified by asset class, investment approach and security holdings; and the maintenance of sufficient liquidity to meet benefit obligations as they come due.

LMIMCo's investment policies require that asset allocations of postretirement benefit plans be maintained within the following approximate ranges:

Asset Class	Asset Allocation Ranges
Cash and cash equivalents	0-20%
Equity	15-65%
Fixed income	10-60%
Alternative investments:	
Private equity funds	0-15%
Real estate funds	0-10%
Hedge funds	0-20%
Commodities	0-25%

**Fair value measurements** – The rules related to accounting for postretirement benefit plans under GAAP require certain fair value disclosures related to postretirement benefit plan assets, even though those assets are not included on our consolidated balance sheets. The following table presents the fair value of the assets (in millions) of our qualified defined benefit pension plans and retiree medical and life insurance plans by asset category and their level within the fair value hierarchy, which has three levels based on the reliability of the inputs used to determine fair value. Level 1 refers to fair values determined based on quoted prices in active markets for identical assets, Level 2 refers to fair values estimated using significant other observable inputs and Level 3 includes fair values estimated using significant unobservable inputs. Certain other investments are measured at fair value using their Net Asset Value (NAV) per share and do not have readily determined values and are thus not subject to leveling in the fair value hierarchy. The NAV is the total value of the fund divided by the number of shares outstanding.

	December 31, 2016				December 31, 2015			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
<b>Investments measured at fair value</b>								
Cash and cash equivalents <sup>(a)</sup>	\$ 2,301	\$ 2,301	\$ —	\$ —	\$ 2,658	\$ 2,658	\$ —	\$ —
Equity <sup>(a)</sup> :								
U.S. equity securities	4,166	4,139	23	4	4,790	4,771	19	—
International equity securities	3,971	3,927	40	4	6,121	6,087	24	10
Commingled equity funds	2,332	788	1,544	—	1,794	614	1,180	—
Fixed income <sup>(a)</sup> :								
Corporate debt securities	4,333	—	4,316	17	3,929	—	3,914	15
U.S. Government securities	6,811	—	6,811	—	5,069	—	5,069	—
U.S. Government-sponsored enterprise securities	919	—	919	—	1,377	—	1,377	—
Other fixed income investments	2,215	—	2,214	1	3,252	—	3,246	6
Alternative investments:								
Hedge funds	33	—	33	—	57	—	57	—
Private equity funds	—	—	—	—	200	—	—	200
Commodities <sup>(a)</sup>	523	525	(2)	—	(26)	1	(27)	—
<b>Total</b>	<b>\$27,604</b>	<b>\$11,680</b>	<b>\$15,898</b>	<b>\$ 26</b>	<b>\$29,221</b>	<b>\$14,131</b>	<b>\$14,859</b>	<b>\$ 231</b>
<b>Investments measured at NAV <sup>(b)</sup></b>								
Commingled equity funds	60				141			
Private equity funds	3,614				2,931			
Real estate funds	1,411				1,108			
Hedge funds	462				465			
<b>Total investments measured at NAV</b>	<b>5,547</b>				<b>4,645</b>			
Receivables, net	53				43			
<b>Total</b>	<b>\$33,204</b>				<b>\$33,909</b>			

<sup>(a)</sup> Cash and cash equivalents, equity securities, fixed income securities and commodities included derivative assets and liabilities whose fair values were not material as of December 31, 2016 and 2015. LMIMCo's investment policies restrict the use of derivatives to either establish long exposures for purposes of expediency or capital efficiency or to hedge risks to the extent of a plan's current exposure to such risks. Most derivative transactions are settled on a daily basis.

<sup>(b)</sup> Certain investments that are valued using the net asset value per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy and are included in the table to permit reconciliation of the fair value hierarchy to the aggregate postretirement benefit plan assets.

As of December 31, 2016 and 2015, the assets associated with our foreign defined benefit pension plans were not material and have not been included in the table above.

The following table presents the changes during 2016 and 2015 in the fair value of plan assets categorized as Level 3 in the preceding table (in millions):

	<b>Private Equity Funds</b>	<b>Other</b>	<b>Total</b>
Balance at January 1, 2015	\$ —	\$ 61	\$ 61
Actual return on plan assets:			
Realized losses, net	—	(12)	(12)
Unrealized gains, net	—	7	7
Purchases, sales and settlements, net	—	(22)	(22)
Transfers into (out of) Level 3, net	200	(3)	197
Balance at December 31, 2015	\$200	\$ 31	\$231
Actual return on plan assets:			
Realized losses, net	—	(6)	(6)
Unrealized gains, net	—	3	3
Purchases, sales and settlements, net	(200)	(7)	(207)
Transfers into Level 3, net	—	5	5
Balance at December 31, 2016	<b>\$ —</b>	<b>\$ 26</b>	<b>\$ 26</b>

**Valuation techniques** – Cash equivalents are mostly comprised of short-term money-market instruments and are valued at cost, which approximates fair value.

U.S. equity securities and international equity securities categorized as Level 1 are traded on active national and international exchanges and are valued at their closing prices on the last trading day of the year. For U.S. equity securities and international equity securities not traded on an active exchange, or if the closing price is not available, the trustee obtains indicative quotes from a pricing vendor, broker or investment manager. These securities are categorized as Level 2 if the custodian obtains corroborated quotes from a pricing vendor or categorized as Level 3 if the custodian obtains uncorroborated quotes from a broker or investment manager.

Commingled equity funds categorized as Level 1 are traded on active national and international exchanges and are valued at their closing prices on the last trading day of the year. For commingled equity funds not traded on an active exchange, or if the closing price is not available, the trustee obtains indicative quotes from a pricing vendor, broker or investment manager. These securities are categorized as Level 2 if the custodian obtains corroborated quotes from a pricing vendor.

Fixed income investments categorized as Level 2 are valued by the trustee using pricing models that use verifiable observable market data (e.g., interest rates and yield curves observable at commonly quoted intervals and credit spreads), bids provided by brokers or dealers or quoted prices of securities with similar characteristics. Fixed income investments are categorized at Level 3 when valuations using observable inputs are unavailable. The trustee obtains pricing based on indicative quotes or bid evaluations from vendors, brokers or the investment manager.

Commodities are traded on an active commodity exchange and are valued at their closing prices on the last trading day of the year.

Certain commingled equity funds, consisting of equity mutual funds, are valued using the NAV. The NAV valuations are based on the underlying investments and typically redeemable within 90 days.

Private Equity funds consist of partnership and co-investment funds. The NAV is based on valuation models of the underlying securities, which includes unobservable inputs that cannot be corroborated using verifiable observable market data. These funds typically have redemption periods between eight and 12 years.

Real Estate funds consist of partnerships, most of which are closed-end funds, for which the NAV is based on valuation models and periodic appraisals. These funds typically have redemption periods between eight and 10 years.

Hedge Funds consist of direct hedge funds for which the NAV is generally based on the valuation of the underlying investments. Redemptions in hedge funds are based on the specific terms of each fund, and generally range from a minimum of one month to several months.



