

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, 2017

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

For the transition period from to

Commission file number 001-37975

**L3 TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**13-3937436**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**600 Third Avenue, New York, NY**

**10016**

(Address of principal executive offices)

(Zip Code)

**(212) 697-1111**

(Registrant's telephone number, including area code)

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

**Title of each class**

**Name of each exchange on which registered:**

Common stock, par value \$0.01 per share

New York Stock Exchange

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

None.

Indicate by check mark if the 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 the 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 the delinquent filer 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

(Do not check if a smaller reporting company)

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

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

The aggregate market value of the registrant's voting stock held by non-affiliates as of June 30, 2017, based upon the closing price of the stock on the New York Stock Exchange, was approximately \$12.9 billion. For purposes of this calculation, the registrant has assumed that the directors and executive officers are affiliates.

There were 78,223,953 shares of the registrant's common stock with a par value of \$0.01 outstanding as of the close of business on February 16, 2018.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed with the Securities and Exchange Commission ("SEC") pursuant to Regulation 14A relating to the registrant's Annual Meeting of Shareholders, to be held on May 7, 2018, will be incorporated by reference in this Form 10-K in response to Items 10, 11, 12, 13 and 14 of Part III. The definitive proxy statement will be filed with the SEC no later than 120 days after the registrant's fiscal year ended December 31, 2017.



**L3 TECHNOLOGIES, INC.**  
**ANNUAL REPORT ON FORM 10-K**  
**For the Year Ended December 31, 2017**

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## PART I

For convenience purposes in this filing on Form 10-K, references to “L3”, “Company”, “we”, “us” and “our” refer to L3 Technologies, Inc. and its subsidiaries.

### Item 1. Business

#### Overview

L3 Technologies, Inc. (L3 Technologies, Inc. and, together with our subsidiaries, referred to herein as L3) is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, aircraft sustainment (including modifications and fleet management of special mission aircraft), simulation and training, night vision and image intensification equipment, and security and detection systems. L3 is also a leading provider of a broad range of communication, electronic and sensor systems used on military, homeland security and commercial platforms. Our customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), foreign governments, and domestic and foreign commercial customers.

For the year ended December 31, 2017, we generated sales of \$9,573 million, operating income of \$1,020 million and cash from continuing operations of \$985 million. The table below presents a summary of our 2017 sales by major category of end customer. For a more detailed presentation of our sales by end customer, see “Major Customers” within this Business section.

	<u>2017 Sales</u> (in millions)	<u>% of</u> <u>Total Sales</u>
DoD .....	\$6,329	66%
Other U.S. Government .....	<u>368</u>	<u>4</u>
Total U.S. Government .....	6,697	70
Foreign governments .....	1,420	15
Commercial — foreign .....	809	8
Commercial — domestic .....	<u>647</u>	<u>7</u>
Total sales .....	<u>\$9,573</u>	<u>100%</u>

We have the following four reportable segments: (1) Electronic Systems, (2) Aerospace Systems, (3) Communication Systems and (4) Sensor Systems. Financial information for our segments, including sales by geographic area, is included in “Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in Note 21 to our audited consolidated financial statements.

On October 16, 2017, our Board of Directors approved a plan to explore strategic alternatives to sell or otherwise divest the Vertex Aerospace business. We expect to complete a sale in 2018. The divestiture of the Vertex Aerospace business represents a strategic shift by us to exit the logistics solution and maintenance services business for military aircraft where we do not provide complex ISR systems integration and modification. The Vertex Aerospace business generated sales of \$1.4 billion in 2017, \$1.3 billion in 2016 and \$1.2 billion in 2015. The assets and liabilities and results of operations of the Vertex Aerospace business are reported as discontinued operations for all periods presented.

All references made to financial data in this Annual Report on Form 10-K are to L3’s continuing operations, unless otherwise specifically noted.

#### Business Strategy

Our goal is to build on our strong aerospace & defense company in a focused and disciplined way. We aspire to become a non-traditional sixth prime through teaming arrangements, joint ventures and integrating our capabilities to compete for larger and higher value contracts. The key elements of our growth strategy are summarized in the paragraphs below. Our business is centered around serving our customers’ needs through innovation, quality, dependability and reliability. We believe in and operate under the principles that there are no short cuts to hard work, integrity, accountability and excellence. We believe these principles drive sustainable shareholder value over the long term. We continually evaluate ways to improve our positioning in core markets within Electronic Systems, Aerospace

Systems, Communication Systems and Sensor Systems. We intend to leverage our excellent customer relationships and pursue adjacent market opportunities including, international and commercial markets, through greater cross segment collaboration and integration across the enterprise. We intend to gain market share with innovative and affordable solutions and by building on the trust that results from demonstrated past performance that addresses customer needs. We expect that we will continue to focus our business portfolio around products and systems in core attractive markets, namely defense electronics, ISR and Communications. Financially, our emphasis is to grow sales, operating income, earnings per share and cash flow, as well as increase operating margins. In addition to striving for organic growth, we pursue select acquisitions and divestitures. We also intend to continue to seek new and existing routes for efficiencies through L365 (L3's operational excellence program) and other cost reduction efforts, in order to streamline our organization for greater agility and adaptability. We believe that these focused actions will enable us to both grow the company and return cash to our shareholders in a balanced and disciplined manner. Our strategy includes the elements discussed below.

***Maintain an Innovative, Agile and Adaptable Culture of Continuous Improvement Focused on Excellence, Integrity and Accountability.*** A key part of L3's strategy is an agile, adaptable, and results-driven culture that focuses on meeting or exceeding our customers' needs. L3 is a unique aerospace and defense company, a federation of highly entrepreneurial businesses, with driven and diverse people providing creative, innovative and affordable solutions in an environment that fosters teamwork and collaboration across the enterprise. Operating with integrity and a commitment to the highest standards of ethical conduct and maintaining strong internal controls are foundational elements of our success. We endeavor to build and maintain the trust of our customers, our shareholders, our employees, suppliers and communities where we live and work every day.

***Strengthen and Expand Our Market Positions and Unique Capabilities.*** We intend to use our existing prime contractor and supplier positions and internal investments to increase our market share, grow sales and continue to build upon our strong businesses with durable discriminators that have leading market positions as we strive to continue to move up the value chain. We intend to expand our prime contractor roles in select business areas where we have domain expertise, including special operations forces and U.S. Government classified business. We expect to benefit from and expand our supplier positions to multiple bidders by leveraging customer relationships, pursuing adjacent market opportunities and expanding content on Original Equipment Manufacturer (OEM) platforms. As an independent supplier of a broad range of products, subsystems and systems in several key business areas, our growth will partially be driven by expanding our share of existing mature programs and participating in new programs. Teaming arrangements with other prime contractors and platform OEMs is one way we intend to pursue select new business opportunities and expand our content on select platforms. We plan to maintain our diversified and broad business mix with limited reliance on any single contract, follow-on or new business opportunity. While sales to the U.S. Government, especially the DoD, will remain an integral part of L3's business, we also intend to continue to increase our sales to foreign governments and domestic and international commercial businesses. We expect to continue to supplement our organic sales growth by acquiring, on a select basis, businesses that provide attractive returns on investment and add new products, technologies, programs and contracts, or provide access to select DoD, other U.S. Government, international and/or commercial customers.

***Collaborate to Increase Growth Opportunities through Innovation.*** We intend to deepen the collaboration among our diversified businesses to develop new business opportunities, combine our leading technologies and deliver the right solutions to our customers quickly. We expect that our core strengths of agility, responsiveness and cost-effectiveness will allow us to continue to provide exceptional performance to our customers. We intend to continue to focus on innovation and research and development, which will allow us to enhance our existing products and to create new and more affordable solutions and products for our customers.

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

***Increase Margins by Proactively Managing Our Cost Structure and Optimizing Our Business Portfolio.*** We intend to increase our operating margin by improving productivity and reducing direct contract costs and overhead costs, including general and administrative costs through streamlining and consolidation activities within our organization. Our effective management of labor, material, subcontractor and other direct costs is also an important

element of cost control and favorable contract performance. We believe that proactively re-sizing our businesses to their anticipated sales, combined with continuous cost improvement, will enable us to increase our cost competitiveness and operating margin and to also selectively invest in new product development, business acquisitions, bids and proposals and other business development activities to win new business. We intend to continue to evaluate our portfolio of businesses to address the needs of a dynamic and demanding market place and to strengthen our core business through select business acquisitions or divestitures.

**Achieve Outstanding Program Performance.** We believe that outstanding performance on our existing programs and contracts, in terms of on-budget, on-schedule and satisfying and exceeding technical and other contractual performance requirements, is the foundation for expanding L3's prime contractor and supplier positions and winning new business. We believe that a prerequisite for growing and winning new business is to retain our existing business by successfully meeting or exceeding the performance criteria included in our contracts. We will continue to focus on delivering superior contract performance with affordable prices to our customers in order to maintain our reputation as an agile and responsive contractor and to differentiate ourselves from our competitors.

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

### Business Acquisitions and Divestitures

During the years ended December 31, 2017, 2016 and 2015, we used net cash of \$316 million, \$388 million and \$320 million for business acquisitions, respectively. See "Part II — Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Business Acquisitions and Divestitures" for additional information regarding our business acquisitions and divestitures.

### Products and Services

Our four reportable segments provide a wide range of products and services to various customers and are described below. See "Part II — Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Reportable Segment Results of Operations" and Note 21 to our audited consolidated financial statements for financial information about each segment.

#### Electronic Systems Reportable Segment

In 2017, Electronic Systems had net sales of \$3,024 million, representing 32% of our total net sales. The businesses in this reportable segment provide a broad range of products and services, including components, products, subsystems, systems and related services to military and commercial customers. These products and services serve niche markets such as, aircraft simulation and training, power and distribution, cockpit avionics, airport security and precision weapons. The table below provides a summary of the segment's business areas and the percentage that each contributed to Electronic Systems' net sales in 2017.

Business Area	% of 2017 Segment Sales
Total Training Solutions . . . . .	30%
Power & Propulsion Systems . . . . .	24
Aviation Products . . . . .	17
Precision Engagement Systems . . . . .	15
Security & Detection Systems . . . . .	<u>14</u>
Total Electronic Systems . . . . .	<u>100%</u>

*Total Training Solutions* (TTS) is a leading supplier of military and commercial aircraft flight simulators and advanced flight simulation technologies. In addition, TTS provides flight training services for both rotary and fixed wing aircraft and support and maintenance services. Key customers include DoD and foreign militaries, commercial airlines and aircraft OEMs.

*Power & Propulsion Systems* (PPS) is a provider of maritime power and distribution solutions. Offerings include electric propulsion, conversion, distribution and protection for naval submarines, surface ships and aircraft carriers.

In addition, PPS provides integrated bridge equipment including Command, Control, Communications, Computers and Navigation (C<sup>4</sup>N) systems, as well as combat vehicle engines and transmissions. Key customers include the U.S. Navy (USN), the U.S. Coast Guard (USCG), U.S. Army, foreign ministries of defense, foreign navies and commercial ship owners.

*Aviation Products* is a provider of cockpit and mission displays, airborne traffic and collision avoidance systems, terrain awareness warning systems, advanced cockpit avionics and solid state voice and flight data recorders. Key customers include various commercial transport, business, regional and military aircraft manufacturers.

*Precision Engagement Systems* (PES) is a prime and component provider of precision weapon systems including fuzing and ordinance systems, unmanned systems and radar-based sensors and systems. In addition, PES provides global positioning system receivers for guided projectiles and precision munitions as well as navigation systems for fire control systems. Key customers include DoD, U.S. Government and foreign militaries.

*Security & Detection Systems* (SDS) is a leading provider of integrated security solutions for airports, ports, border crossings and other critical infrastructure. Offerings include airport security screening solutions, explosive detection systems and whole body scanning systems as well as non-intrusive systems for threat and contraband detection. Key customers include the U.S. Transportation Security Administration, domestic and international airports, the U.S. Customs and Border Protection agency and international equivalents, and domestic and international port operators.

### ***Aerospace Systems Reportable Segment***

In 2017, Aerospace Systems had net sales of \$2,773 million, representing 29% of our total net sales. The businesses in this reportable segment provide products and services for the global ISR and Command, Control and Communications (C<sup>3</sup>) markets, specializing in signals intelligence (SIGINT) and multi-intelligence platforms, including engineering, modernization and sustainment solutions for military and various government aircraft, ground support equipment and other platforms. These strategic and tactical products and services provide warfighters with the ability to detect, collect, identify, analyze and disseminate information from command centers, communication nodes and air defense systems for real-time situational awareness and response. The table below provides a summary of the segment's business areas and the percentage that each contributed to Aerospace Systems' net sales in 2017.

<b>Business Area</b>	<b>% of 2017 Segment Sales</b>
Mission Integration .....	87%
MAS .....	6
Aerostructures .....	4
Advanced Systems .....	<u>3</u>
Total Aerospace Systems .....	<u>100%</u>

*Mission Integration* is a systems integration organization specializing in complex ISR capabilities including fleet management support services, procurement, systems integration, sensor development, modifications and periodic depot maintenance for ISR and special mission aircraft and airborne systems. These products and services are critical elements for a substantial number of major C<sup>3</sup> and intelligence gathering systems. Key customers include DoD, and classified customers within the U.S. Government, U.K. Ministry of Defence (MoD) and select foreign militaries.

*MAS* is a provider of modernization and life extension maintenance upgrade and support services for military aircraft, which include structural modifications and inspections, installation of mission equipment, navigation and avionics products and interior modifications. Key customers include the Canadian Department of National Defence, USN, U.S. Air Force (USAF) and select foreign militaries.

*Aerostructures* provide aircraft fabrication and assembly of fixed and rotary wing aerostructures as well as avionics hardware and software systems to address mission critical needs. Key customers include DoD, U.S. Special Operations Command (USSOCOM), commercial customers and aircraft OEMs.

*Advanced Systems* is a provider of prime mission systems integration and sensor development for military ISR aircraft platforms and ground systems. Key customers include DoD and USAF.



### ***Communication Systems Reportable Segment***

In 2017, Communication Systems had net sales of \$2,229 million, representing 23% of our total net sales. The businesses in this reportable segment provide network and communication systems, secure communications products, radio frequency (RF) components, satellite communication terminals and space, microwave and telemetry products. These products include secure data links that are used to connect a variety of space, airborne, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring and dissemination functions of these communication systems. The table below provides a summary of the segment's business areas and the percentage that each contributed to Communication Systems' net sales in 2017.

<b>Business Area</b>	<b>% of 2017 Segment Sales</b>
Broadband Communication Systems .....	66%
Space & Power Systems .....	19
Advanced Communications .....	<u>15</u>
Total Communication Systems .....	<u>100%</u>

*Broadband Communication Systems* is focused on the development, design, manufacturing and integration of secure networked communications equipment. Offerings include airborne, space and surface data link terminals, ground stations, and transportable tactical satellite communications (SATCOM) systems used on manned aircraft, unmanned aerial vehicles (UAVs) and naval ships. In addition, Broadband Communication Systems provides managed communications security (COMSEC) satellite networks and integrated remote very small aperture terminals (VSAT) satellite systems. Key customers include DoD, USSOCOM, USAF, U.S. Army, U.S. intelligence agencies and commercial customers.

*Space & Power Systems* is a provider of traveling wave tube amplifiers, telemetry and instrumentation systems, and low-power SATCOM products. Offerings include microwave vacuum electron devices and power modules for unmanned and manned platforms, including satellites, radar systems, communication systems, UAVs, various missile programs and commercial broadcast. Additional offerings include spacecraft telemetry tracking and control encryption as well as high data rate transmitters and tactical intelligence receivers. Key customers include DoD, foreign militaries, commercial customers and aircraft and satellite OEMs.

*Advanced Communications* is a provider of secure communications terminals and equipment, secure network encryption products, shipboard communications systems, advance radar antennas and radomes. Offerings include secure and non-secure voice, data and video communication for office, battlefield and secure internet protocol (IP) network applications, and surveillance and radar detection. Key customers include USN, USCG and foreign navies.

### ***Sensor Systems Segment***

In 2017, Sensor Systems had net sales of \$1,547 million, representing 16% of our total net sales. The businesses in this reportable segment provide a broad range of multi-domain ISR mission solutions from seabed to space for DoD, intelligence community, international, federal, civil and commercial customers. Major capabilities and mission solutions include networked warfighter systems, integrated ISR and targeting systems, space avionics and imaging payloads, Counter Unmanned Aircraft Systems (CUAS) mission solutions, integrated maritime mission solutions, directed energy, cyber and electronic warfare, special mission command & control, lightweight unmanned undersea vehicles, modeling & simulation and life cycle support. The table below provides a summary of the segment's business areas and the percentage that each contributed to Sensor Systems' net sales in 2017.

<b>Business Area</b>	<b>% of 2017 Segment Sales</b>
Space & Sensor Systems .....	23%
Airborne Sensor Systems .....	23
Warrior Sensor Systems .....	22
Maritime Sensor Systems .....	21
Intelligence & Mission Systems .....	7
Advanced Programs .....	<u>4</u>
Total Sensor Systems .....	<u>100%</u>

*Space & Sensor Systems* provides avionics, payloads and exploitation systems for DoD, intelligence and commercial space exploration, including space launch vehicle avionics, space imaging and information systems, and tactical imaging systems. Key customers include National Aeronautics Space Administration (NASA), DoD and commercial space companies.

*Airborne Sensor Systems* provides multi-spectral and multi-intelligence ISR and targeting sensor systems designed for manned and unmanned platforms for ISR military, law enforcement and government missions. Key customers include DoD, foreign ministries of defense, intelligence and security agencies and law enforcement agencies.

*Warrior Sensor Systems* provides multi-domain warfighter mission integration including networked augmented reality systems, advanced night vision and electro-optical technology and systems, weapon sights, integrated information systems and rangefinding systems. Key customers include DoD, federal agencies, law enforcement agencies, foreign militaries, commercial hunting and professional shooting communities.

*Maritime Sensor Systems* provides integrated maritime mission solutions for surface and undersea acoustic, imaging and detection systems, including surface electro-optical/infrared systems for surface ships and submarines, dipping sonar systems, towed arrays, maritime command and control systems, undersea platforms and ranges, directed energy, cabled ocean systems, undersea warfare and anti-submarine systems, and integrated, multi-intelligence autonomous undersea vehicles. Key customers include USN, allied navies, and other military customers.

*Intelligence & Mission Systems* provides solutions that gather and protect intelligence to deliver successful mission outcomes including cyber and electronic warfare solutions, situational awareness for border security and maritime surveillance, and the protection of the most sensitive of information with leading-edge, government grade cyber security. Key customers include U.K. MoD, Australian Defence Force, other international military and security agencies and commercial customers.

*Advanced Programs* provides advanced ISR and special mission capabilities, directed energy, special mission command and control, modeling & simulation, networked system of system capabilities, unmanned systems and CUAS, lightweight unmanned undersea vehicles and geospatial application technology programs for cueing system software, hardware and wide-area sensor integration solutions. Key customers include USAF, USSOCOM, USN and other DoD agencies.

## Funded Backlog and Orders

We define funded backlog as the value of funded orders received from customers, less the cumulative amount of sales recognized on such orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. The table below presents our funded backlog, percentage of funded backlog at December 31, 2017 expected to be recorded as sales in 2018 and funded orders for each of our reportable segments and on a consolidated basis.

	Funded Backlog at December 31,		Percentage of Funded Backlog at December 31, 2017 Expected to be Recorded as Sales in 2018	Funded Orders	
	2017	2016		2017	2016
	(in millions)			(in millions)	
<b>Reportable Segment:</b>					
Electronic Systems . . . . .	\$2,905	\$2,708	55%	\$3,201	\$2,956
Aerospace Systems . . . . .	2,140	2,218	72%	2,673	2,768
Communication Systems . . . . .	1,825	1,932	70%	2,120	1,967
Sensor Systems . . . . .	<u>2,009</u>	<u>1,522</u>	56%	<u>2,002</u>	<u>1,829</u>
Consolidated . . . . .	<u>\$8,879</u>	<u>\$8,380</u>	62%	<u>\$9,996</u>	<u>\$9,520</u>

Our funded backlog does not include the full potential value of our contract awards, including those pertaining to multi-year, cost-plus type contracts, which are generally funded on an annual basis. Funded backlog also excludes

the potential future orders and related sales from unexercised priced contract options that may be exercised by customers under existing contracts and the potential future orders and related sales of purchase orders that we may receive in the future under indefinite quantity contracts or basic ordering agreements during the term of such agreements.

### Major Customers

The table below presents a summary of our sales by end customer and the percent contributed by each to our total sales. For additional information regarding domestic and international sales, see Note 21 to our audited consolidated financial statements.

	2017		2016	
	Sales (in millions)	% of Total Sales	Sales (in millions)	% of Total Sales
Air Force . . . . .	\$3,173	33%	\$2,873	31%
Navy/Marines . . . . .	1,324	14	1,367	15
Army . . . . .	1,071	11	1,034	11
Other Defense . . . . .	<u>761</u>	<u>8</u>	<u>824</u>	<u>9</u>
Total DoD . . . . .	6,329	66	6,098	66
Other U.S. Government . . . . .	<u>368</u>	<u>4</u>	<u>301</u>	<u>3</u>
Total U.S. Government . . . . .	6,697	70	6,399	69
Foreign governments . . . . .	1,420	15	1,531	17
Commercial — foreign . . . . .	809	8	732	8
Commercial — domestic . . . . .	<u>647</u>	<u>7</u>	<u>548</u>	<u>6</u>
Total sales . . . . .	<u>\$9,573</u>	<u>100%</u>	<u>\$9,210</u>	<u>100%</u>

Direct sales to the end customer represented approximately 64% of our consolidated 2017 sales, and sales as a subcontractor or supplier represented the remaining 36%.

Our sales are predominantly derived from contracts with agencies of, and prime system contractors to, the U.S. Government. Various U.S. Government agencies and contracting entities exercise independent and individual purchasing decisions, subject to annual appropriations by the U.S. Congress. For the year ended December 31, 2017, our five largest contracts (revenue arrangements) generated 14% of our consolidated sales.

### Research and Development

We conduct research and development activities that consist of projects involving applied research, new product and systems development and select concept studies. We employ scientific, engineering and other personnel to improve our existing product lines and systems and develop new products, technologies and systems. At December 31, 2017, we employed approximately 7,000 engineers, substantially all of whom hold advanced degrees, who work on company-sponsored research and development efforts and customer-funded research and development contracts.

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

	Year Ended December 31,		
	2017	2016	2015
	(in millions)		
Company-Sponsored Research and Development Costs:			
U.S. Government Contractor Businesses . . . . .	\$224	\$204	\$176
Commercial Businesses . . . . .	<u>63</u>	<u>54</u>	<u>52</u>
Total . . . . .	<u>\$287</u>	<u>\$258</u>	<u>\$228</u>

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

## **Competition**

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

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

- the effectiveness and innovation of our technologies, systems and research and development programs;
- our ability to offer superior program performance at an affordable and competitive cost;
- historical, technical, cost and schedule performance;
- our ability to attain supplier positions on contracts;
- our ability to maintain an effective supplier and vendor base;
- our ability to retain our employees and hire new ones, particularly those who have U.S. Government security clearances;
- the capabilities of our facilities, equipment and personnel to undertake the business for which we compete; and
- our ability to quickly and flexibly meet customer requirements and priorities.

L3 is an aerospace and defense contractor with a broad and diverse portfolio of products and services. We have prime contractor and subcontractor positions. We supply our products and services to other prime system contractors. However, we also compete directly with other large prime system contractors for: (1) certain products, subsystems and systems, where they have vertically integrated businesses, and (2) niche areas where we are a prime contractor. We also compete with numerous other aerospace and defense contractors, which generally provide similar products, subsystems, systems or services.

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

## **Patents and Licenses**

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

## **Raw Materials**

Although we generated 70% of our 2017 sales from products and systems, our businesses are generally engaged in limited manufacturing activities and have minimal exposure to fluctuations in the supply of raw materials. For those businesses that manufacture and sell products and systems, most of the value that we provide is labor oriented, such as design, engineering, assembly and test activities. In manufacturing our products, we use our own production capabilities as well as a diverse base of third party suppliers and subcontractors. Although certain aspects of our manufacturing activities require relatively scarce raw materials, we have not experienced difficulty in our ability to procure raw materials, components, sub-assemblies and other supplies required in our manufacturing processes.

## **Contracts**

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

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract. Accounting for the sales on a fixed-price type contract that is covered by contract accounting standards requires the preparation of estimates for: (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work, and (3) the measurement of progress towards completion. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated total profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change.

On a cost-plus type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit which can be fixed or variable depending on the contract's fee arrangement up to predetermined funding levels determined by our customers. Cost-plus type contracts with award and incentive fee provisions are our primary variable contract fee arrangement. Award fees provide for a fee based on actual performance relative to contractually specified performance criteria. Incentive fees provide for a fee based on the relationship which total allowable costs bear to target cost. Award and incentive fees earned were not material to our results of operations for 2017, 2016 and 2015.

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

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

Contract Type	Year Ended December 31,		
	2017	2016	2015
Fixed-price <sup>(1)</sup>	73%	76%	78%
Cost-plus <sup>(2)</sup>	24	21	19
Time-and-material	3	3	3
Total sales	<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>(1)</sup> Includes fixed-price incentive fee type contracts, which contributed approximately 1% to our total sales for each of the years ended December 31, 2017, 2016 and 2015.

<sup>(2)</sup> Includes cost-plus award and incentive fee type contracts, which contributed approximately 5% to our total sales for each of the years ended December 31, 2017 and 2016 and 4% for the year ended December 31, 2015.

## Regulatory Environment

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

Our U.S. Government contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance with these requirements. Investigations could result in administrative, civil or criminal liabilities, including repayments, disallowance of certain costs, or fines and penalties. As is common in the U.S. defense industry, we are subject to business risks, including changes in the U.S. Government's procurement policies (such as greater emphasis on

competitive procurement), governmental appropriations, national defense policies or regulations, service modernization plans and availability of funds. A reduction in expenditures by the U.S. Government for products and services of the type we manufacture and provide, lower margins resulting from increasingly competitive procurement policies, a reduction in the volume of contracts or subcontracts awarded to us or the incurrence of substantial contract cost overruns could materially adversely affect our business.

In 2017, sales under foreign military sales (FMS) agreements, which are included in the international (foreign governments) category in the “Major Customers” table above, were \$372 million, or 4% of our total consolidated sales. FMS agreements are made directly between the U.S. Government and foreign governments. In such cases, because we serve only as the supplier, we do not have unilateral control over the terms of the agreements. Certain of our sales are direct commercial sales to foreign governments. These sales are subject to U.S. Government approval and licensing under the Arms Export Control Act. Legal restrictions on sales of sensitive U.S. technology also limit the extent to which we can sell our products to foreign governments or private parties.

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

### **Environmental Matters**

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

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

### **Employees**

At December 31, 2017, we employed approximately 31,000 full-time and part-time employees (excluding employees of discontinued operations), 82% of whom were located in the United States. Of these employees, approximately 10% are covered by approximately 47 separate collective bargaining agreements with various labor unions. The success of our business is, to a large extent, dependent upon the knowledge of our employees and on the management, contracting, engineering and technical skills of our employees. In addition, our ability to grow our businesses, obtain additional orders for our products and services and to satisfy contractual obligations under certain of our existing revenue arrangements is largely dependent upon our ability to attract and retain employees who have U.S. Government security clearances, particularly those with clearances of top-secret and above. Historically, we have renegotiated labor agreements without significant disruptions to operating activities, and we believe that relations with our employees are positive.

### **Available Information**

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

You may also obtain a free copy of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statement for the annual shareholders' meeting, as well as any amendments to those reports as soon as reasonably practicable after electronic filing with the SEC through our website on the Internet at <http://www.L3T.com>.

We also have a Corporate Governance webpage. You can access our Corporate Governance Guidelines and charters for the audit and ethics, compensation and nominating/corporate governance committees of our Board of Directors through our website, <http://www.L3T.com>, by clicking on the "Corporate Governance" link under the heading "Investor Relations." You can access our Code of Ethics and Business Conduct by clicking on the "Code of Ethics and Business Conduct" link under the heading "Code of Ethics." Our Code of Ethics and Business Conduct applies to all directors, officers and employees, including our chief executive officer and president, our senior vice president and chief financial officer and our vice president, controller and principal accounting officer. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. (NYSE), on our website within the required periods. The information on or accessible through our website is not incorporated by reference into this report.

To learn more about L3, please visit our website at <http://www.L3T.com>. From time to time, we use our website as a channel of distribution of material company information. Financial and other material information regarding L3 is routinely posted on our website and is readily accessible.

## **Item 1A. Risk Factors**

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

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

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

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

The total DoD budget for FY 2016 was \$581 billion, an increase of 4% compared to FY 2015. The increase was due to a higher base budget of \$522 billion, representing an increase of \$25 billion compared to FY 2015. The FY 2016 Overseas Contingency Operations (OCO) budget declined slightly to \$59 billion compared to \$63 billion for FY 2015.

On May 4, 2017, Congress passed the FY 2017 Appropriations Bill, which provides for a \$606 billion total FY 2017 DoD Budget (\$523 billion base budget, \$83 billion OCO), an increase of 4% compared to the appropriated FY 2016 DoD budget. President Trump signed the FY 2017 Appropriations Bill into law on May 5, 2017.

On May 23, 2017, the Trump Administration submitted its FY 2018 DoD budget request (Budget Request) to Congress. The Budget Request included a \$574 billion base budget and a \$65 billion OCO budget for a total FY 2018 DoD budget of \$639 billion, an increase of 5% compared to the total FY 2017 DoD Budget. On July 14, 2017, the House of Representatives and, separately on September 18, 2017, the Senate each passed their own versions of the National Defense Authorization Act (NDAA). Both the House and Senate versions of the FY 2018 NDAA included authorization spending levels higher than the Budget Request, and such authorized spending would represent an increase of at least 10% compared to the total FY 2017 DoD Budget. The FY 2018 Budget Request and both the

House and Senate versions of the FY 2018 NDAA exceed the statutory budget cap for defense spending as specified by the Budget Control Act of 2011 (BCA), which mandates a DoD base budget of approximately \$522 billion for FY 2018. Accordingly, in order to appropriate funds as submitted by the Budget Request or House and Senate versions of the FY 2018 NDAA, Congress must provide relief from the BCA spending caps through law enacted by Congress. The House and Senate versions of the FY 2018 NDAA were reconciled via the conference process and signed into law by the President on December 12, 2017. The enacted FY 2018 NDAA authorizes a total of \$699.9 billion for all Defense spending, including a \$634.2 billion base budget and an additional \$65.7 billion for OCO.

Because the FY 2018 DoD Appropriations bill was not enacted into law prior to start of fiscal year 2018 (October 1, 2017), DoD's FY 2018 funding was addressed through a series of Continuing Resolutions (CR), the latest of which is due to expire on March 23, 2018. However, on February 9, 2018, President Trump signed into law the Bipartisan Budget Act of 2018 (BBA), a bipartisan two-year budget and debt ceiling agreement that provides a level of stability in the U.S. Government budget process over the next two fiscal years (FYs 2018 and 2019). The BBA included a short-term CR extension to March 23, 2018, to allow for completion of the FY 2018 appropriations process (including enactment of the FY 2018 DoD Appropriations bill). While 2018 BBA does raise the spending caps for FY 2018 and FY 2019 previously constrained by the BCA and temporarily suspends the statutory debt ceiling through March 1, 2019, it does not modify the BCA's spending caps or sequestration mechanism beyond FY 2019.

Future DoD budgets and spending levels are difficult to predict as the U.S. Government's overall fiscal challenges remain. A significant decline in or redirection of U.S. military expenditures in the future, or the loss or significant reduction in U.S. Government funding of a large program in which we participate, could have a material adverse effect on our financial position, results of operations and cash flows.

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

Our sales are predominantly derived from contracts (revenue arrangements) with agencies of, and prime system contractors to, the U.S. Government. The loss or delay of all or a substantial portion of our sales to the U.S. Government would have a material adverse effect on our results of operations and cash flows. Approximately 70%, or \$6.7 billion, of our sales for the year ended December 31, 2017 were made directly or indirectly to U.S. Government agencies, including 66% to the DoD. Aggregate sales for our five largest contracts (revenue arrangements) amounted to approximately \$1.3 billion, or 14% of our consolidated sales for the year ended December 31, 2017.

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

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

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

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

Since 2010, the DoD has implemented efficiency initiatives and other best practices for procurement that are intended to reduce prices, ensure adequate competition and control costs throughout the acquisition cycle. In addition, under the Better Buying Power 3.0 initiative, the DoD has focused on technology innovation, incentive-based cost-plus and fixed-price contracts and Company-sponsored independent research and development efforts. The U.S.



Government may continue to implement changes to its procurement practices that change the way contracts are solicited, negotiated and managed, which may impact our future sales, earnings and cash flows, and could affect whether, and how we pursue opportunities to provide our products and services to the U.S. Government, including the terms and conditions under which we do so.

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

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

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

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

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

At December 31, 2017, we had a backlog of funded orders, primarily under contracts with the U.S. Government, totaling \$8,879 million. As described above, the U.S. Government may unilaterally modify or terminate its contracts with us. Accordingly, most of our backlog could be modified or terminated by the U.S. Government, which would have a material adverse effect on our future sales, results of operations and cash flows.

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

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

- the frequent need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties and/or cost overruns;
- the substantial time, effort and experience required to prepare bids and proposals for competitively awarded contracts that may not be awarded to us;
- design complexity and rapid technological obsolescence; and
- the constant need for design improvement.

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

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

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

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

U.S. Government contracts are subject to extensive legal and regulatory requirements, and from time to time agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. As discussed in Note 18 to our audited consolidated financial statements, we are currently cooperating with the U.S. Government on several investigations. Under U.S. Government regulations, an indictment of L3 by a federal grand jury, or an administrative finding against us as to our present responsibility to be a U.S. Government contractor or subcontractor, could result in us being suspended for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges, which could have a material adverse effect on our results of operations and cash flows. A conviction, or an administrative finding against us that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specific term, which could have a material adverse effect on our results of operations and cash flows.

***Our commercial aviation products and services businesses are affected by global demand and economic factors that could negatively impact our financial results.***

The operating results of our commercial aviation products and services businesses may be adversely affected by downturns in the global demand for air travel which impacts new aircraft production and orders, and global flying hours, which impacts air transport, regional and business aircraft utilization rates and pilot training needs. The aviation industry is highly cyclical, and the level of demand for air travel is correlated to the strength of the U.S. and international economies and is impacted by long-term trends in airline passenger and cargo traffic. The results of our commercial aviation business also depend on other factors, including general economic growth, political stability in both developed and emerging markets, pricing pressures, trends in capital goods markets and changes in OEM production rates.

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

For the year ended December 31, 2017, sales to international customers, excluding our international sales made under FMS agreements directly between the U.S. Government and foreign governments, represented approximately 19% of our consolidated sales. Consequently, our businesses are subject to a variety of risks that are specific to international operations, including the following:

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

- potential military conflicts and political risks.

Our international contracts may include industrial cooperation agreements requiring specific local purchases, manufacturing agreements or financial support obligations, known as offset obligations, and provide for penalties if we fail to meet such requirements. See “Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Contractual Obligations” for further discussion. While we have and will continue to adopt measures to reduce the potential impact of losses resulting from the risks of our international business, these measures may not be adequate.

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

At any given time, we are a defendant in various material legal proceedings and litigation matters arising in the ordinary course of business, including litigation, claims and assessments that have been asserted against acquired businesses, which we have assumed. Although we maintain insurance policies, these policies may not be adequate to protect us from all material judgments and expenses related to current or future claims and may not cover the conduct that is the subject of the litigation. Desired levels of insurance may not be available in the future at economical prices or at all. In addition, we believe that while we have valid defenses with respect to legal matters pending against us, the results of litigation can be difficult to predict, including those involving jury trials. Accordingly, our current judgment as to the likelihood of our loss (or our current estimate as to the potential range of loss, if applicable) with respect to any particular litigation matter may be wrong. A significant judgment against us, arising out of any of our current or future legal proceedings and litigation, could have a material adverse effect on our business, financial condition, results of operations, cash flows and future prospects. For a discussion of material litigation to which we are currently a party, see Note 18 to our audited consolidated financial statements.

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

The rapid change of technology is a key feature of most of the markets in which our products, services and systems oriented businesses operate. To succeed in the future, we will need to continue to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. Historically, our technology has been developed through customer-funded and internally funded research and development and through certain business acquisitions. We may not be able to continue to maintain comparable levels of research and development or successfully complete such acquisitions. In the past, we have allocated substantial funds to capital expenditures, programs and other investments. This practice will continue to be required in the future. Even so, we may not be able to successfully identify new opportunities and may not have the necessary financial resources to develop new products and systems in a timely or cost-effective manner. At the same time, products and technologies developed by others may render our products, services and systems obsolete or non-competitive.

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

Goodwill represents the largest asset on our balance sheet, with an aggregate balance of \$6,615 million at December 31, 2017. We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable and also review goodwill annually in accordance with the accounting standards for goodwill and intangible assets. The annual impairment test requires us to determine the fair value of our reporting units in comparison to their carrying values. A decline in the estimated fair value of a reporting unit could result in a goodwill impairment and a related non-cash impairment charge against earnings if the estimated fair value for the reporting unit is less than the carrying value of the net assets of the reporting unit, including its goodwill.

Our annual impairment tests at November 30, 2017 and 2016 did not result in impairments to goodwill. The fair value of all of our reporting units exceeded the carrying value of the net assets of those reporting units by more than 20% at November 30, 2017, the date of our most recent annual impairment assessment. A decline in the estimated fair value of one or more of our reporting units could potentially trigger goodwill impairment charges and a material adverse effect on our results of operations. See “Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies — Goodwill and Identifiable Intangible Assets” for further discussion.

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

Our sales are transacted using written revenue arrangements, or contracts, which are generally fixed-price, cost-plus or time-and-material. For a description of our revenue recognition policies, see “Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies.” For information on the percentage of our total sales generated from each contract type, see “Item 1 —Business — Contracts.”

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

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

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

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

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

As a U.S. defense contractor, we have faced, and continue to face, various security threats, including, but not limited to, threats to the physical security of our facilities and employees, cybersecurity threats to our information technology infrastructure and attempts to gain access to our proprietary or classified information as well as the proprietary or classified information of our customers.

Although we utilize various procedures and controls to monitor, deter and mitigate these threats, these procedures and controls may not be sufficient to prevent disruptions in mission critical systems, the unauthorized release of confidential, sensitive or classified information and the corruption of data, systems or networks. Any significant operational delays, or any destruction, manipulation or improper use of our or our customers’ data, information systems or networks, could materially and adversely affect our financial results, damage the reputation of our products and services and require significant management attention and expense. In addition, our insurance coverage and/or indemnification arrangements that we enter into, if any, may not be adequate to cover all of the costs related to cybersecurity attacks or disruptions resulting from such events.

To date, cyber attacks directed at us have not had a material impact on our financial results. Due to the evolving nature and increased frequency of security threats, however, the impact of any future incident cannot be predicted. The threats we face vary from those common to most industries to more advanced and persistent, highly organized adversaries who target us because we operate in the defense industry and 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, which could result in us having to spend a significant amount of money to upgrade our networks and systems and could otherwise have a material adverse effect on our business, financial condition, results of operations and cash flows.

In the current environment, there are also numerous and evolving risks to cybersecurity and privacy, including the use of viruses, worms or other malicious software programs and threats involving criminal hackers,

state-sponsored intrusions, terrorist attacks, industrial espionage, employee malfeasance, and human or technological error. As these risks develop and these attacks become more frequent and sophisticated, we may find it necessary to make significant further investments to protect data and infrastructure from cyber and other security attacks.

We must also rely on the safeguards put in place by customers, suppliers, vendors, subcontractors, venture partners or other third parties to minimize the impact of cyber threats, other security threats or business disruptions. These third parties may have varying levels of cybersecurity expertise and safeguards and their relationships with government contractors, such as L3, may increase the likelihood that they are targeted by the same cyber threats we face. In the event of a breach affecting these third parties, our business and financial results could suffer materially. With respect to our commercial arrangements with these third parties, we have processes designed to require that the third parties and their employees and agents agree to maintain certain standards for the storage, protection and transfer of confidential, personal and proprietary information. However, we remain at risk of a data breach due to the intentional or unintentional non-compliance by a third party's employee or agent, the breakdown of a third party's data protection processes, which may not be as sophisticated as ours, or a cyber attack on a third party's information network and systems.

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

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

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

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

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

**Environmental laws and regulations may subject us to significant liability.**

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

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

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

We opportunistically seek to acquire businesses that enhance our capabilities and add new technologies, products, services, programs, contracts and customers to our existing businesses. We may not be able to continue to identify acquisition candidates on commercially reasonable terms or at all. If we make additional business acquisitions, we may not realize the benefits anticipated from these acquisitions, including sales growth, cost synergies and margin improvement. Furthermore, we may not be able to obtain additional financing for business acquisitions, since such additional financing could be restricted or limited by the terms of our debt agreements or due to unfavorable capital market conditions.

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

**Our spin-off of Engility could result in substantial tax liability to us and our shareholders.**

In connection with our spin-off of Engility in 2012, we received an Internal Revenue Service (IRS) Ruling stating that L3 and its shareholders would not recognize any taxable income, gain or loss for U.S. federal income tax purposes as a result of the transaction. In addition, we received an opinion of counsel that the spin-off satisfied certain requirements for tax-free treatment that are not covered in the IRS Ruling; however, an opinion of counsel is not binding on the IRS. Accordingly, the IRS or the courts may reach conclusions with respect to the spin-off that are different from the conclusions reached in the opinion of counsel. Moreover, both the IRS Ruling and the opinion of counsel are based on certain factual statements and representations made by us, which, if incomplete or untrue in any material respect, could invalidate the IRS Ruling or opinion of counsel.

If, notwithstanding receipt of the IRS Ruling and opinion of counsel, the spin-off and certain related transactions were determined to be taxable, then we would be subject to a substantial tax liability. In addition, if the spin-off were taxable, each holder of our common stock who received shares of Engility would generally be treated as having received a taxable distribution of property in an amount equal to the fair market value of the shares of Engility received.

**Item 1B. Unresolved Staff Comments**

None.