## **Contributions and Expected Benefit Payments**

The funding of our qualified defined benefit pension plans is determined in accordance with ERISA, as amended by the PPA, and in a manner consistent with CAS and Internal Revenue Code rules. There were no contributions to our legacy qualified defined benefit pension plans during 2016. We do not plan to make contributions to our legacy pension plans in 2017 because none are required using current assumptions including investment returns on plan assets. We made \$23 million in contributions during 2016 to our newly established Sikorsky pension plan and expect to make \$45 million in contributions to this plan during 2017.

The following table presents estimated future benefit payments, which reflect expected future employee service, as of December 31, 2016 (in millions):

	2017	2018	2019	2020	2021	2022 – 2026
Qualified defined benefit pension plans	\$2,260	\$2,340	\$2,420	\$2,510	\$2,590	\$13,920
Retiree medical and life insurance plans	180	180	190	190	190	870

## **Defined Contribution Plans**

We maintain a number of defined contribution plans, most with 401(k) features, that cover substantially all of our employees. Under the provisions of our 401(k) plans, we match most employees' eligible contributions at rates specified in the plan documents. Our contributions were \$617 million in 2016, \$393 million in 2015 and \$385 million in 2014, the majority of which were funded in our common stock. Our defined contribution plans held approximately 36.9 million and 40.0 million shares of our common stock as of December 31, 2016 and 2015.

## **Note 12 – Stockholders' Equity**

At December 31, 2016 and 2015, our authorized capital was composed of 1.5 billion shares of common stock and 50 million shares of series preferred stock. Of the 290 million shares of common stock issued and outstanding as of December 31, 2016, 289 million shares were considered outstanding for consolidated balance sheet presentation purposes; the remaining shares were held in a separate trust. Of the 305 million shares of common stock issued and outstanding as of December 31, 2015, 303 million shares were considered outstanding for consolidated balance sheet presentation purposes; the remaining shares were held in a separate trust. No shares of preferred stock were issued and outstanding at December 31, 2016 or 2015.

## **Repurchases of Common Stock**

During 2016, we repurchased 8.9 million shares of our common stock for \$2.1 billion. During 2015 and 2014, we paid \$3.1 billion and \$1.9 billion to repurchase 15.2 million and 11.5 million shares of our common stock.

On September 22, 2016, our Board of Directors approved a \$2.0 billion increase to our share repurchase program. Inclusive of this increase, the total remaining authorization for future common share repurchases under our program was \$3.5 billion as of December 31, 2016. 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. 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 \$1.7 billion and \$2.4 billion recorded as a reduction of retained earnings in 2016 and 2015.

We paid dividends totaling \$2.0 billion (\$6.77 per share) in 2016, \$1.9 billion (\$6.15 per share) in 2015 and \$1.8 billion (\$5.49 per share) in 2014. We have increased our quarterly dividend rate in each of the last three years, including a 10% increase in the quarterly dividend rate in the fourth quarter of 2016. We declared quarterly dividends of \$1.65 per share during each of the first three quarters of 2016 and \$1.82 per share during the fourth quarter of 2016; \$1.50 per share during each of the first three quarters of 2015 and \$1.65 per share during the fourth quarter of 2015; and \$1.33 per share during each of the first three quarters of 2014 and \$1.50 per share during the fourth quarter of 2014.

## Accumulated Other Comprehensive Loss

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

	Postretirement Benefit Plans	Other, net	AOCL
Balance at December 31, 2013 <sup>(a)</sup>	\$ (9,649)	\$ 48	\$ (9,601)
Other comprehensive loss before reclassifications	(2,870)	(103)	(2,973)
Amounts reclassified from AOCL			
Recognition of net actuarial losses	806	—	806
Amortization of net prior service credits	(100)	—	(100)
Other	—	(2)	(2)
Total reclassified from AOCL	706	(2)	704
Total other comprehensive loss	(2,164)	(105)	(2,269)
Balance at December 31, 2014 <sup>(a)</sup>	(11,813)	(57)	(11,870)
Other comprehensive loss before reclassifications	(351)	(73)	(424)
Amounts reclassified from AOCL			
Recognition of net actuarial losses	1,109	—	1,109
Amortization of net prior service credits	(259)	—	(259)
Total reclassified from AOCL	850	—	850
Total other comprehensive income (loss)	499	(73)	426
Balance at December 31, 2015 <sup>(a)</sup>	(11,314)	(130)	(11,444)
Other comprehensive loss before reclassifications	(1,232)	—	(1,232)
Amounts reclassified from AOCL			
Recognition of net actuarial losses	938	—	938
Amortization of net prior service credits	(239)	—	(239)
Recognition of net prior service credits from divestiture of IS&GS segment <sup>(b)</sup>	(134)	—	(134)
Other <sup>(b)</sup>	—	9	9
Total reclassified from AOCL	565	9	574
Total other comprehensive (loss) income	(667)	9	(658)
Balance at December 31, 2016 <sup>(a)</sup>	<b>\$(11,981)</b>	<b>\$(121)</b>	<b>\$(12,102)</b>

<sup>(a)</sup> AOCL related to postretirement benefit plans is shown net of tax benefits at December 31, 2016, 2015 and 2014 of \$6.5 billion, \$6.2 billion and \$6.4 billion. These tax benefits include amounts recognized on our income tax returns as current deductions and deferred income taxes, which will be recognized on our tax returns in future years. See “Note 9 – Income Taxes” and “Note 11 – Postretirement Plans” for more information on our income taxes and postretirement benefit plans.

<sup>(b)</sup> Associated with the divestiture of the IS&GS business and included in net gain on divestiture of discontinued operations.

## Note 13 – Stock-Based Compensation

During 2016, 2015 and 2014, we recorded non-cash stock-based compensation expense totaling \$149 million, \$133 million and \$154 million, which is included as a component of other unallocated, net on our consolidated statements of earnings. The net impact to earnings for the respective years was \$97 million, \$86 million and \$100 million.

As of December 31, 2016, we had \$83 million of unrecognized compensation cost related to nonvested awards, which is expected to be recognized over a weighted average period of 1.8 years. We received cash from the exercise of stock options totaling \$106 million, \$174 million and \$308 million during 2016, 2015 and 2014. In addition, our income tax liabilities for 2016, 2015 and 2014 were reduced by \$219 million, \$213 million and \$215 million due to recognized tax benefits on stock-based compensation arrangements.

### Stock-Based Compensation Plans

Under plans approved by our stockholders, we are authorized to grant key employees stock-based incentive awards, including options to purchase common stock, stock appreciation rights, restricted stock units (RSUs), performance stock units (PSUs) or other stock units. The exercise price of options to purchase common stock may not be less than the fair market value of our stock on the date of grant. No award of stock options may become fully vested prior to the third anniversary of the grant and no portion of a stock option grant may become vested in less than one year. The minimum

vesting period for restricted stock or stock units payable in stock is three years. Award agreements may provide for shorter or pro-rated vesting periods or vesting following termination of employment in the case of death, disability, divestiture, retirement, change of control or layoff. The maximum term of a stock option or any other award is 10 years.

At December 31, 2016, inclusive of the shares reserved for outstanding stock options, RSUs and PSUs, we had approximately 12 million shares reserved for issuance under the plans. At December 31, 2016, approximately six million of the shares reserved for issuance remained available for grant under our stock-based compensation plans. We issue new shares upon the exercise of stock options or when restrictions on RSUs and PSUs have been satisfied.

## RSUs

The following table summarizes activity related to nonvested RSUs:

	Number of RSUs (In thousands)	Weighted Average Grant-Date Fair Value Per Share
Nonvested at December 31, 2013	3,859	\$ 82.42
Granted	745	146.85
Vested	(2,194)	87.66
Forfeited	(84)	91.11
Nonvested at December 31, 2014	2,326	\$ 97.80
Granted	595	192.47
Vested	(1,642)	103.30
Forfeited	(43)	132.28
Nonvested at December 31, 2015	1,236	\$ 134.87
Granted	<b>679</b>	<b>206.69</b>
Vested	<b>(1,009)</b>	<b>137.62</b>
Forfeited	<b>(118)</b>	<b>203.65</b>
Nonvested at December 31, 2016	<b>788</b>	<b>\$ 183.00</b>

In 2016, we granted certain employees approximately 0.7 million restricted stock units (RSUs) with a grant-date fair value of \$206.69 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.

## Stock Options

We generally recognize compensation cost for stock options ratably over the three-year vesting period. At December 31, 2016 and 2015, there were 3.0 million (weighted average exercise price of \$85.82) and 4.2 million (weighted average exercise price of \$86.61) stock options outstanding. All of the stock options outstanding are vested as of December 31, 2016 and have a weighted average remaining contractual life of approximately three years and an aggregate intrinsic value of \$491 million. There were 1.2 million (weighted average exercise price of \$88.61) stock options exercised during 2016. We did not grant stock options to employees during 2016 and 2015.

The following table pertains to stock options granted through 2012, in addition to stock options that vested and were exercised in 2016, 2015 and 2014 (in millions):

	2016	2015	2014
Grant-date fair value of all stock options that vested	\$ —	\$ 8	\$ 18
Intrinsic value of all stock options exercised	<b>172</b>	265	297

In 2012, we estimated the fair value for stock options at the date of grant using the Black-Scholes option pricing model, which required us to make certain assumptions. We used the following weighted average assumptions in the model: risk-free interest rate of 0.78%, dividend yield of 5.40%, a five year historical volatility factor of 0.28 and an expected option life of five years.

## PSUs

In 2016, we granted certain employees PSUs with an aggregate target award of approximately 0.1 million shares of our common stock. The PSUs vest three years from the grant date based on continuous service, with the number of shares earned (0% to 200% of the target award) depending upon the extent to which we achieve certain financial and market performance targets measured over the period from January 1, 2016 through December 31, 2018. About half of the PSUs were valued at \$206.37 per PSU in a manner similar to RSUs mentioned above as the financial targets are based on our operating results. We recognize the grant-date fair value of these PSUs, less estimated forfeitures, as compensation expense ratably over the vesting period based on the number of awards expected to vest at each reporting date. The remaining PSUs were valued at \$212.37 per PSU using a Monte Carlo model as the performance target is related to our total shareholder return relative to our peer group. We recognize the grant-date fair value of these awards, less estimated forfeitures, as compensation expense ratably over the vesting period.

## Note 14 – Legal Proceedings, Commitments 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, we assumed the defense of and any potential liability for the following civil False Claims Act lawsuit. In October 2014, the U.S. Government filed a complaint in the U.S. District Court for the Eastern District of Wisconsin alleging that Sikorsky and two of its wholly-owned subsidiaries, Derco Aerospace (Derco) and Sikorsky Support Services, Inc. (SSSI), violated the civil False Claims Act in connection with a contract that 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 the spare parts for the training aircraft. The Government alleges that SSSI overbilled the Navy on the contract because Derco added profit and overhead costs to the price of the spare parts that Derco procured and then sold to SSSI. The Government also claims that SSSI submitted false Certificates of Final Indirect Costs in the years 2006 through 2012.

The Government's complaint asserts numerous claims for violations of the False Claims Act, breach of contract and unjust enrichment. The Government seeks damages in excess of \$45 million, subject to trebling, plus statutory penalties. We believe that we have legal and factual defenses to the government's 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 Government prevails in this matter and proves damages at the high end of the range sought and is successful in having these 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 cost 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. At this time we are awaiting a decision from the District Court. Although this matter relates to the IS&GS business, we retained it when IS&GS was divested.

## **Environmental Matters**

We are involved in environmental proceedings and potential proceedings relating to soil and groundwater contamination, disposal of hazardous waste and other environmental matters at several of our current or former facilities or 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 continuously 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 recent 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 to not be recoverable under U.S. Government contracts, in our cost of sales at the time the liability is established.

At each of December 31, 2016 and 2015, the aggregate amount of liabilities recorded relative to environmental matters was \$1.0 billion, most of which are recorded in other noncurrent liabilities on our consolidated balance sheets. We have recorded receivables totaling \$870 million and \$858 million at December 31, 2016 and 2015, 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 cleanup activities usually span several 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 continually evolving regulatory environmental standards. There are a number of former 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 are pursuing claims for recovery of costs incurred or contribution to site cleanup costs against other PRPs, including the U.S. Government, and are conducting remediation activities under various consent decrees and orders relating to soil, groundwater, sediment or surface water contamination at certain sites of former or current operations. Under an agreement related to our Burbank and Glendale, California, sites, the U.S. Government reimburses us an amount equal to approximately 50% of expenditures for certain remediation activities in its capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

The current standard in California for the maximum level of the contaminant hexavalent chromium in drinking water is 10 parts per billion (ppb). This standard is being challenged by the California Manufacturers and Technology Association (CMTA) as being lower than is required to protect public health. If the standard remains at 10 ppb, it will not have a material impact on our existing remediation costs in California. The U.S. EPA is considering whether to regulate hexavalent chromium.

In addition, California is reevaluating its existing drinking water standard of 6 ppb for perchlorate, and the U.S. Environmental Protection Agency (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 to not 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.

### **Operating Leases**

We rent certain equipment and facilities under operating leases. Certain major plant facilities and equipment are furnished by the Government under short-term or cancelable arrangements. Our total rental expense under operating leases was \$202 million, \$195 million and \$197 million for 2016, 2015 and 2014. Future minimum lease commitments at December 31, 2016 for long-term non-cancelable operating leases were \$762 million (\$179 million in 2017, \$150 million in 2018, \$131 million in 2019, \$103 million in 2020, \$78 million in 2021 and \$121 million in later years).

### **Letters of Credit, Surety Bonds and Third-Party Guarantees**

We have entered into standby letters of credit, surety bonds and third-party guarantees with financial institutions and other 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 \$3.7 billion at December 31, 2016 and \$3.8 billion at December 31, 2015.

At December 31, 2016 and 2015, third-party guarantees totaled \$709 million and \$678 million, of which approximately 56% and 79% 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 partners. In addition, we generally have cross-indemnities in place that may enable us to recover amounts that may be paid on behalf of a venture partner. We believe our current and former venture partners will be able to perform their obligations, as they have done through December 31, 2016, and that it will not be necessary to make payments under the guarantees. In determining our exposures, we evaluate the reputation, technical capabilities and credit quality of our current and former venture partners. There were no material amounts recorded in our consolidated financial statements related to third-party guarantees.