## Item 2. Properties

At December 31, 2017, we operated in 273 locations consisting of manufacturing facilities, administration, research and development and other properties throughout the United States and internationally. Of these, we owned 30 locations consisting of approximately 5.2 million square feet and leased space at 243 locations consisting of approximately 9.4 million square feet. Additionally, our Aerospace Systems segment utilized a facility consisting of approximately 3.3 million square feet through a land lease expiring in 2031 with the city of Greenville, Texas.

A summary of square footage by reportable segment at December 31, 2017, is presented below.

	<u>Leased</u>	<u>Owned</u>	<u>Government- Owned</u>	<u>Total</u>
			(Square feet in millions)	
Electronic Systems .....	3.4	2.0	—	5.4
Aerospace Systems .....	1.0	1.7	3.3	6.0
Communication Systems .....	3.3	0.4	—	3.7
Sensor Systems .....	<u>1.5</u>	<u>1.1</u>	<u>—</u>	<u>2.6</u>
Total .....	<u>9.2</u>	<u>5.2</u>	<u>3.3</u>	<u>17.7</u>

Our reportable segments have major operations at the following locations:

- Electronic Systems — Phoenix, Arizona; Anaheim, San Diego and San Leandro, California; Pueblo, Colorado; Sanford, Sarasota and St. Petersburg, Florida; Woburn, Massachusetts; Grand Rapids and Muskegon, Michigan; Mount Olive, New Jersey; Kirkwood, New York; Cincinnati, Ohio; Tulsa, Oklahoma; Philadelphia, Pennsylvania; Arlington, Grand Prairie and Plano, Texas; Melbourne, Australia; Hamilton, New Zealand; and Bracknell, Crawley, Droitwich and Luton, U.K.
- Aerospace Systems — Greenville, Rockwall and Waco, Texas; and Quebec and Ontario, Canada.
- Communication Systems — San Diego, Simi Valley and Torrance, California; Ayer, Massachusetts; Camden, New Jersey; Hauppauge, New York; Williamsport, Pennsylvania; and Salt Lake City, Utah.
- Sensor Systems — Tempe, Arizona; Sylmar, California; Orlando, Florida; Northampton and Wilmington, Massachusetts; Londonderry, New Hampshire; Mason, Ohio; Pittsburgh, Pennsylvania; Ontario, Canada; Bologna, Italy; and Tewkesbury, U.K.

Additionally, our Corporate staff occupies a total of 0.2 million square feet of office space in New York, New York and Arlington, Virginia. Management believes all of our properties have been well maintained, are in good condition and are adequate and suitable for our business as presently conducted.

## Item 3. Legal Proceedings

The information required with respect to this item can be found in Note 18 to our audited consolidated financial statements and is incorporated by reference into this Item 3.

## Item 4. Mine Safety Disclosures

None.

## PART II

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

The common stock of L3 is traded on the New York Stock Exchange (NYSE) under the symbol “LLL.” On February 16, 2018, the number of holders of L3’s common stock was approximately 197,000. On February 16, 2018, the closing price of L3’s stock, as reported by the NYSE, was \$212.89 per share.

The table below sets forth the amount of dividends paid per share and the high and low closing price of L3’s common stock as reported on the NYSE during the past two calendar years.

	Dividends Paid		Closing Price (High-Low)	
	2017	2016	2017	2016
<b>Common Stock — Dividends Paid and Market Prices</b>				
First Quarter . . . . .	\$0.75	\$0.70	\$170.81 — 145.71	\$120.55 — 108.05
Second Quarter . . . . .	0.75	0.70	173.94 — 160.69	147.90 — 118.50
Third Quarter . . . . .	0.75	0.70	190.32 — 168.99	151.63 — 140.11
Fourth Quarter . . . . .	<u>0.75</u>	<u>0.70</u>	199.05 — 183.09	161.56 — 134.05
Year Ended December 31. . . . .	<u>\$3.00</u>	<u>\$2.80</u>	\$199.05 — 145.71	\$161.56 — 108.05

On February 12, 2018, L3 announced that its Board of Directors increased L3’s regular quarterly cash dividend from \$0.75 per share to \$0.80 per share, or 7%, payable on March 15, 2018, to shareholders of record at the close of business on March 1, 2018.

### Issuer Purchases of Equity Securities

The following table provides information about repurchases of L3’s common stock made in the quarterly period ended December 31, 2017. Repurchases are made from time to time at management’s discretion in accordance with applicable federal securities laws. All share repurchases of L3’s common stock have been recorded as treasury shares.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Program <sup>(1)</sup> (in millions)
September 30 — October 31, 2017. . . . .	—	\$ —	—	\$1,435
November 1 — 30, 2017 . . . . .	212,665	185.73	212,665	1,396
December 1 — 31, 2017 . . . . .	<u>248,627</u>	197.16	<u>248,627</u>	1,347
Total. . . . .	<u>461,292</u>	191.89	<u>461,292</u>	

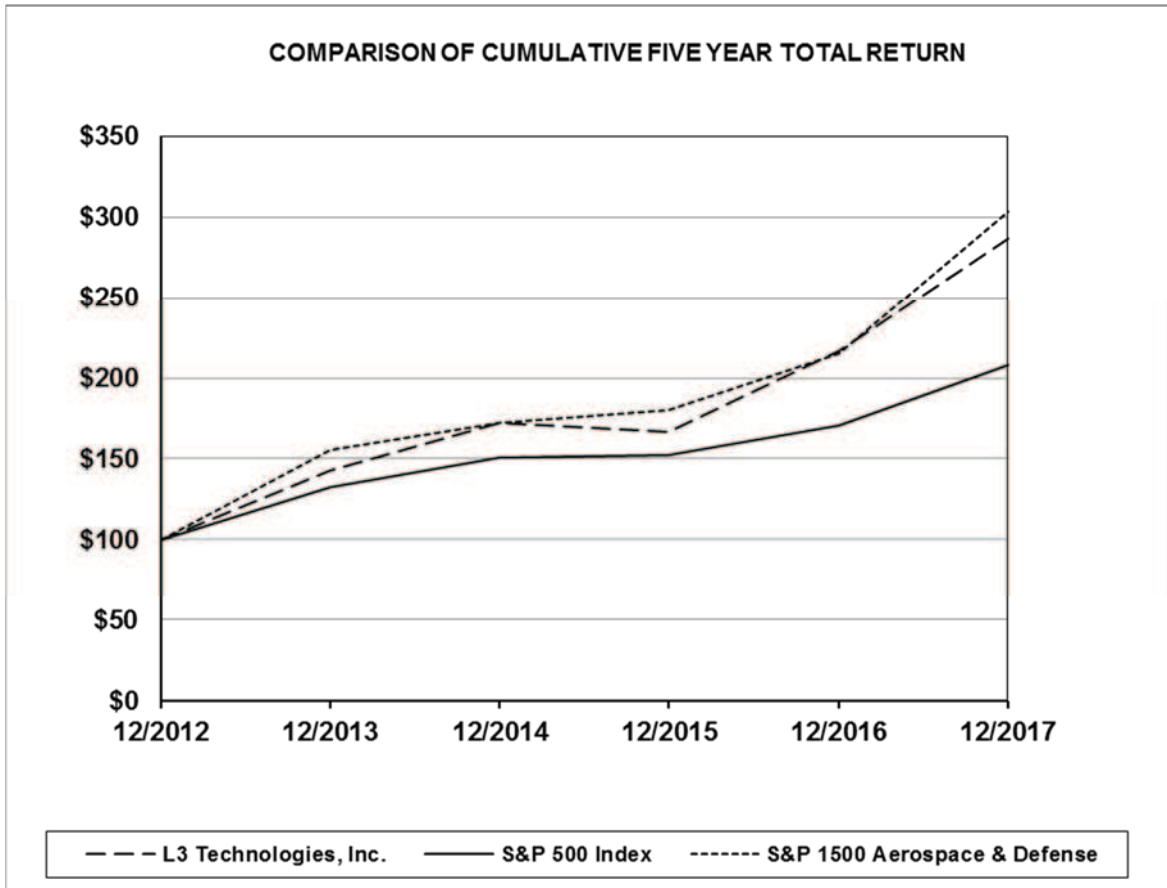
<sup>(1)</sup> The share repurchases described in the table above were made pursuant to the \$1.5 billion share repurchase program authorized by L3’s Board of Directors on May 8, 2017. The program became effective on July 1, 2017 and has no set expiration date.

From January 1, 2018 through February 16, 2018, L3 repurchased 433,039 shares of its common stock at an average price of \$203.33 per share for an aggregate amount of approximately \$88 million.



The graph below compares the cumulative total returns of our common stock with the cumulative total return of the Standard & Poor's 500 Composite Stock Index and the Standard & Poor's 1500 Aerospace & Defense Index, for the period from December 31, 2012 to December 31, 2017. These figures assume that all dividends paid over the performance period were reinvested. On July 17, 2012, we completed the Engility spin-off. Our shareholders received one share of Engility common stock for every six shares of our common stock held on the record date (July 16, 2012). The effect of the spin-off is reflected in the cumulative total return as a reinvested dividend for the year ended December 31, 2012. The figures also assume that the starting value of each index and the investment in our common stock was \$100 on December 31, 2012.

We are one of the companies included in the Standard & Poor's 1500 Aerospace & Defense Index and the Standard & Poor's 500 Composite Stock Index. The starting point for the measurement of our common stock cumulative total return was our closing stock price on the NYSE of \$76.62 per share on December 31, 2012. The graph is not, and is not intended to be, indicative of future performance of our common stock.



## Item 6. Selected Financial Data

The selected financial data presented below is derived from our audited consolidated financial statements.

	Year Ended December 31,				
	<u>2017</u>	<u>2016</u>	<u>2015<sup>(1)</sup></u>	<u>2014</u>	<u>2013</u>
	(in millions, except per share data)				
<b>Statements of Operations Data:</b>					
Net sales . . . . .	\$9,573	\$9,210	\$9,231	\$9,691	\$10,104
Operating income . . . . .	\$1,020	\$ 957	\$ 785	\$1,000	\$ 1,036
Goodwill impairment charges . . . . .	—	—	46	—	—
Loss related to business divestitures . . . . .	—	—	31	—	—
Segment operating income . . . . .	<u>\$1,020</u>	<u>\$ 957</u>	<u>\$ 862</u>	<u>\$1,000</u>	<u>\$ 1,036</u>
Operating margin . . . . .	10.7%	10.4%	8.5%	10.3%	10.3%
Segment operating margin . . . . .	10.7%	10.4%	9.3%	10.3%	10.3%
Interest and other, net. . . . .	\$ (149)	\$ (153)	\$ (146)	\$ (129)	\$ (128)
Income from continuing operations before income taxes . . . . .	\$ 871	\$ 804	\$ 639	\$ 871	\$ 908
Provision for income taxes . . . . .	(102) <sup>(2)</sup>	(171)	(132)	(225)	(236)
Income from continuing operations . . . . .	769	633	507	646	672
Net income from continuing operations attributable to noncontrolling interests . . . . .	(16)	(14)	(15)	(13)	(9)
Net income from continuing operations attributable to L3 . . . . .	<u>\$ 753</u>	<u>\$ 619</u>	<u>\$ 492</u>	<u>\$ 633</u>	<u>\$ 663</u>
Earnings per share from continuing operations allocable to L3 common shareholders:					
Basic . . . . .	<u>\$ 9.65</u>	<u>\$ 7.99</u>	<u>\$ 6.10</u>	<u>\$ 7.41</u>	<u>\$ 7.42</u>
Diluted . . . . .	<u>\$ 9.46</u>	<u>\$ 7.86</u>	<u>\$ 6.01</u>	<u>\$ 7.21</u>	<u>\$ 7.28</u>
L3 weighted average common shares outstanding: . . . . .					
Basic . . . . .	<u>78.0</u>	<u>77.4</u>	<u>80.7</u>	<u>85.4</u>	<u>89.4</u>
Diluted . . . . .	<u>79.6</u>	<u>78.8</u>	<u>81.9</u>	<u>87.8</u>	<u>91.1</u>
Cash dividends declared per common share . . . . .	<u>\$ 3.00</u>	<u>\$ 2.80</u>	<u>\$ 2.60</u>	<u>\$ 2.40</u>	<u>\$ 2.20</u>

<sup>(1)</sup> Income from continuing operations for the year ended December 31, 2015 includes: (1) non-cash goodwill impairment charge of \$46 million (\$44 million after income taxes), or \$0.54 per diluted share, related to a business retained by L3 in connection with the sale of the National Security Solutions (NSS) business and (2) a pre-tax loss of \$31 million (\$20 million after income taxes), or \$0.25 per diluted share, related to business divestitures.

<sup>(2)</sup> Provision for income taxes for the year ended December 31, 2017 includes estimated tax benefits of \$79 million, or \$0.99 per diluted share, related to the enactment of the U.S. Tax Cuts and Jobs Act (U.S. Tax Reform) in December 2017.

	Year Ended December 31,				
	2017	2016	2015	2014	2013
	(in millions)				
<b>Balance Sheet Data (at year end):</b>					
Working capital <sup>(1)</sup> . . . . .	\$ 1,871	\$ 1,467	\$ 797	\$ 1,580	\$ 1,749
Total assets . . . . .	12,729	11,865	12,069	13,692	13,849
Long-term debt, including current portion . . . . .	3,330	3,325	3,626	3,916	3,611
Equity . . . . .	5,151	4,624	4,429	5,360	6,056
<b>Cash Flow Data:</b>					
Net cash from operating activities from continuing operations . . . . .	\$ 985	\$ 1,022	\$ 1,035	\$ 1,065	\$ 1,058
Net cash used in investing activities from continuing operations . . . . .	(453)	(10)	(190)	(218)	(256)
Net cash used in financing activities from continuing operations . . . . .	(366)	(856)	(1,205)	(893)	(853)

<sup>(1)</sup> Excludes net assets held for sale.

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

### Overview and Outlook

#### *L3's Business*

L3 is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, aircraft sustainment (including modifications and fleet management of special mission aircraft), simulation and training, night vision and image intensification equipment, and security and detection systems. L3 is also a leading provider of a broad range of communication, electronic and sensor systems used on military, homeland security and commercial platforms. Our customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), foreign governments, and domestic and foreign commercial customers.

We have the following four reportable segments: (1) Electronic Systems, (2) Aerospace Systems, (3) Communication Systems and (4) Sensor Systems. Financial information for our segments is included in Note 21 to our audited consolidated financial statements.

Electronic Systems provide a broad range of products and services, including components, products, subsystems, systems and related services to military and commercial customers. These products and services serve niche markets such as, aircraft simulation and training, power and distribution, cockpit avionics, airport security and precision weapons. The Electronic Systems business areas are Total Training Solutions, Power & Propulsion Systems, Aviation Products, Precision Engagement Systems and Security & Detection Systems.

Aerospace Systems provide products and services for the global ISR and Command, Control and Communications (C<sup>3</sup>) markets, specializing in signals intelligence (SIGINT) and multi-intelligence platforms, including engineering, modernization and sustainment solutions for military and various government aircraft, ground support equipment and other platforms. These strategic and tactical products and services provide warfighters with the ability to detect, collect, identify, analyze and disseminate information from command centers, communication nodes and air defense systems for real-time situational awareness and response. Aerospace Systems sells these products and services primarily to the DoD and select foreign governments. The Aerospace Systems business areas are Mission Integration, MAS, Aerostructures and Advanced Systems.

Communication Systems provide network and communication systems, secure communications products, radio frequency (RF) components, satellite communication terminals and space, microwave and telemetry products. These products include secure data links that are used to connect a variety of space, airborne, ground and sea-based communication systems and are used in transmission, processing, recording, monitoring and dissemination functions of these communication systems. Communication Systems sells these products and services primarily to the DoD and select foreign governments. The Communications Systems business areas are Broadband Communication Systems, Space & Power Systems and Advanced Communications.

Sensor Systems provide a broad range of multi-domain ISR mission solutions from seabed to space for DoD, intelligence community, international, federal civil and commercial customers. Major capabilities and mission solutions include networked warfighter systems, integrated ISR and targeting systems, space avionics and imaging payloads, Counter Unmanned Aircraft Systems mission solutions, integrated maritime mission solutions, directed energy, cyber and electronic warfare, special mission command & control, lightweight unmanned undersea vehicles, modeling & simulation and life cycle support. Sensor Systems sells these products and services primarily to the DoD and select foreign governments. The Sensor Systems business areas are Space & Sensor Systems, Airborne Sensor Systems, Warrior Sensor Systems, Maritime Sensor Systems, Intelligence & Mission Systems and Advanced Programs.

On October 16, 2017, our Board of Directors approved a plan to explore strategic alternatives to sell or otherwise divest the Vertex Aerospace business. We expect to complete a sale in 2018. The divestiture of the Vertex Aerospace business represents a strategic shift by us to exit the logistics solution and maintenance services business for military aircraft where we do not provide complex ISR systems integration and modification. The Vertex Aerospace business generated sales of \$1.4 billion in 2017, \$1.3 billion in 2016 and \$1.2 billion in 2015. The assets and liabilities and results of operations of the Vertex Aerospace business are reported as discontinued operations for all periods presented.

On December 7, 2015, we entered into a definitive agreement to sell our National Security Solutions (NSS) segment to CACI International Inc. The transaction was completed on February 1, 2016. NSS provided cybersecurity solutions, high-performance computing, enterprise IT services, analytics and intelligence analysis to the DoD, U.S. Government intelligence agencies, federal civilian agencies and foreign governments. The results of operations of NSS are reported as discontinued operations for all periods presented.

All references made to financial data in this Annual Report on Form 10-K are to L3's continuing operations, unless specifically noted.

We generated sales of \$9,573 million and \$9,210 million for the years ended December 31, 2017 and 2016, respectively, and our primary customer was the DoD. See "Part I — Item 1 — Business — Major Customers" for additional information regarding a summary of our sales by end customer and the percent contributed by each to our total sales.

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

### *Business Environment*

*U.S. Government Markets.* Sales to U.S. Government customers represented 70% of our 2017 sales and were primarily to DoD customers, which comprised 66% of our sales. Therefore, our annual sales are generally highly correlated to changes in U.S. Government spending levels, especially DoD budget levels.

The total DoD budget for FY 2016 was \$581 billion, an increase of 4% compared to FY 2015. The increase was due to a higher base budget of \$522 billion, representing an increase of \$25 billion compared to FY 2015. The FY 2016 OCO budget declined slightly to \$59 billion compared to \$63 billion for FY 2015.

On May 4, 2017, Congress passed the FY 2017 Appropriations Bill, which provides for a \$606 billion total FY 2017 DoD Budget (\$523 billion base budget, \$83 billion OCO), an increase of 4% compared to the appropriated FY 2016 DoD budget. President Trump signed the FY 2017 Appropriations Bill into law on May 5, 2017.

On May 23, 2017, the Trump Administration submitted its FY 2018 DoD budget request (Budget Request) to Congress. The Budget Request included a \$574 billion base budget and a \$65 billion OCO budget for a total FY 2018 DoD budget of \$639 billion, an increase of 5% compared to the total FY 2017 DoD Budget. On July 14, 2017, the House of Representatives and, separately on September 18, 2017, the Senate each passed their own versions of the National Defense Authorization Act (NDAA). Both the House and Senate versions of the FY 2018 NDAA included authorization spending levels higher than the Budget Request, and such authorized spending would represent an increase of at least 10% compared to the total FY 2017 DoD Budget. The FY 2018 Budget Request and both the

House and Senate versions of the FY 2018 NDAA exceed the statutory budget cap for defense spending as specified by the Budget Control Act of 2011 (BCA), which mandates a DoD base budget of approximately \$522 billion for FY 2018. Accordingly, in order to appropriate funds as submitted by the Budget Request or House and Senate versions of the FY 2018 NDAA, Congress must provide relief from the BCA spending caps through law enacted by Congress. The House and Senate versions of the FY 2018 NDAA were reconciled via the conference process and signed into law by the President on December 12, 2017. The enacted FY 2018 NDAA authorizes a total of \$699.9 billion for all Defense spending, including a \$634.2 billion base budget and an additional \$65.7 billion for OCO.

Because the FY 2018 DoD Appropriations bill was not enacted into law prior to start of fiscal year 2018 (October 1, 2017), DoD's FY 2018 funding was addressed through a series of Continuing Resolutions (CR), the latest of which is due to expire on March 23, 2018. However, on February 9, 2018, President Trump signed into law the Bipartisan Budget Act of 2018 (BBA), a bipartisan two-year budget and debt ceiling agreement that provides a level of stability in the U.S. Government budget process over the next two fiscal years (FYs 2018 and 2019). The BBA included a short-term CR extension to March 23, 2018, to allow for completion of the FY 2018 appropriations process (including enactment of the FY 2018 DoD Appropriations bill). While 2018 BBA does raise the spending caps for FY 2018 and FY 2019 previously constrained by the BCA and temporarily suspends the statutory debt ceiling through March 1, 2019, it does not modify the BCA's spending caps or sequestration mechanism beyond FY 2019.

On February 12, 2018, the Trump Administration submitted its FY 2019 DoD budget request to Congress. The table below presents the FY 2011 through FY 2017 DoD enacted budgets and the FY 2018 Budget Request for DoD and the FY 2019 DoD Future Years Defense Plan (FYDP), as proposed within the FY 2019 DoD Budget Request.

Fiscal Year (Ending September 30)	DoD Budget			Annual Total Budget Change
	Base	OCO	Total	
	(in billions)			
2012	\$530	\$115	\$645	-6%
2013	\$496	\$ 82	\$578	-10%
2014	\$496	\$ 85	\$581	+1%
2015	\$497	\$ 63	\$560	-4%
2016	\$522	\$ 59	\$581	+4%
2017	\$524	\$ 82	\$606	+4%
2018 <sup>(1)</sup>	\$529	\$ 83	\$612	+1%
2019	\$617	\$ 69	\$686	+12%
2020	\$681	\$ 20	\$701	+2%
2021	\$694	\$ 20	\$714	+2%
2022	\$708	\$ 19	\$727	+2%
2023	\$722	\$ 20	\$742	+2%

Source: United States Department of Defense FY 2019 Budget Request.

<sup>(1)</sup> FY 2018 Base and OCO budget amounts presented above are presently being provided via a CR, which continues FY 2017 funding levels, with some limited exceptions, and expires March 23, 2018. We anticipate Congress to enact appropriations for an FY 2018 total DoD budget consistent with the FY 2018 BBA.

While the BBA provides a level of stability, future DoD budgets and spending levels are determined by a number of factors beyond our control, including changes to U.S. procurement policies, current and future domestic and international budget conditions, presidential administration priorities and changing national security and defense requirements. Furthermore, the U.S. Government's overall fiscal challenges remain, including uncertainties regarding BCA sequestration cuts after FY 2019 and, therefore, future DoD budgets and spending levels are difficult to predict. Although, uncertainty exists, we believe that L3 will benefit from several of the DoD's focus areas such as ISR, unmanned systems, undersea warfare, precision strike, secure communications, missile defense and space programs, electronic warfare, aircraft readiness and the ability to project power in denied environments. For more information on the risks and uncertainties related to our U.S. Government contracts, see "Part I — Item 1A — Risk Factors" in this Annual Report on Form 10-K.

*International and Commercial Markets.* Sales to end customers other than the U.S. Government represented 30% of our 2017 sales. We expect sales to international and commercial customers to continue to represent approximately 30% of our consolidated 2018 sales. These sales are generally affected by global economic conditions,

geopolitical and security conditions and commodity prices, as well as our competitive success in winning new business and increasing our market share. We believe that L3 will benefit from a large addressable international market with sales directly to foreign allied governments and under Foreign Military Sales agreements between the U.S. Government and foreign governments. Although our international sales are experiencing near-term softness, we believe the focus of our international markets in areas such as ISR, simulators, communication systems, night vision products and sensors systems will benefit L3 in the long-term. We also believe that the commercial markets in which we participate such as aviation products, security and screening, simulation and training, and radio frequency microwave and power have long-term favorable fundamentals.

### *Key Performance Measures*

The primary financial performance measures that we use to manage our businesses and monitor results of operations are (i) sales, (ii) operating income and (iii) net cash from operating activities (“Operating Cash Flow”). Management believes that these financial performance measures are the primary growth drivers for our earnings per share and cash flow per common share. Generally, in evaluating our businesses and contract performance, we focus on net sales, operating income, operating margin, which we define as operating income as a percentage of sales, and the financial performance measure of Operating Cash Flow, and not the type or amount of operating costs.

One of our primary business objectives is to increase sales organically and through select business acquisitions. We define organic sales as net sales excluding the sales impact of acquisitions and divestitures. Sales declines related to business divestitures are sales from divestitures that are included in our actual results for a twelve-month period prior to the divestitures. Sales increases related to acquired businesses are sales from acquisitions that are included in our actual results for less than a twelve-month period. We expect to supplement, strengthen and enhance our existing businesses by selectively acquiring businesses that: (1) add important new technologies and products, (2) provide access to select customers, programs and contracts and (3) provide attractive returns on investment. Another important financial performance measure that we use is operating margin, because sales growth combined with operating margin levels determine our operating income levels. Operating Cash Flow is also an important financial performance measure because Operating Cash Flow measures our ability to convert operating income into cash after paying income taxes and interest expenses and investing in working capital.

*Sales Trends.* For the year ended December 31, 2017, consolidated net sales of \$9,573 million increased by 4%, compared to the year ended December 31, 2016. Organic sales increased \$213 million, or 2%, and net sales from business acquisitions was \$204 million, or 2%. These increases were partially offset by divestitures of \$54 million, or 1%. Our average annual sales declined for the five years ended December 31, 2017 by 2% primarily due to a decline in average annual organic sales of approximately 1%. See “Results of Operations,” including segment results below for a further discussion of sales.

We derived approximately 66% of our 2017 sales from DoD customers; as a result, our sales are highly correlated to DoD budget levels. DoD budgets are a function of several factors and uncertainties beyond our control, including, but not limited to, changes in U.S. procurement policies, budget considerations, current and future economic conditions, presidential administration priorities, U.S. military engagements, changing national security and defense requirements, geo-political developments, actual fiscal year congressional appropriations for defense budgets, and sequestration and other DoD budget reductions. Any of these factors could result in a significant increase, decrease or redirection of DoD budgets and impact L3’s future results of operations, including our sales and operating income growth rates. Additionally, L3’s future results of operations will be affected by our ability to retain our existing business, including our revenue arrangements with DoD customers, and to successfully re-compete for existing business and compete for new business, which largely depends on: (1) our successful performance on existing contracts, (2) the effectiveness and innovation of our technologies and research and development activities, (3) our ability to offer better program performance than our competitors at an affordable cost and (4) our ability to retain our employees and hire new ones, particularly those employees who have U.S. Government security clearances and those with clearances of top-secret and above. We expect our 2018 consolidated sales to increase by approximately 4% compared to 2017, including an organic sales increase of 3%. We expect organic sales to the DoD and U.S. Government to increase by approximately 4% and organic international sales to decline by approximately 4% due to the completion of certain contracts with foreign governments. We expect organic commercial sales to increase by approximately 9%, primarily for commercial aviation products.

*Operating Income and Margin Trends.* For the year ended December 31, 2017, our operating income was \$1,020 million, an increase of 7% from \$957 million for the year ended December 31, 2016. Our operating margin

was 10.7% for the year ended December 31, 2017, an increase of 30 basis points from 10.4% for the year ended December 31, 2016. See “Results of Operations”, including segment results below, for a further discussion of operating margin.

Our effective management of labor, material, subcontractor and other direct costs is an important element of cost control and favorable contract performance. We believe that proactively re-sizing our businesses to their anticipated sales, combined with continuous cost improvement, will enable us to increase our cost competitiveness. While we continue to undertake cost management actions, such as reducing our indirect costs, curtailing pension benefits for salaried employees, resizing select business units and improving our productivity and contract performance in an effort to maintain or even increase operating margin, these efforts may not be successful and may be partially or fully offset by other cost increases. Furthermore, as a U.S. Government contractor, we do not retain the benefit of all cost management actions, particularly on cost-plus type contracts or on contracts where we are the sole-source provider. Although we expect our 2018 annual consolidated and segment operating margin to increase as compared to 2017, changes in the competitive environment and DoD procurement practices and changes in annual pension expense, including related assumptions such as the benefit obligation discount rates, among other factors, could result in lower operating margin. Furthermore, select business acquisitions and new business, including contract renewals and new contracts, could have lower future operating margins compared to our operating margins on existing contracts and could reduce future operating margins.

*Operating Cash Flow Trends.* For the year ended December 31, 2017, Operating Cash Flow was \$985 million, a decrease of 4%, compared to the year ended December 31, 2016. The decrease in Operating Cash Flow was primarily driven by higher income tax payments.

#### *U.S. Tax Reform*

On December 22, 2017, the U.S. Government enacted the U.S. Tax Cuts and Jobs Act (U.S. Tax Reform), which made significant changes to the U.S. tax system. Significant changes under U.S. Tax Reform include, among other things, the reduction of the U.S. corporate income tax rate from 35% to 21%, the implementation of a modified territorial tax system, and the imposition of a one-time repatriation tax on deemed repatriated earnings and profits of U.S. owned foreign subsidiaries (Toll Charge).

We recognized the income tax effects of U.S. Tax Reform in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 118, *Income Tax Accounting Implication of the Tax Cuts and Job Act* (SAB 118), in our consolidated financial statements for the year ended December 31, 2017. SAB 118 provides guidance for the application of income tax accounting standards related to U.S. Tax Reform. Accordingly, our consolidated financial statements reflect the income tax effects of U.S. Tax Reform for which the accounting is incomplete but a reasonable estimate could be determined. We recorded an estimated tax benefit of \$79 million from U.S. Tax Reform, which includes a \$101 million estimated tax benefit related to the remeasurement of deferred taxes partially offset by an estimated tax provision of \$22 million related to the Toll Charge. The preliminary net tax benefit recorded may differ in the future due principally to changes to the interpretations of U.S. Tax Reform, legislative action to clarify the interpretation of U.S. Tax Reform and changes to estimates we have utilized to calculate the tax benefit. We expect to finalize the tax benefit from U.S. Tax Reform with the filing of our tax return and record the difference between the final benefit and the provisional benefit recorded in the 2018 fourth quarter, if any, at that time.

#### *Discontinued Operations*

*Vertex Aerospace.* On October 16, 2017, our Board of Directors approved a plan to explore strategic alternatives to sell or otherwise divest the Vertex Aerospace business. We expect to complete a sale in 2018. The divestiture of the Vertex Aerospace business represents a strategic shift by us to exit the logistics solution and maintenance services business for military aircraft where we do not provide complex ISR systems integration and modification. The Vertex Aerospace business generated sales of \$1.4 billion in 2017, \$1.3 billion in 2016 and \$1.2 billion in 2015. The assets and liabilities and results of operations of the Vertex Aerospace business are reported as discontinued operations for all periods presented.

*National Security Solutions (NSS).* On February 1, 2016, we completed the sale of our NSS segment to CACI International Inc. for a sales price of \$547 million.

See Note 3 to the audited consolidated financial statements for additional information.

The table below presents the statements of operations data for Vertex Aerospace and NSS. The amounts presented in discontinued operations include allocated interest expenses for debt not directly attributable or related to L3's other operations. Interest expense was allocated in accordance with the accounting standards for discontinued operations and were based on the ratio of their net assets to the sum of: (1) total L3 consolidated net assets and (2) L3 consolidated total debt.

	<b>Year Ended December 31,</b>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Net sales . . . . .	\$ 1,429	\$ 1,402	\$ 2,334
Cost of sales . . . . .	(1,342)	(1,357)	(2,259)
(Loss) gain related to business divestiture <sup>(1)</sup> . . . . .	(1)	64	—
Goodwill impairment charges <sup>(2)</sup> . . . . .	<u>(187)</u>	<u>—</u>	<u>(909)</u>
Operating (loss) income from discontinued operations . . . . .	(101)	109	(834)
Interest expense allocated to discontinued operations . . . . .	<u>(2)</u>	<u>(5)</u>	<u>(26)</u>
(Loss) income from discontinued operations before income taxes . . . . .	(103)	104	(860)
Income tax benefit (expense) . . . . .	<u>27</u>	<u>(13)</u>	<u>128</u>
(Loss) income from discontinued operations net of income taxes . . . . .	<u>\$ (76)</u>	<u>\$ 91</u>	<u>\$ (732)</u>

<sup>(1)</sup> For the year ended December 31, 2017, we recognized \$1 million of trailing expenses related to the sale of NSS. The year ended December 31, 2016 included a gain of \$64 million (before and after income taxes) on the sale of NSS.

<sup>(2)</sup> Due to a decline in estimated fair value, we recorded goodwill impairment charges for the years ended December 31, 2017 and 2015. The impairment charge of \$187 million recorded during 2017 relates to Vertex Aerospace. The impairment charge of \$909 million recorded during 2015 consists of: (i) \$571 million related to NSS and (ii) \$338 million related to Vertex Aerospace.

### Business Acquisitions and Divestitures

As discussed above, one aspect of our strategy is to selectively acquire businesses that add new products and technologies or provide access to select customers, programs and contracts. We intend to continue acquiring select businesses for reasonable valuations that will provide attractive returns to L3. Our business acquisitions, depending on their contract-type, sales mix or other factors, could reduce L3's consolidated operating margin while still increasing L3's operating income, earnings per share and net cash from operating activities. In addition, we may also dispose of certain businesses if we determine that they no longer fit into L3's overall business strategy and we are able to receive an attractive price.

*Acquisitions.* We regularly evaluate potential business acquisitions. The table below summarizes the acquisitions that we have completed during the years ended December 31, 2015, 2016 and 2017 referred to herein as business acquisitions. See Note 3 to our audited consolidated financial statements for further information regarding our business acquisitions. During the year ended December 31, 2017, we used net cash of \$316 million for business acquisitions.

<u>Business Acquisitions</u>	<u>Date Acquired</u>	<u>Segment</u>	<u>Purchase Price<sup>(1)</sup></u> (in millions)
<b>2015</b>			
MITEQ, Inc. . . . .	January 21, 2015	Communication Systems	\$ 41
CTC Aviation Group (L3 CTC) . . . . .	May 27, 2015	Electronic Systems	236
ForceX, Inc. (L3 ForceX) . . . . .	October 13, 2015	Sensor Systems	<u>61</u>
Total 2015 . . . . .			<u>\$338</u>
<b>2016</b>			
Advanced Technical Materials, Inc. (ATM) . . . . .	January 22, 2016	Communication Systems	\$ 27
Micreo Limited (Micreo) and Flight Training Acquisitions LLC (Aerosim) . . . . .	September 30, 2016	Sensor Systems and Electronic Systems	86
MacDonald Humfrey (Automation) Limited (MacH) . . . . .	November 22, 2016	Electronic Systems	<u>327<sup>(2)</sup></u>
<b>Total 2016</b> . . . . .			<u>\$440</u>



<u>Business Acquisitions</u>	<u>Date Acquired</u>	<u>Segment</u>	<u>Purchase Price<sup>(1)</sup></u> (in millions)
<b>2017</b>			
Explosive Trace Detection business of Implant Sciences (ETD business) . . . . .	January 5, 2017	Electronic Systems	\$118
OceanServer Technology, Inc. (OceanServer), Open Water Power, Inc. (Open Water Power), and Doss Aviation, Inc. (Doss Aviation) . . . . .	March 17, 2017 May 19, 2017	Sensor Systems and Electronic Systems	147 <sup>(3)</sup>
Adaptive Methods, Inc. (Adaptive Methods) . .	September 12, 2017	Sensor Systems	33
Escola De Aviacao Aerocondor, S.A. (G-Air) .	September 8, 2017	Electronic Systems	13
Kigre, Inc. (Kigre) . . . . .	October 27, 2017	Sensor Systems	13
	December 18, 2017		<u>13</u>
<b>Total 2017</b> . . . . .			<u>\$324</u>

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

(2) Excludes additional purchase price, not to exceed £30 million (approximately \$38 million), which is contingent upon the post-acquisition financial performance of MacH for the three-year period ending December 31, 2019.

(3) Excludes additional purchase price, not to exceed \$17 million, which is contingent upon the post-acquisition milestone achievements of Open Water Power for the four-year period ending December 31, 2021.

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

*Divestitures.* We regularly evaluate potential business divestitures. Below summarizes the divestitures that we have completed during the years ended December 31, 2017, 2016 and 2015. See Note 3 to our audited consolidated financial statements for further information regarding our business divestitures.

*2017 Divestitures*

During the year ended December 31, 2017, we completed the sales of the CTC Aviation Jet Services Limited (Aviation Jet Services) business, the L3 Coleman Aerospace (Coleman) business and the Display Product Line. The table below presents pre-tax (loss) gain recognized, the proceeds received and net sales included in continuing operations from these divestitures.

	<u>Year Ended December 31, 2017</u>		
	<u>Pre-Tax</u> <u>(Loss) gain</u>	<u>Proceeds</u> <u>Received</u> (in millions)	<u>Net Sales</u>
Aviation Jet Services divestiture . . . . .	\$(5)	\$ 1	\$ 1
Coleman divestiture . . . . .	(3)	17	9
Display Product Line divestiture . . . . .	<u>4</u>	<u>7</u>	<u>—</u>
Total . . . . .	<u>\$(4)</u>	<u>\$25</u>	<u>\$10</u>

*Aviation Jet Services Divestiture.* On March 1, 2017, we divested our Aviation Jet Services business for a sales price of £1 million (approximately \$1 million). Aviation Jet Services provided non-core aircraft management and operational services as part of commercial training solutions based in the United Kingdom and was included in the Electronic Systems segment.

*Coleman Divestiture.* On February 24, 2017, we divested our Coleman business for a sales price of \$15 million. Coleman provided air-launch ballistic missile targets and was included in the Electronic Systems segment.

*Display Product Line Divestiture.* On February 23, 2017, we divested our Display Product Line for a sales price of \$7 million. The Display Product Line provided cockpits to various military aircraft and was included in the Electronic Systems segment.

### 2016 Business Divestitures

NSS. On February 1, 2016, we completed the sale of our NSS segment to CACI International Inc. for a sales price of \$547 million.

### 2015 Business Divestitures

During the year ended December 31, 2015, we completed the sales of Marine Systems International (MSI), Broadcast Sports Inc. (BSI), the Tinsley Product Line and Klein Associates, Inc. (Klein). The table below presents pre-tax loss recognized, the proceeds received and net sales included in continuing operations from these business divestitures.

	Year Ended December 31, 2015		
	<u>Pre-Tax Loss</u>	<u>Proceeds Received</u> (in millions)	<u>Net Sales</u>
MSI divestiture . . . . .	\$(17)	\$318	\$185
BSI divestiture . . . . .	(4)	26	7
Tinsley Product Line divestiture . . . . .	(8)	4	9
Klein divestiture . . . . .	<u>(2)</u>	<u>10</u>	<u>8</u>
Total . . . . .	<u>\$(31)</u>	<u>\$358</u>	<u>\$209</u>

*MSI Divestiture.* On May 29, 2015, we completed the sale of our MSI business to Wärsilä Corporation for a sales price of €295 million (approximately \$318 million), in addition to the assumption by Wärsilä Corporation of approximately €60 million of MSI employee pension-related liabilities. The sales price was finalized as of June 24, 2016, with no significant changes to preliminary amounts. MSI was a sector within our Electronic Systems segment, primarily selling to the commercial shipbuilding industry.

*BSI Divestiture.* On April 24, 2015, we divested our BSI business for a sales price of \$26 million. BSI provided wireless technology and communications systems services for use in the field of sports television broadcasting and was included in the Sensor Systems segment.

*Tinsley Product Line Divestiture.* On July 27, 2015, we divested our Tinsley Product Line for a sales price of \$4 million. Tinsley provided optical components, sub-assemblies and passive sub-systems and was included in the Sensor Systems segment.

*Klein Divestiture.* On December 31, 2015, we divested our Klein business for a sales price of \$10 million. Klein provided side scan sonar equipment and waterside security and surveillance systems and was included in the Sensor Systems segment.

### Critical Accounting Policies

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and cost of sales during the reporting period. The most significant of these estimates and assumptions for L3 relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, pension and post-retirement benefit obligations, income taxes, including the valuations of deferred tax assets, litigation reserves, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Changes in estimates are reflected in the periods during which they become known. Actual amounts may differ from these estimates and could differ materially. We believe that our critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are uncertain and require judgment at the time of the estimate, (2) use of reasonably different assumptions could have changed our estimates, particularly with respect to estimates of contract revenues and costs, and recoverability of assets, and (3) changes in the estimate could have a material effect on our financial condition or results of operations. We believe the following critical accounting policies contain the more significant judgments and estimates used in the preparation of our financial statements.

*Contract Revenue Recognition and Contract Estimates.* Approximately 59% of our consolidated net sales are generated from contracts (revenue arrangements) that require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment and to provide related engineering and technical services according to the buyer's specifications. These revenue arrangements or contracts are generally fixed-price, cost-plus or time-and-material type and are covered by contract accounting standards. Substantially all of our cost-plus type and time-and-material type contracts are with the U.S. Government, primarily the DoD. Certain of our contracts with the U.S. Government are multi-year contracts that are funded annually by the customer, and sales on these multi-year contracts are based on amounts appropriated (funded) by the U.S. Government. Our remaining sales are accounted for in accordance with accounting standards for revenue arrangements with commercial customers.

Sales and profits on fixed-price type contracts that are covered by contract accounting standards are substantially recognized using percentage-of-completion (POC) methods of accounting. Sales on such contracts represent approximately 49% of our consolidated net sales. Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the "units-of-delivery" method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to the total estimated costs at completion of the contract, multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the "cost-to-cost" method). Under both POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

Accounting for the sales and profits on these fixed-price contracts requires the preparation of estimates of the: (1) total contract revenue, (2) total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work and (3) measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units-of-delivery method, sales on a fixed-price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost-to-cost method, sales on a fixed-price type contract are recorded at amounts equal to the ratio of actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (i) the total estimated contract revenue, less (ii) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to (i) the current estimated total profit margin multiplied by the cumulative sales recognized, less (ii) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenues, a loss arises, and a provision for the entire loss is recorded in the period that the loss becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded as a component of other current liabilities entitled "Estimated cost in excess of estimated contract value to complete contracts in process in a loss position."