### **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 December 31, 2016, 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.

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 December 31, 2016, and that it will not be necessary to make payments under the cross-indemnities or guarantees.

Our 50% ownership share of ULA's net assets initially exceeded the book value of our investment by approximately \$395 million (of which approximately \$40 million remaining was amortized during 2016). This yearly amortization and our share of ULA's net earnings are reported as equity in net earnings (losses) of equity investees in other income, net on our consolidated statements of earnings. Our investment in ULA totaled \$788 million and \$748 million at December 31, 2016 and 2015.

## Note 15 – Restructuring Charges

### 2016 Actions

During 2016, we recorded severance charges totaling approximately \$80 million related to our Aeronautics business segment. The charges consisted of severance costs associated with the planned elimination of certain positions through either voluntary or involuntary actions. Upon separation, terminated employees receive lump-sum severance payments primarily based on years of service, the majority of which are expected to be paid over the next several quarters. During 2016, we paid \$70 million in severance payments associated with these actions.

### 2015 Actions

During 2015, we recorded severance charges totaling \$82 million, of which \$67 million related to our RMS business segment and \$15 million related to businesses that were reported in our former IS&GS business prior to our fourth quarter 2015 program realignment. The charges consisted of severance costs associated with the planned elimination of certain positions through either voluntary or involuntary actions. Upon separation, terminated employees receive lump-sum severance payments primarily based on years of service, the majority of which are expected to be paid over the next several quarters. During 2016, we paid \$64 million in severance payments associated with these actions.

In connection with the Sikorsky acquisition, we assumed obligations related to certain restructuring actions committed to by Sikorsky in June 2015. Net of amounts we anticipate to recover through the pricing of our products and services to our customers, we incurred and paid \$40 million of costs in 2016 related to these actions.

We expect to recover a substantial amount of the restructuring charges through the pricing of our products and services to the U.S. Government and other customers in future periods, with the impact included in the respective business segment's results of operations.

## Note 16 – Fair Value Measurements

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

	December 31, 2016			December 31, 2015		
	Total	Level 1	Level 2	Total	Level 1	Level 2
Assets						
Equity securities	\$ 79	\$ 79	\$ —	\$ 89	\$ 89	\$ —
Mutual funds	856	856	—	745	745	—
U.S. Government securities	113	—	113	119	—	119
Other securities	151	—	151	147	—	147
Derivatives	27	—	27	15	—	15
Liabilities						
Derivatives	85	—	85	35	—	35

Substantially all assets measured at fair value, other than derivatives, represent investments classified as trading securities 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 equity securities and mutual funds 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 transfers of assets or liabilities between levels of the fair value hierarchy during 2016.

In addition to the financial instruments listed in the table above, we hold other financial instruments, including cash and cash equivalents, receivables, accounts payable and debt. The carrying amounts for cash and cash equivalents, receivables and accounts payable approximated their fair values. The estimated fair value of our outstanding debt was \$16.2 billion and \$16.6 billion at December 31, 2016 and 2015 and the outstanding principal amount was \$15.3 billion and \$16.3 billion at December 31, 2016 and 2015, excluding \$1.0 billion of unamortized discounts and issuance costs at the end of each of those years. The estimated fair values of our outstanding debt were determined based on quoted prices for similar instruments in active markets (Level 2).

In connection with the Sikorsky acquisition, we recorded the assets acquired and liabilities assumed at fair value. See “Note 3 – Acquisitions and Divestitures” for further information about the fair values assigned and amounts subject to adjustment.

## Note 17 – Summary of Quarterly Information (Unaudited)

A summary of quarterly information is as follows (in millions, except per share data):

	<b>2016 Quarters</b>			
	<b>First <sup>(b)</sup></b>	<b>Second</b>	<b>Third <sup>(c)(d)</sup></b>	<b>Fourth <sup>(d)</sup></b>
Net sales <sup>(a)</sup>	<b>\$10,368</b>	<b>\$11,577</b>	<b>\$11,551</b>	<b>\$13,752</b>
Operating profit <sup>(a)</sup>	<b>1,158</b>	<b>1,375</b>	<b>1,588</b>	<b>1,428</b>
Net earnings from continuing operations	<b>806</b>	<b>899</b>	<b>1,089</b>	<b>959</b>
Net earnings from discontinued operations	<b>92</b>	<b>122</b>	<b>1,306</b>	<b>29</b>
Net earnings	<b>898</b>	<b>1,021</b>	<b>2,395</b>	<b>988</b>
Earnings per common share from continuing operations <sup>(f)</sup> :				
Basic	<b>2.65</b>	<b>2.97</b>	<b>3.64</b>	<b>3.29</b>
Diluted	<b>2.61</b>	<b>2.93</b>	<b>3.61</b>	<b>3.25</b>
Earnings per common share from discontinued operations <sup>(f)</sup> :				
Basic	<b>0.30</b>	<b>0.40</b>	<b>4.38</b>	<b>0.10</b>
Diluted	<b>0.30</b>	<b>0.39</b>	<b>4.32</b>	<b>0.10</b>
Basic earnings per common share <sup>(f)</sup>	<b>2.95</b>	<b>3.37</b>	<b>8.02</b>	<b>3.39</b>
Diluted earnings per common share <sup>(f)</sup>	<b>2.91</b>	<b>3.32</b>	<b>7.93</b>	<b>3.35</b>

	<b>2015 Quarters</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth <sup>(e)</sup></b>
Net sales <sup>(a)</sup>	\$8,721	\$10,235	\$10,060	\$11,520
Operating profit <sup>(a)</sup>	1,147	1,273	1,192	1,100
Net earnings from continuing operations	738	815	756	817
Net earnings from discontinued operations	140	114	109	116
Net earnings <sup>(g)</sup>	878	929	865	933
Earnings per common share from continuing operations <sup>(f)</sup> :				
Basic	2.34	2.61	2.45	2.67
Diluted	2.30	2.58	2.42	2.63
Earnings per common share from discontinued operations <sup>(f)</sup> :				
Basic	0.44	0.37	0.35	0.38
Diluted	0.44	0.36	0.35	0.38
Basic earnings per common share <sup>(f)</sup>	2.78	2.98	2.80	3.05
Diluted earnings per common share <sup>(f)</sup>	2.74	2.94	2.77	3.01

<sup>(a)</sup> Net sales and operating profit vary from the amounts previously reported on Form 10-Q as a result of our former IS&GS business being classified as discontinued operations in the third quarter of 2016, which is reflected for all periods presented.

<sup>(b)</sup> The first quarter of 2016 varies from the amounts previously reported on Form 10-Q as a result of adopting ASU No. 2016-09 (see “Note 1 – Significant Accounting Policies”).

<sup>(c)</sup> The third quarter of 2016 includes a net gain of \$1.2 billion related to the divestiture of our former IS&GS business.

<sup>(d)</sup> The third quarter of 2016 includes the results of AWE from August 26, 2016, the date we obtained controlling interest, including approximately \$103 million in net sales and \$104 million in net earnings. Third quarter net earnings includes a non-cash gain on the step acquisition of AWE (see “Note 3 – Acquisitions and Divestitures”). The fourth quarter of 2016 includes the results of AWE for the entire quarter, including approximately \$307 million in net sales and \$2.9 million in net earnings.

<sup>(e)</sup> The fourth quarter of 2015 includes the results of Sikorsky since the November 6, 2015 acquisition date through December 31, 2015, including approximately \$400 million in net sales and about \$45 million in operating loss, inclusive of intangible amortization and adjustments required to account for the acquisition.

<sup>(f)</sup> The sum of the quarterly earnings per share amounts do not equal the earnings per share amounts included on our consolidated statements of earnings, primarily due to the timing of our share repurchases during each respective year.

<sup>(g)</sup> The third and fourth quarters of 2015 include charges for workforce reductions of \$15 million and \$67 million (\$10 million and \$44 million after tax). The fourth quarter of 2015 includes a tax benefit of about \$71 million due to the retroactive reinstatement of the R&D tax credit in 2015.



## **ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

### **ITEM 9A. Controls and Procedures.**

#### **Evaluation of Disclosure Controls and Procedures**

We performed an evaluation of the effectiveness of our disclosure controls and procedures as of December 31, 2016. The evaluation was performed with the participation of senior management of each business segment and key Corporate functions, under the supervision of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Based on this evaluation, the CEO and CFO concluded that our disclosure controls and procedures were not effective due to a material weakness in internal control over financial reporting at Sikorsky Aircraft Corporation which we acquired on November 6, 2015 and which operates as a business unit of our Rotary and Mission Systems business segment.

Notwithstanding the identified material weakness, management, including our CEO (principal executive officer) and CFO (principal financial officer), believes the consolidated financial statements included in this annual report on Form 10-K fairly represent in all material respects our financial condition, results of operations and cash flows at and for the periods presented in accordance with U.S. GAAP.

#### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes.

Our management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2016. This assessment was based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (2013 framework). Based on this assessment, management concluded that a material weakness exists in our internal control over financial reporting as of December 31, 2016. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements could occur but will not be prevented or detected on a timely basis.

Sikorsky was acquired on November 6, 2015 and generated about 10% of our total net sales for the year ended December 31, 2016. Prior to 2016, Sikorsky was not included in assessments of the effectiveness of our internal control over financial reporting as the Securities and Exchange Commission (SEC) rules provide companies one year to assess controls at an acquired entity. Accordingly, within this period, we performed our first comprehensive assessment of the design and effectiveness of internal controls at Sikorsky and determined that Sikorsky's internal control over financial reporting was ineffective as of December 31, 2016. Specifically, Sikorsky did not adequately identify, design and implement appropriate process-level controls for its processes and appropriate information technology controls for its information technology systems, including Sikorsky's contract accounting / sales recognition processes, inventory accounting process and payroll process. There were no material errors in the financial results or balances identified as a result of the control deficiencies, and there was no restatement of prior period financial statements and no change in previously released financial results were required as the result of these control deficiencies.

Our independent registered public accounting firm has issued a report expressing an adverse opinion on the effectiveness of our internal control over financial reporting, which is below.

#### **Remediation Efforts to Address Material Weakness**

Management has and will continue to enhance the risk assessment process and design of internal control over financial reporting at Sikorsky. This includes initiation of compensating controls and enhanced and revised design of existing financial reporting controls, information technology applications and procedures at Sikorsky. The material weakness will not be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. We expect that the remediation of this material weakness will be completed prior to the end of fiscal year 2017.

## **Changes in Internal Control Over Financial Reporting**

Other than with respect to the remediation efforts described above, there were no changes in our internal control over financial reporting during the most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Report of Ernst & Young LLP,  
Independent Registered Public Accounting Firm,  
Regarding Internal Control Over Financial Reporting**

Board of Directors and Stockholders  
Lockheed Martin Corporation

We have audited Lockheed Martin Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Lockheed Martin Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

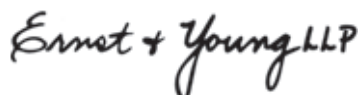
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment. Management identified a material weakness in the design and operation of internal controls, including information technology controls, within Sikorsky's processes (including the contract accounting / sales recognition processes, inventory accounting process, and payroll process). We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lockheed Martin Corporation as of December 31, 2016 and 2015, and the related consolidated statement of earnings, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2016. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2016 financial statements, and this report does not affect our report dated February 9, 2017, which expressed an unqualified opinion on those financial statements.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Lockheed Martin Corporation has not maintained effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.



McLean, Virginia  
February 9, 2017

**ITEM 9B. Other Information.**

None.

**PART III****ITEM 10. Directors, Executive Officers and Corporate Governance.**

The information concerning directors required by Item 401 of Regulation S-K is included under the caption “Proposal 1 – Election of Directors” in our definitive Proxy Statement to be filed pursuant to Regulation 14A (the 2017 Proxy Statement), and that information is incorporated by reference in this Form 10-K. Information concerning executive officers required by Item 401 of Regulation S-K is located under Part I, Item 4(a) of this Form 10-K. The information required by Item 405 of Regulation S-K is included under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2017 Proxy Statement, and that information is incorporated by reference in this Form 10-K. The information required by Items 407(c)(3), (d)(4) and (d)(5) of Regulation S-K is included under the captions “Committees of the Board of Directors – 2016 Membership on Board Committees” and “Committees of the Board of Directors – Audit Committee Report” in the 2017 Proxy Statement, and that information is incorporated by reference in this Form 10-K.

We have had a written code of ethics in place since our formation in 1995. *Setting the Standard*, our Code of Ethics and Business Conduct, applies to all our employees, including our principal executive officer, principal financial officer, and principal accounting officer and controller, and to members of our Board of Directors. A copy of our Code of Ethics and Business Conduct is available on our investor relations website: [www.lockheedmartin.com/investor](http://www.lockheedmartin.com/investor). Printed copies of our Code of Ethics and Business Conduct may be obtained, without charge, by contacting Investor Relations, Lockheed Martin Corporation, 6801 Rockledge Drive, Bethesda, Maryland 20817. We are required to disclose any change to, or waiver from, our Code of Ethics and Business Conduct for our Chief Executive Officer and senior financial officers. We use our website to disseminate this disclosure as permitted by applicable SEC rules.

**ITEM 11. Executive Compensation.**

The information required by Item 402 of Regulation S-K is included in the text and tables under the captions “Executive Compensation” and “Director Compensation” in the 2017 Proxy Statement and that information is incorporated by reference in this Form 10-K. The information required by Item 407(e)(5) of Regulation S-K is included under the caption “Executive Compensation – Compensation Committee Report” in the 2017 Proxy Statement, and that information is furnished by incorporation by reference in this Form 10-K.

## ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by Item 12 is included under the heading “Security Ownership of Management and Certain Beneficial Owners” in the 2017 Proxy Statement, and that information is incorporated by reference in this Form 10-K.