Revisions or adjustments to estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained, as facts and circumstances change and as new information is obtained, even though the scope of work required under the contract may not change. Revisions or adjustments may also be required if contract modifications occur. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The impact of revisions in profit (loss) estimates for all types of contracts subject to POC accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. Revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates amounted to increases of \$184 million, or 18%, of consolidated operating income (\$1.48 per diluted share) for the year ended December 31, 2017, increases of \$149 million, or 16%, of consolidated operating income (\$1.23 per diluted share) for the year ended December 31, 2016, and increases of \$52 million, or 7%, of consolidated operating income (\$0.45 per diluted share) for the year ended December 31, 2015.

Sales and profits on cost-plus type contracts that are covered by contract accounting standards are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. Sales on such contracts represent approximately 10% of our consolidated net sales. The estimated

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

Sales on arrangements for (1) fixed-price type contracts that require us to perform services that are not related to the production of tangible assets (Fixed-Price Service Contracts) and (2) certain commercial customers are recognized in accordance with accounting standards for revenue arrangements with commercial customers. Sales for our businesses whose customers are primarily commercial business enterprises are substantially all generated from single element revenue arrangements. Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectability is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on a straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are generally recognized when the units of work are completed. Sales and profit on cost-plus and time-and-material type contracts within the scope of accounting standards for revenue arrangements with commercial customers are recognized in the same manner as those within the scope of contract accounting standards, except for incentive and award fees. Cost-based incentive fees are recognized when they are realizable in the amount that would be due under the contractual termination provisions as if the contract was terminated. Performance based incentive fees and award fees are recorded as sales when objective evidence exists that the fees have been earned.

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

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

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*, As Amended (commonly referred to as ASC 606), which will replace numerous requirements in U.S. GAAP, including industry-specific requirements, provides companies with a single revenue recognition model for recognizing revenue from contracts with customers and significantly expands the disclosure requirements for revenue arrangements. The new standard, as amended, will be effective for us for interim and annual reporting periods beginning on January 1, 2018. See Note 2 to our audited consolidated financial statements for discussion of our efforts to evaluate and implement the new standard along with our evaluation of the expected impact of the standard on our audited consolidated financial statements.

*Goodwill and Identifiable Intangible Assets.* In accordance with the accounting standards for business combinations, we record the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). Identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged. However, we do not recognize separate intangible assets for the assembled workforces of our business acquisitions.

Generally, the largest separately identifiable intangible asset from the businesses that we acquire is the value of their assembled workforces, which includes the human capital of the management, administrative, marketing and business development, scientific, engineering and technical employees of the acquired businesses. The success of our

businesses, including their ability to retain existing business (revenue arrangements) and to successfully compete for and win new business (revenue arrangements), is primarily dependent on the management, marketing and business development, contracting, engineering and technical skills and knowledge of our employees, rather than on productive capital (plant and equipment, and technology and intellectual property). Additionally, for a significant portion of our businesses, our ability to attract and retain employees who have U.S. Government security clearances, particularly those with top-secret and above clearances, is critical to our success and is often a prerequisite for retaining existing revenue arrangements and pursuing new ones. Generally, patents, trademarks and licenses are not material for our acquired businesses. Furthermore, our U.S. Government contracts (revenue arrangements) generally permit other companies to use our patents in most domestic work performed by such other companies for the U.S. Government. Therefore, because intangible assets for assembled workforces are part of goodwill, the substantial majority of the intangible assets for our acquired business acquisitions are recognized as goodwill. Additionally, the value assigned to goodwill for our business acquisitions also includes the value that we expect to realize from growth expectations and cost reduction measures that we implement for our acquired businesses. Goodwill equals the amount of the purchase price of the business acquired in excess of the sum of the fair value of identifiable acquired assets, both tangible and intangible, less the fair value of liabilities assumed. At December 31, 2017, we had goodwill of \$6,615 million and identifiable intangible assets of \$292 million.

The most significant identifiable intangible asset that is separately recognized in accordance with U.S. GAAP for our business acquisitions is customer contractual relationships. All of our customer relationships are established through written customer contracts (revenue arrangements). The fair value for customer contractual relationships is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows from working capital) arising from the follow-on sales on contract (revenue arrangement) renewals expected from customer contractual relationships over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory asset charge, all of which is discounted to present value. All identifiable intangible assets are amortized over their estimated useful lives as the economic benefits are consumed. We review customer contractual relationships for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable in accordance with the accounting standards for long-lived assets. If any such event or change in circumstances occurs, and, if our revised estimates of future after-tax cash flows are significantly lower than our estimates at the date we acquired the customer contractual relationships, we may be required to record an impairment charge to write-down these intangible assets to their realizable values. We also review and update our estimates of the duration of our customer contractual relationships, at least annually. If such estimates indicate that the duration of our customer contractual relationships has decreased compared to the estimates made as of the date we acquired these intangible assets, then we accelerate the amortization period for our customer contractual relationships over their remaining useful lives.

We review goodwill for impairment annually as of November 30 and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The accounting standards for goodwill allow for the assessment of qualitative factors, such as macroeconomic conditions, industry and market conditions and entity relevant events or circumstances, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. We did not utilize a qualitative assessment approach for the November 30, 2017 goodwill impairment test, as we chose instead to complete the quantitative testing process for each reporting unit.

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

L3 had 13 reporting units at December 31, 2017 and at November 30, 2017 when our annual goodwill impairment assessment was completed. L3 had 9 reporting units at December 31, 2016. The change in reporting units was a result of the segment realignment; effective March 1, 2017, we realigned our Electronic Systems segment, which was separated into two segments named (1) Electronic Systems and (2) Sensor Systems. Our annual impairment tests at November 30, 2017 and 2016 did not result in impairments to goodwill. In addition, the fair value of all of our reporting units exceeded the carrying value of the net assets of those reporting units by more than 20% at November 30, 2017.

L3's aggregate balance of goodwill from continuing operations increased by \$241 million to \$6,615 million at December 31, 2017 from \$6,374 million at December 31, 2016 due to increases of \$200 million for business acquisitions, net of divestitures and \$93 million for foreign currency translation adjustments, partially offset by \$52 million reclassified to assets held for sale. The table below presents the number of reporting units and the associated goodwill at December 31, 2017 for each of our reportable segments.

Reportable Segment	Number of Reporting Units	Aggregate Goodwill (in millions)
Electronic Systems . . . . .	5	\$2,813
Aerospace Systems . . . . .	1	1,146
Communication Systems . . . . .	1	1,023
Sensor Systems . . . . .	<u>6</u>	<u>1,633</u>
Total . . . . .	<u>13</u>	<u>\$6,615</u>

To test goodwill for potential impairment, we compare the carrying value of the reporting unit to its fair value. To the extent the carrying value of a reporting unit exceeds its fair value, a goodwill impairment charge is recognized. Our methodology for determining the fair value of a reporting unit uses a discounted cash flow (DCF) valuation approach, and is dependent on estimates for future sales, operating income, depreciation and amortization, income tax payments, working capital changes and capital expenditures, as well as expected long-term growth rates for cash flows. All of these factors are affected by economic conditions related to the industries in which we operate (predominantly the U.S. defense industry), as well as conditions in the U.S. capital markets.

We performed an interim impairment test during the quarterly period ended September 29, 2017 for the Vertex Aerospace reporting unit and as a result of a decline in the estimated fair value, we recorded an impairment charge of \$187 million (\$133 million after income taxes) in 2017. The impairment charge is included in the Vertex Aerospace results of operations which are classified as discontinued operations. We performed an interim impairment test in 2015 for the NSS and the Vertex Aerospace reporting units and due to a decline in the estimated fair values we recorded aggregate goodwill impairment charges of \$955 million (\$46 million classified in continuing operations, for the retained businesses, and \$909 million classified in discontinued operations).

The more significant assumptions used in our DCF valuations to determine the fair values of our reporting units in connection with the goodwill valuation assessment at November 30, 2017 were: (1) detailed three-year cash flow projections for each of our reporting units, (2) the expected long-term cash flow growth rates for each of our reporting units (commonly known as Terminal Growth Rates), which approximate the expected long-term nominal growth rate for the U.S. DoD budget, the U.S. economy and the respective industries in which the reporting units operate, expected inflation rates, and specific circumstances for each reporting unit, including contracts or programs ending and expected new business and (3) risk adjusted discount rates, which represent the weighted average cost of capital (WACC) for each reporting unit and include the estimated risk-free rate of return that is used to discount future cash flow projections to their present values. There were no changes to the underlying methods used in 2017 as compared to the prior year DCF valuations of our reporting units.

The WACC for each reporting unit was comprised of: (1) an estimated required rate of return on equity, based on publicly traded companies with business and economic risk characteristics comparable to each of L3's reporting units (Market Participants), including a risk free rate of return of 2.65% on the 20-year U.S. Treasury Bond at November 30, 2017 (2.73% as of November 30, 2016) and an equity risk premium of 6% (unchanged compared to November 30, 2016), and (2) an after-tax rate of return on Market Participants' debt, which was derived from a selected corporate bond index having a Baa debt rating, consistent with the credit rating of the Market Participants. Each of the estimated required rate of return on equity and the after-tax rate of return on Market Participants' debt is weighted by the relative market value percentages of the Market Participants' equity and debt. The WACC assumptions for each reporting unit are based on a number of market inputs that are outside of our control and are updated annually to reflect changes to such market inputs as of the date of our annual goodwill impairment assessments, including changes to: (1) the estimated required rate of return on equity based on historical returns on common stock of Market Participants and the Standard & Poor's 500 Index over the prior five-year period, (2) the risk free rate of return based on the prevailing market yield on the 20 year U.S. Treasury Bond, (3) the rate of return on corporate bonds having a debt rating consistent with the credit rating of the Market Participants and (4) the relative market value percentages of Market Participants' equity and debt.

The table below presents the weighted average risk adjusted discount rate assumptions in the WACC used in our DCF valuation for each of our reportable segments for our goodwill impairment assessments at November 30, 2017 and 2016.

Reportable Segments	WACC	
	2017	2016
Electronic Systems <sup>(1)</sup>	7.35%	7.44%
Aerospace Systems	7.05%	6.98%
Communication Systems	7.27%	7.21%
Sensor Systems <sup>(2)</sup>	7.03%	7.00%

(1) The weighted average risk adjusted discount rate in WACC for the Electronic Systems reportable segment is comprised of separate discount rates for each reporting unit within the segment that range from 7.05% to 7.78% for 2017 and 6.98% to 8.06% for 2016.

(2) The weighted average risk adjusted discount rate in WACC for the Sensor Systems reportable segment is comprised of separate discount rates for each reporting unit within the segment that range from 7.05% to 8.31% for 2017 and 6.98% to 8.01% for 2016.

As presented in the table below, L3's historical three-year average annual cash flow growth rates for 2017, 2016 and 2015 for our reportable segments ranged from a negative 9% to a positive 8%. The annual cash flows generated by each of our reporting units vary from year to year, and, therefore, the annual cash flow growth rates do not result in linear trends due to a number of factors, including, but not limited to: (1) variability of annual sales volume and sales growth rates, (2) increases and decreases in working capital, including customer advance payments and billings on multi-year contracts (revenue arrangements) with long-term performance periods (exceeding one year), (3) the timing of invoicing and cash collections between fiscal years from receivables due from customers on multi-year contracts (revenue arrangements), (4) the timing of increases and decreases of select inventories procured and produced in anticipation of future product sales, which frequently overlap the ending and beginning of fiscal years, (5) the timing of the receipt of award fee and incentive fee payments from customers on contracts (revenue arrangements), (6) variability in annual cash outlays for research and development costs, (7) changes in cash outlays for capital expenditures for property, plant and equipment and (8) increases in annual sales and costs and expense volumes of a reporting unit resulting from business acquisitions. As a result of the factors discussed above and the varying sizes of our reporting units, the annual cash flow levels and growth rates at the reporting unit level tend to fluctuate significantly from year to year.

The 2017 cash flow amount and the cash flow growth rate for each of the last three years for each of our segments are presented in the following table.

Reportable Segment	Estimated 2017 Cash Flow <sup>(1)</sup> (in millions)	Estimated Average Annual Cash Flow Growth Rate <sup>(1)</sup>			
		2017	2016	2015	3 Yr. Average
Electronic Systems <sup>(2)</sup>	\$342	10%	7%	7%	8%
Aerospace Systems <sup>(3)</sup>	\$241	4%	26%	(31)%	—%
Communication Systems <sup>(4)</sup>	\$208	11%	(36)%	(2)%	(9)%
Sensor Systems <sup>(5)</sup>	\$140	(26)%	47%	(26)%	(2)%

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

(2) The increase in 2017 cash flows for Electronic Systems was primarily due to higher cash flows from operations and lower working capital requirements at Power & Propulsion Systems in 2017 compared to 2016. The increase in 2016 cash flows was primarily due to lower working capital requirements and lower capital expenditures primarily at Power & Propulsion Systems. The increase in 2015 cash flows was primarily due to increases in working capital requirements at Aviation Products during 2014 that did not recur in 2015.

(3) The increase in 2017 cash flows for Aerospace Systems was primarily due to lower working capital requirements at Mission Integration. The increase in 2016 cash flows was primarily due to higher cash flows from operations compared to 2015 and lower working capital requirements at Mission Integration in 2016 compared to 2015. The decrease in 2015 cash flows was due to lower cash flows from operations compared to 2014 at Mission Integration due to cost growth on international head-of-state aircraft modification contracts and higher working capital requirements at Mission Integration.

(4) The increase in 2017 cash flows for Communication Systems was due to improved cash flows from operations and lower working capital requirements at Broadband Communication Systems. The decrease in 2016 cash flows was primarily due to higher working capital requirements in 2016 compared to 2015. The decrease in 2015 cash flows was due to an increase in capital expenditures.

(5) The decrease in 2017 cash flows for Sensor Systems was primarily due to higher working capital requirements primarily at Maritime Sensor

Systems. The increase in 2016 cash flows was primarily due to lower working capital requirements in 2016 compared to 2015. The decrease in 2015 cash flows was primarily related to Warrior Sensor Systems which was negatively impacted by costs related to alleged performance issues with EoTech's holographic weapons sight products and working capital reductions for night vision products in 2014 that did not recur in 2015.

We consider several factors to determine expected future annual cash flows for our reporting units, including historical multi-year average cash flow trends by reporting unit and the expected future cash flow growth rates for each of our reporting units primarily based on our estimates of future sales, operating income and working capital changes. Furthermore, the substantial majority of our reporting units are primarily dependent upon the DoD budget and spending. Sales from DoD customers generate a significant portion of our annual sales and have historically represented approximately 66% or more of our total sales. Accordingly, to determine expected future annual cash flows for our reporting units we also consider: (1) the DoD budget and spending priorities, (2) expansion into new markets, (3) changing conditions in existing markets for our products, systems and services, (4) possible termination of certain government contracts, (5) expected success in new business competitions and re-competitions on existing business and (6) anticipated operating margins and working capital requirements, which vary significantly depending on the stage of completion (early, mature, ending) of contracts (revenue arrangements). We closely monitor changes in these factors and their impact on the expected cash flow of our reporting units. In addition to these factors that were relevant and specific to each of our reporting units, our goodwill impairment assessments at November 30, 2017 assumed 3.0% nominal growth in the base budget beginning with FY 2019, which is slightly less than the base budget cumulative average growth rate during the five year period from FY 2018 to FY 2023, as shown in the DoD budget table presented with our discussion of the business environment on page 25.

Additionally, our actual cash flows may be higher than our projections, and the DCF valuation does not reflect actions that we may take to increase the profitability and cash flows of our reporting units. Actions we may take include consolidating and streamlining select business operations, creating future synergies with other L3 businesses or pursuing incremental targeted growth opportunities. Additionally, the DCF valuations do not assume future business acquisitions or divestitures.

The table below presents the estimated: (1) compound annual growth rate (CAGR) of cash flow for 2018 – 2022 and (2) terminal cash flow growth rates after 2022 for each of our reportable segments.

Reportable Segment	Estimated Average Annual Cash Flow Growth Rate	
	Five Yr. CAGR 2018 - 2022	After 2022 Terminal Growth Rate
Electronic Systems	2%	2.5%
Aerospace Systems <sup>(1)</sup>	(3)%	2.5%
Communications Systems	1%	2.5%
Sensor Systems <sup>(2)</sup>	14%	2.5%

<sup>(1)</sup> Aerospace Systems projected cash flow is expected to decrease from \$241 million in 2017 to \$208 million in 2022. We expect a decrease primarily due to higher working capital requirements at Mission Integration for a foreign military contract.

<sup>(2)</sup> Sensor Systems projected cash flow is expected to increase from \$140 million in 2017 to \$268 million in 2022. We expect projected cash flow levels to increase due to: (1) expected improvements in cash conversion rates at Warrior Systems due to timing of collection from international programs, (2) forecasted average annual sales growth of approximately 4%, primarily at Advanced Programs due to higher expected demand for lightweight unmanned undersea vehicles and (3) expected improvement in forecasted operating margins of approximately 90 basis points.

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

As discussed above, the more significant assumptions used in our DCF valuations for each of our reporting units were detailed three-year undiscounted cash flow projections, risk adjusted discount rates, or WACC, used to discount the cash flow projections to their present value and expected Terminal Growth Rates. The current year (2018-2020) consolidated three-year undiscounted cash flow projections increased 21% compared to the prior year (2017-2019), with the changes by each reporting unit ranging from a decline of 13% to an increase of 93%. The risk adjusted



discount rate, or WACC, increased by an average of 10 basis points compared to the prior year valuations primarily due to changes in the capital structure of business area-specific guideline public companies. The expected Terminal Growth Rates utilized in the current year valuations remain flat when compared with those utilized in the prior year valuations for all reporting units.

As part of our annual impairment test, we evaluated the sensitivity of the DCF fair value estimates for each reporting unit, which were used for our goodwill impairment assessment, by separately assessing the impact on the estimated fair value of each reporting unit by: (1) increasing the risk adjusted discount rate (WACC) by 50 basis points or (2) reducing the Terminal Growth Rate by 50 basis points, compared to those used in our estimated fair value calculations, while holding all other assumptions unchanged. All of our reporting units would have had a fair value in excess of their carrying value under both scenarios. In addition, we applied hypothetical decreases to the estimated fair values of each of our reporting units. We determined that a decrease in fair value of at least 30% would be required before any reporting unit would have a carrying value in excess of its fair value.

As discussed previously, in addition to the annual goodwill impairment assessment, we review goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount of a reporting unit's goodwill may not be recoverable. Accordingly, depending on their outcomes, certain circumstances, such as the ability of the reporting units to: (1) achieve 2018 projected sales, operating income and cash flow and (2) win contract re-competitions and new business pursuits, may require us to review goodwill for impairment prior to the next annual assessment (November 30, 2018).

*Pension Plan and Postretirement Benefit Plan Obligations.* The obligations for our pension plans and postretirement benefit plans and the related annual costs of employee benefits are calculated based on several long-term assumptions, including discount rates and expected mortality for employee benefit liabilities, rates of return on plan assets, expected annual rates for salary increases for employee participants in the case of pension plans, and expected annual increases in the costs of medical and other health care benefits in the case of postretirement benefit obligations. These long-term assumptions are subject to revision based on changes in interest rates, financial market conditions, expected versus actual returns on plan assets, expected participant mortality and other actuarial assumptions, including future rates of salary increases, benefit formulas and levels, and rates of increase in the costs of benefits. Changes in the assumptions, if significant, could materially affect the amount of annual net periodic benefit costs recognized in our results of operations from one year to the next, the liabilities for the pension plans and postretirement benefit plans, and our annual cash requirements to fund these plans. Our pension expense for 2018 is expected to decrease by \$11 million to \$99 million from \$110 million in 2017. Our discount rate assumption decreased from a weighted average rate of 4.40% at December 31, 2016 to 3.78% at December 31, 2017. The expected decrease in our 2018 pension expense is primarily due to higher expected asset returns due to an increase in plan asset balances compared to the prior year, partially offset by the decrease in the weighted average discount rate.

In 2016, we changed the approach utilized to measure the service and interest cost components of expense for all of our pension and postretirement benefit plans. Historically, we measured the service and interest cost components using a single weighted average discount rate derived from the yield curve used to measure the benefit obligation at the beginning of the period. Beginning in 2016, we elected to use a spot rate approach for our plans in the measurement of the components of benefit cost by applying specific spot rates along the yield curve to the relevant projected cash flows, as we believe the new approach provides a more precise measurement of service and interest costs. We have accounted for this change prospectively as a change in accounting estimate. This change did not affect the measurement of our total benefit obligation. The estimated weighted average discount rates used to measure pension service and interest costs were 4.55% and 3.84% in 2017, respectively, compared to 4.83% and 3.95% in 2016, respectively. The previous method would have used a weighted average discount rate for both pension and service costs of 4.40% for 2017 and 4.67% for 2016, which represented the weighted average discount rate used to determine our benefit obligation at December 31, 2016 and 2015, respectively. The change resulted in a reduction to pension expense of approximately \$21 million in 2017 and \$28 million in 2016 compared to the prior approach. This change did not result in a material impact to postretirement medical expense. See “— Liquidity and Capital Resources — Pension Plans” for a further discussion of our estimated 2018 pension expense.

Discount rates are used to determine the present value of our pension obligations and also affect the amount of pension expense in any given period. The discount rate assumptions used to determine our pension and postretirement benefit obligations at December 31, 2017 and 2016 were based on a hypothetical AA yield curve represented by a series of annualized individual discount rates. Each bond issue underlying the yield curve is required to have a rating

of AA or better by Moody's Investors Service, Inc. and/or Standard & Poor's. The resulting discount rate reflects the matching of plan liability cash flows to the yield curve. For a sensitivity analysis projecting the impact of a change in the discount rate on our projected benefit obligation and pension expense, see "— Liquidity and Capital Resources — Pension Plans."

*Valuation of Deferred Income Tax Assets and Liabilities.* At December 31, 2017, we had deferred tax assets of \$493 million, a valuation allowance of \$10 million and deferred tax liabilities of \$638 million. The deferred tax assets included \$12 million for loss carryforwards and \$5 million for tax credit carryforwards which are subject to various limitations and will expire if unused within their respective carryforward periods. Deferred income taxes are determined separately for each of our tax-paying entities in each tax jurisdiction. The future realization of our deferred income tax assets ultimately depends on our ability to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law and, to a lesser extent, our ability to execute successful tax planning strategies. Based on our estimates of the amounts and timing of future taxable income and tax planning strategies, we believe that we will be able to realize our deferred tax assets, except for certain U.S. Federal, foreign and state net operating losses. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement desired tax planning strategies, could affect our ability to realize the future tax deductions underlying our deferred tax assets, and require us to provide a valuation allowance against our deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and, if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

*Liabilities for Pending and Threatened Litigation.* We are subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business or assumed in connection with certain business acquisitions. In accordance with the accounting standards for contingencies, we accrue a charge for a loss contingency when we believe it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. If the loss is within a range of specified amounts, the most likely amount is accrued, and we accrue the minimum amount in the range if no amount within the range represents a better estimate. Generally, we record the loss contingency at the amount we expect to pay to resolve the contingency and the amount is generally not discounted to the present value. Amounts recoverable under insurance contracts are recorded as assets when recovery is deemed probable. Contingencies that might result in a gain are not recognized until realizable. Changes to the amount of the estimated loss or resolution of one or more contingencies could have a material impact on our results of operations, financial position and cash flows. See Note 18 to our audited consolidated financial statements for further discussion of our litigation matters.

*Valuation of Long-Lived Assets.* In addition to goodwill and identifiable intangible assets recognized in connection with our business acquisitions, our long-lived assets also include property, plant and equipment, capitalized software development costs for software to be sold, leased or otherwise marketed, and certain long-term investments. At December 31, 2017, the consolidated carrying values of our property, plant and equipment were \$1,110 million, capitalized software development costs were \$57 million and certain long-term investments were \$12 million. At December 31, 2017, the carrying value of our property, plant and equipment represented 9% of total assets, and the carrying value of our capitalized software development costs and certain long-term investments each represented less than 1% of total assets. We review the valuation of our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value or net realizable value expected to result from the asset's use and eventual disposition. We use a variety of factors to assess valuation, depending upon the asset. Long-lived assets are evaluated based upon the expected period the asset will be utilized, and other factors depending on the asset, including estimated future sales, profits and related cash flows, estimated product acceptance and product life cycles, changes in technology and customer demand, and the performance of invested companies and joint ventures. Changes in estimates and judgments on any of these factors could have a material impact on our results of operations and financial position.

## **Results of Operations**

The following information should be read in conjunction with our audited consolidated financial statements. Our results of operations for the periods presented are affected by our business acquisitions. See Note 3 to our audited consolidated financial statements for a discussion of our business acquisitions and dispositions.

## Consolidated Results of Operations

The table below provides selected financial data, excluding discontinued operations, for the years ended December 31, 2017, 2016 and 2015.

(in millions, except per share data)	Year Ended December 31,		Increase/ (decrease)	Year Ended December 31,		Increase/ (decrease)
	2017	2016		2016	2015	
Net sales . . . . .	\$9,573	\$9,210	4%	\$9,210	\$9,231	(0.2)%
Operating income . . . . .	\$1,020	\$ 957	7%	\$ 957	\$ 785	22%
Goodwill impairment charges. . . . .	—	—	nm	—	46	nm
Loss related to business divestitures . . . . .	—	—	nm	—	31	nm
Segment operating income . . . . .	<u>\$1,020</u>	<u>\$ 957</u>	7%	<u>\$ 957</u>	<u>\$ 862</u>	11%
Operating margin . . . . .	10.7%	10.4%	30 bpts	10.4%	8.5%	190 bpts
Segment operating margin. . . . .	10.7%	10.4%	30 bpts	10.4%	9.3%	110 bpts
Interest expense and other. . . . .	\$ (149)	\$ (153)	(3)%	\$ (153)	\$ (146)	5%
Effective income tax rate . . . . .	11.7%	21.3%	(960) bpts	21.3%	20.7%	60 bpts
Net income from continuing operations attributable to L3 . . . . .	\$ 753	\$ 619	22%	\$ 619	\$ 492	26%
Adjusted net income from continuing operations attributable to L3 <sup>(1)</sup> . . . . .	\$ 753	\$ 619	22%	\$ 619	\$ 556	11%
Diluted earnings per share from continuing operations. . . . .	\$ 9.46	\$ 7.86	20%	\$ 7.86	\$ 6.01	31%
Adjusted diluted earnings per share from continuing operations <sup>(1)</sup> . . . . .	\$ 9.46	\$ 7.86	20%	\$ 7.86	\$ 6.80	16%
Diluted weighted average common shares outstanding . . . . .	79.6	78.8	1%	78.8	81.9	(4)%

<sup>(1)</sup> Non-GAAP metric that excludes the goodwill impairment charges and the aggregate loss related to business divestitures. See the table on page 42 for a reconciliation and a discussion of why this information is presented.  
nm – not meaningful

### 2017 Compared with 2016

**Net Sales:** For the year ended December 31, 2017, consolidated net sales of \$9,573 million increased \$363 million, or 4%, compared to the year ended December 31, 2016. Organic sales increased by \$213 million, or 2%, to \$9,369 million for the year ended December 31, 2017. Organic sales exclude \$204 million of sales increases related to business acquisitions and \$54 million of sales declines related to business divestitures. For the year ended December 31, 2017, organic sales to the U.S. Government increased \$288 million, or 5%, to \$6,642 million, and organic sales to international and commercial customers decreased \$75 million, or 3%, to \$2,727 million.

Sales from products increased by \$280 million to \$6,733 million for the year ended December 31, 2017, compared to \$6,453 million for the year ended December 31, 2016. Product sales represented 70% of consolidated net sales for both of the years ended December 31, 2017 and 2016. Sales from products increased by: (1) \$147 million primarily driven by Broadband Communication Systems due to increased deliveries of secure networked communication systems primarily for the U.S. DoD, (2) \$120 million due to business acquisitions, net of divestitures, (3) \$98 million for Total Training Solutions primarily due to higher volume on commercial flight simulators and training systems for the U.S. Air Force (USAF) and (4) \$73 million for Precision Engagement Systems primarily due to increased deliveries of fuzing and ordnance products and higher volume for guidance and control products to the U.S. Army and U.S. USAF. These increases were partially offset by decreases of (1) \$90 million for Mission Integration due to lower volume for international aircraft modifications, primarily international head-of-state aircraft and the procurement and delivery of two aircraft for a foreign military customer in 2016 compared to one for the USAF Compass Call Recap in the 2017, (2) \$43 million due to reduced deliveries for UH-1Y aircraft cabin assemblies and (3) \$25 million primarily due to fewer deliveries of enhanced night vision goggle products to the U.S. Army as contracts near completion.

Sales from services increased by \$83 million to \$2,840 million for the year ended December 31, 2017, compared to \$2,757 million for the year ended December 31, 2016. Service sales represented 30% of consolidated net sales for both of the years ended December 31, 2017 and 2016. Sales from services increased primarily by: (1) \$37 million

for Total Training Solutions due to increased support services primarily to the USAF, (2) \$31 million due to business acquisitions, net of divestitures and (3) \$12 million due to higher volume of mission management software upgrades for the USAF. See the reportable segment results below for additional discussion of our segment sales trends.

*Operating income and operating margin:* Operating income for the year ended December 31, 2017 increased by \$63 million, or 7%, to \$1,020 million, compared to the year ended December 31, 2016. Operating margin increased by 30 basis points to 10.7% for the year ended December 31, 2017, compared to 10.4% for the year ended December 31, 2016. The increase in operating margin was driven by: (1) 60 basis points primarily due to improved contract performance for Electronic Systems, Communication Systems and Sensor Systems and (2) 30 basis points at Sensor Systems for a settlement of the class action litigation and product return allowances recorded in 2016 that did not recur. These increases were partially offset by 60 basis points due to severance and restructuring costs of \$59 million, including a \$12 million non-cash loss on the sale of a building in Sensor Systems and a \$4 million pension curtailment charge in connection with the decision to discontinue future service accruals for substantially all salaried employee defined benefit plans effective January 1, 2019 (Pension Curtailment). See the reportable segment results below for additional discussion of sales and operating margin trends.

*Interest expense and other:* Interest expense and other for the year ended December 31, 2017 declined by \$4 million, primarily due to the absence of \$7 million of debt retirement charges related to the redemption of: (1) \$300 million aggregate principal amount of 3.95% Senior Notes due November 15, 2016 (the 2016 Notes) in the second quarter of 2016 and (2) \$350 million aggregate principal amount of 1.50% Senior Notes due May 28, 2017 (the 2017 Notes) in the fourth quarter of 2016. This decline was partially offset by higher average interest rates on outstanding debt.

*Effective income tax rate:* The effective income tax rate for the year ended December 31, 2017 decreased to 11.7% from 21.3% for year ended December 31, 2016. The decrease was driven by: (1) \$79 million of estimated tax benefits related to U.S. Tax Reform and (2) \$30 million of tax benefits from a realignment of foreign legal entities to conform with our segment reporting structure. These increases were partially offset by \$21 million for the reversal of previously accrued amounts related to various U.S. Federal, foreign and state tax matters in 2016 that did not recur.

*Net income from continuing operations attributable to L3 and diluted earnings per share (EPS) from continuing operations:* Net income from continuing operations attributable to L3 increased 22% to \$753 million for the year ended December 31, 2017, compared to \$619 million for the year ended December 31, 2016. Diluted EPS from continuing operations increased 20% to \$9.46 for the year ended December 31, 2017, compared to \$7.86 for the year ended December 31, 2016. Diluted EPS for 2017 included \$0.99 of estimated tax benefits related to U.S. Tax Reform.

*Diluted weighted average common shares outstanding:* Diluted weighted average common shares outstanding for the year ended December 31, 2017 increased 1% compared to the year ended December 31, 2016, due to changes in the dilutive impact of common share equivalents, primarily caused by a higher L3 stock price.

## **2016 Compared with 2015**

*Net Sales:* For the year ended December 31, 2016, consolidated net sales of \$9,210 million decreased \$21 million, or 0.2%, compared to the year ended December 31, 2015. Organic sales for the year ended December 31, 2016 increased \$95 million, or 1%. Organic sales exclude \$209 million related to business divestitures and \$93 million from business acquisitions. For the year ended December 31, 2016, organic sales to the U.S. Government increased \$270 million, or 4%, to \$6,382 million, and organic sales to international and commercial customers decreased \$175 million, or 6%, to \$2,735 million.

Sales from products decreased by \$147 million to \$6,453 million for the year ended December 31, 2016, compared to \$6,600 million for the year ended December 31, 2015. Product sales represented 70% and 71% of consolidated net sales for the years ended December 31, 2016 and 2015, respectively. Sales from products declined by \$156 million due to the divestiture of MSI on May 29, 2015 and \$86 million in the Space & Power Systems sector primarily due to reduced demand for power devices for commercial satellites. These decreases were partially offset by increases of \$49 million in the Broadband Communication Systems sector primarily due to increased volume and deliveries of secure networked communication systems for the DoD and \$46 million primarily at Security & Detection Systems due to deliveries of airport security screening systems to international customers and commercial aviation recorders products.

Sales from services increased by \$126 million to \$2,757 million for the year ended December 31, 2016, compared to \$2,631 million for the year ended December 31, 2015. Service sales represented 30% and 29% of

consolidated net sales for the years ended December 31, 2016 and 2015, respectively. Sales from services increased by \$72 million due to the CTC Aviation Group (L3 CTC), L3 ForceX and Aerosim business acquisitions and \$54 million primarily for Broadband Communication Systems due to increased volume for logistics support services for the DoD. See the reportable segment results below for additional discussion of our segment sales trends.

*Operating income and operating margin:* Consolidated operating income for the year ended December 31, 2016 increased by \$172 million to \$957 million, compared to the year ended December 31, 2015. Segment operating income for the year ended December 31, 2016 increased by \$95 million, or 11%, compared to the year ended December 31, 2015. Segment operating margin increased by 110 basis points to 10.4% for the year ended December 31, 2016, compared to 9.3% for the year ended December 31, 2015. Segment operating margin increased by: (1) 90 basis points due to losses in 2015 at Aerospace Systems on international head-of-state aircraft modification contracts which did not recur and (2) 50 basis points due to lower pension expense of \$45 million. These increases were partially offset by sales mix changes. See the reportable segment results below for additional discussion of sales and operating margin trends.

*Interest expense and other:* Interest expense and other for the year ended December 31, 2016 included \$7 million of debt retirement charges related to the redemption of: (1) \$300 million aggregate principal amount of the 2016 Notes in the second quarter of 2016 and (2) \$350 million aggregate principal amount of the 2017 Notes in the fourth quarter of 2016.

*Effective income tax rate:* The effective income tax rate for the year ended December 31, 2016 increased to 21.3% from 20.7% for the year ended December 31, 2015. The increase in the effective income tax rate was driven by lower foreign tax benefits and lower Federal Research and Experimentation tax credits in 2016 compared to 2015, partially offset by a benefit of \$17 million due to the early adoption of a new accounting standard related to income tax benefits from employee stock-based compensation awards.

*Net income from continuing operations attributable to L3 and diluted EPS from continuing operations:* Net income from continuing operations attributable to L3 in the year ended December 31, 2016 increased to \$619 million, compared to \$492 million in the year ended December 31, 2015. Diluted EPS from continuing operations was \$7.86 for the year ended December 31, 2016, compared to \$6.01 for the year ended December 31, 2015.

*Adjusted net income from continuing operations attributable to L3 and adjusted diluted EPS from continuing operations:* Adjusted net income from continuing operations attributable to L3 increased 11% to \$619 million compared to the year ended December 31, 2015, and adjusted diluted EPS from continuing operations increased 16% to \$7.86.

*Diluted weighted average common shares outstanding:* Diluted weighted average common shares outstanding for the year ended December 31, 2016 declined by 4% compared to the year ended December 31, 2015 due to repurchases of L3 common stock in connection with our share repurchase programs authorized by our Board of Directors, partially offset by additional shares issued in connection with various employee stock-based compensation programs and contributions to employee savings plans made in common stock.

The table below presents a reconciliation of: (1) net income from continuing operations attributable to L3 to adjusted net income from continuing operations attributable to L3 and (2) diluted EPS from continuing operations to adjusted diluted EPS from continuing operations.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	<u>(in millions, except per share data)</u>		
Diluted EPS from continuing operations attributable to L3's common stockholders.....	\$9.46	\$7.86	\$ 6.01
EPS impact of the goodwill impairment charges <sup>(1)</sup> .....	—	—	0.54
EPS impact of loss on business divestitures <sup>(2)</sup> .....	—	—	<u>0.25</u>
Adjusted diluted EPS from continuing operations <sup>(3)</sup> .....	<u>\$9.46</u>	<u>\$7.86</u>	<u>\$ 6.80</u>
Net income from continuing operations attributable to L3.....	\$ 753	\$ 619	\$ 492
Goodwill impairment charges <sup>(1)</sup> .....	—	—	44
Loss on business divestitures <sup>(2)</sup> .....	—	—	<u>20</u>
Adjusted net income from continuing operations attributable to L3 <sup>(3)</sup> ....	<u>\$ 753</u>	<u>\$ 619</u>	<u>\$ 556</u>
<hr/>			
<sup>(1)</sup> Goodwill impairment charges.....	\$ —	\$ —	\$ (46)
Tax benefit.....	—	—	<u>2</u>
After-tax impact.....	—	—	(44)
Diluted weighted average common shares outstanding.....	—	—	<u>81.9</u>
Per share impact <sup>(4)</sup> .....	<u>\$ —</u>	<u>\$ —</u>	<u>\$(0.54)</u>
<sup>(2)</sup> Loss on business divestitures.....	\$ —	\$ —	\$ (31)
Tax benefit.....	—	—	<u>11</u>
After-tax impact.....	—	—	(20)
Diluted weighted average common shares outstanding.....	—	—	<u>81.9</u>
Per share impact <sup>(4)</sup> .....	<u>\$ —</u>	<u>\$ —</u>	<u>\$(0.25)</u>

<sup>(3)</sup> Adjusted diluted EPS is diluted EPS attributable to L3's common stockholders, excluding the goodwill impairment charges and charges or credits relating to business divestitures. Adjusted net income attributable to L3 is net income attributable to L3, excluding the goodwill impairment charges and charges or credits relating to business divestitures. These amounts are not calculated in accordance with U.S. GAAP. We believe that the goodwill impairment charges and charges or credits relating to business divestitures affect the comparability of the results of operations for 2017 and 2016 to the results of operations for 2015. We also believe that disclosing net income and diluted EPS excluding the goodwill impairment charges and charges or credits relating to business divestitures will allow investors to more easily compare the 2017 and 2016 results to the 2015 results. However, these measures may not be defined or calculated by other companies in the same manner.

<sup>(4)</sup> Amounts may not recalculate directly due to rounding.

## Reportable Segment Results of Operations

The table below presents selected data by reportable segment reconciled to consolidated totals. The results of operations of the Vertex Aerospace business and the NSS segment sold to CACI International Inc. are classified as discontinued operations for all periods presented. See Note 21 to our audited consolidated financial statements for additional reportable segment data.

	Year Ended December 31,		
	2017	2016	2015
	(dollars in millions)		
<b>Net sales:<sup>(1)</sup></b>			
Electronic Systems . . . . .	\$3,024	\$2,753	\$2,824
Aerospace Systems . . . . .	2,773	2,936	2,919
Communication Systems . . . . .	2,229	2,053	2,042
Sensor Systems . . . . .	<u>1,547</u>	<u>1,468</u>	<u>1,446</u>
Consolidated net sales . . . . .	<u>\$9,573</u>	<u>\$9,210</u>	<u>\$9,231</u>
<b>Operating income:</b>			
Electronic Systems . . . . .	\$ 403	\$ 360	\$ 337
Aerospace Systems . . . . .	210	255	193
Communication Systems . . . . .	212	195	190
Sensor Systems . . . . .	<u>195</u>	<u>147</u>	<u>142</u>
Total segment operating income . . . . .	1,020	957	862
Goodwill impairment charges . . . . .	—	—	(46)
Loss related to business divestitures . . . . .	—	—	(31)
Consolidated operating income . . . . .	<u>\$1,020</u>	<u>\$ 957</u>	<u>\$ 785</u>
<b>Operating margin:</b>			
Electronic Systems . . . . .	13.3%	13.1%	11.9%
Aerospace Systems . . . . .	7.6%	8.7%	6.6%
Communication Systems . . . . .	9.5%	9.5%	9.3%
Sensor Systems . . . . .	<u>12.6%</u>	<u>10.0%</u>	<u>9.8%</u>
Total segment operating margin . . . . .	10.7%	10.4%	9.3%
Goodwill impairment charges . . . . .	—%	—%	(0.5)%
Loss related to business divestitures . . . . .	—%	—%	(0.3)%
Consolidated operating margin . . . . .	<u>10.7%</u>	<u>10.4%</u>	<u>8.5%</u>

<sup>(1)</sup> Net sales are after intercompany eliminations.

### Electronic Systems

	Year Ended December 31,		Increase	Year Ended December 31,		Increase/ (decrease)
	2017	2016		2016	2015	
	(dollars in millions)					
Net sales . . . . .	\$3,024	\$2,753	10%	\$2,753	\$2,824	(3)%
Operating income . . . . .	\$ 403	\$ 360	12%	\$ 360	\$ 337	7%
Operating margin . . . . .	13.3%	13.1%	20 bpts	13.1%	11.9%	120 bpts

### 2017 Compared with 2016

Electronic Systems net sales for the year ended December 31, 2017 increased by \$271 million, or 10%, compared to the year ended December 31, 2016. Organic sales increased by \$147 million, or 5%, compared to the year ended December 31, 2016. Organic sales exclude \$178 million of sales increases related to business acquisitions

and \$54 million of sales declines related to business divestitures. Organic sales increased by: (1) \$135 million for Total Training Solutions primarily due to higher volume on commercial flight simulators and training systems for the USAF, (2) \$80 million for Precision Engagement Systems primarily due to increased deliveries of fuzing and ordnance products and higher volume for guidance and control products to the U.S. Army and USAF and (3) \$30 million for Power & Propulsion primarily due to higher volume for U.S. Navy (USN) power conversion and distribution systems. These increases were partially offset by \$98 million primarily for Security & Detection due to fewer deliveries for airport screening devices to the U.S. Transportation Security Administration and foreign customers and fewer deliveries of cargo screening devices to foreign customers.

Electronic Systems operating income for the year ended December 31, 2017 increased by \$43 million, or 12%, compared to the year ended December 31, 2016. Operating margin increased by 20 basis points to 13.3%. Higher sales volume and mix changes, primarily for Total Training Solutions and Power & Propulsion, increased operating margin by 110 basis points. These increases were partially offset by 40 basis points primarily due to lower margins related to acquisitions and 50 basis points due to higher severance costs of \$13 million.

### **2016 Compared with 2015**

Electronic Systems net sales for the year ended December 31, 2016 decreased by \$71 million, or 3%, compared to the year ended December 31, 2015. Organic sales increased \$52 million, or 2%, compared to the year ended December 31, 2015. Organic sales exclude \$62 million of sales increases related to business acquisitions and \$185 million of sales declines related to business divestitures. Sales increased by: (1) \$30 million for Aviation Products due to: (i) deliveries of commercial aviation recorders products and (ii) higher volume for overhaul and repair services for cockpit display products to the USAF and a new commercial cockpit control/display unit product, (2) \$12 million for Security & Detection due to deliveries of airport security screening systems to international customers and (3) \$10 million for Power & Propulsion Systems primarily due to higher volume for power conversion and distribution systems to the USN and an allied foreign naval customer.

Electronic Systems operating income for the year ended December 31, 2016 increased by \$23 million, or 7%, compared to the year ended December 31, 2015. Operating margin increased by 120 basis points to 13.1%. Operating margin increased by 70 basis points primarily due to higher margins related to acquisitions and divestitures and 50 basis points due to lower pension expense of \$13 million.

### **Aerospace Systems**

	<u>Year Ended December 31,</u>		<u>Decrease</u>	<u>Year Ended December 31,</u>		<u>Increase</u>
	<u>2017</u>	<u>2016</u>		<u>2016</u>	<u>2015</u>	
	<u>(dollars in millions)</u>					
Net sales . . . . .	\$2,773	\$2,936	(6)%	\$2,936	\$2,919	1%
Operating income . . . . .	\$ 210	\$ 255	(18)%	\$ 255	\$ 193	32%
Operating margin . . . . .	7.6%	8.7%	(110) bpts	8.7%	6.6%	210 bpts

### **2017 Compared with 2016**

Aerospace Systems net sales for the year ended December 31, 2017 decreased by \$163 million, or 6%, compared to the year ended December 31, 2016. Sales decreased by: (1) \$71 million due to lower volume for large ISR aircraft systems for foreign military customers as contracts near completion, (2) \$67 million due to lower volume for international aircraft modifications, primarily international head-of-state aircraft and Australian Defence Force (ADF) C-27J aircraft, (3) \$58 million due to the procurement and delivery of two aircraft to a foreign military customer in the 2016 second quarter compared to one for the USAF Compass Call Recap in the 2017 fourth quarter and (4) \$46 million due to reduced deliveries for UH-1Y aircraft cabin assemblies. These decreases were partially offset by \$79 million primarily due to higher volume for ISR systems to the U.S. Government.

Aerospace Systems operating income for the year ended December 31, 2017 decreased by \$45 million, or 18%, compared to the year ended December 31, 2016. Operating margin decreased by 110 basis points to 7.6%. Operating margin decreased by: (1) 70 basis points due to severance and restructuring costs of \$21 million, (2) 30 basis points primarily due to unfavorable contract performance adjustments on international aircraft modification contracts at Mission Integration and (3) 10 basis points primarily due to the Pension Curtailment.



### 2016 Compared with 2015

Aerospace Systems net sales for the year ended December 31, 2016 increased by \$17 million, or 1%, compared to the year ended December 31, 2015. Sales increases at Mission Integration were due to: (1) \$107 million primarily due to the procurement and delivery of two business jets to foreign military customers in the 2016 second quarter, (2) \$74 million due to higher volume for special mission aircraft and large ISR aircraft systems primarily for the U.S. Government, (3) \$40 million due to higher volume for small ISR aircraft systems primarily for the U.S. Army and (4) \$35 million primarily due to unfavorable contract performance adjustments in the year ended December 31, 2015 that did not recur in the year ended December 31, 2016 on international head-of-state aircraft modification contracts. These increases were partially offset by decreases at Mission Integration of: (1) \$148 million for large ISR aircraft systems for foreign military customers as contracts near completion and (2) \$91 million for small ISR aircraft fleet management services to the USAF due to reduced demand resulting from the U.S. military drawdown from Afghanistan.

Aerospace Systems operating income for the year ended December 31, 2016 increased by \$62 million, or 32%, compared to the year ended December 31, 2015. Operating margin increased by 210 basis points to 8.7%. Operating margin increased by: (1) 370 basis points primarily due to net aggregate unfavorable contract performance adjustments in the year ended December 31, 2015, which included \$101 million of cost growth on international head-of-state aircraft modification contracts, that did not recur in the year ended December 31, 2016 and (2) 50 basis points due to improved performance on the Army C-12 contract due to better terms on the new contract which began August 1, 2015. These increases were partially offset by decreases of (1) 140 basis points due to net aggregate favorable contract performance adjustments primarily for large ISR systems in the year ended December 31, 2015 that did not recur in the year ended December 31, 2016 and (2) 70 basis points primarily due to sales mix changes for ISR systems.

### Communication Systems

	Year Ended December 31,		Increase (dollars in millions)	Year Ended December 31,		Increase
	2017	2016		2016	2015	
Net sales . . . . .	\$2,229	\$2,053	9%	\$2,053	\$2,042	1%
Operating income . . . . .	\$ 212	\$ 195	9%	\$ 195	\$ 190	3%
Operating margin . . . . .	9.5%	9.5%	— bpts	9.5%	9.3%	20 bpts

### 2017 Compared with 2016

Communication Systems net sales for the year ended December 31, 2017 increased by \$176 million, or 9%, compared to the year ended December 31, 2016. The increase was primarily driven by Broadband Communication Systems due to increased deliveries of secure networked communication systems primarily for the U.S. DoD.

Communication Systems operating income for the year ended December 31, 2017 increased by \$17 million, or 9%, compared to the year ended December 31, 2016. Operating margin remained the same at 9.5%. Improved contract performance, primarily at Broadband Communication Systems, increased operating margin by 160 basis points. These increases were partially offset by 130 basis points due to mix changes primarily for Space & Power Systems. Consolidation activities primarily related to the traveling wave tube businesses further reduced operating margin by 30 basis points consisting of severance and restructuring costs of \$48 million partially offset by a pre-tax gain of \$42 million on the sale of the company's property in San Carlos, California in the second quarter of 2017.

### 2016 Compared with 2015

Communication Systems net sales for the year ended December 31, 2016 increased by \$11 million, or 1%, compared to the year ended December 31, 2015. Organic sales decreased by \$4 million, or 0.2%, compared to the year ended December 31, 2015. Organic sales exclude \$15 million of sales increases related to business acquisitions. The decrease was due to: (1) \$88 million in the Space & Power Systems, primarily due to reduced demand for power devices for commercial satellites, and (2) \$64 million in the Broadband Communication Systems due to fewer deliveries on a satellite communications (SATCOM) land terminals contract for the ADF, which was completed in the second quarter of 2016. These decreases were largely offset by increases of \$109 million in the Broadband Communication Systems primarily due to increased volume and deliveries of secure networked communication systems for the DoD and \$39 million primarily for increased volume and deliveries to the DoD of mobile and ground-based SATCOM systems for the U.S. military.

Communication Systems operating income for the year ended December 31, 2016 increased by \$5 million, or 3%, compared to the year ended December 31, 2015. Operating margin increased by 20 basis points to 9.5%. Operating margin increased by 60 basis points due to lower pension expense of \$13 million, partially offset primarily due to sales mix changes.

## Sensor Systems

	<u>Year Ended December 31,</u>		<u>Increase</u>	<u>Year Ended December 31,</u>		<u>Increase</u>
	<u>2017</u>	<u>2016</u>		<u>2016</u>	<u>2015</u>	
			(dollars in millions)			
Net sales . . . . .	\$1,547	\$1,468	5%	\$1,468	\$1,446	2%
Operating income . . . . .	\$ 195	\$ 147	33%	\$ 147	\$ 142	4%
Operating margin . . . . .	12.6%	10.0%	260 bpts	10.0%	9.8%	20 bpts

### 2017 Compared with 2016

Sensor Systems net sales for the year ended December 31, 2017 increased by \$79 million, or 5%, compared to the year ended December 31, 2016. Organic sales increased by \$53 million, or 4%, compared to the year ended December 31, 2016. Organic sales exclude \$26 million of sales increases related to business acquisitions. Organic sales increased primarily due to increased task order volume on U.S. Government contracts, higher volume for space electronics products and increased deliveries of airborne turret systems to the USAF. These increases were partially offset by fewer deliveries of enhanced night vision goggle products to the U.S. Army as contracts near completion.

Sensor Systems operating income for the year ended December 31, 2017 increased by \$48 million, or 33%, compared to the year ended December 31, 2016. Operating margin increased by 260 basis points to 12.6%. Operating margin increased by: (1) 180 basis points for a settlement of the class action litigation and product return allowances recorded in 2016 that did not recur at EoTech, (2) 120 basis points primarily for improved contract performance at Maritime Sensor Systems, (3) 30 basis points due to reserves for excess and obsolete inventory recorded in 2016 that did not recur and (4) 20 basis points primarily due to higher sales volume. These increases were partially offset by 70 basis points due to a \$12 million loss on the sale of a building during the 2017 fourth quarter in anticipation of consolidating two focal plane array foundries during 2018 and 2019 and 20 basis points due to severance costs of \$3 million.

### 2016 Compared with 2015

Sensor Systems net sales for the year ended December 31, 2016 increased by \$22 million, or 2%, compared to the year ended December 31, 2015. Organic sales increased \$30 million, or 2%, compared to the year ended December 31, 2015. Organic sales exclude \$16 million of sales increases related to business acquisitions and \$24 million of sales declines related to business divestitures. Organic sales increased primarily due to increased deliveries for infrared detection and space electronics products to the USAF and higher volume for hybrid electric drive contracts and photonics masts products to the USN.

Sensor Systems operating income for the year ended December 31, 2016 increased by \$5 million, or 4%, compared to the year ended December 31, 2015. Operating margin increased by 20 basis points to 10.0%. Operating margin increased by 90 basis points primarily for improved contract performance at Space & Sensor Systems and Airborne Sensor Systems. This increase was partially offset by 40 basis points for a settlement of the class action litigation and product returns allowance recorded in 2016 at EoTech and 30 basis points due to lower margins related to acquisitions and divestitures.

## Liquidity and Capital Resources

### Anticipated Sources and Uses of Cash Flow

At December 31, 2017, we had total cash and cash equivalents of \$662 million. While no amounts of the cash and cash equivalents are considered restricted, \$286 million of cash was held by our foreign subsidiaries. The repatriation of cash held in non-U.S. jurisdictions is subject to local capital requirements. Our primary sources of liquidity are cash flow generated from operations, cash on hand and our five-year unsecured \$1 billion revolving credit facility (Credit Facility), which we entered into on October 31, 2016. At December 31, 2017, we had the full availability of our Credit Facility. We generated \$985 million of net cash from operating activities from continuing

operations during the year ended December 31, 2017, and we received net cash proceeds of \$74 million substantially all from the sale of the property in San Carlos, California, and \$18 million primarily from the divestitures of Coleman and Aviation Jet Services. Significant cash uses during the year ended December 31, 2017 included \$316 million related to the business acquisitions, \$236 million related to the payment of dividends, \$224 million related to capital expenditures and \$180 million related to repurchasing shares of our common stock.

We currently believe that our cash from operating activities generated during the year, together with our cash on hand and available borrowings under our Credit Facility, will be adequate for the foreseeable future to meet our anticipated requirements for working capital, capital expenditures, defined benefit plan contributions, commitments, contingencies, research and development expenditures, select business acquisitions (depending on the size), program and other discretionary investments, interest payments, income tax payments, L3 dividends and share repurchases.

### ***Balance Sheet***

Billed receivables increased by \$23 million to \$723 million at December 31, 2017, from \$700 million at December 31, 2016, primarily due to the timing of billings and collections for Total Training Solutions and Broadband Communication Systems, \$13 million for foreign currency translation adjustments and \$10 million for business acquisitions. These increases were partially offset by decreases for Warrior Sensor Systems and Advanced Communications and \$14 million for assets classified as held for sale at December 31, 2017.

Contracts in process increased by \$75 million to \$1,933 million at December 31, 2017, from \$1,858 million at December 31, 2016. During the year ended December 31, 2017, contracts in process increased: (1) \$32 million for business acquisitions, (2) \$15 million for foreign currency translation adjustments and (3) \$70 million comprised of:

- increases of \$47 million in inventoried contract costs primarily due to the timing of deliveries for Space & Power Systems and Airborne Sensor Systems, and
- increases of \$23 million in unbilled contract receivables primarily due to sales exceeding billings for Total Training Solutions and Broadband Communication Systems, partially offset by billings exceeding sales for Mission Integration and Power & Propulsion Systems.

These increases were partially offset by \$33 million for assets classified as held for sale, and \$10 million due to the Coleman divestiture.

L3's receivables days sales outstanding (DSO) was 70 at December 31, 2017, compared with 69 at December 31, 2016. We calculate our DSO by dividing: (1) our aggregate end of period billed receivables and net unbilled contract receivables by (2) our trailing 12-month sales adjusted, on a pro forma basis, to include sales from business acquisitions and exclude sales from business divestitures that we completed as of the end of the period, discontinued operations and sales from our Aerostructures and Doss Aviation's Aviation Services businesses, which are classified as held for sale at December 31, 2017, multiplied by the number of calendar days in the trailing 12-month period (365 days at December 31, 2017 and 366 days at December 31, 2016). Our trailing 12-month pro forma sales were \$9,508 million at December 31, 2017 and \$9,354 million at December 31, 2016. The increase in DSO during 2017 was primarily due to an increase in billed and unbilled receivables, which is discussed above, partially offset by the increase in our trailing 12-month pro forma sales.

Inventories increased by \$59 million to \$389 million at December 31, 2017 from \$330 million at December 31, 2016, due to acquisitions, primarily the ETD business acquisition and for Warrior Sensor Systems and Security & Detection Systems to support customer demand.

The increase in other current assets was primarily due to an advance payment by Mission Integration for long lead material on a foreign military contract and income tax receivable benefits due to restructuring of international subsidiaries and additional depreciation deductions from U.S. Tax Reform.

The increase in property, plant and equipment was primarily due to capital expenditures and \$27 million for business acquisitions, primarily Doss Aviation and G-Air, barely exceeding depreciation expense, \$43 million of dispositions, primarily the sale of the property in San Carlos, California and a \$41 million decrease primarily for assets classified as held for sale at December 31, 2017.

Goodwill increased by \$241 million to \$6,615 million at December 31, 2017 from \$6,374 million at December 31, 2016. The table below presents the changes in goodwill by segment.

	<u>Electronic Systems</u>	<u>Aerospace Systems</u>	<u>Communication Systems</u>	<u>Sensor Systems</u>	<u>Consolidated Total</u>
	(in millions)				
<b>December 31, 2016</b> .....	\$2,644	\$1,174	\$1,023	\$1,533	\$6,374
Business acquisitions <sup>(1)</sup> .....	131	—	—	81	212
Business divestitures <sup>(2)</sup> .....	(12)	—	—	—	(12)
Foreign currency translation adjustments.....	60	14	—	19	93
Assets held for sale <sup>(3)</sup> .....	(10)	(42)	—	—	(52)
<b>December 31, 2017</b> .....	<u>\$2,813</u>	<u>\$1,146</u>	<u>\$1,023</u>	<u>\$1,633</u>	<u>\$6,615</u>

<sup>(1)</sup> Business acquisitions for the Electronic Systems segment included the acquisitions of the ETD, Doss Aviation and G-Air businesses and the purchase price allocation adjustments for the MacH and Aerosim business acquisitions. Business acquisitions for the Sensor Systems segment included primarily the Adaptive Methods, Open Water Power, OceanServer and Kigre business acquisitions.

<sup>(2)</sup> The decrease for the Electronic Systems segment was due to the divestitures of Coleman and Aviation Jet Services during the quarterly period ended March 31, 2017.

<sup>(3)</sup> The Aerostructures businesses from the Aerospace Systems segment are classified as held for sale as of December 31, 2017.

The increase in identifiable intangible assets was due to \$114 million of intangible assets recognized related to the business acquisitions, primarily the Open Water Power, ETD, Doss Aviation, Adaptive Methods, Kigre, OceanServer and G-Air business acquisitions, partially offset by the Aviation Jet Services business divestiture, as well as amortization expense.

The increase in accounts payable and accrued expenses was primarily due to the timing of when invoices for purchases from third party vendors and subcontractors were received and payments were made.

Accrued employment costs increased primarily due to increased severance as a result of headcount reductions and \$7 million from business acquisitions.

Other current liabilities decreased primarily due to the payment related to the securities class action settlement of \$14 million in the third quarter of 2017 and the resolution of contractual offset obligations, partially offset by \$11 million of estimated contingent purchase price payable for the Open Water Power business acquisition.

The decrease in deferred tax liabilities was primarily due to the revaluation of deferred taxes for U.S. Tax Reform, partially offset by increases for the acquisition of non-deductible in-process research and development during 2017 and the amortization of certain goodwill and other identifiable intangible assets for tax purposes.

The increase in other liabilities was due to a \$27 million increase in non-current income taxes payable related to uncertain income tax positions and \$15 million related to the Toll Charge in accordance with U.S. Tax Reform.

### ***Pension Plans***

L3 maintains defined benefit pension plans covering approximately 24% of employees. At December 31, 2017, L3's projected benefit obligation (PBO), which includes accumulated benefits plus the incremental benefits attributable to projected future salary increases for covered employees, was \$4,228 million and exceeded the fair value of L3's pension plan assets of \$3,047 million by \$1,181 million. At December 31, 2016, L3's PBO was \$3,758 million and exceeded the fair value of L3's pension plan assets of \$2,721 million by \$1,037 million. The \$144 million increase in our unfunded status was primarily due to the decrease in our weighted average discount rate from 4.40% at December 31, 2016 to 3.78% at December 31, 2017, partially offset by an increase in plan asset balances due to asset returns.

The expected long-term return on plan assets assumption represents the average rate that we expect to earn over the long-term on the assets of our benefit plans, including those from dividends, interest income and capital appreciation. We utilize a third party consultant to assist in the development of the expected long-term return on plan assets, which is based on expectations regarding future long-term rates of return for the plans' investment portfolio, with consideration given to the allocation of investments by asset class and historical and forward looking rates of return for each individual asset class. With respect to the determination of our expected long-term return on plan assets assumption for the year ended December 31, 2017, we considered: (1) a 20-year forward looking return on plan

assets as developed with the assistance of our third party consultant, which is currently 8.03% for our U.S. plans and 7.25% for our Canadian plans, and (2) our historical returns. While we review historical rates of return on our plan assets, the substantial volatility in any one year can result in historical data that is less indicative of future returns. Accordingly, we give greater consideration toward forward looking returns in developing our expected long-term return on plan assets assumption. In reviewing our historical returns, we noted that the average annual return on our U.S. pension plan assets over the period since L3's formation in 1997 through 2016, net of investment management fees and determined on an arithmetic basis, was 7.00%. Arithmetic annual averages represent the simple average returns over independent annual periods. In addition, the actual annual returns have exceeded our long-term return on plan assets assumption in 13 of the past 20 years since L3's formation. The long-term return on plan assets assumption of 8.00% for our U.S. plans and 7.25% for our Canadian plans did not change. Based on the forward looking and historical returns on our plan assets discussed above and an allotment for active management, we believe our weighted average long-term return on plan assets assumption in 2017 of 7.92% continues to be within a reasonable range.

We recorded net actuarial losses of \$200 million in the year ended December 31, 2017 primarily due to the decrease in our weighted average discount rate, which is reflected in accumulated other comprehensive loss. Actuarial gains and losses in a period represent the difference between actual and actuarially assumed experience, primarily due to discount rates and pension plan asset returns. Actuarial gains and losses that our pension plans experience are not recognized in pension expense in the year incurred, but rather are recorded as a component of accumulated other comprehensive income (loss). The accumulated gains and losses in excess of a corridor, defined as the greater of 10% of the fair value of a plan's assets and 10% of its projected benefit obligation, are generally amortized to pension expense in future periods over the estimated average remaining service periods of the covered employees. See Note 19 to our audited consolidated financial statements for additional information regarding our pension plans.

Our pension expense for 2017 was \$110 million, including a \$4 million curtailment charge in connection with management's decision to discontinue future service accruals for substantially all salaried employee pension plans effective January 1, 2019. We currently expect pension expense for 2018 to decrease \$11 million to approximately \$99 million primarily due to higher asset returns caused by an increase in plan asset balances compared to the prior year, partially offset by the decrease in our weighted average discount rate.

Our pension expense for 2018 may be different from our current expectations when finalized due to a number of factors, including the effect of any future business acquisitions and divestitures for which we assume liabilities for pension benefits, changes in headcount at our businesses that sponsor pension plans, actual pension plan contributions and changes (if any) to our pension assumptions for 2018, including the discount rate, mortality rates, expected long-term return on plan assets and salary increases.

We expect our pension expense to decrease significantly in 2019 and future years due to the elimination of future service accruals for substantially all salaried employee pension plan participants and reduced amortization of actuarial losses due to an expected change in the amortization period from the estimated remaining service periods to the estimated remaining expected lifetime of the covered employees. The actual decrease in pension expense will be based on the same factors discussed above, including changes (if any) to our pension assumptions for 2019 and future years.

Our cash pension contributions for 2017 were \$97 million, and we currently expect to contribute approximately \$100 million to our pension plans in 2018. Actual 2018 pension contributions could be affected by changes in the funded status of our pension plans during 2018. A substantial portion of our pension plan contributions for L3's businesses that are U.S. Government contractors are recoverable as allowable indirect contract costs at amounts generally equal to the annual pension contributions.

Our projected benefit obligation and annual pension expense are significantly affected by, holding all other assumptions constant, certain actuarial assumptions. The following table illustrates the sensitivity of a change in certain assumptions for our pension plans and resulting increase (decrease) to the 2018 expected pension expense and PBO at December 31, 2017.

	<u>Effect on 2018 Pension Expense</u>	<u>Effect on December 31, 2017 PBO</u>
	(in millions)	
25 basis point decrease in discount rate . . . . .	\$ 18	\$ 161
25 basis point increase in discount rate . . . . .	(16)	(152)
25 basis point decrease in expected return on assets . . . . .	8	N/A
25 basis point increase in expected return on assets . . . . .	(8)	N/A

### ***Statement of Cash Flows***

The table below provides a summary of our cash flows from (used in) operating, investing and financing activities for the periods indicated.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Net cash from operating activities from continuing operations . . . . .	\$ 985	\$1,022	\$ 1,035
Net cash used in investing activities from continuing operations . . . . .	(453)	(10)	(190)
Net cash used in financing activities from continuing operations . . . . .	(366)	(856)	(1,205)

### ***Operating Activities — Continuing Operations***

*2017 Compared with 2016.* We generated \$985 million of cash from operating activities during the year ended December 31, 2017, a decrease of \$37 million compared with \$1,022 million generated during the year ended December 31, 2016. The decrease was primarily driven by higher income tax payments. The net cash from changes in operating assets and liabilities is further discussed above under “Balance Sheet.”

*2016 Compared with 2015.* We generated \$1,022 million of cash from operating activities during the year ended December 31, 2016, a decrease of \$13 million compared with \$1,035 million generated during the year ended December 31, 2015. The decrease was due to primarily refund payments in connection with the product return allowances at EoTech.

*Interest Payments.* Our cash from operating activities included interest payments on debt of \$165 million for the year ended December 31, 2017, \$162 million for the year ended December 31, 2016 and \$182 million for the year ended December 31, 2015. Our interest expense also included amortization of deferred debt issuance costs and bond discounts, which are non-cash items.

### ***Investing Activities — Continuing Operations***

During 2017, we used \$453 million of cash from investing activities, which included \$316 million for business acquisitions discussed above under “Business Acquisitions and Divestitures” and \$224 million for capital expenditures, partially offset by \$74 million of cash generated primarily from the sale of the property in San Carlos, California and \$18 million from business divestitures.

During 2016, we used \$10 million of cash from investing activities, which included \$388 million for business acquisitions discussed above under “Business Acquisitions and Divestitures” and \$210 million for capital expenditures, partially offset by \$561 million of cash received from business divestitures (primarily NSS).

During 2015, we used \$190 million of cash primarily to: (1) acquire three businesses discussed above under “Business Acquisitions and Divestitures” for \$320 million and (2) pay \$195 million for capital expenditures. These cash outflows were partially offset by net proceeds received of \$318 million from the MSI, BSI, Tinsley Product Line and Klein divestitures.

**Debt**

At December 31, 2017, total outstanding debt was \$3,330 million, compared to \$3,325 million at December 31, 2016, all of which was senior debt. At December 31, 2017, there were no borrowings or letters of credit outstanding under our Credit Facility. Accordingly, we had the full availability of our \$1 billion facility for future borrowings. We also had \$416 million of outstanding standby letters of credit with financial institutions covering performance and financial guarantees per contractual requirements with certain customers at December 31, 2017. These standby letters of credit may be drawn upon in the event that we do not perform on certain of our contractual requirements. At December 31, 2017, our outstanding debt matures between October 15, 2019 and December 15, 2026. See Note 9 to our audited consolidated financial statements for the components of our debt at December 31, 2017.

We consider our credit rating as an important element of our capital allocation strategy and, while no assurances can be given, we intend to maintain our investment grade credit rating. Our senior unsecured credit rating from both Standard and Poor's and Fitch Ratings is BBB- with a stable outlook, and our senior unsecured credit rating from Moody's Investors Service is Baa3 with a stable outlook.

**Repurchases, Redemptions, and Maturities of Senior Notes**

The repurchases, redemptions and maturities of Senior Notes are presented in the table below. See Note 9 to our audited consolidated financial statements for additional information on the redemption provisions of our outstanding Senior Notes.

Note	Settlement Type	Date Settled	Aggregate Amount	Debt Retirement Charge (in millions)	Cash Payments
1.50% Senior Notes due 2017 <sup>(1)</sup> . . . . .	Redemption	December 30, 2016	\$350	\$ 2	\$351
3.95% Senior Notes due 2016. . . . .	Maturity	November 15, 2016	\$200	\$—	\$200
3.95% Senior Notes due 2016 <sup>(2)</sup> . . . . .	Redemption	May 20, 2016	\$300	\$ 5	\$305
3.95% Senior Notes due 2024. . . . .	Tender Offer	December 22, 2015	\$300	\$ 1	\$297

<sup>(1)</sup> The 1.50% Senior Notes due 2017 were redeemed at a price equal to 100.323% of the principal amount thereof, plus accrued and unpaid interest to the redemption date. Interest ceased to accrue on and after the redemption date.

<sup>(2)</sup> The 3.95% Senior Notes due 2016 were redeemed at a price equal to 101.475% of the principal amount thereof, plus accrued and unpaid interest. Interest ceased to accrue on and after May 20, 2016, and the only remaining right of holders of such Notes was to receive payment of the redemption price and accrued interest.

**Debt Covenants and Other Provisions.** The Credit Facility and Senior Notes contain financial and/or other restrictive covenants. See Note 9 to our audited consolidated financial statements for a description of our debt, related financial covenants and cross default provisions. We were in compliance with our financial and other restrictive covenants at December 31, 2017.

**Guarantees.** The borrowings under the Credit Facility are fully and unconditionally guaranteed by L3 and by substantially all of the material 100% owned domestic subsidiaries of L3 on an unsecured senior basis. The payment of principal and premium, if any, and interest on the Senior Notes is fully and unconditionally guaranteed, on an unsecured senior basis, jointly and severally, by L3's material 100% owned domestic subsidiaries that guarantee any of its other indebtedness. The guarantees of the Credit Facility and the Senior Notes rank pari passu with each other.

## Equity

During 2017 and 2016, L3's Board of Directors authorized the following quarterly cash dividends:

Date Declared	Record Date	Cash Dividend Per Share	Total Cash Dividends Declared (in millions)	Date Paid
<b>2017</b>				
February 13 .....	March 1	\$0.75	\$59 <sup>(1)</sup>	March 15
May 9 .....	May 19	\$0.75	\$59 <sup>(1)</sup>	June 15
July 19 .....	August 17	\$0.75	\$59 <sup>(1)</sup>	September 15
October 17 .....	November 17	\$0.75	\$59 <sup>(1)</sup>	December 15
<b>2016</b>				
February 9 .....	March 1	\$0.70	\$55 <sup>(2)</sup>	March 15
May 3 .....	May 17	\$0.70	\$55 <sup>(2)</sup>	June 15
June 21 .....	August 17	\$0.70	\$55 <sup>(2)</sup>	September 15
October 18 .....	November 17	\$0.70	\$55 <sup>(2)</sup>	December 15

<sup>(1)</sup> During the year ended December 31, 2017, we paid \$236 million of cash dividends. Payments of previously accrued dividends for employee held stock awards were offset by accrued dividends to be paid in future periods.

<sup>(2)</sup> During the year ended December 31, 2016, we paid \$220 million of cash dividends. Payments of previously accrued dividends for employee held stock awards were offset by accrued dividends to be paid in future periods.

L3 repurchased \$180 million, or 1.0 million shares, of its common stock during the year ended December 31, 2017, \$373 million, or 3.0 million shares, of its common stock during the year ended December 31, 2016 and \$740 million, or 6.4 million shares, of its common stock during the year ended December 31, 2015.

On February 12, 2018, L3 announced that its Board of Directors had increased L3's regular quarterly cash dividend from \$0.75 per share to \$0.80 per share, or 7%, payable on March 15, 2018, to shareholders of record at the close of business on March 1, 2018.

The number of holders of record of L3's common stock on February 16, 2018 was approximately 197,000. On February 16, 2018, the closing price of L3's common stock as reported by the NYSE was \$212.89 per share.

## Contractual Obligations

The table below presents our estimated total contractual obligations from our continuing operations at December 31, 2017, including the amounts expected to be paid or settled for each of the periods indicated below.

	Total	Payments due by Period			More than 5 years
		Less than 1 year	1 – 3 years (in millions)	3 – 5 years	
<b>Contractual Obligations</b>					
Debt <sup>(1)</sup> .....	\$3,350	\$ —	\$1,800	\$650	\$ 900
Interest payments <sup>(2)</sup> .....	611	157	262	86	106
Non-cancelable operating leases <sup>(3)</sup> .....	642	104	189 <sup>(4)</sup>	115	234
Notes payable and capital lease obligations ...	17	—	1	1	15
Purchase obligations <sup>(5)</sup> .....	2,194	1,873	299	17	5
Toll Charge <sup>(6)</sup> .....	15	1	3	2	9
Other long-term liabilities <sup>(7)</sup> .....	315	110 <sup>(8)</sup>	125	33	47
Total <sup>(9)</sup> .....	<u>\$7,144</u>	<u>\$2,245</u>	<u>\$2,679</u>	<u>\$904</u>	<u>\$1,316</u>

<sup>(1)</sup> Represents principal amount of debt and only includes scheduled principal payments.

<sup>(2)</sup> Represents expected interest payments on L3's debt balance at December 31, 2017 using the stated interest rate on our fixed rate debt, assuming that current borrowings remain outstanding to the contractual maturity date.



- (3) Non-cancelable operating leases are presented net of estimated sublease rental income.
- (4) Includes the residual value guarantee for three real estate lease agreements, expiring on August 31, 2020, that are accounted for as operating leases. We have the right to exercise options under the lease agreements to renew the leases, to purchase the properties for \$45 million or sell the properties on behalf of the lessor. If we elect to sell the properties, we must pay the lessor a residual value guarantee of \$39 million. See Note 18 to our audited consolidated financial statements for a further description of these leases.
- (5) Represents open purchase orders at December 31, 2017 for amounts expected to be paid for goods or services that are legally binding.
- (6) Represents the portion of the \$22 million estimated Toll Charge that is payable as of December 31, 2017. Under U.S. Tax Reform, the Toll Charge will be paid over an eight-year period.
- (7) Other long-term liabilities primarily consist of workers compensation and deferred compensation for the years ending December 31, 2019 and thereafter and also include pension and postretirement benefit plan contributions that we expect to pay in 2018.
- (8) Our pension and postretirement benefit plan funding policy is generally to contribute in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations thereon. For 2018, we expect to contribute approximately \$100 million to our pension plans and approximately \$10 million to our postretirement benefit plans. Due to the current uncertainty of the amounts used to compute our expected pension and postretirement benefit plan funding, we believe it is not practicable to reasonably estimate such future funding for periods in excess of one year and we may decide or be required to contribute more than we expect to our pension and postretirement benefit plans.
- (9) Excludes unrecognized tax benefits in connection with uncertain tax positions taken, or expected to be taken on our income tax returns as of December 31, 2017 since we cannot determine the time period of future tax consequences. For additional information regarding income taxes, see Note 16 to our audited consolidated financial statements.

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 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. 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 are 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, 2017, the remaining obligations under our outstanding offset agreements totaled \$1.1 billion, which primarily relate to our Aerospace Systems segment, some of which extend through 2028. To the extent we have entered into purchase obligations at December 31, 2017 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 \$89 million at December 31, 2017, 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.

### Off Balance Sheet Arrangements

The table below presents our estimated total contingent commitments and other guarantees at December 31, 2017, including the amounts expected to be paid or settled for each of the periods indicated below.

	Total	Commitment Expiration by Period			
		2018	2019 - 2020	2021 - 2022	2023 and thereafter
(in millions)					
<b>Contingent Commitments</b>					
Other standby letters of credit <sup>(1)</sup> . . . . .	\$416	\$290	\$96	\$21	\$ 9
Other guarantees <sup>(2)</sup> . . . . .	<u>7</u>	<u>7</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total <sup>(3)(4)(5)</sup> . . . . .	<u>\$423</u>	<u>\$297</u>	<u>\$96</u>	<u>\$21</u>	<u>\$ 9</u>

<sup>(1)</sup> Represents outstanding letters of credit with financial institutions covering performance and financial guarantees per contractual requirements with certain customers. These letters of credit may be drawn upon in the event of L3's nonperformance.

- (2) Represents the minimum guarantees made by L3 or the lessee under the purchase option for certain operating leases in which the lease renewal is not exercised (see Note 18 to our audited consolidated financial statements for a description of these guarantees). During the first quarter of 2018, the Company expects to purchase the underlying simulator systems at the end of their respective lease terms for approximately \$15 million.
- (3) The total amount does not include residual value guarantees for two real estate lease agreements, expiring on August 31, 2020, that are accounted for as operating leases. We have the right to exercise options under the lease agreements to purchase both properties for \$45 million on or before August 31, 2020. See Note 18 to our audited consolidated financial statements for a further description of these leases.
- (4) The total amount does not include the fair value of the contingent consideration liability for the future potential earn-out payments related to the MacH and Open Water Power acquisitions. See Note 12 to our audited consolidated financial statements for additional information on the fair value of the contingent consideration.
- (5) The total does not include future minimum payments under non-cancelable operating leases. See Note 18 to our audited consolidated financial statements for a further description of these leases.

## **Legal Proceedings and Contingencies**

We are engaged in providing products and services under contracts with the U.S. Government and, to a lesser degree, under foreign government contracts, some of which are funded by the U.S. Government. All such contracts are subject to extensive legal and regulatory requirements, and, periodically, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. Under U.S. Government procurement regulations, an indictment by a federal grand jury, or an administrative finding against us as to our present responsibility to be a U.S. Government contractor or subcontractor, could result in suspension for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges, and could have a material adverse effect on our results of operations and cash flows. A conviction, or an administrative finding that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specified term and could have a material adverse effect on our results of operations and cash flows. We are currently cooperating with the U.S. Government on several investigations, none of which we anticipate will have a material adverse effect on our results of operations or cash flows. Also, we have been periodically subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business. We accrue for these contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. For a description of our legal proceedings and contingencies, see Note 18 to our audited consolidated financial statements.

We continually assess our obligations with respect to applicable environmental protection laws. While it is difficult to determine the timing and ultimate cost that we will incur to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which we are aware, we believe that even without considering potential insurance recoveries, if any, there are no environmental loss contingencies that, in the aggregate, would be material to our consolidated financial position, results of operations or cash flows.

## **Derivative Financial Instruments and Other Market Risk**

Included in our derivative financial instruments are foreign currency forward contracts. All of our derivative financial instruments that are sensitive to market risk are entered into for purposes other than trading.

*Interest Rate Risk.* Our Credit Facility is subject to variable interest and is therefore sensitive to changes in interest rates. The interest rates on the Senior Notes are fixed-rate and are not affected by changes in interest rates. Additional data on our debt obligations and our applicable borrowing spreads included in the interest rates we would pay on borrowings under the Credit Facility, if any, are provided in Note 9 to our audited consolidated financial statements.

*Foreign Currency Exchange Risk.* Our U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, we enter into foreign currency forward contracts, which are generally designated and accounted for as cash flow hedges. At December 31, 2017, our foreign currency forward contracts had maturities ranging through 2023, a notional value of \$307 million and a corresponding net fair value that was an asset of \$10 million.

## **Accounting Standards Issued and Not Yet Implemented**

For a discussion of accounting standards issued and not yet implemented, see Note 2 to our audited consolidated financial statements.

## **Inflation**

The effect of inflation on our sales and earnings has not been significant. Although a majority of our sales are made under long-term contracts (revenue arrangements), the selling prices of such contracts, established for deliveries in the future, generally reflect estimated costs to be incurred in these future periods. In addition, some of our contracts provide for price adjustments through cost escalation clauses.

## **Forward-Looking Statements**

Certain of the matters discussed concerning our operations, cash flows, financial position, economic performance and financial condition, including in particular, the likelihood of our success in developing and expanding our business and the realization of sales from backlog, include forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act.

All statements other than historical facts may be forward-looking statements, such as “may,” “will,” “should,” “likely,” “projects,” “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimates,” and similar expressions are used to identify forward-looking statements. We caution investors that these statements are subject to risks and uncertainties many of which are difficult to predict and generally beyond our control that could cause actual results to differ materially from those expressed in, or implied or projected by, the forward-looking information and statements. Some of the factors that could cause actual results to differ include, but are not limited to, the following: our dependence on the defense industry; backlog processing and program slips resulting from delayed awards and/or funding from the DoD and other major customers; the U.S. Government fiscal situation; changes in DoD budget levels and spending priorities; U.S. Government failure to raise the debt ceiling; our reliance on contracts with a limited number of customers and the possibility of termination of government contracts by unilateral government action or for failure to perform; the extensive legal and regulatory requirements surrounding many of our contracts; our ability to retain our existing business and related contracts; our ability to successfully compete for and win new business; or, identify, acquire and integrate additional businesses; our ability to maintain and improve our operating margin; the availability of government funding and changes in customer requirements for our products and services; the outcome of litigation matters; results of audits by U.S. Government agencies and of ongoing governmental investigations; our significant amount of debt and the restrictions contained in our debt agreements and actions taken by rating agencies that could result in a downgrade of our debt; our ability to continue to recruit, retain and train our employees; actual future interest rates, volatility and other assumptions used in the determination of pension benefits and equity based compensation, as well as the market performance of benefit plan assets; our collective bargaining agreements; our ability to successfully negotiate contracts with labor unions and our ability to favorably resolve labor disputes should they arise; the business, economic and political conditions in the markets in which we operate; the risk that our commercial aviation products and services businesses are affected by a downturn in global demand for air travel or a reduction in commercial aircraft OEM (Original Equipment Manufacturer) production rates; the DoD’s Better Buying Power and other efficiency initiatives; events beyond our control such as acts of terrorism; our ability to perform contracts on schedule; our international operations including currency risks and compliance with foreign laws; our extensive use of fixed-price type revenue arrangements; the rapid change of technology and high level of competition in which our businesses participate; risks relating to technology and data security; our introduction of new products into commercial markets or our investments in civil and commercial products or companies; the impact on our business of improper conduct by our employees, agents or business partners; goodwill impairments and the fair values of our assets; and the ultimate resolution of contingent matters, claims and investigations relating to acquired businesses, and the impact on the final purchase price allocations.

In addition, for a discussion of other risks and uncertainties that could impair our results of operations or financial condition, see “Part I — Item 1A — Risk Factors” and Note 18 to our audited consolidated financial statements, in each case included in this Annual Report on Form 10-K for the year ended December 31, 2017 and any material updates to these factors contained in any of our future filings.

Readers of this document are cautioned that our forward-looking statements are not guarantees of future performance and the actual results or developments may differ materially from the expectations expressed in the forward-looking statements.

As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainties of estimates, forecasts and projections and may be better or worse than projected and such differences could be material. Given these uncertainties, you should not place any reliance on these forward-looking statements. These forward-looking statements also represent our estimates and assumptions

only as of the date that they were made. We expressly disclaim a duty to provide updates to these forward-looking statements, and the estimates and assumptions associated with them, after the date of this filing, to reflect events or changes in circumstances or changes in expectations or the occurrence of anticipated events.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

For data regarding quantitative and qualitative disclosures related to our market risk sensitive financial instruments, see “Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Derivative Financial Instruments and Other Market Risk” and Note 13 to our audited consolidated financial statements. See Notes 12 and 14 to our audited consolidated financial statements for the aggregate fair values and notional amounts of our foreign currency forward contracts at December 31, 2017.

#### **Item 8. Financial Statements and Supplementary Data**

See our audited consolidated financial statements beginning on page F-1.

#### **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

#### **Item 9A. Controls and Procedures**

##### ***Conclusions Regarding Effectiveness of Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports that we file or submit under the Securities Exchange Act of 1934 related to L3 Technologies, Inc. is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and President and our Senior Vice President and Chief Financial Officer, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, with the participation of our Chief Executive Officer and President and our Senior Vice President and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2017. Based upon that evaluation, our Chief Executive Officer and President and our Senior Vice President and Chief Financial Officer concluded that, as of December 31, 2017, the design and operation of our disclosure controls and procedures were effective to accomplish their objectives at the reasonable assurance level.

##### ***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 over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Our 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 L3 Technologies, Inc., (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with U.S. generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements in our consolidated financial statements. 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.

Management assessed the effectiveness of L3 Technologies, Inc. internal control over financial reporting as of December 31, 2017. In making these assessments, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*, issued in 2013. Based on our assessments and those criteria, management determined that L3 Technologies, Inc. maintained effective internal control over financial reporting as of December 31, 2017.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2017 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report. See page F-2 to our audited consolidated financial statements for their report.