### Equity Compensation Plan Information

The following table provides information about our equity compensation plans that authorize the issuance of shares of Lockheed Martin common stock to employees and directors. The information is provided as of December 31, 2016.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders <sup>(1)</sup>	5,802,673	\$85.82	6,216,471
Equity compensation plans not approved by security holders <sup>(2)</sup>	1,082,347	—	2,481,032
<b>Total</b>	<b>6,885,020</b>	<b>\$85.82</b>	<b>8,697,503</b>

<sup>(1)</sup> Column (a) includes, as of December 31, 2016: 1,747,151 shares that have been granted as Restricted Stock Units (RSUs), 936,308 shares that could be earned pursuant to grants of Performance Stock Units (PSUs) (assuming the maximum number of PSUs are earned and payable at the end of the three-year performance period) and 2,967,046 shares granted as options under the Lockheed Martin Corporation 2011 Incentive Performance Award Plan (2011 IPA Plan) or predecessor plans prior to January 1, 2013 and 23,346 shares granted as options and 128,822 stock units payable in stock or cash under the Lockheed Martin Corporation 2009 Directors Equity Plan (Directors Equity Plan) or predecessor plans for members (or former members) of the Board of Directors. Column (c) includes, as of December 31, 2016, 5,751,655 shares available for future issuance under the 2011 IPA Plan as options, stock appreciation rights (SARs), restricted stock awards (RSAs), RSUs or PSUs and 464,816 shares available for future issuance under the Directors Equity Plan as stock options and stock units. Of the 5,751,655 shares available for grant under the 2011 IPA Plan on December 31, 2016, 516,653 and 236,654 shares are issuable pursuant to grants made on January 26, 2017, of RSUs and PSUs (assuming the maximum number of PSUs are earned and payable at the end of the three-year performance period), respectively. The weighted average price does not take into account shares issued pursuant to RSUs or PSUs.

<sup>(2)</sup> The shares represent annual incentive bonuses and Long-Term Incentive Performance (LTIP) payments earned and voluntarily deferred by employees. The deferred amounts are payable under the Deferred Management Incentive Compensation Plan (DMICP). Deferred amounts are credited as phantom stock units at the closing price of our stock on the date the deferral is effective. Amounts equal to our dividend are credited as stock units at the time we pay a dividend. Following termination of employment, a number of shares of stock equal to the number of stock units credited to the employee’s DMICP account are distributed to the employee. There is no discount or value transfer on the stock distributed. Distributions may be made from newly issued shares or shares purchased on the open market. Historically, all distributions have come from shares held in a separate trust and, therefore, do not further dilute our common shares outstanding. As a result, these shares also were not considered in calculating the total weighted average exercise price in the table. Because the DMICP shares are outstanding, they should be included in the denominator (and not the numerator) of a dilution calculation.

## ITEM 13. Certain Relationships and Related Transactions and Director Independence.

The information required by this Item 13 is included under the captions “Corporate Governance – Related Person Transaction Policy,” “Corporate Governance – Certain Relationships and Related Person Transactions of Directors, Executive Officers, and 5 Percent Stockholders,” and “Corporate Governance – Director Independence” in the 2017 Proxy Statement, and that information is incorporated by reference in this Form 10-K.

## ITEM 14. Principal Accountant Fees and Services.

The information required by this Item 14 is included under the caption “Proposal 2 – Ratification of Appointment of Independent Auditors” in the 2017 Proxy Statement, and that information is incorporated by reference in this Form 10-K.

## PART IV

### ITEM 15. Exhibits and Financial Statement Schedules.

#### List of financial statements filed as part of this Form 10-K

The following financial statements of Lockheed Martin Corporation and consolidated subsidiaries are included in Item 8 of this Form 10-K at the page numbers referenced below:

	<u>Page</u>
Consolidated Statements of Earnings – Years ended December 31, 2016, 2015 and 2014 .....	62
Consolidated Statements of Comprehensive Income – Years ended December 31, 2016, 2015 and 2014 .....	63
Consolidated Balance Sheets – At December 31, 2016 and 2015 .....	64
Consolidated Statements of Cash Flows – Years ended December 31, 2016, 2015 and 2014 .....	65
Consolidated Statements of Equity – Years ended December 31, 2016, 2015 and 2014 .....	66
Notes to Consolidated Financial Statements .....	67

The report of Lockheed Martin Corporation’s independent registered public accounting firm with respect to the above-referenced financial statements and their report on internal control over financial reporting appear on pages 61 and 107 of this Form 10-K. Their consent appears as Exhibit 23 of this Form 10-K.

#### List of financial statement schedules filed as part of this Form 10-K

All schedules have been omitted because they are not applicable, not required or the information has been otherwise supplied in the financial statements or notes to the financial statements.

#### Exhibits

- 2.1 Stock Purchase Agreement dated as of July 19, 2015 by and among United Technologies Corporation, the other Sellers identified therein and Lockheed Martin Corporation (incorporated by reference to Exhibit 2.1 to Lockheed Martin Corporation’s Current Report on Form 8-K filed with the SEC on July 20, 2015). The schedules and exhibits to the Stock Purchase Agreement have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Lockheed Martin agrees to furnish supplementally a copy of such schedules and exhibits, or any section thereof, to the SEC upon request.
- 2.2 Amendment No. 1 to Stock Purchase Agreement dated as of November 5, 2015 by and among United Technologies Corporation and certain affiliated entities identified therein and Lockheed Martin Corporation (incorporated by reference to Exhibit 2.1 to Lockheed Martin Corporation’s Current Report on Form 8-K filed with the SEC on November 6, 2015). The exhibits to Amendment No. 1 to Stock Purchase Agreement have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Lockheed Martin agrees to furnish supplementally a copy of such exhibits, or any section thereof, to the SEC upon request.
- 2.3 Agreement and Plan of Merger, dated as of January 26, 2016, among Lockheed Martin Corporation, Leidos Holdings, Inc., Abacus Innovations Corporation and Lion Merger Co. (incorporated by reference to Exhibit 2.1 to Lockheed Martin Corporation’s Current Report on Form 8-K filed with the SEC on January 27, 2016). The schedules and attachments to the Merger Agreement have been omitted pursuant to Item 601(b)(2) of Regulation S-K, and such schedules and attachments will be furnished to the SEC upon request.
- 2.4 Amendment dated as of June 27, 2016 to Agreement and Plan of Merger, dated as of January 26, 2016, among Lockheed Martin Corporation, Leidos Holdings, Inc., Abacus Innovations Corporation and Lion Merger Co. (incorporated by reference to Exhibit 2.1 to Lockheed Martin Corporation’s Quarterly Report on Form 10-Q for the quarter ended June 26, 2016).
- 2.5 Separation Agreement, dated as of January 26, 2016, between Lockheed Martin Corporation and Abacus Innovations Corporation (incorporated by reference to Exhibit 2.2 to Lockheed Martin Corporation’s Current Report on Form 8-K filed with the SEC on January 27, 2016). The schedules and attachments to the Separation Agreement have been omitted pursuant to Item 601(b)(2) of Regulation S-K, and such schedules and attachments will be furnished to the SEC upon request.