***Changes in Internal Control Over Financial Reporting***

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

## PART III

### **Item 10. Directors, Executive Officers and Corporate Governance**

The Company posts its Code of Ethics and Business Conduct on the Corporate Governance webpage of its website at <http://www.L3T.com> under the link “Code of Ethics and Business Conduct.” The Company’s Code of Ethics and Business Conduct applies to all directors, officers and employees, including our chief executive officer and president, our senior vice president and chief financial officer, and our corporate controller and principal accounting officer. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the NYSE, on our website within the required periods.

The remaining information called for by Item 10 will be included in the sections captioned “Proposal 1. Election of Directors,” “Continuing Members of the Board of Directors,” “Executives and Certain Other Officers of the Company,” “Section 16(A) Beneficial Ownership Reporting Compliance” and “The Board of Directors and Certain Governance Matters” in the definitive proxy statement (the “Company’s Proxy Statement”) relating to the Company’s 2018 Annual Meeting of Shareholders, to be held on May 7, 2018, and is incorporated herein by reference. L3 will file its proxy statement with the SEC pursuant to Regulation 14A within 120 days after the end of its 2017 fiscal year covered by this Form 10-K.

### **Item 11. Executive Compensation**

The “Compensation Discussion and Analysis,” “Compensation Committee Report,” “Tabular Executive Compensation Disclosure,” “Compensation of Directors” and “Compensation Committee Interlocks and Insider Participation” sections of the Company’s Proxy Statement are incorporated herein by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The “Security Ownership of Certain Beneficial Owners,” “Security Ownership of Management” and “Equity Compensation Plan Information” sections of the Company’s Proxy Statement are incorporated herein by reference.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence**

The “Certain Relationships and Related Transactions” and “The Board of Directors and Certain Governance Matters” sections of the Company’s Proxy Statement are incorporated herein by reference.

### **Item 14. Principal Accounting Fees and Services**

The “Independent Registered Public Accounting Firm Fees” section of the Company’s Proxy Statement is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by us in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

**(a)(1) Financial statements filed as part of this report:**

	<u>Page Number</u>
Report of Independent Registered Public Accounting Firm .....	F-2
Consolidated Balance Sheets as of December 31, 2017 and December 31, 2016.....	F-4
Consolidated Statements of Operations for the years ended December 31, 2017, 2016 and 2015.....	F-5
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**(a)(2) Financial Statement Schedules**

Financial statement schedules are omitted since the required information is either not applicable or is included in our audited consolidated financial statements.

**Item 16. Form 10-K Summary**

None.

## Exhibits

Exhibit No.	Description of Exhibits
2.1	Distribution Agreement between L-3 Communications Holdings, Inc. and Engility Holdings, Inc. dated as of July 16, 2012 (incorporated by reference to Exhibit 2.1 to the Registrant's Quarterly Report on Form 10-Q for the period ended September 28, 2012 (File No. 333-46983)).
2.2	Stock Purchase Agreement, dated as of December 7, 2015, by and among L-3 Communications Corporation, CACI International Inc and CACI, Inc.-Federal (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on December 11, 2015 (File No. 333-46983)).
3.1	Restated Certificate of Incorporation of L3 Technologies, Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on January 3, 2017 (File No. 001-37975)).
3.2	Amended and Restated Bylaws of L3 Technologies, Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on February 13, 2018 (File No. 333-46983)).
4.1	Form of Common Stock Certificate of L3 Technologies, Inc. (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (File No. 001-37975)).
10.1	Credit Agreement, dated as of October 31, 2016, among L-3 Communications Corporation, L-3 Communications Holdings, Inc. and certain subsidiaries of the Registrant from time to time party thereto as guarantors, certain lenders from time to time party thereto, and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated October 31, 2016 (File No. 333-46983)).
10.2	Amendment to Credit Agreement, dated as of December 22, 2016, among L-3 Communications Corporation, certain subsidiaries of the Registrant from time to time party thereto as guarantors, certain lenders from time to time party thereto, certain L/C issuers from time to time party thereto and Bank of America, N.A., as administrative agent (incorporated by reference to Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (File No. 001-37975)).
†10.3	Amended and Restated 1998 Directors Stock Option Plan for Non-Employee Directors of L3 Technologies, Inc. (incorporated by reference to Exhibit 10.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (File No. 333-46983)).
†10.4	Form of L-3 Communications Holdings, Inc. 1998 Directors Stock Option Plan Nonqualified Stock Option Agreement (2007 Version) (incorporated by reference to Exhibit 10.3 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 333-46983)).
†10.5	L3 Technologies, Inc. Amended and Restated 2008 Long Term Performance Plan (incorporated by reference to Exhibit 10.7 of the Registrant's Annual Report on Form 10-K for the period ended December 31, 2016 (File No. 001-37975)).
†10.6	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2008 Version) (incorporated by reference to Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 27, 2008 (File No. 333-46983)).
†10.7	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2009 Version) (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 26, 2009 (File No. 333-46983)).
†10.8	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2011 Version) (incorporated by reference to Exhibit 10.12 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2010 (File No. 333-46983)).



Exhibit No.	Description of Exhibits
†10.9	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2014 Version) (incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 28, 2014 (File No. 333-46983)).
†10.10	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2017 Version) (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.11	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2011 and 2012 CEO Version) (incorporated by reference to Exhibit 10.14 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 (File No. 333-46983)).
†10.12	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2013 CEO Version) (incorporated by reference to Exhibit 10.4 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 29, 2013 (File No. 333-46983)).
†10.13	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2014 CEO Version) (incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 27, 2014 (File No. 333-46983)).
†10.14	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2015 CEO Version) (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 27, 2015 (File No. 333-46983)).
†10.15	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2016 CEO Version) (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 25, 2016 (File No. 333-46983)).
†10.16	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement (2017 CEO Version) (incorporated by reference to Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.17	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2014 Version) (incorporated by reference to Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 28, 2014 (File No. 333-46983)).
†10.18	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2017 Version) (incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.19	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2016 CEO Version) (incorporated by reference to Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 25, 2016 (File No. 333-46983)).
†10.20	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2017 CEO Version) (incorporated by reference to Exhibit 10.4 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.21	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2016 Senior Executive Version) (incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 25, 2016 (File No. 333-46983)).
†10.22	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2017 Senior Executive Version) (incorporated by reference to Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).

Exhibit No.	Description of Exhibits
*†10.23	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2017-2 Senior Executive Version).
†10.24	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2013 Non-Employee Directors Version) (incorporated by reference to Exhibit 10.7 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 29, 2013 (File No. 333-46983)).
†10.25	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2014 Non-Employee Directors Annual Equity Award Version) (incorporated by reference to Exhibit 10.4 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 27, 2014 (File No. 333-46983)).
†10.26	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2017 Non-Employee Directors Annual Equity Award Version) (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2017 (File No. 001-37975)).
†10.27	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2014 Non-Employee Directors Deferred Compensation Version) (incorporated by reference to Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 27, 2014 (File No. 333-46983)).
†10.28	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement (2017 Non-Employee Directors Deferred Compensation Version) (incorporated by reference to Exhibit 10.6 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.29	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Performance Unit Agreement (2014 Version) (incorporated by reference to Exhibit 10.8 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 28, 2014 (File No. 333-46983)).
†10.30	Form of L-3 Communications Holdings, Inc. 2008 Long Term Performance Plan Performance Unit Award Notice (2016 Version) (incorporated by reference to Exhibit 10.4 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 25, 2016 (File No. 333-46983)).
†10.31	Form of L3 Technologies, Inc. 2008 Long Term Performance Plan Performance Unit Agreement (2017 Version) (incorporated by reference to Exhibit 10.7 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.32	L3 Technologies, Inc. Amended and Restated 2012 Cash Incentive Plan (incorporated by reference to Exhibit 10.8 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.33	Form of L-3 Communications Holdings, Inc. 2012 Cash Incentive Plan Performance Cash Award Agreement (2014 Version) (incorporated by reference to Exhibit 10.10 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 28, 2014 (File No. 333-46983)).
†10.34	Form of L-3 Communications Holdings, Inc. 2012 Cash Incentive Plan Performance Cash Award Notice (2016 Version) (incorporated by reference to Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 25, 2016 (File No. 333-46983)).
†10.35	Form of L3 Technologies, Inc. 2012 Cash Incentive Plan Performance Cash Award Agreement (2017 Version) (incorporated by reference to Exhibit 10.9 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.36	L3 Technologies, Inc. Amended and Restated 2008 Directors Stock Incentive Plan (incorporated by reference to Exhibit 10.34 of the Registrant's Annual Report on Form 10-K for the period ended December 31, 2016 (File No. 001-37975)).
†10.37	Form of L-3 Communications Holdings, Inc. 2008 Directors Stock Incentive Plan Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 27, 2009 (File No. 333-46983)).

Exhibit No.	Description of Exhibits
†10.38	Global Spin-Off Amendment to Equity Award Agreements dated as of July 18, 2012 (incorporated by reference to Exhibit 10.26 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 (File No. 333-46983)).
†10.39	Global Amendment to Non-Employee Director RSU Agreements dated as of April 30, 2013 (incorporated by reference to Exhibit 10.10 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 29, 2013 (File No. 333-46983)).
†10.40	Global Amendment to Equity-Based Award Agreements and Award Notices and Cash-Based Award Agreements and Award Notices dated as of December 31, 2016 (incorporated by reference to Exhibit 10.38 of the Registrant's Annual Report on Form 10-K for the period ended December 31, 2016 (File No. 001-37975)).
†10.41	L3 Technologies, Inc. Amended and Restated Change in Control Severance Plan (incorporated by reference to Exhibit 10.10 of the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2017 (File No. 001-37975)).
†10.42	L3 Technologies, Inc. Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.40 of the Registrant's Annual Report on Form 10-K for the period ended December 31, 2016 (File No. 001-37975)).
†10.43	L3 Technologies, Inc. Deferred Compensation Plan I (incorporated by reference to Exhibit 10.41 of the Registrant's Annual Report on Form 10-K for the period ended December 31, 2016 (File No. 001-37975)).
†10.44	L3 Technologies, Inc. Deferred Compensation Plan II (incorporated by reference to Exhibit 10.42 of the Registrant's Annual Report on Form 10-K for the period ended December 31, 2016 (File No. 001-37975)).
†10.45	L3 Technologies, Inc. Supplemental Savings Plan II (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form S-8 filed on November 29, 2017 (File No. 333-221805)).
†10.46	Consulting Agreement between L3 Technologies, Inc. and Curtis Brunson (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated February 23, 2017 (File No. 001-37975)).
†10.47	Consulting Agreement between L3 Technologies, Inc. and Steve Kantor (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated February 23, 2017 (File No. 001-37975)).
†10.48	Offer Letter between L3 Technologies, Inc. and Christopher E. Kubasik (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K/A dated October 31, 2017 (File No. 001-37975)).
*†10.49	L3 Technologies, Inc. 2008 Long Term Performance Plan Nonqualified Stock Option Agreement, effective as of December 20, 2017, between L3 Technologies, Inc. and Christopher E. Kubasik.
*†10.50	L3 Technologies, Inc. 2008 Long Term Performance Plan Restricted Stock Unit Agreement, effective as of December 20, 2017, between L3 Technologies, Inc. and Christopher E. Kubasik.
†10.51	Retirement Agreement and General Release between L3 Technologies, Inc. and Michael T. Strianese (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated November 8, 2017 (File No. 001-37975)).
10.52	Tax Matters Agreement between L-3 Communications Holdings, Inc. and Engility Holdings, Inc. dated as of July 16, 2012 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the period ended September 28, 2012 (File No. 333-46983)).
+10.53	Master Supply Agreement between L-3 Communications Corporation (as Seller) and Engility Corporation (as Buyer) dated as of July 16, 2012 (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the period ended September 28, 2012 (File No. 333-46983)).
+10.54	Master Supply Agreement between L-3 Communications Corporation (as Buyer) and Engility Corporation (as Seller) dated as of July 16, 2012 (incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the period ended September 28, 2012 (File No. 333-46983)).

Exhibit No.	Description of Exhibits
*11	L3 Technologies, Inc. Computation of Basic Earnings Per Share and Diluted Earnings Per Common Share.
*21	Subsidiaries of the Registrant.
*23	Consent of PricewaterhouseCoopers LLP.
*31.1	Certification of Chairman and Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
*31.2	Certification of Senior Vice President and Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
*32	Section 1350 Certification.
***101.INS	XBRL Instance Document
***101.SCH	XBRL Taxonomy Extension Schema Document
***101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
***101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
***101.LAB	XBRL Taxonomy Extension Label Linkbase Document
***101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed herewith.

\*\* The information required in this exhibit is presented in Note 15 to the consolidated financial statements as of December 31, 2017 in accordance with the provisions of ASC 260, *Earnings Per Share*.

\*\*\* Filed electronically with this report.

† Represents management contract, compensatory plan or arrangement in which directors and/or executive officers are entitled to participate.

+ Pursuant to a request for confidential treatment, portions of these exhibits have been redacted from the publicly filed document and have been furnished separately to the Securities and Exchange Commission as required by Rule 24b-2 under the Securities Exchange Act of 1934, as amended.

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by the Company in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs at the date they were made or at any other time.

## Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on their behalf by the undersigned, thereunto duly authorized.

L3 TECHNOLOGIES, INC.

By: /s/ RALPH G. D'AMBROSIO

Title: Senior Vice President and Chief Financial Officer

Date: February 22, 2018

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities indicated on February 22, 2018.

<u>Signature</u>	<u>Title</u>
<u>/s/ CHRISTOPHER E. KUBASIK</u> Christopher E. Kubasik	Chief Executive Officer and President (Principal Executive Officer) and Director
<u>/s/ RALPH G. D'AMBROSIO</u> Ralph G. D'Ambrosio	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
<u>/s/ DAN AZMON</u> Dan Azmon	Vice President, Controller and Principal Accounting Officer
<u>/s/ MICHAEL T. STRIANESE</u> Michael T. Strianese	Chairman
<u>/s/ ROBERT B. MILLARD</u> Robert B. Millard	Lead Director
<u>/s/ CLAUDE R. CANIZARES</u> Claude R. Canizares	Director
<u>/s/ THOMAS A. CORCORAN</u> Thomas A. Corcoran	Director
<u>/s/ ANN E. DUNWOODY</u> Ann E. Dunwoody	Director
<u>/s/ LEWIS KRAMER</u> Lewis Kramer	Director
<u>/s/ LLOYD W. NEWTON</u> Lloyd W. Newton	Director
<u>/s/ VINCENT PAGANO, JR.</u> Vincent Pagano, Jr.	Director
<u>/s/ H. HUGH SHELTON</u> H. Hugh Shelton	Director
<u>/s/ ARTHUR L. SIMON</u> Arthur L. Simon	Director

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## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Financial Statements as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016 and 2015.

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## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of L3 Technologies, Inc.

### ***Opinions on the Financial Statements and Internal Control over Financial Reporting***

We have audited the accompanying consolidated balance sheets of L3 Technologies, Inc. and its subsidiaries as of December 31, 2017 and December 31, 2016, and the related consolidated statements of operations, comprehensive income, equity and cash flows for each of the three years in the period ended December 31, 2017, including the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and December 31, 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

### ***Basis for Opinions***

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### ***Definition and Limitations of Internal Control over Financial Reporting***

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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

/s/ PricewaterhouseCoopers LLP

New York, New York

February 22, 2018

We have served as the Company's auditor since 1997.

**L3 TECHNOLOGIES, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in millions, except share data)

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents . . . . .	\$ 662	\$ 363
Billed receivables, net of allowances of \$18 in 2017 and \$13 in 2016 . . . . .	723	700
Contracts in process . . . . .	1,933	1,858
Inventories . . . . .	389	330
Prepaid expenses and other current assets . . . . .	300	175
Assets held for sale . . . . .	135	—
Assets of discontinued operations . . . . .	306	481
Total current assets . . . . .	4,448	3,907
Property, plant and equipment, net . . . . .	1,110	1,107
Goodwill . . . . .	6,615	6,374
Identifiable intangible assets . . . . .	292	229
Other assets . . . . .	264	248
Total assets . . . . .	\$12,729	\$11,865
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable, trade . . . . .	\$ 531	\$ 419
Accrued employment costs . . . . .	493	462
Accrued expenses . . . . .	217	188
Advance payments and billings in excess of costs incurred . . . . .	509	476
Income taxes payable . . . . .	19	22
Other current liabilities . . . . .	367	392
Liabilities held for sale . . . . .	17	—
Liabilities of discontinued operations . . . . .	226	235
Total current liabilities . . . . .	2,379	2,194
Pension and postretirement benefits . . . . .	1,313	1,177
Deferred income taxes . . . . .	158	189
Other liabilities . . . . .	398	356
Long-term debt . . . . .	3,330	3,325
Total liabilities . . . . .	7,578	7,241
Commitments and contingencies (see Note 18)		
Equity:		
Shareholders' equity:		
Common stock: \$.01 par value; 300,000,000 shares authorized, 77,876,687 shares outstanding at December 31, 2017 and 77,232,204 shares outstanding at December 31, 2016 . . . . .	6,519	6,285
Treasury stock (at cost), 83,362,412 shares at December 31, 2017 and 82,385,075 shares at December 31, 2016 . . . . .	(7,404)	(7,224)
Retained earnings . . . . .	6,659	6,218
Accumulated other comprehensive loss . . . . .	(691)	(726)
Total shareholders' equity . . . . .	5,083	4,553
Noncontrolling interests . . . . .	68	71
Total equity . . . . .	5,151	4,624
Total liabilities and equity . . . . .	\$12,729	\$11,865

See notes to consolidated financial statements.

**L3 TECHNOLOGIES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share data)

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Net sales:			
Products.....	\$ 6,733	\$ 6,453	\$ 6,600
Services.....	<u>2,840</u>	<u>2,757</u>	<u>2,631</u>
Total net sales.....	<u>9,573</u>	<u>9,210</u>	<u>9,231</u>
Cost of sales:			
Products.....	(5,999)	(5,818)	(6,036)
Services.....	<u>(2,554)</u>	<u>(2,435)</u>	<u>(2,333)</u>
Total cost of sales.....	<u>(8,553)</u>	<u>(8,253)</u>	<u>(8,369)</u>
Goodwill impairment charges.....	—	—	(46)
Loss related to business divestitures.....	—	—	<u>(31)</u>
Operating income.....	1,020	957	785
Interest expense.....	(169)	(164)	(162)
Interest and other income, net.....	20	18	17
Debt retirement charges.....	—	<u>(7)</u>	<u>(1)</u>
Income from continuing operations before income taxes.....	871	804	639
Provision for income taxes.....	<u>(102)</u>	<u>(171)</u>	<u>(132)</u>
Income from continuing operations.....	769	633	507
(Loss) income from discontinued operations, net of income taxes.....	<u>(76)</u>	<u>91</u>	<u>(732)</u>
Net income (loss).....	693	724	(225)
Net income from continuing operations attributable to noncontrolling interests.....	<u>(16)</u>	<u>(14)</u>	<u>(15)</u>
Net income (loss) attributable to L3.....	<u>\$ 677</u>	<u>\$ 710</u>	<u>\$ (240)</u>
Basic earnings (loss) per share attributable to common shareholders:			
Continuing operations.....	\$ 9.65	\$ 7.99	\$ 6.10
Discontinued operations.....	<u>(0.97)</u>	<u>1.18</u>	<u>(9.07)</u>
Basic earnings (loss) per share.....	<u>\$ 8.68</u>	<u>\$ 9.17</u>	<u>\$ (2.97)</u>
Diluted earnings (loss) per share attributable to common shareholders:			
Continuing operations.....	\$ 9.46	\$ 7.86	\$ 6.01
Discontinued operations.....	<u>(0.95)</u>	<u>1.15</u>	<u>(8.94)</u>
Diluted earnings (loss) per share.....	<u>\$ 8.51</u>	<u>\$ 9.01</u>	<u>\$ (2.93)</u>
Cash dividends declared per common share.....	<u>\$ 3.00</u>	<u>\$ 2.80</u>	<u>\$ 2.60</u>
Weighted average common shares outstanding:			
Basic.....	<u>78.0</u>	<u>77.4</u>	<u>80.7</u>
Diluted.....	<u>79.6</u>	<u>78.8</u>	<u>81.9</u>

See notes to consolidated financial statements.

**L3 TECHNOLOGIES, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in millions)

	Year Ended December 31,		
	2017	2016	2015
Net income (loss) .....	\$ 693	\$ 724	\$(225)
Other comprehensive income (loss):			
Foreign currency translation adjustments .....	124	(77)	(120)
Unrealized gains (losses) on hedging instruments <sup>(1)</sup> .....	3	14	(3)
Pension and postretirement benefit plans:			
Amortization of net loss and prior service cost previously recognized <sup>(2)</sup> .....	45	30	43
Net (loss) gain arising during the period <sup>(3)</sup> .....	<u>(137)</u>	<u>(119)</u>	<u>90</u>
Net change in pension and postretirement benefit plans .....	<u>(92)</u>	<u>(89)</u>	<u>133</u>
Total other comprehensive income (loss) .....	<u>35</u>	<u>(152)</u>	<u>10</u>
Comprehensive income (loss) .....	728	572	(215)
Comprehensive income attributable to noncontrolling interests .....	<u>(16)</u>	<u>(14)</u>	<u>(15)</u>
Comprehensive income (loss) attributable to L3 .....	<u>\$ 712</u>	<u>\$ 558</u>	<u>\$(230)</u>

(1) Net of income taxes of \$1 million in 2017, \$5 million in 2016 and income tax benefits of \$2 million in 2015.

(2) Net of income taxes of \$14 million in 2017, \$18 million in 2016 and \$24 million in 2015.

(3) Net of income tax benefits of \$42 million in 2017, \$69 million in 2016 and income taxes of \$49 million in 2015. The 2015 amount includes \$9 million (net of income taxes of \$5 million) for the reclassification of actuarial losses into net income related to the Marine Systems International business divestiture in accordance with Accounting Standards Codification 715, *Defined Benefit Plans – Pension*.

See notes to consolidated financial statements.

**L3 TECHNOLOGIES, INC.**  
**CONSOLIDATED STATEMENTS OF EQUITY**  
(in millions, except per share data)

	Common Stock		Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Noncontrolling Interests	Total Equity
	Shares Outstanding	Par Value						
Balance at December 31, 2014	82.0	\$1	\$5,798	\$(6,111)	\$6,181	\$(584)	\$ 75	\$5,360
Net (loss) income					(240)		15	(225)
Other comprehensive income						10		10
Distributions to noncontrolling interests							(16)	(16)
Cash dividends declared (\$2.60 per share)					(213)			(213)
Shares issued:								
Employee savings plans	1.1		120					120
Exercise of stock options	0.7		74					74
Employee stock purchase plan	0.3		34					34
Vesting of restricted stock and performance units	0.7							
Repurchases of common stock to satisfy tax withholding obligations	(0.3)		(33)					(33)
Stock-based compensation expense			49					49
Treasury stock purchased	(6.4)			(740)				(740)
Other	—	—	9	—	—	—	—	9
Balance at December 31, 2015	78.1	1	6,051	(6,851)	5,728	(574)	74	4,429
Net income					710		14	724
Other comprehensive loss						(152)		(152)
Distributions to noncontrolling interests							(17)	(17)
Cash dividends declared (\$2.80 per share)					(220)			(220)
Shares issued:								
Employee savings plans	0.9		115					115
Exercise of stock options	0.6		53					53
Employee stock purchase plan	0.4		31					31
Vesting of restricted stock and performance units	0.5							
Repurchases of common stock to satisfy tax withholding obligations	(0.3)		(21)					(21)
Stock-based compensation expense			49					49
Treasury stock purchased	(3.0)			(373)				(373)
Other	—	—	6	—	—	—	—	6
Balance at December 31, 2016	77.2	1	6,284	(7,224)	6,218	(726)	71	4,624
Net income					677		16	693
Other comprehensive income						35		35
Distributions to noncontrolling interests							(19)	(19)
Cash dividends declared (\$3.00 per share)					(236)			(236)
Shares issued:								
Employee savings plans	0.8		113					113
Exercise of stock options	0.5		46					46
Employee stock purchase plan	0.2		32					32
Vesting of restricted stock and performance units	0.3							
Repurchases of common stock to satisfy tax withholding obligations	(0.1)		(18)					(18)
Stock-based compensation expense			53					53
Treasury stock purchased	(1.0)			(180)				(180)
Other	—	—	8	—	—	—	—	8
Balance at December 31, 2017	<u>77.9</u>	<u>\$1</u>	<u>\$6,518</u>	<u>\$(7,404)</u>	<u>\$6,659</u>	<u>\$(691)</u>	<u>\$ 68</u>	<u>\$5,151</u>

See notes to consolidated financial statements.

**L3 TECHNOLOGIES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions)

	Year Ended December 31,		
	2017	2016	2015
<b>Operating activities:</b>			
Net income (loss) . . . . .	\$ 693	\$ 724	\$ (225)
Less: Loss (income) from discontinued operations, net of tax . . . . .	76	(91)	732
Income from continuing operations . . . . .	769	633	507
Depreciation of property, plant and equipment . . . . .	172	156	161
Amortization of intangibles and other assets . . . . .	53	42	42
Deferred income tax (benefit) provision . . . . .	(8)	27	18
Stock-based employee compensation expense . . . . .	53	49	46
Contributions to employee savings plans in L3's common stock . . . . .	106	102	98
Goodwill impairment charges . . . . .	—	—	46
Amortization of pension and postretirement benefit plans net loss and prior service cost . . . . .	59	48	67
Amortization of bond discounts and deferred debt issue costs (included in interest expense) . . . . .	6	8	8
Gain on sale of property, plant and equipment . . . . .	(31)	(5)	—
Loss related to business divestitures . . . . .	—	—	31
Other non-cash items . . . . .	9	17	(3)
Changes in operating assets and liabilities, excluding amounts from acquisitions, divestitures, and discontinued operations:			
Billed receivables . . . . .	(18)	1	61
Contracts in process . . . . .	(70)	26	6
Inventories . . . . .	(69)	22	(38)
Other assets . . . . .	(13)	29	(27)
Accounts payable, trade . . . . .	99	(5)	(27)
Accrued employment costs . . . . .	28	10	35
Accrued expenses . . . . .	32	(6)	23
Advance payments and billings in excess of costs incurred . . . . .	13	(73)	(7)
Income taxes . . . . .	(39)	33	(9)
Other current liabilities . . . . .	(42)	(20)	3
Pension and postretirement benefits . . . . .	(48)	(57)	(8)
All other operating activities . . . . .	(76)	(15)	2
Net cash from operating activities from continuing operations . . . . .	985	1,022	1,035
<b>Investing activities:</b>			
Business acquisitions, net of cash acquired . . . . .	(316)	(388)	(320)
Proceeds from the sale of businesses, net of closing date cash balances . . . . .	18	561	318
Capital expenditures . . . . .	(224)	(210)	(195)
Dispositions of property, plant and equipment . . . . .	74	21	3
Other investing activities . . . . .	(5)	6	4
Net cash used in investing activities from continuing operations . . . . .	(453)	(10)	(190)
<b>Financing activities:</b>			
Proceeds from sale of senior notes . . . . .	—	547	—
Repurchases, redemptions and maturities of senior notes . . . . .	—	(856)	(297)
Borrowings under revolving credit facility . . . . .	1,328	819	1,194
Repayments of borrowings under revolving credit facility . . . . .	(1,328)	(819)	(1,194)
Common stock repurchased . . . . .	(180)	(373)	(740)
Dividends paid . . . . .	(236)	(220)	(214)
Proceeds from exercise of stock options . . . . .	46	53	48
Proceeds from employee stock purchase plan . . . . .	32	31	34
Debt issue costs . . . . .	—	(10)	—
Repurchases of common stock to satisfy tax withholding obligations . . . . .	(18)	(21)	(33)
Other financing activities . . . . .	(10)	(7)	(3)
Net cash used in financing activities from continuing operations . . . . .	(366)	(856)	(1,205)
Effect of foreign currency exchange rate changes on cash and cash equivalents . . . . .	20	(13)	(19)
Net cash from (used in) discontinued operations:			
Operating activities . . . . .	117	19	90
Investing activities . . . . .	(4)	(6)	(7)
Net cash from discontinued operations . . . . .	113	13	83
Change in cash balance in assets held for sale . . . . .	—	—	61
Net increase (decrease) in cash and cash equivalents . . . . .	299	156	(235)
Cash and cash equivalents, beginning of the year . . . . .	363	207	442
Cash and cash equivalents, end of the year . . . . .	\$ 662	\$ 363	\$ 207

See notes to consolidated financial statements.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of Business**

L3 Technologies, Inc. (L3 Technologies, Inc. and, together with its subsidiaries, referred to herein as L3 or the Company), is a prime contractor in Intelligence, Surveillance and Reconnaissance (ISR) systems, aircraft sustainment (including modifications and fleet management of special mission aircraft), simulation and training, night vision and image intensification equipment, and security and detection systems. L3 is also a leading provider of a broad range of communication, electronic and sensor systems used on military, homeland security and commercial platforms. The Company's customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), foreign governments, and domestic and foreign commercial customers.

The Company has the following four reportable segments: (1) Electronic Systems, (2) Aerospace Systems, (3) Communication Systems and (4) Sensor Systems. Financial information with respect to each of its segments is included in Note 21.

Electronic Systems provides a broad range of products and services, including components, products, subsystems, systems and related services to military and commercial customers. These products and services serve niche markets such as, aircraft simulation and training, power and distribution, cockpit avionics, airport security and precision weapons. The Electronic Systems business areas are Total Training Solutions, Power & Propulsion Systems, Aviation Products, Precision Engagement Systems and Security & Detection Systems.

Aerospace Systems provide products and services for the global ISR and Command, Control and Communications (C<sup>3</sup>) markets, specializing in signals intelligence (SIGINT) and multi-intelligence platforms, including engineering, modernization and sustainment solutions for military and various government aircraft, ground support equipment and other platforms. These strategic and tactical products and services provide the warfighter with the ability to detect, collect, identify, analyze and disseminate information from command centers, communication nodes and air defense systems for real-time situational awareness and response. Aerospace Systems sells these products and services primarily to the DoD and select foreign governments. The Aerospace Systems business areas are Mission Integration, MAS, Aerostructures and Advanced Systems.

Communication Systems provide network and communication systems, secure communications products, radio frequency (RF) components, satellite communication terminals and space, microwave and telemetry products. These products include secure data links that are used to connect a variety of space, airborne, ground and sea-based communication systems and are used in transmission, processing, recording, monitoring and dissemination functions of these communication systems. Communication Systems sells these products and services primarily to the DoD and select foreign governments. The Communications Systems business areas are Broadband Communication Systems, Space & Power Systems and Advanced Communications.

Sensor Systems provide a broad range of multi-domain ISR mission solutions from seabed to space for DoD, intelligence community, international, federal civil and commercial customers. Major capabilities and mission solutions include networked warfighter systems, integrated ISR and targeting systems, space avionics and imaging payloads, Counter Unmanned Aircraft Systems mission solutions, integrated maritime mission solutions, directed energy, cyber and electronic warfare, special mission command & control, lightweight unmanned undersea vehicles, modeling & simulation and life cycle support. Sensor Systems sells these products and services primarily to the DoD and select foreign governments. The Sensor Systems business areas are Space & Sensor Systems, Airborne Sensor Systems, Warrior Sensor Systems, Maritime Sensor Systems, Intelligence & Mission Systems and Advanced Programs.

On October 16, 2017, the Company's Board of Directors approved a plan to explore strategic alternatives to sell or otherwise divest the Vertex Aerospace business. The Company expects to complete a sale in 2018. The divestiture of the Vertex Aerospace business represents a strategic shift by the Company to exit the logistics solution and maintenance services business for military aircraft where the Company does not provide complex ISR systems integration and modification. The Vertex Aerospace business generated sales of \$1.4 billion in 2017, \$1.3 billion in 2016 and \$1.2 billion in 2015. The assets and liabilities and results of operations of the Vertex Aerospace business are reported as discontinued operations for all periods presented.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

On December 7, 2015, the Company entered into a definitive agreement to sell its National Security Solutions (NSS) segment to CACI International Inc. The transaction was completed on February 1, 2016. NSS provided cybersecurity solutions, high-performance computing, enterprise IT services, analytics and intelligence analysis to the DoD, U.S. Government intelligence agencies, federal civilian agencies and foreign governments. The results of operations of NSS are reported as discontinued operations for all periods presented.

All references made to financial data in this Annual Report on Form 10-K are to the Company's continuing operations, unless specifically noted. See Note 3 for additional information.

## **2. Summary of Significant Accounting Policies**

**Principles of Consolidation:** The accompanying financial statements comprise the consolidated financial statements of L3. The consolidated financial statements of the Company include all wholly-owned and majority-owned subsidiaries. All significant intercompany transactions are eliminated in consolidation. Investments in equity securities, joint ventures and limited liability corporations over which the Company has significant influence but does not have voting control are accounted for using the equity method. Investments over which the Company does not have significant influence are accounted for using the cost method. For the classification of contract related assets and liabilities, the Company uses the duration of the related contract or program as its operating cycle, which may be longer than one year, and classifies them as current. Certain reclassifications have been made to conform prior-year amounts to the current-year presentation.

All references made to financial data noted in the footnotes are to L3's continuing operations unless otherwise specifically noted.

**Accounting Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs of sales during the reporting period. The most significant of these estimates and assumptions for L3 relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, market values for inventories reported at lower of cost or market, pension and post-retirement benefit obligations, stock-based employee compensation expense, income taxes, including the valuations of deferred tax assets, litigation reserves, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Changes in estimates are reflected in the periods during which they become known. Actual amounts may differ from these estimates and could differ materially.

Revisions or adjustments to estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained, as facts and circumstances change and as new information is obtained, even though the scope of work required under the contract may not change. Revisions or adjustments may also be required if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to percentage-of-completion (POC) accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. The revisions in contract estimates, if significant, can materially affect the Company's results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position. Aggregate net changes in contract estimates amounted to increases of \$184 million, or 18%, of consolidated operating income (\$1.48 per diluted share) for the year ended December 31, 2017, increases of \$149 million, or 16%, of consolidated operating income (\$1.23 per diluted share) for the year ended December 31, 2016, and increases of \$52 million, or 7%, of consolidated operating income (\$0.45 per diluted share) for the year ended December 31, 2015.

**Revenue Recognition:** Substantially all of the Company's sales are generated from written contractual (revenue) arrangements. The sales price for the Company's revenue arrangements are either fixed-price, cost-plus or time-and-material type. Depending on the contractual scope of work, the Company utilizes either contract accounting standards or accounting standards for revenue arrangements with commercial customers to account for these contracts. Approximately 59% of the Company's net sales in 2017 were accounted for under contract accounting standards, of which approximately 49% were fixed-price type contracts and approximately 10% were cost-plus type contracts. For contracts that are accounted for under contract accounting standards, sales and profits are recognized



**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

based on: (1) a POC method of accounting (fixed-price type contracts), (2) allowable costs incurred plus the estimated profit on those costs (cost-plus type contracts), or (3) direct labor hours expended multiplied by the contractual fixed rate per hour plus incurred costs for material (time-and-material type contracts).

Sales and profits on fixed-price type contracts that are covered by contract accounting standards are substantially recognized using POC methods of accounting. Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the “units-of-delivery” method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to the total estimated costs at completion of the contract, multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the “cost-to-cost” method). Under both POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year. Losses on contracts are recognized in the period in which they become evident. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The impact of revisions of contract estimates, which may result from contract modifications, performance or other reasons, are recognized on a cumulative catch-up basis in the period in which the revisions are made.

Sales and profits on cost-plus type contracts that are covered by contract accounting standards are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. The estimated profit on a cost-plus type contract is fixed or variable based on the contractual fee arrangement types. Incentive and award fees are the primary variable fee contractual arrangement types for the Company. Incentive and award fees on cost-plus type contracts are included as an element of total estimated contract revenues and are recorded as sales when a basis exists for the reasonable prediction of performance in relation to established contractual targets and the Company is able to make reasonably dependable estimates for them.

Sales and profits on time-and-material type contracts are recognized on the basis of direct labor hours expended multiplied by the contractual fixed rate per hour, plus the actual costs of materials and other direct non-labor costs.

Sales on arrangements for (1) fixed-price type contracts that require the Company to perform services that are not related to the production of tangible assets (Fixed-Price Service Contracts) and (2) certain commercial customers are recognized in accordance with accounting standards for revenue arrangements with commercial customers. Sales for the Company’s businesses whose customers are primarily commercial business enterprises are substantially all generated from single element revenue arrangements. Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectability is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on a straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are generally recognized when the units of work are completed. Sales and profit on cost-plus and time-and-material type contracts within the scope of accounting standards for revenue arrangements with commercial customers are recognized in the same manner as those within the scope of contract accounting standards, except for incentive and award fees. Cost-based incentive fees are recognized when they are realizable in the amount that would be due under the contractual termination provisions as if the contract was terminated. Performance based incentive fees and award fees are recorded as sales when objective evidence exists that the fees have been earned.

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

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

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

**Research and Development:** Independent research and development (IRAD) costs sponsored by the Company and bid and proposal (B&P) costs relate to both U.S. Government contracts and those for international and commercial customers. The IRAD and B&P costs for certain of the Company's businesses that are U.S. Government contractors are recoverable indirect contract costs that are allocated to U.S. Government contracts in accordance with U.S. Government procurement regulations, and are specifically excluded from research and development accounting standards. The Company includes the recoverable IRAD and B&P costs allocated to U.S. Government contracts in inventoried contract costs, and charges them to cost of sales when the related contract sales are recognized as revenue. Research and development costs that are not recoverable on U.S. Government contracts are accounted for in accordance with research and development accounting standards and are expensed to cost of sales as incurred.

Customer-funded research and development costs are incurred pursuant to contracts (revenue arrangements) to perform research and development activities according to customer specifications. These costs are not accounted for as research and development expenses, and are also not indirect contract costs. Instead, these costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the research and development services are performed. Customer-funded research and development costs are substantially all incurred under cost-plus type contracts with the U.S. Government.

**Product Warranties:** Product warranty costs are accrued when revenue is recognized for the covered products. Product warranty expense is recognized based on the terms of the product warranty and the related estimated costs. Accrued warranty costs are reduced as product warranty costs are incurred or as warranty periods expire.

The table below presents the changes in the Company's accrued product warranty costs.

	Year Ended December 31,	
	2017	2016
	(in millions)	
<b>Accrued product warranty costs<sup>(1)</sup>:</b>		
Balance at January 1 . . . . .	\$109	\$105
Acquisitions during this period . . . . .	3	3
Accruals for product warranties issued during the period . . . . .	52	51
Foreign currency translation adjustments . . . . .	1	(1)
Settlements made during the period . . . . .	<u>(66)</u>	<u>(49)</u>
Balance at December 31 . . . . .	<u>\$ 99</u>	<u>\$109</u>

<sup>(1)</sup> Warranty obligations incurred in connection with long-term production contracts that are accounted for under the POC cost-to-cost method are included within the contract estimates at completion and are excluded from the above amounts. The balances above include both the current and non-current amounts.

**Deferred Debt Issue Costs:** Costs to issue debt are capitalized and deferred when incurred, and subsequently amortized to interest expense over the term of the related debt using the effective interest rate method. Deferred debt issuance costs, other than for line-of credit arrangements, are presented in the Company's consolidated balance sheets as a direct deduction from the carrying amount of the associated debt liability. Deferred debt issue costs for line-of-credit arrangements are presented in the Company's consolidated balance sheets in other assets.

**Pension Plan and Postretirement Benefit Plan Obligations:** The Company maintains multiple pension plans, both contributory and non-contributory, covering employees at certain locations. Eligibility for participation in these plans varies and benefits are generally based on the participant's compensation and/or years of service. The Company's funding policy is generally to contribute in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations thereon.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The Company also provides postretirement medical and life insurance benefits for retired employees and dependents at certain locations. Participants are eligible for these benefits when they retire from active service and meet the eligibility requirements for the Company's pension plans. These benefits are funded primarily on a pay-as-you-go basis with the retiree generally paying a portion of the cost through contributions, deductibles and coinsurance provisions.

In accordance with accounting standards for employee pension and postretirement benefits, the Company recognizes on a plan-by-plan basis the unfunded status of its pension and postretirement benefit plans in the consolidated financial statements and measures its pension and postretirement benefit plan assets and benefit obligations at December 31.

The obligation for the Company's pension plans and postretirement benefit plans and the related annual costs of employee benefits are calculated based on several long-term assumptions, including discount rates and expected mortality for employee benefit liabilities, and rates of return on plan assets, and expected annual rates for salary increases for employee participants in the case of pension plans, and expected annual increases in the costs of medical and other health care benefits in the case of postretirement benefit obligations. See Note 19, *Pensions and Other Employee Benefits* for additional information.

**Stock-Based Compensation:** The Company follows the fair value based method of accounting for stock-based employee compensation, which requires the Company to expense all stock-based employee compensation. Stock-based employee compensation is primarily a non-cash expense because the Company settles these obligations by issuing shares of L3 common stock instead of settling such obligations with cash payments.

Compensation expense for restricted stock unit and stock option awards is generally recognized on a straight-line basis over the requisite service period for the entire award based on the grant date fair value. All of the stock options granted to employees by the Company are non-qualified stock options under U.S. income tax regulations. Compensation expense for performance units payable in L3 common stock is based on the fair value of the units at the grant date (measurement date), adjusted each reporting period for progress towards the target award, and recognized on a straight-line basis over the requisite service period. Stock-based compensation expense is recognized net of estimated forfeitures.

**Income Taxes:** The Company provides for income taxes using the liability method. Deferred income tax assets and liabilities reflect tax carryforwards and the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes, as determined under enacted tax laws and rates. The effect of changes in tax laws or rates is accounted for in the period of enactment. Valuation allowances for deferred tax assets are provided when it is more likely than not that the assets will not be realized, considering, when appropriate, tax planning strategies. Deferred income tax assets and liabilities are classified as noncurrent in the Company's balance sheet.

Income tax accounting standards prescribe: (1) a minimum recognition threshold that an income tax benefit arising from an uncertain income tax position taken, or expected to be taken, on an income tax return is required to meet before being recognized in the financial statements and (2) the measurement of the income tax benefits recognized from such positions. The Company's accounting policy is to classify uncertain income tax positions that are not expected to be resolved in one year as non-current income tax liabilities and to classify potential interest and penalties on uncertain income tax positions as elements of the provision for income taxes in its financial statements.

**Cash and Cash Equivalents:** Cash equivalents consist of highly liquid investments with an original maturity of three months or less at the time of purchase.

**Contracts in Process:** Contracts in Process include unbilled contract receivables and inventoried contract costs for which sales and profits are recognized primarily using a POC method of accounting. Unbilled Contract Receivables represent accumulated incurred costs and earned profits on contracts in process that have been recorded as sales, primarily using the cost-to-cost method, but have not been billed to customers. Inventoried Contract Costs primarily represent incurred costs on contracts using the units-of-delivery method of accounting and include direct costs and indirect costs, including overhead costs, and materials acquired for U.S. Government service contracts. As discussed in Note 4, the Company's inventoried contract costs for U.S. Government contracts, and contracts with prime contractors or subcontractors of the U.S. Government include allocated general and administrative costs

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

(G&A), IRAD costs and B&P costs. Contracts in Process contain amounts relating to contracts and programs with long performance cycles, a portion of which may not be realized within one year. For contracts in a loss position, the unrecoverable costs expected to be incurred in future periods are recorded in Estimated Costs in Excess of Estimated Contract Value to Complete Contracts in Process in a Loss Position, which is a component of Other Current Liabilities. Under the terms of certain revenue arrangements (contracts) with the U.S. Government, the Company is entitled to receive progress payments as costs are incurred or milestone payments as work is performed. The U.S. Government has a security interest in the Unbilled Contract Receivables and Inventoried Contract Costs to which progress payments have been applied, and such progress payments are reflected as a reduction of the related amounts. Milestone payments that have been received in excess of contract costs incurred and related estimated profits are reported on the Company's balance sheet as Advance Payments and Billings in Excess of Costs Incurred.

The Company values its acquired contracts in process in connection with business acquisitions on the date of acquisition at contract value less the Company's estimated costs to complete the contract and a reasonable profit allowance on the Company's completion effort.

**Inventories:** Inventories, other than Inventoried Contract Costs, are stated at cost (first-in, first-out or average cost), but not in excess of realizable value. A provision for excess, obsolete or inactive inventory is recorded based upon an analysis that considers current inventory levels, historical usage patterns and future sales expectations.

**Property, Plant and Equipment:** Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation is computed by generally applying the straight-line method to the estimated useful lives of the related assets. Useful lives generally range from 10 to 40 years for buildings and improvements and three to 10 years for machinery, equipment, furniture and fixtures. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the improvements. When property, plant or equipment is retired or otherwise disposed of, the net book value of the asset is removed from the Company's balance sheet and the net gain or loss is included in the determination of operating income. Property, plant and equipment acquired as part of a business acquisition is recorded at fair value.

**Goodwill and Indefinite-lived Intangible Assets:** The carrying value of goodwill and indefinite-lived identifiable intangible assets are not amortized, but are tested for impairment annually as of November 30 and, additionally on an interim basis, whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. The accounting standards for goodwill allow for the assessment of qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The Company did not utilize a qualitative assessment approach for the November 30, 2017 goodwill impairment test, as the Company chose instead to complete the quantitative testing process for each reporting unit. The Company has elected to early adopt Accounting Standards Update (ASU) 2017-04, *Simplifying the Test for Goodwill Impairment*, effective January 1, 2017, which eliminated Step 2 of the previous accounting standard which required computing an implied fair value of goodwill. The Company identifies any potential impairment by comparing the carrying value of a reporting unit to its fair value. The Company determines the fair value of its reporting units using a discounted cash flow valuation approach. If a potential impairment is identified, the Company will determine the amount of goodwill impairment by comparing the fair value of a reporting unit with its carrying amount. To the extent the carrying value of a reporting unit exceeds its fair value, a goodwill impairment charge is recognized. The annual impairment tests at November 30, 2017 and 2016 did not result in impairments to goodwill. The Company performed an interim impairment test during the quarterly period ended September 29, 2017 for the Vertex Aerospace reporting unit and as a result of a decline in its estimated fair value, the Company recorded an impairment charge of \$187 million (\$133 million after income taxes) in 2017. The impairment charge is included in the Vertex Aerospace results of operations which are classified as discontinued operations. The Company performed an interim impairment test in 2015 for the NSS and the Vertex Aerospace reporting units and due to a decline in their estimated fair values, the Company recorded aggregate goodwill impairment charges of \$955 million (\$46 million classified in continuing operations, for the retained businesses, and \$909 million classified in discontinued operations). See Note 3 for additional information on the goodwill impairment charges.

**Identifiable Intangible Assets:** Identifiable intangible assets represent assets acquired as part of the Company's business acquisitions and include customer contractual relationships, technology, favorable leasehold interests and trade names. The initial measurement of these intangible assets is based on their fair values. Identifiable intangible assets are: (1) tested for impairment whenever events or changes in circumstances indicate that the carrying amount

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

of these assets may not be recoverable and (2) amortized over their estimated useful lives as the economic benefits are consumed. The Company reviews and updates its estimates of the duration of its customer contractual relationships. If the Company's current estimates indicate that the duration of its customer contractual relationships have decreased, then the Company adjusts the amortization period for those customer contractual relationships to their remaining useful economic life.

***Derivative Financial Instruments:*** The Company's derivative financial instruments include foreign currency forward contracts, which are entered into for risk management purposes.

The Company's U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, the Company enters into foreign currency forward contracts. The Company's activities involving foreign currency forward contracts are designed to hedge the changes in the functional currency equivalent cash flows due to movements in foreign exchange rates compared to the functional currency. The foreign currencies hedged are primarily the U.S. dollar, the Canadian dollar, the Euro and the British pound. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. Foreign currency forward contracts are recorded in the Company's balance sheets at fair value and are generally designated and accounted for as cash flow hedges in accordance with the accounting standards for derivative instruments and hedging activities. Gains and losses on designated foreign currency forward contracts that are highly effective in offsetting the corresponding change in the cash flows of the hedged transactions are recorded net of income taxes in accumulated other comprehensive income (loss) (accumulated OCI) and then recognized in income when the underlying hedged transaction affects income. Gains and losses on foreign currency forward contracts that do not meet hedge accounting criteria are recognized in income immediately.

***Treasury Stock:*** The Company records treasury stock purchases at cost, which includes incremental direct transaction costs.

***Translation of Foreign Currency and Foreign Currency Transactions:*** Transactions in foreign currencies are translated into the local (functional) currency of the respective business at the approximate prevailing rate at the time of the transaction. Foreign exchange transaction gains and losses in the years ended December 31, 2017, 2016 and 2015 were not material to the Company's results of operations. The operations of the Company's foreign subsidiaries are translated from the local (functional) currencies into U.S. dollars using weighted average rates of exchange during each reporting period. The rates of exchange at each balance sheet date are used for translating the assets and liabilities of the Company's foreign subsidiaries. Gains or losses resulting from these translation adjustments are included in the balance sheets as a component of accumulated OCI and are only recognized in income when a foreign subsidiary is divested.

***Accounting Standards Issued and Not Yet Implemented:*** In August 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*. The amendments in this update intend to better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedge relationships and the presentation of hedge results. The amendments in this update require an entity to present the earnings effect of the hedging instrument in the same income statement line in which the earnings effect of the hedged item is reported. Current U.S. GAAP provides for hedge accounting only for the portion of the hedge deemed to be highly effective and requires an entity to separately reflect the amount by which the hedging instrument does not offset the hedged item, which is referred to as the ineffective amount. The amendments in this update no longer require entities to separately measure and report hedge ineffectiveness. The new standard is effective for the Company for interim and annual reporting periods beginning on January 1, 2019, with early adoption permitted. For cash flow hedges existing at the date of adoption, the Company is required to apply a cumulative effect adjustment relating to the separate measurement of ineffectiveness to the opening balance of retained earnings. The amended presentation and disclosure guidance is required only prospectively. The Company will adopt ASU 2017-12 effective January 1, 2019. The Company does not expect the adoption of this standard to have a material effect on its financial position, results of operations or cash flows.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Under current U.S. GAAP, defined benefit pension and postretirement benefit cost (net benefit cost) comprise several components that reflect different aspects of the Company's financial arrangements as well as the cost of benefits provided to employees. Those components are aggregated for reporting in the financial statements, and current U.S. GAAP presents those costs within the operating section of the income statement or capitalized into assets (inventories) when appropriate. The amendments in this update require the Company to report the service cost component in the same line item as other compensation costs arising from services rendered by the employees during the period. The other components of net benefit cost are required to be presented separately from the service cost component and below income from operations. Plan administrative expenses, which are currently included in service cost, will be presented in the expected return on plan assets component below income from operations. The amendments in this update also allow only the service cost component to be eligible for capitalization when applicable. The amendments in this update will be effective for the Company for interim and annual periods beginning January 1, 2018. Upon adoption, the amendments in this update will be applied retrospectively for the presentation of the components of net benefit cost and prospectively for the capitalization of the service cost component of net benefit cost. The adoption of this standard will increase operating income and decrease interest and other income, net, each by \$11 million for the year ended December 31, 2017 and by \$1 million for the year ended December 31, 2016. The adoption of this standard will not impact pre-tax income for the years ended December 31, 2017 and 2016.

In January 2017, the FASB issued ASU 2017-01, *Clarifying the Definition of a Business*, with the objective of providing additional guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this update provide new guidance to determine when an integrated set of assets and activities (collectively referred to as a "set") is not a business. The new guidance requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. The new guidance reduces the number of transactions that need to be evaluated as a business. The new standard, as amended, will be effective for the Company prospectively for interim and annual reporting periods beginning on January 1, 2018, with early application permitted. The Company believes that the evaluation of whether transactions should be accounted for as acquisitions (or dispositions) of assets or businesses will be simplified under the new standard.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which updates the existing guidance on accounting for leases and requires new qualitative and quantitative disclosures about the Company's leasing activities. The new standard requires the Company to recognize lease assets and lease liabilities on the balance sheet for all leases under which the Company is the lessee, including those classified as operating leases under previous accounting guidance. The new standard allows the Company to make an accounting policy election not to recognize on the balance sheet lease assets and liabilities for leases with a term of 12 months or less. The accounting applied by a lessor is largely unchanged from previous guidance. The new standard, as amended, will be effective for the Company for interim and annual reporting periods beginning on January 1, 2019, with early adoption permitted. In the adoption year, the Company will be required to recognize and measure all leases using a modified retrospective approach, which requires the restatement of each prior reporting period presented. The Company is currently evaluating the expected impact of the adoption of this standard on its consolidated financial statements and disclosures related to leasing activities. The Company plans to adopt ASU 2016-02 effective January 1, 2019. Refer to Note 18 for information about the Company's leases.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, As Amended (commonly referred to as ASC 606), which will replace numerous requirements in U.S. GAAP, including industry-specific requirements, provides companies with a single revenue recognition model for recognizing revenue from contracts with customers and significantly expands the disclosure requirements for revenue arrangements. The new standard, as amended, will be effective for the Company for interim and annual reporting periods beginning on January 1, 2018. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application with disclosure of results under the new and old standards for the first year of adoption.

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The Company will adopt the standard as of January 1, 2018, using the modified retrospective transition method, and has evaluated the impact of the adoption on its consolidated financial statements and related disclosures. Under the modified retrospective transition method, the Company will calculate and record the cumulative effect of adopting the new standard at January 1, 2018, in the Company's Quarterly Report on Form 10-Q for the first quarter of 2018.

The Company has evaluated the changes from adopting this new standard on its financial reporting, disclosures and its various revenue streams. The Company will recognize revenue over time on most of its (i) contracts that are covered by current contract accounting standards and (ii) fixed-price type contracts that require it to perform services that are not related to the production of tangible assets by using cost inputs to measure progress toward the completion of its performance obligations. This method is similar to the POC cost-to-cost method currently used on the majority of the Company's contracts covered by current contract accounting standards. Accordingly, the adoption of this standard will primarily impact certain (i) contracts currently covered by contract accounting standards that currently recognize revenue using the POC units-of-delivery method and (ii) fixed-price type contracts for services that are not related to the production of tangible assets that currently recognize revenue on a straight-line basis over the contractual service period.

Based on contracts in process at December 31, 2017, the Company expects to record, upon adoption of ASC 606, a net increase to shareholders' equity ranging from \$10 million to \$20 million, which includes the acceleration of net sales ranging from \$350 million to \$400 million and the related cost of sales. The adjustment to retained earnings primarily relates to contracts currently accounted for under the POC units-of-delivery method, which would have been recognized under ASC 606 earlier in the performance period as costs were incurred, as opposed to when the units were delivered under ASC 605.

The Company will make certain presentation changes on its consolidated balance sheets to comply with the new standard. The components of contracts in process will be presented separately as contract assets or inventories based on the amounts of unbilled revenue or the cost of inventories, respectively. Advance payments and billings in excess of costs and deferred revenue, which is currently classified in other current liabilities, will be combined and presented as contract liabilities. The Company expects that the adoption of ASC 606 will result in a decrease in inventories and an increase in contract assets (unbilled receivables) primarily to reflect the impact of converting contracts currently applying the units-of-delivery method to the cost input method for recognizing revenue and profit. Additionally, the Company will reclassify approximately \$50 million of capitalized contract fulfillment costs from inventories to other assets upon adoption of ASC 606. The Company accounts for contract fulfillment costs as a contract cost under current accounting standards, and capitalizes them to inventoried contract costs if they relate to contracts that are accounted for under the POC units of delivery method of revenue recognition. The Company expects the net impact of these adjustments will decrease its current assets and current liabilities each by approximately 2%.

Additionally, the Company has updated its accounting policies affected by this standard, redesigned its internal controls over financial reporting related to the standard, and determined the extent of the expanded disclosure requirements. The Company has substantially completed the evaluation of the impact of the accounting and disclosure changes on its business processes, controls and systems and has implemented the necessary changes to such business processes, controls and systems.

Other accounting standard updates effective for interim and annual periods beginning after December 31, 2017 are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

### **3. Acquisitions, Divestitures and Discontinued Operations**

#### ***Business Acquisitions***

The Company continually evaluates potential acquisitions that either strategically fit within the Company's existing portfolio or expand the Company's portfolio into new product lines or adjacent markets. The Company has completed a number of acquisitions that have been accounted for as business combinations and have resulted in the recognition of goodwill in the Company's financial statements. This goodwill includes the know-how of the assembled workforce, the ability of the workforce to further improve technology and product offerings, and the expected cash flows resulting from these efforts. Goodwill may also include expected synergies resulting from the complementary strategic fit these businesses bring to existing operations. The business acquisitions discussed below are included in the Company's results of operations from their respective dates of acquisition.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

*2017 Business Acquisitions*

*Kigre, Inc. (Kigre).* On December 18, 2017, the Company acquired Kigre, Inc., renamed L3 Kigre, Inc., for a purchase price of \$13 million, which was financed with cash on hand. Kigre designs, manufactures, markets and distributes laser glass, filter glass and laser transmitter solutions involving rare earth elements. The goodwill recognized for this business was \$9 million, which was assigned to the Sensor Systems segment, and is not expected to be deductible for income tax purposes. The final purchase price is subject to customary adjustments for final working capital. The final purchase price allocation, which is expected to be completed in the second quarter of 2018, will be based on final appraisals and other analysis of fair values of acquired assets and liabilities. The Company does not expect that differences between the preliminary and final purchase price allocation will have a material impact on its results of operations or financial position.

*Escola De Aviacao Aerocondor, S.A. (G-Air).* On October 27, 2017, the Company acquired Escola De Aviacao Aerocondor, S.A., renamed G-Air, Inc., for a purchase price of \$13 million, which was financed with cash on hand. G-Air is a European airplane and helicopter training academy located in Cascais, Portugal. The goodwill recognized for this business was \$12 million, which was assigned to the Electronic Systems segment, and is not expected to be deductible for income tax purposes. The final purchase price allocation, which is expected to be completed in the second quarter of 2018, will be based on final appraisals and other analysis of fair values of acquired assets and liabilities. The Company does not expect that differences between the preliminary and final purchase price allocation will have a material impact on its results of operations or financial position.

*Doss Aviation, Inc. (Doss Aviation).* On September 12, 2017, the Company acquired Doss Aviation, Inc., which has been renamed L3 Doss Aviation, Inc. Doss Aviation is the sole provider of initial flight training for U.S. Air Force (USAF) pilots and offers curriculum coursework and flight training for both fixed-wing and unmanned aircraft pilots and weapons officers from its full-service, turnkey training facility. Doss Aviation also provides instructor pilots for rotary-wing aircraft for the U.S. Army, as well as global airfield service support activities at U.S. government bases, including aircraft and bulk refueling services and aircraft component repair and modification. The strength of Doss Aviation's military training, combined with the Company's existing training solutions, increases the Company's position to support customers' growing demand for trained international military and commercial pilots. The acquisition was financed with cash on hand. The goodwill recognized for this business was \$37 million, which was assigned to the Electronic Systems segment, of which \$13 million is expected to be deductible for income tax purposes. The final purchase price is subject to customary adjustments for final working capital. The final purchase price allocation, which is expected to be completed in the second quarter of 2018, will be based on final appraisals and other analysis of fair values of acquired assets and liabilities. The Company does not expect that differences between the preliminary and final purchase price allocation will have a material impact on its results of operations or financial position.

*Adaptive Methods, Inc. (Adaptive Methods).* On September 8, 2017, the Company acquired Adaptive Methods, Inc., renamed L3 Adaptive Methods, Inc., for a purchase price of \$33 million, which was financed with cash on hand. Adaptive Methods delivers Undersea Warfare (USW) and Anti-Submarine Warfare capabilities for U.S. military customers and develops autonomy and sensor payload solutions for use by Unmanned Undersea Vehicles (UUVs). The acquisition provides the Company with an innovative UUV autonomy technology that will broaden its capabilities in the dynamic and growing undersea market. The acquisition was financed with cash on hand. The goodwill recognized for this business was \$28 million, which was assigned to the Sensor Systems segment, all of which is expected to be deductible for income tax purposes. The final purchase price is subject to customary adjustments for final working capital. The final purchase price allocation, which is expected to be completed in the second quarter of 2018, will be based on final appraisals and other analysis of fair values of acquired assets and liabilities. The Company does not expect that differences between the preliminary and final purchase price allocation will have a material impact on its results of operations or financial position.

*Open Water Power, Inc. (Open Water Power).* On May 19, 2017, the Company acquired Open Water Power, Inc., which has been renamed L3 Open Water Power, Inc. Open Water Power develops safe and high-energy-density undersea power generation technologies for use by UUVs and other maritime platforms. The acquisition enhances the Company's growing portfolio of innovative undersea capabilities. The acquisition was financed with cash on hand. The purchase price is subject to additional contingent consideration not to exceed \$17 million and is based on Open Water Power's post-acquisition milestone achievements for the four-year period ending December 31, 2021.



**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The Company recorded a \$14 million liability on the acquisition date for the fair value of the contingent consideration. The goodwill recognized for this business was \$25 million, which was assigned to the Sensor Systems segment, and is not expected to be deductible for income tax purposes. The Company also recognized indefinite-lived intangible assets of \$65 million for in-process research and development (IPR&D) costs. The purchase price and purchase price allocation of Open Water Power was finalized as of December 31, 2017, with no significant changes to preliminary amounts.

*OceanServer Technology, Inc. (OceanServer).* On March 17, 2017, the Company acquired OceanServer Technology, Inc., which has been renamed L3 OceanServer, Inc. OceanServer develops and manufactures autonomous, lightweight UUVs. OceanServer provides highly capable UUVs to a wide array of military, commercial and international customers. The acquisition was financed with cash on hand. The goodwill recognized for this business was \$19 million, which was assigned to the Sensor Systems segment, all of which is expected to be deductible for income tax purposes. The purchase price and purchase price allocation of OceanServer was finalized as of September 29, 2017, with no significant changes to preliminary amounts.

*Explosive Trace Detection business of Implant Sciences.* On October 10, 2016, the Company entered into an asset purchase agreement (APA) to acquire the explosive trace detection (ETD) business of Implant Sciences Corporation (Implant), at which time Implant entered into Chapter 11 bankruptcy protection of the U.S. Bankruptcy Code. In December 2016, Implant received U.S. Bankruptcy Court approval to consummate the APA. The ETD business bolsters the Company’s leadership in efficient, scalable security solutions and greatly enhances its capabilities in the global aviation security and national security markets. On January 5, 2017, the Company completed the acquisition of the ETD business for a purchase price of \$118 million, in addition to the assumption of specified liabilities, which was financed with cash on hand. The goodwill recognized for this business was \$80 million, which was assigned to the Electronic Systems segment, all of which is expected to be deductible for income tax purposes. The purchase price and purchase price allocation of the ETD business was finalized as of December 31, 2017, with no significant changes to preliminary amounts.

Net sales and income before income taxes for Kigre, G-Air, Doss Aviation, Adaptive Methods, Open Water Power, OceanServer and the ETD business, included in L3’s consolidated statement of operations for the year ended December 31, 2017, are presented in the table below.

	<u>Year Ended</u> <u>December 31, 2017</u> (in millions)
Net sales . . . . .	\$80
Loss before income taxes . . . . .	\$ (1)

*2016 Business Acquisitions*

*MacDonald Humfrey (Automation) Limited.* On November 22, 2016, the Company acquired MacDonald Humfrey (Automation) Limited, which has been renamed L3 MacDonald Humfrey (MacH), for a purchase price of £263 million (approximately \$327 million). The purchase price is subject to additional, contingent consideration not to exceed £30 million (approximately \$38 million) and is based on MacH’s post-acquisition financial performance for the three-year period ending December 31, 2019. The Company recorded a £21 million (approximately \$26 million) liability on the acquisition date for the fair value of the contingent consideration. The acquisition was funded from cash on hand and revolving credit borrowings that were repaid before the end of 2016. The purchase price and purchase price allocation of MacH was finalized as of December 31, 2017, with no significant changes to preliminary amounts. MacH is a globally recognized leader in the deployment of operationally effective and efficient aviation checkpoint security solutions, as well as in the development of state-of-the-art process automation and collaborative robotic capabilities supporting aviation and other adjacent markets. The goodwill recognized for this business was £204 million (approximately \$255 million), which was assigned to the Electronics Systems reportable segment, and is not expected to be deductible for income tax purposes. The Company also recognized identifiable intangible assets of £45 million (approximately \$56 million) in the aggregate, which consisted of £6 million (approximately \$8 million) for trade name, £10 million (approximately \$12 million) for technology and £29 million (approximately \$36 million) for customer relationships. Identifiable intangible assets will be amortized over a weighted average useful life of 10 years.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

*Micro Limited and Aerosim.* On September 30, 2016, the Company acquired Micro Limited (Micro) and Flight Training Acquisitions LLC (Aerosim), in separate transactions, for an aggregate purchase price of approximately \$86 million, which was financed with cash on hand. The purchase price and purchase price allocation of Micro and Aerosim was finalized as of September 29, 2017, with no significant changes to preliminary amounts. Micro specializes in solutions that utilize high-performance microwave, millimeter wave and photonic technology that complements the Company's wide range of sensor products and is expected to strengthen the development of the Company's future products in the higher Electronic Warfare (EW) radio frequency (RF) bandwidth. Micro currently supports a variety of airborne, land and security programs in Australia. Aerosim provides innovative, portable and flexible pilot and maintenance technician training products and provides a flight school for prospective airline pilots. Aerosim's commercial training capabilities are complementary to those offered by L3 Commercial Training Solutions. The aggregate goodwill recognized for these businesses was \$59 million, which was assigned to the Electronic Systems and Sensor Systems reportable segments, of which \$6 million is expected to be deductible for income tax purposes.

*Advanced Technical Materials, Inc. (ATM) Acquisition.* On January 22, 2016, the Company acquired the assets of ATM for a purchase price of \$27 million, which was financed with cash on hand. The purchase price and purchase price allocation of ATM was finalized as of September 23, 2016, with no significant changes to preliminary amounts. ATM develops and manufactures a broad product line of passive microwave waveguides and specialized coaxial components. The goodwill recognized for this business was \$20 million, which was assigned to the Communication Systems reportable segment, all of which is expected to be deductible for income tax purposes.

*2015 Business Acquisitions*

*ForceX, Inc. Acquisition.* On October 13, 2015, the Company acquired ForceX, Inc., renamed L3 ForceX, for a purchase price of \$61 million, which was financed with cash on hand. The purchase price and purchase price allocation of L3 ForceX was finalized as of September 23, 2016, with no significant changes to preliminary amounts. L3 ForceX specializes in ISR mission management software and geospatial application technology programs, offering an array of advanced products, including cueing system software, hardware and video algorithms, and wide-area sensor integration solutions and software. L3 ForceX's proprietary processing, exploitation and dissemination capabilities provide an integrated tactical operational picture, allowing users to make critical decisions in real time. L3 ForceX also supports several key DoD ISR initiatives and classified programs. L3 ForceX's customer base includes the USAF, U.S. Special Operations Command, the Naval Surface Warfare Center and a variety of DoD agencies. The goodwill recognized for this business was \$53 million, which was assigned to the Sensor Systems reportable segment, of which \$52 million is expected to be deductible for income tax purposes.

*CTC Aviation Group Acquisition.* On May 27, 2015, the Company acquired CTC Aviation Group, renamed L3 CTC Ltd. (L3 CTC), for a purchase price of £153 million (approximately \$236 million), which was financed with cash on hand. The purchase price and purchase price allocation of L3 CTC was finalized as of June 24, 2016, with no significant changes to preliminary amounts. L3 CTC is a global airline pilot training and crew resourcing specialist, based in the United Kingdom, which offers customized and innovative solutions to major airlines and flight training customers globally. L3 CTC expands L3's commercial aviation training business to encompass a growing portfolio of airline and third-party training company customers. The goodwill recognized for this business was £118 million (approximately \$182 million), which was assigned to the Electronic Systems reportable segment, and is not expected to be deductible for income tax purposes.

*MITEQ, Inc. Acquisition.* On January 21, 2015, the Company acquired the assets of MITEQ, Inc. (Miteq) for a purchase price of \$41 million, which was financed with cash on hand. The purchase price and purchase price allocation of Miteq was finalized as of September 25, 2015, with no significant changes to preliminary amounts. Miteq was combined with the Company's Narda Microwave-East business and the new organization was re-named L3 Narda-Miteq. Miteq offers a broad product line of active and passive RF microwave components and low-power satellite communications (SATCOM) products for space and military applications that complement the existing Narda Microwave East product line. The combined L3 Narda-Miteq business provides products for the DoD, other U.S. Government agencies, prime contractors and commercial customers. The goodwill recognized for this business was \$11 million, of which \$4 million is expected to be deductible for income tax purposes. The goodwill was assigned to the Communication Systems reportable segment.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

**Unaudited Pro Forma Statements of Operations Data**

The following unaudited pro forma Statements of Operations data present the combined results of the Company and its business acquisitions completed during the years ended December 31, 2017 and 2016 assuming that the business acquisitions completed during 2017 and 2016 had occurred on January 1, 2016 and January 1, 2015, respectively. The unaudited pro forma Statements of Operations data below include adjustments for additional amortization expense related to acquired intangible assets and depreciation assuming the 2017 and 2016 acquisitions had occurred on January 1, 2016 and January 1, 2015, respectively.

	Year Ended December 31,	
	2017	2016
	(in millions, except per share data)	
Pro forma net sales . . . . .	\$9,638	\$9,493
Pro forma income from continuing operations attributable to L3 . . . . .	\$ 753	\$ 621
Pro forma net income attributable to L3 . . . . .	\$ 677	\$ 712
Pro forma diluted earnings per share from continuing operations . . . . .	\$ 9.46	\$ 7.88
Pro forma diluted earnings per share . . . . .	\$ 8.51	\$ 9.03

**Business Divestitures**

*2017 Divestitures*

During the year ended December 31, 2017, the Company completed the sales of the CTC Aviation Jet Services Limited (Aviation Jet Services) business, the L3 Coleman Aerospace (Coleman) business and the Display Product Line. The table below presents pre-tax (loss) gain recognized, the proceeds received and net sales included in continuing operations from these divestitures.

	Year Ended December 31, 2017		
	Pre-Tax (Loss) gain	Proceeds Received	Net Sales
	(in millions)		
Aviation Jet Services divestiture . . . . .	\$(5)	\$ 1	\$ 1
Coleman divestiture . . . . .	(3)	17	9
Display Product Line divestiture . . . . .	<u>4</u>	<u>7</u>	<u>—</u>
Total . . . . .	<u>\$(4)</u>	<u>\$25</u>	<u>\$10</u>

*Aviation Jet Services Divestiture.* On March 1, 2017, the Company divested its Aviation Jet Services business for a sales price of £1 million (approximately \$1 million). Aviation Jet Services provided non-core aircraft management and operational services as part of commercial training solutions based in the United Kingdom and was included in the Electronic Systems segment.

*Coleman Divestiture.* On February 24, 2017, the Company divested its Coleman business for a sales price of \$15 million. Coleman provided air-launch ballistic missile targets and was included in the Electronic Systems segment.

*Display Product Line Divestiture.* On February 23, 2017, the Company divested its Display Product Line for a sales price of \$7 million. The Display Product Line provided cockpits to various military aircraft and was included in the Electronic Systems segment.

*2016 Divestitures*

*NSS.* On February 1, 2016, the Company completed the sale of its NSS segment to CACI International Inc. for a sales price of \$547 million. See Discontinued Operations below for additional information.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

*2015 Business Divestitures*

During the year ended December 31, 2015, the Company completed the sales of Marine Systems International (MSI), Broadcast Sports Inc. (BSI), the Tinsley Product Line and Klein Associates, Inc. (Klein). The table below presents pre-tax loss recognized, the proceeds received and net sales included in continuing operations from these business divestitures.

	<u>Year Ended December 31, 2015</u>		
	<u>Pre-Tax Loss</u>	<u>Proceeds Received</u>	<u>Net Sales</u>
		(in millions)	
MSI divestiture . . . . .	\$(17)	\$318	\$185
BSI divestiture . . . . .	(4)	26	7
Tinsley Product Line divestiture . . . . .	(8)	4	9
Klein divestiture . . . . .	<u>(2)</u>	<u>10</u>	<u>8</u>
Total . . . . .	<u>\$(31)</u>	<u>\$358</u>	<u>\$209</u>

*MSI Divestiture.* On May 29, 2015, the Company completed the sale of its MSI business to Wärtsilä Corporation for a sales price of €295 million (approximately \$318 million), in addition to the assumption by Wärtsilä Corporation of approximately €60 million of MSI employee pension-related liabilities. The sales price was finalized as of June 24, 2016, with no significant changes to preliminary amounts. MSI was a sector within the Company’s Electronic Systems segment, primarily selling to the commercial shipbuilding industry.

*BSI Divestiture.* On April 24, 2015, the Company divested its BSI business for a sales price of \$26 million. BSI provided wireless technology and communications systems services for use in the field of sports television broadcasting, and was included in the Sensor Systems segment.

*Tinsley Product Line Divestiture.* On July 27, 2015, the Company divested its Tinsley Product Line for a sales price of \$4 million. Tinsley provided optical components, sub-assemblies and passive sub-systems and was included in the Sensor Systems segment.

*Klein Divestiture.* On December 31, 2015, the Company divested its Klein business for a sales price of \$10 million. Klein provided side scan sonar equipment and waterside security and surveillance systems, and was included in the Sensor Systems segment.

Net sales and income before income taxes for Aviation Jet Services, Coleman, the Display Product Line, MSI, BSI, the Tinsley Product Line and Klein, included in L3’s consolidated statements of operations, are presented in the table below on an aggregate basis, and are included in income from continuing operations for all periods presented.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
		(in millions)	
Net sales . . . . .	\$10	\$59	\$259
Income before income taxes . . . . .	\$ 2	\$ 8	\$ 8

***Discontinued Operations***

*Vertex Aerospace.* As discussed in Note 1, on October 16, 2017, the Company’s Board of Directors approved a plan to explore strategic alternatives to sell or otherwise divest the Vertex Aerospace business. The Company expects to complete a sale in 2018. The divestiture of the Vertex Aerospace business is a strategic shift by the Company to exit the logistics solution and maintenance services business for military aircraft where the Company does not provide complex ISR systems integration and modification. The Vertex Aerospace business generated sales of \$1.4 billion in 2017, \$1.3 billion in 2016, and \$1.2 billion in 2015. The assets and liabilities, and results of operations of the Vertex Aerospace business are reported as discontinued operations for all periods presented.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

NSS. On February 1, 2016, the Company completed the sale of its NSS segment to CACI International Inc. for a sales price of \$547 million. The results of operations NSS are reported as discontinued operations for all periods presented.

The table below presents the statements of operations data for Vertex Aerospace and NSS. The amounts presented in discontinued operations include allocated interest expenses for debt not directly attributable or related to L3's other operations. Interest expense was allocated in accordance with the accounting standards for discontinued operations and were based on the ratio of their net assets to the sum of: (1) total L3 consolidated net assets and (2) L3 consolidated total debt.

	Year Ended December 31,		
	2017	2016	2015
	(in millions)		
Net sales . . . . .	\$ 1,429	\$ 1,402	\$ 2,334
Cost of sales . . . . .	(1,342)	(1,357)	(2,259)
(Loss) gain related to business divestiture <sup>(1)</sup> . . . . .	(1)	64	—
Goodwill impairment charges <sup>(2)</sup> . . . . .	(187)	—	(909)
Operating (loss) income from discontinued operations . . . . .	(101)	109	(834)
Interest expense allocated to discontinued operations . . . . .	(2)	(5)	(26)
(Loss) income from discontinued operations before income taxes . . . . .	(103)	104	(860)
Income tax benefit (expense) . . . . .	27	(13)	128
(Loss) income from discontinued operations net of income taxes . . . . .	<u>\$ (76)</u>	<u>\$ 91</u>	<u>\$ (732)</u>

<sup>(1)</sup> For the year ended December 31, 2017, the Company recognized \$1 million of trailing expenses related to the sale of NSS. The year ended December 31, 2016 included a gain of \$64 million (before and after income taxes) on the sale of NSS.

<sup>(2)</sup> Due to a decline in estimated fair value, the Company recorded goodwill impairment charges for the years ended December 31, 2017 and 2015. The impairment charge of \$187 million recorded during 2017 relates to Vertex Aerospace. The impairment charge of \$909 million recorded during 2015 consists of: (i) \$571 million related to NSS and (ii) \$338 million related to Vertex Aerospace.

The major classes of assets and liabilities included in discontinued operations related to Vertex Aerospace are presented in the table below. As discussed above, since the sale of NSS was completed on February 1, 2016, the balances below do not reflect NSS. These balances have been classified as current as the sale is expected to be completed within one year and the proceeds are not expected to be used to pay down long-term debt.

	December 31,	December 31,
	2017	2016
	(in millions)	
<b>Assets</b>		
Current assets . . . . .	\$284	\$271
Property, plant and equipment, net . . . . .	13	14
Goodwill . . . . .	—	187
Other Intangible Assets . . . . .	7	9
Other assets . . . . .	2	—
Total assets of discontinued operations . . . . .	<u>\$306</u>	<u>\$481</u>
<b>Liabilities</b>		
Accounts payable, trade . . . . .	\$ 63	\$ 16
Other current liabilities . . . . .	131	160
Current liabilities . . . . .	194	176
Long-term liabilities . . . . .	32	59
Total liabilities of discontinued operations . . . . .	<u>\$226</u>	<u>\$235</u>

**L3 TECHNOLOGIES, INC.**  
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**Assets Held for Sale**

*Aerostructures.* The Aerostructures businesses are classified as held for sale as of December 31, 2017. Aerostructures within the Company's Aerospace Systems Segment, primarily provides aircraft fabrication and assembly of fixed and rotary wing aero structures as well as avionics hardware and software systems to address mission critical needs. The major classes of assets and liabilities included as held for sale related to the Aerostructures businesses are presented in the table below.

	<u>December 31,</u> <u>2017</u>
	(in millions)
<b>Assets</b>	
Billed receivables .....	\$ 14
Contracts in process .....	<u>33</u>
Total current assets .....	<u>47</u>
Property, plant and equipment, net.....	34
Goodwill .....	52
Identifiable intangible assets.....	<u>2</u>
Total assets classified as held for sale .....	<u>\$135</u>
<b>Liabilities</b>	
Accounts payable, trade .....	\$ 3
Accrued employment costs.....	2
Accrued expenses .....	3
Other current liabilities .....	<u>5</u>
Total current liabilities .....	<u>13</u>
Deferred income taxes .....	<u>4</u>
Total liabilities classified as held for sale .....	<u>\$ 17</u>

**4. Contracts in Process**

The components of contracts in process are presented in the table below. The unbilled contract receivables, inventoried contract costs and unliquidated progress payments principally relate to contracts with the U.S. Government and prime contractors or subcontractors of the U.S. Government.

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
Unbilled contract receivables, gross .....	\$1,874	\$1,890
Unliquidated progress payments .....	<u>(761)</u>	<u>(827)</u>
Unbilled contract receivables, net.....	<u>1,113</u>	<u>1,063</u>
Inventoried contract costs, gross.....	891	998
Unliquidated progress payments .....	<u>(71)</u>	<u>(203)</u>
Inventoried contract costs, net.....	<u>820</u>	<u>795</u>
Total contracts in process .....	<u>\$1,933</u>	<u>\$1,858</u>

*Unbilled Contract Receivables.* Unbilled contract receivables represent accumulated incurred costs and earned profits on contracts (revenue arrangements), which have been recorded as sales, but have not yet been billed to customers. Unbilled contract receivables arise from the cost-to-cost method of revenue recognition that is used to record sales on certain fixed-price contracts. Unbilled contract receivables from fixed-price type contracts are converted to billed receivables when amounts are invoiced to customers according to contractual billing terms, which

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

generally occur when deliveries or other performance milestones are completed. Unbilled contract receivables also arise from cost-plus type contracts, time-and-material type contracts and fixed-price service type contracts for revenue amounts that have not been billed by the end of the accounting period due to the timing of preparation of invoices to customers. The Company believes that approximately 92% of the unbilled contract receivables, net at December 31, 2017 will be billed and collected within one year.

**Unliquidated Progress Payments.** Unliquidated progress payments arise from fixed-price type contracts with the U.S. Government that contain progress payment clauses, and represent progress payments on invoices that have been collected in cash, but have not yet been liquidated. Progress payment invoices are billed to the customer as contract costs are incurred at an amount generally equal to 80% of incurred costs. Unliquidated progress payments are liquidated as deliveries or other contract performance milestones are completed, at an amount equal to a percentage of the contract sales price for the items delivered or work performed, based on a contractual liquidation rate. Therefore, unliquidated progress payments are a contra asset account, and are classified against unbilled contract receivables if revenue for the underlying contract is recorded using the cost-to-cost method, and against inventoried contract costs if revenue is recorded using the units-of-delivery method.

**Inventoried Contract Costs.** In accordance with contract accounting standards, the Company's U.S. Government contractor businesses account for the portion of their G&A, IRAD and B&P costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on their U.S. Government contracts (revenue arrangements) as inventoried contract costs. G&A, IRAD and B&P costs are allocated to contracts for which the U.S. Government is the end customer and are charged to costs of sales when sales on the related contracts are recognized. The Company's U.S. Government contractor businesses record the unallowable portion of their G&A, IRAD and B&P costs to expense as incurred, and do not include them in inventoried contract costs.

The table below presents a summary of G&A, IRAD and B&P costs included in inventoried contract costs and the changes to them, including amounts charged to cost of sales by the Company's U.S. Government contractor businesses for the periods presented.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Amounts included in inventoried contract costs at beginning of the year . . .	\$ 173	\$ 137	\$ 114
Contract costs incurred:			
IRAD and B&P . . . . .	333	304	280
Other G&A <sup>(1)</sup> . . . . .	<u>842</u>	<u>749</u>	<u>742</u>
Total . . . . .	<u>1,175</u>	<u>1,053</u>	<u>1,022</u>
Amounts charged to cost of sales . . . . .	<u>(1,179)</u>	<u>(1,017)</u>	<u>(999)</u>
Amounts included in inventoried contract costs at end of the year . . . . .	<u>\$ 169</u>	<u>\$ 173</u>	<u>\$ 137</u>

<sup>(1)</sup> Amounts include severance and restructuring-related costs of \$91 million, \$13 million and \$14 million for the years ended December 31, 2017, 2016 and 2015, respectively.

The table below presents a summary of selling, general and administrative expenses and research and development expenses for the Company's commercial businesses, which are expensed as incurred and included in cost of sales on the consolidated statements of operations.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Selling, general and administrative expenses . . . . .	\$278	\$223	\$261
Research and development expenses . . . . .	<u>63</u>	<u>54</u>	<u>52</u>
Total . . . . .	<u>\$341</u>	<u>\$277</u>	<u>\$313</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

**5. Inventories**

*Inventories at Lower of Cost or Realizable Value.* The table below presents the components of inventories at the lower of cost (first-in, first-out or average cost) or realizable value.

	December 31,	
	2017	2016
	(in millions)	
Raw materials, components and sub-assemblies . . . . .	\$184	\$165
Work in process . . . . .	98	106
Finished goods . . . . .	107	59
Total . . . . .	\$389	\$330

**6. Goodwill and Identifiable Intangible Assets**

*Goodwill.* In accordance with the accounting standards for business combinations, the Company records the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). Goodwill represents the purchase price paid in excess of the fair value of net tangible and intangible assets acquired. As part of the purchase price allocations for the Company’s business acquisitions, identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged. However, the Company does not recognize any intangible assets apart from goodwill for the assembled workforces of its business acquisitions. At December 31, 2017, the Company had approximately 31,000 employees, and the substantial majority of the sales generated by the Company’s businesses were from the productive labor efforts of its employees, as compared to selling manufactured products or right-to-use technology.

Generally, the largest intangible assets from the businesses that the Company acquires are the assembled workforces, which includes the human capital of the management, administrative, marketing and business development, scientific, engineering and technical employees of the acquired businesses. The success of the Company’s businesses, including their ability to retain existing business (revenue arrangements) and to successfully compete for and win new business (revenue arrangements), is primarily dependent on the management, marketing and business development, contracting, engineering and technical skills and knowledge of its employees, rather than on productive capital (plant and equipment, and technology and intellectual property). Additionally, for a significant portion of its businesses, the Company’s ability to attract and retain employees who have U.S. Government security clearances, particularly those of top-secret and above, is critical to its success, and is often a prerequisite for retaining existing revenue arrangements and pursuing new ones. Generally, patents, trademarks and licenses are not material for the Company’s acquired businesses. Furthermore, the Company’s U.S. Government contracts (revenue arrangements) generally permit other companies to use the Company’s patents in most domestic work performed by such other companies for the U.S. Government. Therefore, because intangible assets for assembled workforces are part of goodwill in accordance with the accounting standards for business combinations, the substantial majority of the intangible assets for the Company’s business acquisitions is recognized as goodwill. Additionally, the value assigned to goodwill for the Company’s business acquisitions also includes the value that the Company expects to realize from cost reduction measures that it implements for its acquired businesses.