- 2.6 Amendment dated as of June 27, 2016 to Separation Agreement, dated as of January 26, 2016, between Lockheed Martin Corporation and Abacus Innovations Corporation (incorporated by reference to Exhibit 2.2 to Lockheed Martin Corporation's Quarterly Report on Form 10-Q for the quarter ended June 26, 2016). The schedules to the amendment have been omitted pursuant to Item 601(b)(2) of Regulation S-K, and such schedules and attachments will be furnished to the SEC upon request.
- 3.1 Charter of Lockheed Martin Corporation, as amended by Articles of Amendment dated April 23, 2009 (incorporated by reference to Exhibit 3.1 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2010 (File No. 001-11437)).
- 3.2 Bylaws of Lockheed Martin Corporation, as amended and restated effective September 22, 2016 (incorporated by reference to Exhibit 3.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on September 22, 2016).
- 4.1 Indenture, dated May 15, 1996, among Lockheed Martin Corporation, Lockheed Martin Tactical Systems, Inc. and First Trust of Illinois, National Association as Trustee (incorporated by reference to Exhibit 4.A to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on May 20, 1996 (File No. 001-11437)).
- 4.2 Indenture, dated as of August 30, 2006, between Lockheed Martin Corporation and The Bank of New York (incorporated by reference to Exhibit 99.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on August 31, 2006 (File No. 001-11437)).
- 4.3 Indenture, dated as of March 11, 2008, between Lockheed Martin Corporation and The Bank of New York (incorporated by reference to Exhibit 4.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on March 12, 2008 (File No. 001-11437)).
- 4.4 Indenture, dated as of May 25, 2010, between Lockheed Martin Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 99.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on May 25, 2010 (File No. 001-11437)).
- 4.5 Indenture, dated as of September 6, 2011, between Lockheed Martin Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on September 8, 2011 (File No. 001-11437)).
- 4.6 Indenture, dated as of December 14, 2012, between Lockheed Martin Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 99.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on December 17, 2012).

See also Exhibits 3.1 and 3.2.

No instruments defining the rights of holders of long-term debt that is not registered are filed because the total amount of securities authorized under any such instrument does not exceed 10% of the total assets of Lockheed Martin Corporation on a consolidated basis. Lockheed Martin Corporation agrees to furnish a copy of such instruments to the SEC upon request.

- 10.1 364-Day Credit Agreement dated as of October 9, 2015, among Lockheed Martin Corporation, the lenders listed therein, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on October 13, 2015).
- 10.2 Five-Year Credit Agreement dated as of October 9, 2015, among Lockheed Martin Corporation, the lenders listed therein, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.2 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on October 13, 2015).
- 10.3 Extension Agreement dated as of October 7, 2016 by and among Lockheed Martin Corporation, the lenders listed therein, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on October 7, 2016).
- 10.4 Lockheed Martin Corporation Directors Deferred Stock Plan, as amended (incorporated by reference to Exhibit 10.4 to Lockheed Martin Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 (File No. 001-11437)).
- 10.5 Lockheed Martin Corporation Directors Deferred Compensation Plan, as amended (incorporated by reference to Exhibit 10.2 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 001-11437)).

- 10.6 Martin Marietta Corporation Directors' Life Insurance Program (incorporated by reference to Exhibit 10.17 to Lockheed Martin Corporation's Registration Statement on Form S-4 (File No. 033-57645) filed with the SEC on February 9, 1995).
- 10.7 Lockheed Martin Corporation Directors Equity Plan, as amended (incorporated by reference to Exhibit 10.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on November 2, 2006 (File No. 001-11437)).
- 10.8 Lockheed Martin Corporation 2009 Directors Equity Plan (incorporated by reference to Appendix E to Lockheed Martin Corporation's Definitive Proxy Statement on schedule 14A filed with the SEC on March 14, 2008 (File No. 001-11437)).
- 10.9 Lockheed Martin Corporation Supplemental Savings Plan, as amended and restated effective January 1, 2015 (incorporated by reference to Exhibit 10.4 to Lockheed Martin Corporation's Quarterly Report on Form 10-Q for the quarter ended March 29, 2015).
- 10.10 Lockheed Martin Corporation Deferred Management Incentive Compensation Plan, as amended and restated effective May 16, 2016 (incorporated by reference to Exhibit 10.1 to Lockheed Martin Corporation's Quarterly Report on Form 10-Q for the quarter ended June 26, 2016).
- 10.11 Lockheed Martin Corporation Amended and Restated 2006 Management Incentive Compensation Plan (Performance Based), amended and restated effective January 1, 2016 (incorporated by reference to Exhibit 10.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on February 2, 2016).
- 10.12 Lockheed Martin Corporation Amended and Restated 2003 Incentive Performance Award Plan (incorporated by reference to Exhibit 10.17 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 001-11437)).
- 10.13 Forms of Stock Option Award Agreements under the Lockheed Martin Corporation 2003 Incentive Performance Award Plan (incorporated by reference to Exhibit 10.39 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-11437)).
- 10.14 Forms of Stock Option Award Agreements under the Lockheed Martin Corporation 2003 Incentive Performance Award Plan (incorporated by reference to Exhibit 10.32 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 001-11437)).
- 10.15 Forms of Stock Option Award Agreements under the Lockheed Martin Corporation 2003 Incentive Performance Award Plan (incorporated by reference to Exhibit 10.33 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2009 (File No. 001-11437)).
- 10.16 Form of Stock Option Award Agreement under the Lockheed Martin Corporation 2003 Incentive Performance Award Plan (incorporated by reference to Exhibit 99.3 of Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on February 3, 2011 (File No. 001-11437)).
- 10.17 Form of Indemnification Agreement (incorporated by reference to Exhibit 10.34 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2009 (File No. 001-11437)).
- 10.18 Lockheed Martin Corporation 2011 Incentive Performance Award Plan, as amended June 23, 2016 effective as of January 1, 2017 (incorporated by reference to Exhibit 10.2 to Lockheed Martin Corporation's Quarterly Report on Form 10-Q for the quarter ended June 26, 2016).
- 10.19 Forms of Stock Option Award Agreements under the Lockheed Martin Corporation 2011 Incentive Performance Award Plan (incorporated by reference to Exhibit 10.39 of Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2011 (File No. 001-11437)).
- 10.20 Form of Restricted Stock Unit Award Agreement, Form of Long-Term Incentive Performance Award Agreement (2014-2016 performance period), and Form of Performance Stock Unit Award Agreement (2014-2016 performance period) under the Lockheed Martin Corporation 2011 Incentive Performance Award Plan (incorporated by reference to Exhibits 10.3, 10.4 and 10.5, respectively, to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on January 28, 2014).
- 10.21 Lockheed Martin Corporation Nonqualified Capital Accumulation Plan, as amended and restated generally effective as of December 18, 2015 (incorporated by reference to Exhibit 10.22 of Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2015).
- 10.22 Non-Employee Director Compensation Summary (incorporated by reference to Exhibit 10.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on June 26, 2015).