**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The table below presents the changes in goodwill allocated to the Company's reporting units in each reportable segment.

	<u>Electronic Systems</u>	<u>Aerospace Systems</u>	<u>Communication Systems</u>	<u>Sensor Systems</u>	<u>Consolidated Total</u>
	(in millions)				
<b>December 31, 2015</b>					
Goodwill . . . . .	\$2,445	\$1,167	\$1,038	\$1,549	\$6,199
Accumulated impairment losses . . . . .	<u>(43)</u>	<u>—</u>	<u>(35)</u>	<u>(26)</u>	<u>(104)</u>
	<u>2,402</u>	<u>1,167</u>	<u>1,003</u>	<u>1,523</u>	<u>6,095</u>
Business acquisitions <sup>(1)</sup> . . . . .	287	—	20	28	335
Foreign currency translation adjustments . . . . .	(45)	7	—	(18)	(56)
<b>December 31, 2016</b>					
Goodwill . . . . .	2,687	1,174	1,058	1,559	6,478
Accumulated impairment losses . . . . .	<u>(43)</u>	<u>—</u>	<u>(35)</u>	<u>(26)</u>	<u>(104)</u>
	<u>2,644</u>	<u>1,174</u>	<u>1,023</u>	<u>1,533</u>	<u>6,374</u>
Business acquisitions <sup>(1)</sup> . . . . .	131	—	—	81	212
Business divestitures <sup>(2)</sup> . . . . .	(12)	—	—	—	(12)
Foreign currency translation adjustments . . . . .	60	14	—	19	93
Assets held for sale <sup>(3)</sup> . . . . .	(10)	(42)	—	—	(52)
<b>December 31, 2017</b>					
Goodwill . . . . .	2,856	1,146	1,058	1,659	6,719
Accumulated impairment losses . . . . .	<u>(43)</u>	<u>—</u>	<u>(35)</u>	<u>(26)</u>	<u>(104)</u>
	<u>\$2,813</u>	<u>\$1,146</u>	<u>\$1,023</u>	<u>\$1,633</u>	<u>\$6,615</u>

<sup>(1)</sup> For the year ended December 31, 2017, business acquisitions for the Electronic Systems segment included the acquisitions of the ETD, Doss Aviation and G-Air businesses and the purchase price allocation adjustments for the MacH and Aerosim business acquisitions. Business acquisitions for the Sensor Systems segment included primarily the Adaptive Methods, Open Water Power, OceanServer and Kigre business acquisitions. For the year ended December 31, 2016, business acquisitions for the Electronic Systems segment included the acquisitions of the MacH and Aerosim businesses and the final purchase price allocation for L3 CTC business acquisition. Business acquisition for the Communication Systems segment included the ATM business acquisition. Business acquisitions for the Sensor Systems segment included the Micro business acquisition and the final purchase price allocation for the L3 ForceX business acquisition.

<sup>(2)</sup> The decrease for the Electronic Systems segment was due to the divestitures of Coleman and Aviation Jet Services during the quarterly period ended March 31, 2017.

<sup>(3)</sup> The Aerostructures businesses from the Company's Aerospace Systems segment are classified as held for sale as of December 31, 2017.

*Identifiable Intangible Assets.* The most significant identifiable intangible asset that is separately recognized for the Company's business acquisitions is customer contractual relationships. All of the Company's customer relationships are established through written customer contracts (revenue arrangements). The fair value for customer contractual relationships is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows for working capital) arising from the follow-on sales on contract (revenue arrangement) renewals expected from the customer contractual relationships over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory assets charge, all of which is discounted to present value. The Company's indefinite-lived intangible assets include IPR&D.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The table below presents information for the Company’s identifiable intangible assets that are subject to amortization and indefinite-lived intangible assets.

	Weighed Average Amortization Period  (in years)	December 31, 2017			December 31, 2016		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		(in millions)					
Customer contractual relationships..	14	\$393	\$257	\$136	\$360	\$229	\$131
Technology .....	10	189	114	75	191	102	89
Other .....	15	29	14	15	21	12	9
Total subject to amortization ....		<u>611</u>	<u>385</u>	<u>226</u>	<u>572</u>	<u>343</u>	<u>229</u>
IPR&D.....	indefinite	66	—	66	—	—	—
Total.....		<u>\$677</u>	<u>\$385</u>	<u>\$292</u>	<u>\$572</u>	<u>\$343</u>	<u>\$229</u>

The table below presents amortization expense recorded by the Company for its identifiable intangible assets.

	Year Ended December 31,		
	2017	2016	2015
	(in millions)		
Amortization expense.....	<u>\$43</u>	<u>\$33</u>	<u>\$32</u>

Based on gross carrying amounts at December 31, 2017, the Company’s estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2018 through 2022 is presented in the table below.

	Year Ending December 31,				
	2018	2019	2020	2021	2022
	(in millions)				
Estimated amortization expense .....	<u>\$44</u>	<u>\$39</u>	<u>\$31</u>	<u>\$25</u>	<u>\$21</u>

**7. Other Current Liabilities and Other Liabilities**

The table below presents the components of other current liabilities.

	December 31,	
	2017	2016
	(in millions)	
<b>Other Current Liabilities:</b>		
Accrued product warranty costs .....	\$ 69	\$ 68
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position .....	63	70
Accrued interest.....	43	43
Deferred revenues .....	38	34
Estimated contingent purchase price payable for acquired businesses (see Note 3) .....	11	—
Accruals for pending and threatened litigation .....	3	14
Other .....	<u>140</u>	<u>163</u>
Total other current liabilities.....	<u>\$367</u>	<u>\$392</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The table below presents the components of other liabilities.

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
<b>Other Liabilities:</b>		
Non-current income taxes payable (see Note 16) .....	\$164	\$121
Deferred compensation .....	49	47
Accrued product warranty costs .....	30	41
Accrued workers' compensation .....	23	25
Estimated contingent purchase price payable for acquired businesses (see Note 3) .....	20	29
Notes payable and capital lease obligations .....	16	10
Other .....	<u>96</u>	<u>83</u>
Total other liabilities .....	<u>\$398</u>	<u>\$356</u>

**8. Property, Plant and Equipment**

The table below presents the components of property, plant and equipment.

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
Land .....	\$ 34	\$ 53
Buildings and improvements .....	404	437
Machinery, equipment, furniture and fixtures .....	1,959	1,857
Leasehold improvements .....	<u>376</u>	<u>337</u>
Gross property, plant and equipment .....	2,773	2,684
Accumulated depreciation and amortization .....	<u>(1,663)</u>	<u>(1,577)</u>
Property, plant and equipment, net .....	<u>\$ 1,110</u>	<u>\$ 1,107</u>

**9. Debt**

The components of debt and a reconciliation to the carrying amount of long-term debt is presented in the table below.

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
Borrowings under Revolving Credit Facility <sup>(1)</sup> .....	\$ —	\$ —
5.20% Senior Notes due 2019 .....	1,000	1,000
4.75% Senior Notes due 2020 .....	800	800
4.95% Senior Notes due 2021 .....	650	650
3.95% Senior Notes due 2024 .....	350	350
3.85% Senior Notes due 2026 .....	<u>550</u>	<u>550</u>
Principal amount of long-term debt .....	3,350	3,350
Unamortized discounts .....	(7)	(8)
Deferred debt issue costs .....	<u>(13)</u>	<u>(17)</u>
Carrying amount of long-term debt .....	<u>\$3,330</u>	<u>\$3,325</u>

<sup>(1)</sup> During 2017, L3's aggregate borrowings and repayments under the Credit Facility were \$1,328 million. L3 had the full availability of its \$1 billion Credit Facility at December 31, 2017 and December 31, 2016.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

***L3 Revolving Credit Facility***

On October 31, 2016, L3 entered into a new five year unsecured revolving credit facility (Credit Facility), which replaced its amended and restated revolving credit agreement dated February 3, 2012. The Credit Facility provides for total aggregate borrowings of \$1 billion and any outstanding borrowings under the Credit Facility are due and payable on October 31, 2021. Borrowings under the Credit Facility may consist of: (1) base rate loans, which shall bear interest at a rate equal to the sum of the applicable rate (as defined in the Credit Facility), and the “base rate” (as defined in the Credit Facility) and/or (2) eurodollar loans, which shall bear interest at a rate equal to the sum of the applicable rate plus the “Eurodollar rate” (as defined in the Credit Facility). The applicable rate for base rate loans under the Credit Facility ranges from 0.125% to 1.000%, and the applicable rate for eurodollar loans ranges from 1.125% to 2.000%, in each case based on the long-term debt rating of L3. In addition, the Credit Facility provides for uncommitted incremental revolving facilities and additional term loan facilities in an aggregate principal amount of up to \$600 million.

***L3 Senior Notes***

The Senior Notes are unsecured senior obligations of L3. The terms of each outstanding Senior Note are presented in the table below.

<u>Note</u>	<u>Date of Issuance</u>	<u>Amount Issued</u>	<u>Discount<sup>(1)</sup></u> <u>(in millions)</u>	<u>Net Cash Proceeds</u>	<u>Effective Interest Rate</u>	<u>Redemption at Treasury Rate<sup>(2)(3)</sup></u>
5.20% Senior Notes due October 15, 2019 . . . . .	October 2, 2009	\$1,000	\$4	\$987	5.25%	30 bps
4.75% Senior Notes due July 15, 2020 . . . . .	May 21, 2010	\$ 800	\$3	\$790	4.79%	25 bps
4.95% Senior Notes due February 15, 2021 . . . . .	February 7, 2011	\$ 650	\$4	\$639	5.02%	25 bps
3.95% Senior Notes due May 28, 2024 . . . . .	May 28, 2014	\$ 650	\$3	\$641	4.02%	20 bps
3.85% Senior Notes due December 15, 2026 . . . . .	December 5, 2016	\$ 550	\$3	\$542	3.91%	25 bps

<sup>(1)</sup> Bond discounts are recorded as a reduction to the principal amount of the notes and are amortized as interest expense over the term of the notes.

<sup>(2)</sup> The Senior Notes maturing in 2019 and 2020 may be redeemed at any time prior to their maturity and the Senior Notes maturing in 2021, 2024 and 2026 may be redeemed at any time prior to November 15, 2020, February 28, 2024 and September 15, 2026, respectively, (three months prior to their maturity) at the option of L3, in whole or in part, at a redemption price equal to the greater of: (1) 100% of the principal amount, or (2) the present value of the remaining principal and interest payments discounted to the date of redemption, on a semi-annual basis, at the Treasury Rate (as defined in the indentures governing the Senior Notes), plus the spread indicated in the table above. In addition, if the Senior Notes maturing in 2021, 2024 and 2026 are redeemed at any time on or after November 15, 2020, February 28, 2024 and September 15, 2026, respectively, the redemption price would be equal to 100% of the principal amount.

<sup>(3)</sup> Upon the occurrence of a change in control (as defined in the indentures governing the Senior Notes), each holder of the notes will have the right to require L3 to repurchase all or any part of such holder’s notes at an offer price in cash equal to 101% of the aggregate principal amount plus accrued and unpaid interest, if any, to the date of purchase.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

***Repurchases, Redemptions and Maturities of Senior Notes***

The repurchases, redemptions and maturities of Senior Notes are presented in the table below.

<u>Note</u>	<u>Settlement Type</u>	<u>Date Settled</u>	<u>Aggregate Amount</u>	<u>Debt Retirement Charge</u>	<u>Cash Payments</u>
				(in millions)	
1.50% Senior Notes due 2017 <sup>(1)</sup> . .	Redemption	December 30, 2016	\$350	\$ 2	\$351
3.95% Senior Notes due 2016 . . .	Maturity	November 15, 2016	\$200	\$—	\$200
3.95% Senior Notes due 2016 <sup>(2)</sup> . .	Redemption	May 20, 2016	\$300	\$ 5	\$305
3.95% Senior Notes due 2024 . . .	Tender Offer	December 22, 2015	\$300	\$ 1	\$297

<sup>(1)</sup> The 1.50% Senior Notes due 2017 were redeemed at a price equal to 100.323% of the principal amount thereof, plus accrued and unpaid interest to the redemption date. Interest ceased to accrue on and after the redemption date.

<sup>(2)</sup> The 3.95% Senior Notes due 2016 were redeemed at a price equal to 101.475% of the principal amount thereof, plus accrued and unpaid interest. Interest ceased to accrue on and after May 20, 2016, and the only remaining right of holders of such Notes was to receive payment of the redemption price and accrued interest.

***Guarantees***

The borrowings under the Credit Facility are fully and unconditionally guaranteed by L3 and by substantially all of the material 100% owned domestic subsidiaries of L3 on an unsecured senior basis. The payment of principal and premium, if any, and interest on the Senior Notes is fully and unconditionally guaranteed, on an unsecured senior basis, jointly and severally, by L3's material 100% owned domestic subsidiaries that guarantee any of its other indebtedness. See Note 24.

***Subordination***

The guarantees of the Credit Facility and the Senior Notes rank pari passu with each other.

***Covenants***

*Financial and other restrictive covenants.* The Credit Facility contains financial and other restrictive covenants that limit, among other things, the ability of the subsidiaries of L3 to borrow additional funds, and the ability of L3 and its subsidiaries to incur liens, make investments, merge or consolidate or dispose of assets. The Company's Credit Facility contains covenants that require that: (1) the Company's consolidated interest coverage ratio be greater than or equal to 3.0 to 1.0, (2) the Company's consolidated leverage ratio be less than or equal to 3.75 to 1.0, provided that the foregoing consolidated leverage ratio shall be increased to 4.0 to 1.0 as of the end of each of the four fiscal quarters immediately following a material acquisition (as defined in the Credit Facility). Calculations of the financial covenants are to exclude, among other things, certain items such as impairment losses on goodwill or other intangible assets, non-cash gains or losses from discontinued operations, gains or losses in connection with asset dispositions, and gains or losses with respect to judgments or settlements in connection with litigation matters. At December 31, 2017, the Company was in compliance with its financial and other restrictive covenants.

The indentures governing the Senior Notes (Senior Indentures) contain covenants customary for investment grade notes, including covenants that restrict the ability of L3 and its 100% owned domestic subsidiaries to create, incur, assume or permit to exist any lien, except permitted liens (as defined in the Senior Indentures) and restrict the ability of L3 and its subsidiaries to enter into certain sale and leaseback transactions (as defined in the Senior Indentures).

*Cross default provisions.* The Credit Facility contains cross default provisions that are triggered when a payment default occurs or certain other defaults occur that would allow the acceleration of indebtedness, swap contracts or guarantees of L3 or its subsidiaries, so long as the aggregate amount of such indebtedness, swap contracts or guarantees is at least \$75 million and such defaults (other than payment defaults and defaults that have resulted in acceleration) have not been cured within 10 days. The Senior Notes indenture contains a cross acceleration provision that is triggered when a default or acceleration occurs under any indenture or instrument of L3 or its subsidiaries or the payment of which is guaranteed by L3 or its subsidiaries in an aggregate amount of at least \$100 million.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

**10. Accumulated Other Comprehensive (Loss) Income (AOCI)**

The changes in the AOCI balances, including amounts reclassified from AOCI into net income, are presented in the table below.

	<u>Foreign currency translation</u>	<u>Unrealized (losses) gains on hedging instruments</u>	<u>Unrecognized (losses) gains and prior service cost, net</u>	<u>Total accumulated other comprehensive loss</u>
	(in millions)			
<b>Balance at December 31, 2014</b> .....	\$ 19	\$ (5)	\$(598)	\$(584)
Other comprehensive (loss) income before reclassifications, net of tax .....	(161)	(15)	81	(95)
Amounts reclassified from AOCI, net of tax .....	<u>41</u>	<u>12</u>	<u>52</u>	<u>105</u>
Net current period other comprehensive (loss) income ..	<u>(120)</u>	<u>(3)</u>	<u>133</u>	<u>10</u>
<b>Balance at December 31, 2015</b> .....	<u>\$(101)</u>	<u>\$ (8)</u>	<u>\$(465)</u>	<u>\$(574)</u>
Other comprehensive (loss) income before reclassifications, net of tax .....	(77)	3	(119)	(193)
Amounts reclassified from AOCI, net of tax .....	<u>—</u>	<u>11</u>	<u>30</u>	<u>41</u>
Net current period other comprehensive (loss) income ..	<u>(77)</u>	<u>14</u>	<u>(89)</u>	<u>(152)</u>
<b>Balance at December 31, 2016</b> .....	<u>\$(178)</u>	<u>\$ 6</u>	<u>\$(554)</u>	<u>\$(726)</u>
Other comprehensive income (loss) before reclassifications, net of tax .....	124	7	(137)	(6)
Amounts reclassified from AOCI, net of tax .....	<u>—</u>	<u>(4)</u>	<u>45</u>	<u>41</u>
Net current period other comprehensive income (loss) ..	<u>124</u>	<u>3</u>	<u>(92)</u>	<u>35</u>
<b>Balance at December 31, 2017</b> .....	<u>\$ (54)</u>	<u>\$ 9</u>	<u>\$(646)</u>	<u>\$(691)</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

Further details regarding the amounts reclassified from AOCI into net income are presented in the table below.

<u>Details About AOCI Components</u>	<u>Amount Reclassified from AOCI<sup>(a)</sup></u>			<u>Affected Line Item in the Audited Consolidated Statements of Operations</u>
	<u>Year Ended December 31,</u>			
	<u>2017</u>	<u>2016</u>	<u>2015</u>	
	(in millions)			
<b>Foreign currency translation adjustments:</b>				
MSI divestiture.....	\$ —	\$ —	\$ (41)	Loss related to business divestitures
	—	—	(41)	Income from continuing operations before income taxes
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (41)</u>	Income from continuing operations
<b>Gain (loss) on hedging instruments:</b>				
MSI divestiture.....	\$ —	\$ —	\$ (2)	Loss related to business divestitures
Other.....	5	(13)	(16)	Cost of sales-products
	5	(13)	(18)	Income from continuing operations before income taxes
	<u>(1)</u>	<u>2</u>	<u>6</u>	Provision for income taxes
	<u>\$ 4</u>	<u>\$ (11)</u>	<u>\$ (12)</u>	Income from continuing operations
<b>Amortization of defined benefit pension and postretirement items:</b>				
MSI divestiture.....	\$ —	\$ —	\$ (14)	Loss related to business divestitures
Net loss.....	(59)	(48)	(67)	(b)
	(59)	(48)	(81)	Income from continuing operations before income taxes
	<u>14</u>	<u>18</u>	<u>29</u>	Provision for income taxes
	<u>\$ (45)</u>	<u>\$ (30)</u>	<u>\$ (52)</u>	Income from continuing operations
Total reclassification for the period ..	<u>\$ (41)</u>	<u>\$ (41)</u>	<u>\$ (105)</u>	Income from continuing operations

<sup>(a)</sup> Amounts in parentheses indicate charges to the consolidated statements of operations.

<sup>(b)</sup> Amounts related to pension and postretirement benefit plans were reclassified from AOCI and recorded as a component of net periodic benefit cost (see Note 19 for additional information).

## 11. Equity

On December 4, 2014, L3's Board of Directors approved a share repurchase program that authorized L3 to repurchase up to \$1.5 billion of its common stock which expired on June 30, 2017. On May 8, 2017, L3's Board of Directors approved a new share repurchase program that authorizes L3 to repurchase up to an additional \$1.5 billion of its common stock. The new program became effective on July 1, 2017 and has no set expiration date. Repurchases of L3's common stock are made from time to time at management's discretion in accordance with applicable U.S. Federal securities laws. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including, but not limited to, the Company's financial position, earnings, legal requirements, other investment opportunities (including acquisitions) and market conditions. L3 repurchased 1.0 million shares of its common stock at an average price of \$183.67 per share for an aggregate amount of \$180 million from January 1, 2017 through December 31, 2017. All share repurchases of L3's common stock have been recorded as treasury shares. From January 1, 2018 through February 16, 2018, L3 repurchased 433,039 shares of its common stock at an average price of \$203.33 per share for an aggregate amount of approximately \$88 million.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

On February 12, 2018, L3’s Board of Directors declared a quarterly cash dividend of \$0.80 per share, payable on March 15, 2018 to shareholders of record at the close of business on March 1, 2018. During the year ended December 31, 2017, the Company paid \$236 million of cash dividends.

**12. Fair Value Measurements**

Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants. The standards establish a fair value hierarchy that gives the highest priority to observable inputs and the lowest priority to unobservable inputs.

The following table presents the fair value hierarchy level for each of the Company’s assets and liabilities that are measured and recorded at fair value on a recurring basis.

Description	December 31, 2017			December 31, 2016		
	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Level 3 <sup>(3)</sup>	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Level 3 <sup>(3)</sup>
	(in millions)					
<b>Assets</b>						
Cash equivalents . . . . .	\$310	\$—	\$—	\$104	\$—	\$—
Derivatives (foreign currency forward contracts) . .	—	11	—	—	12	—
Total assets. . . . .	<u>\$310</u>	<u>\$11</u>	<u>\$—</u>	<u>\$104</u>	<u>\$12</u>	<u>\$—</u>
<b>Liabilities</b>						
Derivatives (foreign currency forward contracts) . .	\$ —	\$ 1	\$—	\$ —	\$ 6	\$—
Contingent consideration <sup>(4)</sup> . . . . .	—	—	31	—	—	29
Total liabilities. . . . .	<u>\$ —</u>	<u>\$ 1</u>	<u>\$31</u>	<u>\$ —</u>	<u>\$ 6</u>	<u>\$29</u>

<sup>(1)</sup> Level 1 is based on quoted market prices available in active markets for identical assets or liabilities as of the reporting date. Cash equivalents are primarily held in registered money market funds, which are valued using quoted market prices.

<sup>(2)</sup> Level 2 is based on pricing inputs other than quoted prices in active markets, which are either directly or indirectly observable. The fair value is determined using a valuation model based on observable market inputs, including quoted foreign currency forward exchange rates and consideration of non-performance risk.

<sup>(3)</sup> Level 3 is based on pricing inputs that are not observable and not corroborated by market data.

<sup>(4)</sup> The contingent consideration liability represents the future potential earn-out payments relating to the MacH and Open Water Power acquisitions. The fair value of the MacH contingent consideration liability is based on a Monte Carlo Simulation of the aggregate revenue of MacH for the three-year period ending December 31, 2019. The significant unobservable inputs used in calculating the fair value of the MacH contingent consideration include: (i) projected revenues of the MacH acquired business, (ii) company specific risk premium, which is a component of the discount rate applied to the revenue projections and (iii) volatility. The fair value of the Open Water Power contingent consideration liability is based on the Scenario-Based Method of the income approach using post-acquisition milestone achievements of Open Water Power through December 31, 2020. The significant unobservable inputs used in calculating the fair value of the Open Water Power contingent consideration include: (i) timing of achieving the milestones associated with the contingent consideration arrangement, (ii) probabilities of achieving each milestone and (iii) discount rate. The fair value of the contingent consideration for potential earn-out payments is reassessed quarterly, including an analysis of the significant inputs used in the evaluation, as well as the accretion of the present value discount. Changes are reflected within cost of sales in the consolidated statements of operations.

The table below presents the changes to contingent consideration obligations during the year ended December 31, 2017.

	December 31, 2017
	(in millions)
Balance at beginning of period. . . . .	\$ 29
Acquisitions . . . . .	14
Changes in fair value of contingent consideration, net . . . . .	<u>(12)</u>
Balance at end of period. . . . .	<u>\$ 31</u>



**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

**13. Financial Instruments**

At December 31, 2017 and 2016, the Company's financial instruments consisted primarily of cash and cash equivalents, billed receivables, trade accounts payable, Senior Notes and foreign currency forward contracts. The carrying amounts of cash and cash equivalents, billed receivables and trade accounts payable are representative of their respective fair values because of the short-term maturities or expected settlement dates of these instruments. The carrying amounts and estimated fair values of the Company's other financial instruments are presented in the table below.

	<u>December 31, 2017</u>		<u>December 31, 2016</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
	(in millions)			
Senior Notes <sup>(1)</sup> . . . . .	\$3,330	\$3,502	\$3,325	\$3,526
Foreign currency forward contracts <sup>(2)</sup> . . . . .	\$ 10	\$ 10	\$ 6	\$ 6

<sup>(1)</sup> The Company measures the fair value of its Senior Notes using Level 2 inputs based primarily on current market yields for its existing debt traded in the secondary market.

<sup>(2)</sup> The Company measures the fair values of foreign currency forward contracts based on forward exchange rates. See Note 14 for additional disclosures regarding the notional amounts and fair values of foreign currency forward contracts.

**14. Derivative Financial Instruments**

Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The table below presents the notional amounts of the Company's outstanding foreign currency forward contracts by currency at December 31, 2017.

<u>Currency</u>	<u>Notional Amount</u>
	(in millions)
U.S. dollar . . . . .	\$108
Canadian dollar . . . . .	100
Euro . . . . .	84
British pound . . . . .	<u>15</u>
Total . . . . .	<u>\$307</u>

At December 31, 2017, the Company's foreign currency forward contracts had maturities through 2023.

The table below presents the location of the Company's derivative instruments recorded at fair value on the consolidated balance sheets.

	<u>December 31, 2017</u>				<u>December 31, 2016</u>			
	<u>Other Current Assets</u>	<u>Other Assets</u>	<u>Other Current Liabilities</u>	<u>Other Liabilities</u>	<u>Other Current Assets</u>	<u>Other Assets</u>	<u>Other Current Liabilities</u>	<u>Other Liabilities</u>
	(in millions)							
<b>Derivatives designated as hedging instruments:</b>								
Foreign currency forward contracts <sup>(1)</sup> . . .	<u>\$11</u>	<u>\$—</u>	<u>\$1</u>	<u>\$—</u>	<u>\$10</u>	<u>\$2</u>	<u>\$6</u>	<u>\$—</u>
Total derivative instruments . . . . .	<u>\$11</u>	<u>\$—</u>	<u>\$1</u>	<u>\$—</u>	<u>\$10</u>	<u>\$2</u>	<u>\$6</u>	<u>\$—</u>

<sup>(1)</sup> See Note 12 for a description of the fair value hierarchy related to the Company's foreign currency forward contracts.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The effects from foreign currency forward contracts on the consolidated statements of operations were a pre-tax gain of \$5 million for the year ended December 31, 2017, a pre-tax loss of \$13 million for the year ended December 31, 2016, and a pre-tax loss of \$18 million for the year ended December 31, 2015. At December 31, 2017, the estimated net amount of existing gains that are expected to be reclassified into income within the next 12 months is \$2 million.

**15. L3's Earnings Per Share**

A reconciliation of basic and diluted earnings per share (EPS) is presented in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	<u>(in millions, except per share data)</u>		
<b>Reconciliation of net income (loss):</b>			
Net income (loss) . . . . .	\$ 693	\$ 724	\$ (225)
Net income from continuing operations attributable to noncontrolling interests . . . . .	<u>(16)</u>	<u>(14)</u>	<u>(15)</u>
Net income (loss) attributable to L3's common shareholders . . . . .	<u>\$ 677</u>	<u>\$ 710</u>	<u>\$ (240)</u>
<b>Earnings (loss) attributable to L3's common shareholders:</b>			
Continuing operations . . . . .	\$ 753	\$ 619	\$ 492
Discontinued operations, net of income tax . . . . .	<u>(76)</u>	<u>91</u>	<u>(732)</u>
Net income (loss) attributable to L3's common shareholders . . . . .	<u>\$ 677</u>	<u>\$ 710</u>	<u>\$ (240)</u>
<b>Earnings (loss) per share attributable to L3's common shareholders:</b>			
<b>Basic:</b>			
Weighted average common shares outstanding . . . . .	<u>78.0</u>	<u>77.4</u>	<u>80.7</u>
<b>Basic earnings (loss) per share:</b>			
Continuing operations . . . . .	\$ 9.65	\$7.99	\$ 6.10
Discontinued operations, net of income tax . . . . .	<u>(0.97)</u>	<u>1.18</u>	<u>(9.07)</u>
Net income (loss) . . . . .	<u>\$ 8.68</u>	<u>\$9.17</u>	<u>\$(2.97)</u>
<b>Diluted:</b>			
Common and potential common shares:			
Weighted average common shares outstanding . . . . .	78.0	77.4	80.7
Effect of dilutive securities . . . . .	<u>1.6</u>	<u>1.4</u>	<u>1.2</u>
Common and potential common shares . . . . .	<u>79.6</u>	<u>78.8</u>	<u>81.9</u>
<b>Diluted earnings (loss) per share:</b>			
Continuing operations . . . . .	\$ 9.46	\$7.86	\$ 6.01
Discontinued operations, net of income tax . . . . .	<u>(0.95)</u>	<u>1.15</u>	<u>(8.94)</u>
Net income (loss) . . . . .	<u>\$ 8.51</u>	<u>\$9.01</u>	<u>\$(2.93)</u>

The computation of diluted EPS excludes 0.3 million, 0.4 million and 0.6 million shares for the years ended December 31, 2017, 2016 and 2015, respectively, for share-based payment awards as they were anti-dilutive.

**16. Income Taxes**

On December 22, 2017, the U.S. Government enacted the U.S. Tax Cuts and Jobs Act (U.S. Tax Reform), which made significant changes to the U.S. tax system. Significant changes under U.S. Tax Reform include, among other things, the reduction of the U.S. corporate income tax rate from 35% to 21%, the implementation of a modified territorial tax system, and the imposition of a one-time repatriation tax on deemed repatriated earnings and profits of U.S. owned foreign subsidiaries (Toll Charge).

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The Company recognized the income tax effects of U.S. Tax Reform in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 118, *Income Tax Accounting Implication of the Tax Cuts and Job Act* (SAB 118), in its consolidated financial statements for the year ended December 31, 2017. SAB 118 provides guidance for the application of income tax accounting standards related to U.S. Tax Reform. Accordingly, the consolidated financial statements reflect the income tax effects of U.S. Tax Reform for which the accounting is incomplete but a reasonable estimate could be determined. The Company recorded an estimated tax benefit of \$79 million from U.S. Tax Reform, which includes a \$101 million estimated tax benefit related to the remeasurement of deferred taxes partially offset by an estimated tax provision of \$22 million related to the Toll Charge. The preliminary tax benefit recorded may differ in the future due principally to changes to the interpretations of U.S. Tax Reform, legislative action to clarify the interpretation of U.S. Tax Reform and changes to estimates the Company has utilized to calculate the tax benefit. The Company expects to finalize the tax benefit from U.S. Tax Reform with the filing of its tax return and record the difference between the final benefit and the provisional benefit recorded in the 2018 fourth quarter, if any, at that time.

Income from continuing operations before income taxes is summarized in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Domestic .....	\$649	\$608	\$509
Foreign .....	<u>222</u>	<u>196</u>	<u>130</u>
Income from continuing operations before income taxes .....	<u>\$871</u>	<u>\$804</u>	<u>\$639</u>

The components of the Company's current and deferred portions of the provision for income taxes on continuing operations are presented in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
<b>Current income tax provision:</b>			
Federal .....	\$ 44	\$ 88	\$ 81
State and local .....	10	8	7
Foreign .....	<u>56</u>	<u>48</u>	<u>26</u>
Subtotal .....	<u>110</u>	<u>144</u>	<u>114</u>
<b>Deferred income tax provision/(benefit):</b>			
Federal .....	(16)	25	9
State and local .....	6	2	7
Foreign .....	<u>2</u>	<u>—</u>	<u>2</u>
Subtotal .....	<u>(8)</u>	<u>27</u>	<u>18</u>
Total provision for income taxes .....	<u>\$102</u>	<u>\$171</u>	<u>\$132</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

A reconciliation of the statutory federal income tax rate to the effective income tax rate on continuing operations of the Company is presented in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutory federal income tax rate.....	35.0%	35.0%	35.0%
State and local income taxes, net of federal income tax benefit.....	2.0	2.0	2.0
Foreign income taxes.....	(6.7)	(3.0)	(7.1)
Manufacturing benefits.....	(1.4)	(2.2)	(2.2)
Research and experimentation and other tax credits.....	(4.1)	(4.6)	(6.5)
Resolution of tax contingencies.....	(0.4)	(3.1)	(1.4)
Tax deductible dividends.....	(0.9)	(1.0)	(1.2)
Equity compensation - excess income tax benefits.....	(2.3)	(2.1)	—
Goodwill impairment.....	—	—	1.9
Tax Reform.....	(9.1)	—	—
Other, net.....	<u>(0.4)</u>	<u>0.3</u>	<u>0.2</u>
Effective income tax rate on continuing operations.....	<u>11.7%</u>	<u>21.3%</u>	<u>20.7%</u>

The significant components of the Company's net deferred tax assets and liabilities are presented in the table below.

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
<b>Deferred tax assets:</b>		
Inventoried costs.....	\$ 44	\$ 53
Compensation and benefits.....	94	139
Pension and postretirement benefits.....	281	413
Loss carryforwards.....	12	19
Tax credit carryforwards.....	5	6
Other.....	<u>57</u>	<u>87</u>
Deferred tax assets.....	<u>493</u>	<u>717</u>
Less: valuation allowance.....	<u>(10)</u>	<u>(12)</u>
Deferred tax assets, net of valuation allowance.....	<u>483</u>	<u>705</u>
<b>Deferred tax liabilities:</b>		
Goodwill and other intangible assets.....	\$(514)	\$(722)
Income recognition on contracts in process.....	(24)	(22)
Property, plant and equipment.....	(59)	(93)
Other.....	<u>(41)</u>	<u>(55)</u>
Deferred tax liabilities.....	<u>(638)</u>	<u>(892)</u>
Total deferred tax liabilities, net of valuation allowance.....	<u>\$(155)</u>	<u>\$(187)</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The classification of the Company's deferred tax assets and liabilities are presented in the table below.

	December 31,	
	2017	2016
	(in millions)	
Non-current deferred tax assets . . . . .	\$ 3	\$ 2
Non-current deferred tax liabilities . . . . .	(158)	(189)
Total net deferred tax liabilities . . . . .	<u>\$(155)</u>	<u>\$(187)</u>

Non-current deferred tax assets are presented in other assets on the consolidated balance sheets.

The following table presents the Company's loss and tax credit carryforwards at December 31, 2017 on a tax return basis. The Company has established a valuation allowance as indicated in those instances in which it does not believe that it is more likely than not it will generate sufficient taxable income, of the appropriate character and in the applicable subsidiary, to utilize the carryforwards.

	Year Ended December 31, 2017				
	Carryforwards		Valuation Allowances		Expiration Periods
	Gross	Tax Effected	Gross	Tax Effected	
	(in millions)				
Federal net operating loss carryforwards . . . . .	29	6	(5)	(1)	2026-2036
Foreign net operating loss carryforwards . . . . .	12	3	(6)	(2)	Indefinite
State net operating loss carryforwards . . . . .	160	<u>3</u>	(135)	<u>(2)</u>	2018-2037
Total loss carryforwards . . . . .		<u>\$12</u>		<u>\$(5)</u>	
State tax credit carryforwards . . . . .	6	<u>5</u>	(5)	<u>(4)</u>	2018-2032
Total tax credit carryforwards . . . . .		<u>\$ 5</u>		<u>\$(4)</u>	

At December 31, 2017, the total amount of unrecognized tax benefits was \$178 million, \$157 million of which would reduce the effective income tax rate, if recognized. A reconciliation of the change in unrecognized income tax benefits, excluding potential interest and penalties, is presented in the table below.

	2017	2016	2015
	(in millions)		
Balance at January 1 . . . . .	\$110	\$124	\$150
Additions for tax positions related to the current year . . . . .	14	16	14
Additions for tax positions related to prior years . . . . .	66	2	2
Reductions for tax positions related to prior years . . . . .	(4)	(24)	(34)
Reductions for tax positions related to settlements with taxing authorities . . . . .	—	(1)	(1)
Reduction for tax positions related to prior years as a result of a lapse of statute of limitations . . . . .	<u>(8)</u>	<u>(7)</u>	<u>(7)</u>
Balance at December 31 . . . . .	<u>\$178</u>	<u>\$110</u>	<u>\$124</u>

The Company and its subsidiaries file income tax returns in the U.S. Federal jurisdiction, which is the Company's primary tax jurisdiction, and various state and foreign jurisdictions. At December 31, 2017, the statutes of limitations for the Company's U.S. Federal income tax returns for the years ended December 31, 2012 through 2016 were open. The U.S. Internal Revenue Service (IRS) commenced audits of the Company's U.S. Federal income tax returns for the years ended 2012 and 2013. The Company cannot predict the outcome of the audits at this time. At December 31, 2017, the Company anticipates that unrecognized tax benefits will decrease by approximately

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\$6 million over the next 12 months due to the potential resolution of unrecognized tax benefits involving several jurisdictions and tax periods. The actual amount of the decrease over the next 12 months could vary significantly depending on the ultimate timing and nature of any settlements.

During the years ended December 31, 2017, 2016 and 2015, the Company effectively settled various Federal, state and local and foreign audits. As a result of these settlements, the Company reversed previously accrued income tax expense of \$4 million, \$25 million and \$9 million, including interest and penalties.

At December 31, 2017 and 2016, current and non-current income taxes payable include accrued potential interest of \$15 million (\$11 million after income taxes) and \$11 million (\$7 million after income taxes), respectively, and potential penalties of \$8 million and \$7 million, respectively. With respect to the interest related items, the Company's income tax expense included an expense of \$5 million for the year ended December 31, 2017 and a benefit of \$3 million for the year ended December 31, 2016.

Prior to 2015, the Company recorded a deferred tax liability related to the repatriation of earnings from certain subsidiaries. During 2015, the Company completed a legal restructuring of its significant foreign operations, and the earnings of these subsidiaries are now considered reinvested indefinitely. As a result, the Company recognized a \$17 million deferred tax benefit in the year ended December 31, 2015. At December 31, 2017, the Company had not provided deferred income taxes and foreign withholding taxes for \$844 million of undistributed earnings by its non-U.S. subsidiaries as such earnings are intended to be reinvested indefinitely. Quantification of additional taxes that may be payable on distribution is not practicable.

### **17. Stock-Based Compensation**

*Stock-Based Compensation Plans.* The Company has adopted stock-based compensation plans in order to provide incentives to directors, officers, employees and other individuals providing services to or on behalf of the Company and its subsidiaries. The Company believes that its stock-based compensation awards encourage high levels of performance by individuals who contribute to the success of the Company and enable the Company to attract, retain and reward talented and experienced individuals. This is accomplished by providing eligible individuals with an opportunity to obtain or increase a proprietary interest in the Company and/or by providing eligible individuals with additional incentives to join or remain with the Company. The stock-based compensation plans serve to better align the interests of management and its employees with those of the Company's shareholders. During the year ended December 31, 2017, the Company awarded stock-based compensation under its Amended and Restated 2008 Long Term Performance Plan (2008 LTPP). Awards under the 2008 LTPP may be granted to any officer or employee of the Company or any of its subsidiaries, non-employee directors, or to any other individual who provides services to or on behalf of the Company or any of its subsidiaries. To date, awards under the 2008 LTPP have been in the form of L3's restricted stock units, performance units and options to purchase L3's common stock.

On May 3, 2016, the stockholders of L3 approved an amendment to the 2008 LTPP to increase the number of shares authorized for issuance by 6.8 million shares to approximately 26.0 million shares. Each share of L3's common stock issued under a full value award (that is, awards other than stock options and stock appreciation rights) granted on or after February 23, 2016 is counted as 4.26 shares for purposes of this share limit. Each share issued under full value awards granted between February 26, 2013 and February 22, 2016 is counted as 3.69 shares for purposes of the share limit. At December 31, 2017, 7.9 million shares of L3's common stock remained available for future awards under the 2008 LTPP.

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The Company's stock-based compensation expense by form of award, including stock-based compensation recorded in discontinued operations related to Vertex Aerospace and NSS, is presented in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Stock options . . . . .	\$ 7	\$ 10	\$ 9
Restricted stock units . . . . .	43	35	38
Performance units . . . . .	<u>7</u>	<u>4</u>	<u>2</u>
Total before income taxes . . . . .	57	49	49
Income taxes . . . . .	<u>(12)</u>	<u>(18)</u>	<u>(18)</u>
Total after income taxes . . . . .	45	31	31
Less: Stock-based compensation recorded in discontinued operations, net of income taxes . . . . .	<u>1</u>	<u>1</u>	<u>1</u>
Stock-based compensation recorded in continuing operations, net of income taxes . . . . .	<u>\$ 44</u>	<u>\$ 30</u>	<u>\$ 30</u>

*Stock Options.* The exercise price of stock options granted under the 2008 LTPP may not be less than the fair market value of L3's common stock on the date of grant. Options expire 10 years after the date of grant and vest ratably over a three year period on the annual anniversary of the date of grant. The options granted to the Company's Chairman are also subject to performance-based vesting conditions. All unvested options are subject to forfeiture upon termination of employment (subject to customary exceptions for death or disability). All of the stock option awards issued under the 2008 LTPP are non-qualified stock options for U.S. income tax regulations. The table below presents a summary of the Company's stock option activity at December 31, 2017 and changes during the year then ended.

	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
	(in thousands)		(in years)	(in millions)
Number of shares under option:				
Outstanding at January 1, 2017 . . . . .	2,847.5	\$ 99.54	6.1	\$150
Options granted . . . . .	470.5	174.53		
Options exercised . . . . .	(521.3)	90.13		
Options forfeited . . . . .	<u>(97.8)</u>	120.59		
Outstanding at December 31, 2017 . . . . .	<u>2,698.9</u>	\$113.67	5.7	\$227
Vested and expected to vest at December 31, 2017 <sup>(1)</sup> . . . . .	<u>2,582.5</u>	\$110.21	5.5	\$226
Exercisable at December 31, 2017 . . . . .	<u>1,762.4</u>	\$ 95.80	4.5	\$180

<sup>(1)</sup> Represents outstanding options reduced by expected forfeitures for options not fully vested.

The weighted average grant date fair value of the stock options awarded during 2017, 2016 and 2015 was \$28.35, \$15.90 and \$19.76, respectively. The aggregate intrinsic value, disclosed in the table above, represents the difference between L3's closing stock price on the last trading day for the period, and the exercise price, multiplied by the number of in-the-money stock options.