- 10.23 Form of Restricted Stock Unit Award Agreement, Form of Long-Term Incentive Performance Award Agreement (2015-2017 performance period), and Form of Performance Stock Unit Award Agreement (2015-2017 performance period) under the Lockheed Martin Corporation 2011 Incentive Performance Award Plan (incorporated by reference to Exhibit 10.30 to Lockheed Martin Corporation's Annual Report on Form 10-K for the year ended December 31, 2014).
- 10.24 Form of Restricted Stock Unit Award Agreement, Form of Performance Stock Unit Award Agreement (2016-2018 performance period), and Form of Long-Term Incentive Performance Award Agreement (2016-2018 performance period) under the Lockheed Martin Corporation 2011 Incentive Performance Award Plan (incorporated by reference to Exhibits 10.2, 10.3 and 10.4, respectively, to Lockheed Martin Corporation's Current Report on Form 8-K filed on February 2, 2016).
- 10.25 Lockheed Martin Corporation Consolidated Supplemental Retirement Benefit Plan.
- 10.26 Lockheed Martin Corporation Executive Severance Plan, as amended and restated effective December 1, 2016.
- 10.27 Amendment to Terms of Outstanding Restricted Stock Unit Awards and Performance Stock Unit Awards under the Lockheed Martin Corporation 2011 Incentive Performance Award Plan Relating to Tax Withholding.
- 12 Computation of ratio of earnings to fixed charges.
- 21 Subsidiaries of Lockheed Martin Corporation.
- 23 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
- 24 Powers of Attorney.
- 31.1 Certification of Marillyn A. Hewson pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Bruce L. Tanner pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Marillyn A. Hewson and Bruce L. Tanner Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- \* Exhibits 10.4 through 10.27 constitute management contracts or compensatory plans or arrangements.

**ITEM 16. Form 10-K Summary.**

None.

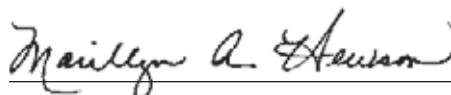


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**CERTIFICATION OF MARILLYN A. HEWSON PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Marillyn A. Hewson, certify that:

1. I have reviewed this Annual Report on Form 10-K of Lockheed Martin Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.



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Marillyn A. Hewson  
Chief Executive Officer

Date: February 9, 2017

**CERTIFICATION OF BRUCE L. TANNER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Bruce L. Tanner, certify that:

1. I have reviewed this Annual Report on Form 10-K of Lockheed Martin Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.



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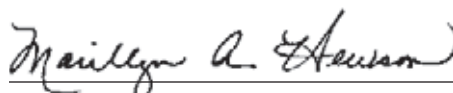
Bruce L. Tanner  
Chief Financial Officer

Date: February 9, 2017

**CERTIFICATION OF MARILLYN A. HEWSON AND BRUCE L. TANNER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Lockheed Martin Corporation (the "Corporation") on Form 10-K for the period ended December 31, 2016, as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Report"), I, Marilyn A. Hewson, Chief Executive Officer of the Corporation, and I, Bruce L. Tanner, Chief Financial Officer of the Corporation, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.



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Marilyn A. Hewson  
Chief Executive Officer



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Bruce L. Tanner  
Chief Financial Officer

Date: February 9, 2017

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## **NON-GAAP DEFINITIONS AND RECONCILIATION OF NON-GAAP MEASURES TO GAAP MEASURES**

This annual report contains non-generally accepted accounting principles (GAAP) financial measures. While we believe that these non-GAAP financial measures may be useful in evaluating Lockheed Martin, this information should be considered supplemental and is not a substitute for financial information prepared in accordance with GAAP. In addition, our definitions for non-GAAP measures may differ from similarly titled measures used by other companies or analysts.

### **Segment Operating Profit / Margin**

Segment Operating Profit represents the total earnings from our business segments before unallocated income and expense, interest expense, other non-operating income and expense, and income tax expense. This measure is used by our senior management in evaluating the performance of our business segments. The caption "Total Unallocated Items" reconciles Segment Operating Profit to Consolidated Operating Profit. Segment Margin is calculated by dividing Segment Operating Profit by Net Sales.

In millions	2016	2015	2014
Net Sales	<b>\$47,248</b>	\$40,536	\$ 39,946
Consolidated Operating Profit	<b>\$ 5,549</b>	\$ 4,712	\$ 5,012
Less: Total Unallocated Items	<b>449</b>	(266)	(104)
Segment Operating Profit (Non-GAAP)	<b>\$ 5,100</b>	\$ 4,978	\$ 5,116
Consolidated Operating Margin	<b>11.7%</b>	11.6%	12.5%
Segment Operating Margin (Non-GAAP)	<b>10.8%</b>	12.3%	12.8%

### **Free Cash Flow**

Lockheed Martin defines Free Cash Flow (FCF) as Cash from Operations, less Capital Expenditures.

In millions	2016
Cash from Operations	<b>\$ 5,189</b>
Capital Expenditures	<b>(1,063)</b>
Free Cash Flow (Non-GAAP)	<b>\$ 4,126</b>



## **GENERAL INFORMATION**

As of December 31, 2016, there were approximately 28,725 holders of record of Lockheed Martin common stock and 290,304,962 shares outstanding.

### **TRANSFER AGENT & REGISTRAR**

Computershare Trust Company, N.A.  
Shareholder Services  
P.O. Box 30170  
College Station, TX 77842-3170  
Telephone: 1-877-498-8861  
TDD for the hearing impaired: 1-800-952-9245  
Internet: [www.computershare.com/investor](http://www.computershare.com/investor)

### **DIRECT STOCK PURCHASE AND DIVIDEND REINVESTMENT PLAN**

Lockheed Martin Direct Invest is a convenient direct stock purchase and dividend reinvestment program available for new investors to make an initial investment in Lockheed Martin common stock and for existing stockholders to increase their holdings of Lockheed Martin common stock. For more information about Lockheed Martin Direct Invest, contact our transfer agent, Computershare Trust Company, N.A. at 1-877-498-8861, or view plan materials online and enroll electronically at [www.computershare.com/investor](http://www.computershare.com/investor)

### **INDEPENDENT AUDITORS**

Ernst & Young LLP  
8484 Westpark Drive  
McLean, VA 22102  
703-747-1000

### **COMMON STOCK**

Stock symbol: LMT  
Listed: New York Stock Exchange (NYSE)

### **2016 FORM 10-K**

Our 2016 Form 10-K is included in this Annual Report in its entirety with the exception of certain exhibits. All of the exhibits may be obtained on our Investor Relations homepage at [www.lockheedmartin.com/investor](http://www.lockheedmartin.com/investor) or by accessing our filings with the U.S. Securities and Exchange Commission. In addition, stockholders may obtain a paper copy of any exhibit by writing to:

Gregory M. Gardner — Vice President Investor Relations  
Lockheed Martin Corporation  
Investor Relations Department MP 279  
6801 Rockledge Drive, Bethesda, MD 20817

Corporate financial data and requests for printed materials may be obtained on our website at [www.lockheedmartin.com/investor](http://www.lockheedmartin.com/investor)

Lockheed Martin Corporation  
6801 Rockledge Drive  
Bethesda, MD 20817  
[www.lockheedmartin.com](http://www.lockheedmartin.com)

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The cover and insert of this report are printed on Chorus Art Silk paper, which contains 30% post-consumer recycled fibers, is manufactured acid and elemental chlorine free and is FSC® Mix certified.



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The Form 10-K in this report is printed on Rolland Opaque 40, which contains 30% post-consumer recycled fibers, is manufactured using renewable biogas energy and is EcoLogo and FSC® Mix certified.



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