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The total intrinsic value of stock options exercised, based on the difference between the L3's stock price at the time of exercise and the related exercise price, was \$44 million, \$34 million and \$35 million for the years ended December 31, 2017, 2016 and 2015, respectively. At December 31, 2017, unrecognized compensation cost related to stock options was \$7 million (\$6 million after income taxes), which is expected to be recognized over a weighted average remaining period of 1.3 years.

The actual income tax benefit realized related to compensation deductions arising from the exercise of stock options by the Company's employees totaled \$16 million, \$12 million and \$13 million for the years ended December 31, 2017, 2016 and 2015, respectively.

*Stock Option Fair Value Estimation Assumptions.* The Company estimates the fair value of its stock options at the date of grant using the Black-Scholes option-pricing valuation model. The Company's valuation model is affected by L3's stock price as well as weighted average assumptions for a number of subjective variables described below.

- *Expected Holding Period.* The expected holding period represents the period of time that granted stock options are expected to be outstanding until they are exercised. The Company uses historical stock option exercise data to estimate the expected holding period.
- *Expected Volatility.* Expected volatility is based on L3's historical share price volatility matching the expected holding period.
- *Expected Dividend Yield.* Expected dividend yield is based on L3's anticipated dividend payments and historical pattern of dividend increases over the expected holding period.
- *Risk-Free Interest Rates.* The risk-free interest rates for stock options are based on U.S. Treasuries for a maturity period matching the expected holding period.

Changes in assumptions can materially impact the estimated fair value of stock options. The weighted average assumptions used in the valuation model are presented in the table below.

	<u>2017</u> <u>Grants</u>	<u>2016</u> <u>Grants</u>	<u>2015</u> <u>Grants</u>
Expected holding period (in years) . . . . .	5.2	5.0	5.0
Expected volatility . . . . .	19.9%	21.3%	21.4%
Expected dividend yield . . . . .	2.0%	2.8%	2.4%
Risk-free interest rate . . . . .	2.0%	1.1%	1.5%

*Restricted Stock Units.* The Company awards restricted stock units that automatically convert into shares of L3's common stock upon vesting (in the case of awards granted to employees) or upon the date on which the recipient ceases to be a director (in the case of awards granted to directors). Restricted stock units typically vest three years after the grant date for employees and one year after the grant date for non-employee directors, or if earlier, on the date of the first annual stockholders meeting held after the grant date. The restricted stock units automatically convert into shares of L3's common stock upon vesting. The weighted average grant date fair value of the restricted stock units awarded during 2017, 2016 and 2015 was \$169.23, \$116.72 and \$128.59, respectively. The grant date fair value of the restricted stock unit awards is based on L3's closing stock price at the date of grant and is generally recognized as compensation expense on a straight-line basis over the vesting period. However, for employees who attain retirement eligibility status prior to the end of the three-year cliff vesting period and who have provided at least one year of service after the date of grant, compensation expense is recognized over the shorter period from the date of grant to the retirement eligibility date. For grants of restricted stock units made during the year ended December 31, 2017, retirement eligible employees are those employees that either: (1) have attained the age of 60 and completed at least five years of service (which service must be continuous through the date of termination except for a single break in service that does not exceed one year in length) or (2) have attained the age of 65 (without regard to their length of service at L3).



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The table below presents a summary of the Company's nonvested restricted stock unit awards at December 31, 2017 and changes during the year then ended.

	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
	(in thousands)	
Nonvested balance at January 1, 2017 .....	977.9	\$119.55
Granted .....	305.6	169.23
Vested .....	(318.4)	114.46
Forfeited .....	<u>(62.4)</u>	134.56
Nonvested balance at December 31, 2017 .....	<u>902.7</u>	\$137.12

At December 31, 2017, total unrecognized compensation costs related to nonvested restricted stock unit awards were \$34 million (\$26 million after income taxes) and are expected to be recognized over a weighted average remaining period of 1.1 years. The total fair value of restricted stock unit awards vested during the years ended December 31, 2017, 2016 and 2015 as of their vesting dates was \$53 million, \$57 million and \$82 million, respectively.

*Performance Units.* The Company grants performance unit awards, with each unit having a value at the time of grant equal to a share of L3's common stock. The number of units ultimately earned can range from zero to 200% of the original award based upon the level of performance achieved by the Company over the associated performance period in relation to pre-determined performance goals. Units earned under the program are converted into shares of L3's common stock, or are paid in cash based on the closing price of L3's common stock at the end of the performance period, as determined at the time of grant by the Compensation Committee of the Board of Directors.

During the years ended December 31, 2017, 2016, and 2015, the Company granted performance unit awards with a weighted average grant date fair value per unit of \$168.80, \$116.20 and \$129.03, respectively. All the awards granted in 2017, 2016, and 2015 have performance conditions based on L3's diluted EPS. The performance periods for the awards began on January 1 of the applicable grant year and end on December 31 of the year corresponding to a three-year performance period. Units earned under the awards are convertible into shares of L3's common stock. At December 31, 2017, total unrecognized compensation costs related to the awards were \$5 million (\$5 million after income taxes) and are expected to be recognized over a weighted average remaining period of 1.7 years.

The table below presents a summary of the Company's performance unit awards based on expected performance at December 31, 2017 and changes during the year then ended.

	<u>Payable in Shares (EPS)</u>	
	<u>Number of Units</u>	<u>Weighted Average Grant Date Fair Value</u>
	(in thousands)	
Outstanding at January 1, 2017 .....	124.7	\$120.83
Granted .....	33.9	168.80
Increase due to expected performance .....	29.7	146.89
Vested .....	(48.4)	129.03
Forfeited .....	<u>(7.8)</u>	121.06
Outstanding at December 31, 2017 .....	<u>132.1</u>	\$135.99

The performance period for awards granted in 2015 ended on December 31, 2017. Based on L3's cumulative diluted EPS during the performance period, a total of 48,365 performance units having a fair market value of \$10 million as of their vesting date were earned by the participants on December 31, 2017.

*Employee Stock Purchase Plan.* Effective July 1, 2009, the Company adopted the 2009 Employee Stock Purchase Plan (2009 ESPP). Under the 2009 ESPP, eligible employees are offered options to purchase shares of L3's

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common stock at the end of each six-month offering period at 95% of fair market value based on the average of the highest and lowest sales prices for the stock on the purchase date. Eligible employees generally include all employees of the Company and each subsidiary or affiliate of the Company that has been designated to participate in the 2009 ESPP. Offering periods begin on the first trading day in January and July of each calendar year and end on the last trading day in June and December of each calendar year. Share purchases are funded through payroll deductions of up to 10% of an employee’s eligible compensation for each payroll period, or \$21,250 each calendar year.

At December 31, 2017, 3.5 million shares were available for future issuance under the 2009 ESPP (i.e., excluding the effect of shares issued in January 2018 as described below). In July 2017, the Company issued 0.1 million shares under the 2009 ESPP at an average price of \$158.59 per share, which covered employee contributions for the six months ended June 30, 2017. In January 2018, the Company issued 0.1 million shares under the 2009 ESPP at an average price of \$188.72 per share, which covered employee contributions for the six months ended December 31, 2017. The 5% discount is not recognized as compensation expense in accordance with the accounting standard for share-based compensation expense.

**18. Commitments and Contingencies**

***Non-Cancelable Operating Leases***

The Company leases certain facilities and equipment under agreements expiring at various dates through 2046. Certain leases contain renewal options or escalation clauses providing for increased rental payments based upon maintenance, utility and tax increases. No lease agreement imposes a restriction on the Company’s ability to pay dividends, engage in debt or equity financing transactions, or enter into further lease agreements.

The following table presents future minimum payments under non-cancelable operating leases with initial or remaining terms in excess of one year at December 31, 2017.

	<u>Real Estate</u>	<u>Equipment</u>	<u>Total</u>
	(in millions)		
2018 .....	\$101	\$ 5	\$106
2019 .....	81	3	84
2020 .....	106	2	108
2021 .....	60	—	60
2022 .....	57	—	57
Thereafter .....	<u>236</u>	<u>—</u>	<u>236</u>
Total minimum payments required .....	641	10	651
Sublease rentals under non-cancelable leases .....	<u>(9)</u>	<u>—</u>	<u>(9)</u>
Net minimum payments required .....	<u>\$632</u>	<u>\$10</u>	<u>\$642</u>

Rent expense was \$103 million for 2017, \$97 million for 2016, and \$102 million for 2015. Sublease rental income was \$1 million for 2017, and \$2 million for each of 2016 and 2015, respectively.

***Letters of Credit***

The Company enters into standby letters of credit with financial institutions covering performance and financial guarantees pursuant to contractual arrangements with certain customers. The Company had total outstanding letters of credit aggregating to \$416 million and \$402 million at December 31, 2017 and 2016, respectively. The Company had the full availability of its \$1 billion Credit Facility at December 31, 2017. These letters of credit may be drawn upon in the event of the Company’s nonperformance.

***Guarantees***

The Company, from time to time, enters into contractual guarantees that arise in connection with its business acquisitions, dispositions, and other contractual arrangements in the normal course of business.

In connection with the spin-off of Engility in 2012, L3 entered into a Distribution Agreement and several other agreements that govern certain aspects of L3’s relationship with Engility, including employee matters, tax matters,

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transition services, and the future supplier/customer relationship between L3 and Engility. These agreements generally provide cross-indemnities that, except as otherwise provided, are principally designed to place the financial responsibility for the obligations and liabilities of each entity with that respective entity. Engility has joint and several liability with L3 to the U.S. IRS for the consolidated U.S. Federal income taxes of L3's consolidated group for taxable periods in which Engility was a part of that group. However, the Tax Matters Agreement specifies the portion of this tax liability for which L3 and Engility will each bear responsibility, and L3 and Engility have agreed to indemnify each other against any amounts for which the other is not responsible. The Tax Matters Agreement also allocates responsibility between L3 and Engility for other taxes, including special rules for allocating tax liabilities in the event that the spin-off is determined not to be tax-free. Though valid as between the parties, the Tax Matters Agreement is not binding on the IRS.

The Company has three existing real estate lease agreements, which include residual guarantee amounts, expiring on August 31, 2020 and are accounted for as operating leases. On or before the lease expiration date, the Company can exercise options under the lease agreements to renew the leases, purchase the properties for \$45 million, or sell the properties on behalf of the lessor (the "Sale Option"). If the Company elects the Sale Option, the Company must pay the lessor a residual guarantee amount of \$39 million for the properties, on or before the lease expiration date. In addition, at the time the properties are sold, the Company must pay the lessor a supplemental rent payment equal to the gross sales proceeds in excess of the residual guarantee, provided that such amount shall not exceed \$6 million. For these real estate lease agreements, if the gross sales proceeds are less than the sum of the residual guarantee amount and the supplemental rent payment, the Company is required to pay a supplemental rent payment to the extent the reduction in the fair value of the properties is demonstrated by an independent appraisal to have been caused by the Company's failure to properly maintain the properties. The aggregate residual guarantee amounts equal \$39 million and are included in the future minimum payments under non-cancelable real estate operating lease payments relating to the expiration dates of such leases.

The Company has a contract to provide and operate a full-service training facility for the USAF, including simulator systems adjacent to a USAF base in Oklahoma. The Company acted as the construction agent on behalf of the third-party owner-lessors for procurement and construction for the simulator systems, which were completed and delivered in August 2002. The Company, as lessee, entered into operating lease agreements for a term of 15 years for the simulator systems with the owner-lessors. During the first quarter of 2018, the Company expects to purchase the simulator systems at the end of their respective lease terms for approximately \$15 million.

***Environmental Matters***

Management continually assesses the Company's obligations with respect to applicable environmental protection laws, including those obligations assumed in connection with certain business acquisitions. While it is difficult to determine the timing and ultimate cost to be incurred by the Company in order to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which management is aware, the Company believes that there are no environmental loss contingencies that, individually or in the aggregate, would be material to the Company's consolidated results of operations. The Company accrues for these contingencies when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated.

***Procurement Regulations***

A substantial majority of the Company's revenues are generated from providing products and services under legally binding agreements or contracts with the U.S. Government, foreign government customers and state and local governments. U.S. Government contracts are subject to extensive legal and regulatory requirements, and, from time to time, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. The Company is currently cooperating with the U.S. Government on several investigations from which civil, criminal or administrative proceedings have or could result and give rise to fines, penalties, compensatory and treble damages, restitution and/or forfeitures, including investigations into the pricing of certain contracts entered into by the Communication Systems segment. The Company does not currently anticipate that any of these investigations will have a material adverse effect, individually or in the aggregate, on its consolidated financial position, results of operations or cash flows. However, under U.S. Government regulations, an

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indictment of the Company by a federal grand jury, or an administrative finding against the Company as to its present responsibility to be a U.S. Government contractor or subcontractor, could result in the Company being suspended for a period of time from eligibility for awards of new government contracts or task orders or in a loss of export privileges. A conviction, or an administrative finding against the Company that satisfies the requisite level of seriousness, could result in debarment from contracting with the federal government for a specified term. In addition, all of the Company's U.S. Government contracts: (1) are subject to audit and various pricing and cost controls, (2) include standard provisions for termination for the convenience of the U.S. Government or for default and (3) are subject to cancellation if funds for contracts become unavailable. Foreign government contracts generally include comparable provisions relating to terminations for convenience or default, as well as other procurement clauses relevant to the foreign government.

***Litigation Matters***

The Company is also subject to litigation, proceedings, claims or assessments and various contingent liabilities incidental to its businesses, including those specified below. Furthermore, in connection with certain business acquisitions, the Company has assumed some or all claims against, and liabilities of, such acquired businesses, including both asserted and unasserted claims and liabilities.

In accordance with the accounting standard for contingencies, the Company records a liability when management believes that it is both probable that a liability has been incurred and the Company can reasonably estimate the amount of the loss. Generally, the loss is recorded at the amount the Company expects to resolve the liability. The estimated amounts of liabilities recorded for pending and threatened litigation are disclosed in Note 7. Amounts recoverable from insurance contracts or third parties are recorded as assets when recovery is deemed probable. At December 31, 2017, the Company did not record any amounts for recoveries from insurance contracts or third parties in connection with the amount of liabilities recorded for pending and threatened litigation. Legal defense costs are expensed as incurred. The Company believes it has recorded adequate provisions for its litigation matters. The Company reviews these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. While it is reasonably possible that an unfavorable outcome may occur in one or more of the following matters, unless otherwise stated below, the Company believes that it is not probable that a loss has been incurred in any of these matters. With respect to the litigation matters below for which it is reasonably possible that an unfavorable outcome may occur, an estimate of loss or range of loss is disclosed when such amount or amounts can be reasonably estimated. Although the Company believes that it has valid defenses with respect to legal matters and investigations pending against it, the results of litigation can be difficult to predict, particularly those involving jury trials. Therefore, it is possible that one or more of the following or other contingencies could have a material impact on the financial position, results of operations or cash flows of the Company in future periods.

*Derivative Action.* On July 13, 2016, a shareholder derivative complaint was filed in the Supreme Court of New York, County of New York, against certain of the Company's current and former directors and officers. The complaint alleged, among other things, that the defendants breached fiduciary duties, caused corporate waste and were unjustly enriched in connection with misconduct and accounting errors identified by the Company at its Aerospace Systems segment, and sought monetary damages, pre- and post-judgment interest, equitable relief and fees and expenses on behalf of the Company. However, the complaint was never served on any defendant, and the Company believes it has been abandoned.

*HVC Alkmaar.* On July 23, 2014, a notice of claim was received by the Company's former JovyAtlas business unit. The notice relates to losses resulting from a fire that occurred at an HVC Alkmaar bio-energy plant on July 21, 2013. The notice states that the fire resulted from the failure of an uninterruptible power supply (UPS) to provide sufficient power to act as a back-up energy supply, alleges that JovyAtlas was the manufacturer and service provider for the UPS and claims €11 million in estimated property damages and €35 million in estimated business interruption damages. The Company has tendered the notice of claim to its insurance carriers.

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**19. Pension and Other Postretirement Benefits**

The following table summarizes changes in the benefit obligations, the plan assets and funded status for all of the Company's pension and postretirement benefit plans, as well as the aggregate balance sheet impact.

	<u>Pension Plans</u>		<u>Postretirement Benefit Plans</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
	(in millions)			
<b>Change in benefit obligation:</b>				
Benefit obligation at the beginning of the year . . . . .	\$ 3,758	\$ 3,448	\$177	\$ 184
Service cost . . . . .	112	108	2	2
Interest cost . . . . .	142	135	5	6
Plan participants' contributions . . . . .	2	2	5	4
Amendments . . . . .	—	15	—	(3)
Actuarial loss (gain) . . . . .	376	167	(13)	(3)
Foreign currency exchange rate changes . . . . .	22	9	2	—
Curtailments and special termination benefits . . . . .	2	2	—	—
Benefits paid . . . . .	<u>(186)</u>	<u>(128)</u>	<u>(13)</u>	<u>(13)</u>
Benefit obligation at the end of the year . . . . .	<u>\$ 4,228</u>	<u>\$ 3,758</u>	<u>\$165</u>	<u>\$ 177</u>
<b>Change in plan assets:</b>				
Fair value of plan assets at the beginning of the year . . . . .	\$ 2,721	\$ 2,552	\$ 60	\$ 57
Actual return on plan assets . . . . .	391	189	8	5
Employer contributions . . . . .	97	97	7	7
Plan participants' contributions . . . . .	2	2	5	4
Foreign currency exchange rate changes . . . . .	22	9	—	—
Benefits paid . . . . .	<u>(186)</u>	<u>(128)</u>	<u>(13)</u>	<u>(13)</u>
Fair value of plan assets at the end of the year . . . . .	<u>\$ 3,047</u>	<u>\$ 2,721</u>	<u>\$ 67</u>	<u>\$ 60</u>
<b>Unfunded status at the end of the year . . . . .</b>	<u><b>\$(1,181)</b></u>	<u><b>\$(1,037)</b></u>	<u><b>\$(98)</b></u>	<u><b>\$(117)</b></u>
<b>Assets and (liabilities) recognized on the consolidated balance sheets consist of:</b>				
Non-current assets . . . . .	\$ 48	\$ 37	\$ —	\$ —
Current liabilities . . . . .	(6)	(6)	(8)	(8)
Non-current liabilities . . . . .	<u>(1,223)</u>	<u>(1,068)</u>	<u>(90)</u>	<u>(109)</u>
	<u><b>\$(1,181)</b></u>	<u><b>\$(1,037)</b></u>	<u><b>\$(98)</b></u>	<u><b>\$(117)</b></u>

The table below summarizes the net loss and prior service cost balances at December 31, in the accumulated other comprehensive loss account, before related tax effects, for all of the Company's pension and postretirement benefit plans.

	<u>Pension Plans</u>		<u>Postretirement Benefit Plans</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
	(in millions)			
Net loss (gain) . . . . .	\$1,035	\$896	\$ (3)	\$(12)
Prior service cost (credit) . . . . .	<u>10</u>	<u>14</u>	<u>(27)</u>	<u>(4)</u>
Total amount recognized . . . . .	<u><b>\$1,045</b></u>	<u><b>\$910</b></u>	<u><b>\$(30)</b></u>	<u><b>\$(16)</b></u>

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The aggregate accumulated benefit obligation (ABO) for all of the Company's pension plans was \$3,831 million at December 31, 2017 and \$3,413 million at December 31, 2016. The table below presents information for the pension plans with an ABO in excess of the fair value of plan assets at December 31, 2017 and 2016.

	<b>Pension Plans</b>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
Projected benefit obligation . . . . .	\$3,875	\$3,528
Accumulated benefit obligation . . . . .	\$3,490	\$3,192
Fair value of plan assets . . . . .	\$2,651	\$2,456

The table below summarizes the weighted average assumptions used to determine the benefit obligations for the Company's pension and postretirement plans disclosed at December 31, 2017 and 2016.

	<b>Pension Plans</b>		<b>Postretirement Benefit Plans</b>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Benefit obligations:				
Discount rate . . . . .	3.78% <sup>(1)</sup>	4.40% <sup>(1)</sup>	3.59% <sup>(2)</sup>	4.05% <sup>(2)</sup>
Rate of compensation increase . . . . .	3.50% <sup>(3)</sup>	3.50% <sup>(3)</sup>		

- <sup>(1)</sup> The weighted average discount rate assumptions used at December 31, 2017 and 2016 were comprised of separate assumptions determined by country of 3.81% and 4.45% for the U.S. based plans, respectively, and 3.39% and 3.79% for the Canadian based plans, respectively.
- <sup>(2)</sup> The weighted average discount rate assumptions used at December 31, 2017 and 2016 were comprised of separate assumptions determined by country of 3.63% and 4.11% for the U.S. based plans, respectively, and 3.33% and 3.64% for the Canadian based plans, respectively.
- <sup>(3)</sup> The weighted average rate of compensation increase assumptions were comprised of separate assumptions determined by country of 3.5% for both the U.S. based plans and Canadian based plans at December 31, 2017 and 2016.

The following table summarizes the components of net periodic benefit cost for the Company's pension and postretirement benefit plans for the years ended December 31, 2017, 2016 and 2015.

	<b>Pension Plans</b>			<b>Postretirement Benefit Plans</b>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)					
<b>Components of net periodic benefit cost:</b>						
Service cost . . . . .	\$ 112	\$ 108	\$ 123	\$ 2	\$ 2	\$ 3
Interest cost . . . . .	142	135	149	5	6	7
Expected return on plan assets . . . . .	(212)	(200)	(205)	(4)	(4)	(5)
Amortization of prior service cost (credits) . . . . .	1	—	1	(1)	(2)	(2)
Amortization of net loss (gains) . . . . .	61	52	68	(2)	(2)	—
Curtailment loss and special termination benefits <sup>(1)</sup> . . . . .	<u>6</u>	<u>2</u>	<u>3</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net periodic benefit cost . . . . .	<u>\$ 110</u>	<u>\$ 97</u>	<u>\$ 139</u>	<u>\$—</u>	<u>\$—</u>	<u>\$ 3</u>

<sup>(1)</sup> During the year ended December 31, 2017, the curtailment loss and special termination benefits charge is primarily due to a pension curtailment charge in connection with the decision to discontinue future service accruals for substantially all salaried employee defined benefit plans effective January 1, 2019.

In 2016, the Company changed the approach used to measure the service and interest components of expense for all of its pension and postretirement benefit plans. For fiscal 2015 and previous periods, the Company measured the service and interest cost components using a single weighted-average discount rate derived from the yield curve used to measure the benefit obligations at the beginning of the period. Beginning in fiscal 2016, the Company elected to use a spot rate approach for its plans in the measurement of the components of benefit cost by applying specific

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spot rates along that yield curve to the relevant projected cash flows, as the Company believes the new approach provides a more precise measurement of service and interest costs. This change does not affect the measurement of the Company's total benefit obligation. The Company has accounted for this change prospectively as a change in accounting estimate.

The following table summarizes the other changes in plan assets and benefit obligations recognized in other comprehensive income for the Company's pension and postretirement benefit plans for the years ended December 31, 2017, 2016 and 2015.

	<u>Pension Plans</u>			<u>Postretirement Benefit Plans</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)					
<b>Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss):</b>						
Net loss (gain) . . . . .	\$200	\$179	\$(132)	\$(17)	\$(4)	\$(7)
Prior service (cost) credit . . . . .	(4)	15	—	—	(2)	—
Amortization of net (loss) gain . . . . .	(61)	(52)	(68)	2	2	—
Amortization of prior service (cost) credit . . . . .	<u>(1)</u>	<u>—</u>	<u>(1)</u>	<u>1</u>	<u>2</u>	<u>2</u>
Total recognized in other comprehensive income (loss) . .	<u>134</u>	<u>142</u>	<u>(201)</u>	<u>(14)</u>	<u>(2)</u>	<u>(5)</u>
Total recognized in net periodic benefit cost and other comprehensive income (loss) . . . . .	<u>\$244</u>	<u>\$239</u>	<u>\$ (62)</u>	<u>\$(14)</u>	<u>\$(2)</u>	<u>\$(2)</u>

The following table summarizes the amounts expected to be amortized from accumulated OCI and recognized as components of net periodic benefit costs during 2018.

	<u>Pension Plans</u>	<u>Postretirement Benefit Plans</u>	<u>Total</u>
	(in millions)		
Net loss (gain) . . . . .	\$74	\$(3)	\$71
Prior service credit . . . . .	<u>—</u>	<u>(1)</u>	<u>(1)</u>
	<u>\$74</u>	<u>\$(4)</u>	<u>\$70</u>

The table below summarizes the weighted average assumptions used to determine the net periodic benefit cost for the years ended December 31, 2017, 2016 and 2015.

	<u>Pension Plans</u>			<u>Postretirement Benefit Plans</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Discount rates:						
Benefit obligation . . . . .	4.40% <sup>(1)</sup>	4.67% <sup>(1)</sup>	4.14% <sup>(1)</sup>	4.05% <sup>(4)</sup>	4.22% <sup>(4)</sup>	3.70% <sup>(4)</sup>
Service cost . . . . .	4.55%	4.83%	— <sup>(5)</sup>	4.21%	4.37%	— <sup>(5)</sup>
Interest cost . . . . .	3.84%	3.95%	— <sup>(5)</sup>	3.26%	3.26%	— <sup>(5)</sup>
Expected long-term return on plan assets . .	7.92% <sup>(2)</sup>	7.92% <sup>(2)</sup>	8.14% <sup>(2)</sup>	7.43%	7.42%	7.65%
Rate of compensation increase . . . . .	3.50% <sup>(3)</sup>	3.50% <sup>(3)</sup>	3.50% <sup>(3)</sup>			

<sup>(1)</sup> The weighted average discount rate assumptions used for the years ended December 31, 2017, 2016, and 2015 were comprised of separate assumptions determined by country of 4.45%, 4.73% and 4.20% for the U.S. based plans and 3.79%, 3.93% and 3.90% for the Canadian based plans, respectively.

<sup>(2)</sup> The weighted average expected long-term return on plan assets assumptions used were comprised of separate assumptions determined by country of 8.00% for each of the years ended December 31, 2017 and 2016 and 8.25% for the year ended December 31, 2015 for the U.S. based plans and 7.25% for the Canadian based plans for the years ended December 31, 2017, 2016 and 2015.

<sup>(3)</sup> The weighted average rate of compensation increase assumptions used for the years ended December 31, 2017, 2016 and 2015 were comprised of separate assumptions determined by country of 3.50% for both the U.S and Canadian based plans.

<sup>(4)</sup> The weighted average discount rate assumptions used for the years ended December 31, 2017, 2016 and 2015 were comprised of separate assumptions determined by country of 4.11%, 4.28% and 3.70% for the U.S. based plans and 3.64%, 3.74% and 3.70% for the Canadian based plans, respectively.

<sup>(5)</sup> Not applicable as the Company changed to the spot rate approach beginning in 2016 as described above.

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The expected long-term return on plan assets assumption represents the average rate that the Company expects to earn over the long-term on the assets of the Company’s benefit plans, including those from dividends, interest income and capital appreciation. The Company utilizes a third-party consultant to assist in the development of the expected long-term return on plan assets, which is based on expectations regarding future long-term rates of return for the plans’ investment portfolio, with consideration given to the allocation of investments by asset class and historical rates of return for each individual asset class. The Company utilizes a building block methodology that utilizes historical and forward looking rates of return for each asset class and takes into account expected returns above inflation and risk premium. These long-term rates of return are then applied to the target portfolio allocations that are generally aligned with the actual asset allocations of the Company’s plans to develop the expected long-term rate of return.

The annual increase in cost of benefits (health care cost trend rate) for the Company’s U.S. based plans covering retirees under 65 years of age is assumed to be an average of 6.5% in 2018 and is assumed to gradually decrease to a rate of 5.0% in 2021 and thereafter. The health care cost trend rate for the Company’s U.S. based plans covering retirees over 65 years of age is assumed to be an average of 8.0% in 2018 and is assumed to gradually decrease to a rate of 5.0% in 2024 and thereafter. The health care cost trend rate for the Company’s Canadian based plans is assumed to be an average of 6.25% in 2018 and is assumed to gradually decrease to a rate of 5.0% in 2023 and thereafter. Health care cost trend assumptions are based on (1) observed or expected short term rates of increase for different types of health models based on actual claims experience and benchmarking, and (2) a reasonable estimate of an appropriate, sustainable level of health care cost trend in the future, weighting the factors that primarily influence trends, which are price inflation and cost leveraging benefit plan features. Assumed health care cost trend rates can have a significant effect on amounts reported for postretirement medical benefit plans. A one percentage point change in the assumed health care cost trend rates would have the following effects:

	<b>1 percentage point</b>	
	<b>Increase</b>	<b>Decrease</b>
	<b>(in millions)</b>	
Effect on total service and interest cost . . . . .	\$—	\$—
Effect on postretirement benefit obligations . . . . .	\$ 5	\$(4)

*Plan Assets.* The Company’s Benefit Plan Committee (Committee) has the responsibility to formulate the investment policies and strategies for the plans’ assets. The Committee structures the investment of plan assets to achieve the following goals: (1) maximize the plans’ long-term rate of return on assets for an acceptable level of risk; and (2) limit the volatility of investment returns and consequent impact on the plans’ assets. In the pursuit of these goals, the Committee has formulated the following investment policies and objectives: (1) invest assets of the plans in a manner consistent with the fiduciary standards of the Employee Retirement Income Security Act of 1974 (ERISA); (2) preserve the plans’ assets; (3) maintain sufficient liquidity to fund benefit payments and pay plan expenses; (4) evaluate the performance of investment managers; and (5) achieve, on average, a minimum total rate of return equal to the established benchmarks for each asset category.

The Committee retains a professional investment consultant to advise the Committee and help ensure that the above policies and strategies are met. The Committee does not actively manage the day to day operations and selection process of individual securities and investments, as it retains the professional services of qualified investment management organizations to fulfill those tasks. Qualified investment management organizations are evaluated on several criteria for selection, with a focus on the investment management organizations’ demonstrated capability to achieve results that will meet or exceed the investment objectives they have been assigned and conform to the policies established by the Committee. While the investment management organizations have investment discretion over the assets placed under their management, the Committee provides each investment manager with specific investment guidelines relevant to its asset class.

The Committee has established the allowable range that the plans’ assets may be invested in for each major asset category. In addition, the Committee has established guidelines regarding diversification within asset categories to limit risk and exposure to a single or limited number of securities. The investments of the plans’ include a diversified portfolio of both equity and fixed income investments. Equity investments are further diversified across U.S. and non-U.S. stocks, small to large capitalization stocks, and growth and value stocks. Fixed income assets are diversified



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across U.S. and non-U.S. issuers, corporate and governmental issuers, and credit quality. The plan also invests in real estate through publicly traded real estate securities. Derivatives may be used only for hedging purposes or to create synthetic long positions. The plans are prohibited from directly owning commodities, unregistered securities, restricted stock, private placements, or interests in oil, gas, mineral exploration, or other development programs. Further, short selling or utilizing margin buying for investment purposes is prohibited.

The table below presents the allowable range for each major category of the plans' assets at December 31, 2017 as well as the Company's pension plan and postretirement benefit plan weighted-average asset allocations at December 31, 2017 and 2016, by asset category.

Asset Category	Range	U.S.		Canada		
		2017	2016	Range	2017	2016
Domestic equity <sup>(1)</sup>	30%-60%	47%	55%	—	15%	15%
International equity <sup>(2)</sup>	10%-20%	11	10	—	47	62
Total equities	45%-75%	58	65	40%-80%	62	77
Fixed income securities	20%-40%	28	22	—	25	13
Other, primarily cash and cash equivalents	0%-15%	7	5	—	13	10
Total fixed income securities and cash and cash equivalents	NA	NA	NA	20%-60%	38	23
Real estate securities	0%-15%	7	8	—	—	—
Total		100%	100%		100%	100%

<sup>(1)</sup> Domestic equities for Canadian plans refers to equities of Canadian companies.

<sup>(2)</sup> International equities for Canadian plans includes equities of U.S. companies.

NA - Not applicable. The Company's Master Pension Trust Investment Policy does not provide an allocation percentage range to fixed income securities and cash and cash equivalents.

The Committee regularly monitors the investment of the plans' assets to ensure that the actual investment allocation remains within the established range. The Committee also regularly measures and monitors investment risk through ongoing performance reporting and investment manager reviews. Investment manager reviews include assessing the managers' performance versus the appropriate benchmark index both in the short and long-term period, performance versus peers, and an examination of the risk the managers assumed in order to achieve rates of return.

The table below presents the fair value of the Company's pension plans' assets by asset category segregated by level within the fair value hierarchy, as described below.

Asset Category	U.S. Pension Plans' Assets				Canadian Pension Plans' Assets			
	Fair Value Measured at December 31, 2017				Fair Value Measured at December 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(in millions)							
Equity securities <sup>(1)</sup> :								
U.S. Equity	\$1,297	\$ —	\$ —	\$1,297	\$ 71	\$ —	\$ —	\$ 71
International Equity	87	—	—	87	105	—	—	105
Fixed Income — Investment Grade <sup>(2)</sup>	329	205	—	534	—	—	—	—
Fixed Income — High Yield <sup>(3)</sup>	—	219	—	219	—	—	—	—
Real Estate Investment Trusts <sup>(4)</sup>	196	—	—	196	—	—	—	—
Other <sup>(5)</sup>	—	198	—	198	8	37	—	45
Total assets at fair value	\$1,909	\$622	\$ —	\$2,531	\$184	\$37	\$ —	\$221
Liabilities for unsettled trades, net				(30)				—
Other investments measured at net asset value <sup>(6)(7)</sup>				203				122
Total				\$2,704				\$343

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Asset Category	U.S. Pension Plans' Assets				Canadian Pension Plans' Assets			
	Fair Value Measured at December 31, 2016				Fair Value Measured at December 31, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(in millions)							
Equity securities <sup>(1)</sup> :								
U.S. Equity	\$1,331	\$ —	\$—	\$1,331	\$ 79	\$—	\$—	\$ 79
International Equity	85	—	—	85	104	—	—	104
Fixed Income — Investment Grade <sup>(2)</sup>	255	159	—	414	—	—	—	—
Fixed Income — High Yield <sup>(3)</sup>	—	136	—	136	—	—	—	—
Real Estate Investment Trusts <sup>(4)</sup>	193	—	—	193	—	—	—	—
Other <sup>(5)</sup>	—	114	—	114	5	27	—	32
Total assets at fair value	<u>\$1,864</u>	<u>\$409</u>	<u>\$—</u>	<u>\$2,273</u>	<u>\$188</u>	<u>\$27</u>	<u>\$—</u>	<u>\$215</u>
Liabilities for unsettled trades, net				(23)				—
Other investments measured at net asset value <sup>(6)(7)</sup>				171				85
Total				<u>\$2,421</u>				<u>\$300</u>

<sup>(1)</sup> Equity securities consist of investments in common stock of U.S. and international companies. The fair value of equity securities is based on quoted market prices available in active markets at the close of a trading day, primarily the New York Stock Exchange (NYSE), National Association of Securities Dealers Automated Quotations (NASDAQ), and various international exchanges.

<sup>(2)</sup> Approximately 62% at December 31, 2017 and 2016 of U.S. plan assets that are invested in the Fixed Income — Investment Grade asset category consist of a mutual fund offered by a registered investment company (the Fund) and fixed income securities. The Fund invests in investment grade fixed income securities, mortgaged-backed securities, U.S. treasury and agency bonds and corporate bonds. These investments are classified by the Company as a Level 1 measurement within the fair value hierarchy, as the mutual fund trades on an active market and daily, quoted prices are available. The remaining 38% at December 31, 2017 and 2016 of U.S. plan assets are fixed income securities, primarily investment grade corporate bonds from various industries held directly by the plan. The fair values of these investments are based on yields currently available on comparable bonds of issuers with similar credit ratings, quoted prices of similar bonds in an active market, or cash flows based on observable inputs and are classified as Level 2.

<sup>(3)</sup> Fixed Income — High Yield consists of investments in corporate high-yield bonds from various industries. The fair values of these investments are based on yields currently available on comparable bonds of issuers with similar credit ratings, quoted prices of similar bonds in an active market, or cash flows based on observable inputs.

<sup>(4)</sup> Real Estate Investment Trusts (REITs) consist of securities that trade on the major exchanges and invest directly in real estate, either through properties or mortgages.

<sup>(5)</sup> Other consists primarily of: (1) money market accounts, which invest primarily in short-term, high quality money market securities such as government obligations, commercial paper, time deposits and certificates of deposit, and are classified as Level 2, and (2) cash, which is classified as Level 1.

<sup>(6)</sup> In accordance with ASU 2015-07, certain investments that are measured at fair value using the net asset value (NAV) per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of financial position.

<sup>(7)</sup> All of the U.S. plans other investments measured using NAV at December 31, 2017 and 2016 and approximately 31% and 55% at December 31, 2017 and 2016, respectively, of the Canadian plans other investments measured using NAV consist of a regulated commingled equity trust fund, for which fair value is based on the NAV at the end of each month. The NAV is calculated by the fund manager based on the fair value of the fund's holdings, primarily equity securities traded in active markets, determined as of the end of each month as a practical expedient to estimating fair value. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Withdrawals are permitted, with notice by the 20th day of each month, based on NAV. Approximately 69% and 45% at December 31, 2017 and 2016, respectively, of the Canadian plans other investments measured using NAV are invested in regulated commingled bond funds (the "Bond Funds"). As these Bond Funds do not trade in an active market, the fair value is based on NAVs calculated by fund managers based on yields currently available on comparable bonds of issuers with similar credit ratings, quoted prices of similar bonds in an active market, or cash flows based on observable inputs as a practical expedient to estimating fair value and classified as Level 2. Withdrawals are permitted monthly, with notice between 0 and 3 days of the transaction date, based on NAV.

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The table below presents the fair value of the Company’s postretirement benefit plans’ assets by asset category segregated by level within the fair value hierarchy, as described below.

Asset Category	Postretirement Benefit Plans’ Assets							
	Fair Value Measured at December 31, 2017				Fair Value Measured at December 31, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(in millions)							
Equity securities <sup>(1)</sup> :								
U.S. Equity . . . . .	\$38	\$—	\$—	\$38	\$37	\$—	\$—	\$37
International Equity . . . . .	2	—	—	2	1	—	—	1
Fixed Income — Investment Grade <sup>(2)</sup> . . . . .	10	3	—	13	8	3	—	11
Fixed Income — High Yield <sup>(3)</sup> . . . . .	—	3	—	3	—	2	—	2
Real Estate Investment Trusts <sup>(4)</sup> . . . . .	3	—	—	3	3	—	—	3
Other <sup>(5)</sup> . . . . .	—	5	—	5	—	3	—	3
Total assets at fair value . . . . .	<u>\$53</u>	<u>\$11</u>	<u>\$—</u>	<u>\$64</u>	<u>\$49</u>	<u>\$ 8</u>	<u>\$—</u>	<u>\$57</u>
Other investments measured at net asset value <sup>(6)(7)</sup> . . . . .				3				3
Total . . . . .				<u>\$67</u>				<u>\$60</u>

(1) Equity securities consist of investments in common stock of U.S. and international companies. The fair value of equity securities is based on quoted market prices available in active markets at the close of a trading day, primarily the NYSE, NASDAQ, and various international exchanges.

(2) Approximately 77% and 73% at December 31, 2017 and 2016, respectively, of the postretirement benefit plan assets that are invested in the Fixed Income — Investment Grade asset category consist of the Fund and fixed income securities. The Fund invests in investment grade fixed income securities, mortgaged-backed securities, U.S. treasury and agency bonds and corporate bonds. These investments are classified by the Company as a Level 1 measurement within the fair value hierarchy as the mutual fund trades on an active market and daily, quoted prices are available. The remaining 23% and 27% at December 31, 2017 and 2016, respectively, of the postretirement benefit plan assets are fixed income securities, primarily investment grade corporate bonds from various industries held directly by the plan. The fair values of these investments are based on yields currently available on comparable bonds of issuers with similar credit ratings, quoted prices of similar bonds in an active market, or cash flows based on observable inputs and are classified as Level 2.

(3) Fixed Income — High Yield consists of investments in corporate high-yield bonds from various industries. The fair values of these investments are based on yields currently available on comparable bonds of issuers with similar credit ratings, quoted prices of similar bonds in an active market, or cash flows based on observable inputs.

(4) REITs consist of securities that trade on the major exchanges and invest directly, either through properties or mortgages.

(5) Other consists primarily of money market accounts, which invest primarily in short-term, high quality money market securities such as government obligations, commercial paper, time deposits and certificates of deposit.

(6) In accordance with ASU 2015-07, certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of financial position.

(7) All of the postretirement benefit plans other investments measured using NAV at December 31, 2017 and 2016 consist of a regulated commingled equity trust fund, which fair value is based on NAV at the end of each month. The NAV is calculated by the fund manager based on the fair value of the fund’s holdings, primarily equity securities traded in active markets, determined as of the end of each month as a practical expedient to estimating fair value. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Withdrawals are permitted, with notice by the 20th day of each month, based on NAV.

**Contributions.** The funding policy for the Company’s pension and postretirement benefit plans is to contribute at least the minimum required by applicable laws and regulations or to directly make benefit payments where appropriate. The Company makes voluntary, additional contributions to the pension plans depending on a number of factors, including operating cash flow levels, alternative uses for excess cash and the plans’ funded status. At December 31, 2017, all legal funding requirements had been met. For the year ending December 31, 2018, the Company currently expects to contribute approximately \$100 million to its pension plans, and approximately \$10 million to its postretirement benefit plans.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

*Estimated Future Benefit Payments.* The following table presents expected pension and postretirement benefit payments and expected postretirement subsidies due to the Medicare Prescription Drug Improvement and Modernization Act of 2003, which reflect expected future service, as appropriate.

	<u>Pension Benefits</u>	<u>Postretirement Benefits</u>	
		<u>Benefit Payments</u>	<u>Subsidy Receipts</u>
	(in millions)		
2018 .....	\$ 158	\$12	\$—
2019 .....	165	12	—
2020 .....	175	13	—
2021 .....	185	13	—
2022 .....	194	12	—
Years 2023 - 2027 .....	1,128	55	1

*Employee Savings Plans.* Under its various employee savings plans, the Company matches the contributions of participating employees up to a designated level. The extent of the match, vesting terms and the form of the matching contributions vary among the plans. Under these plans, the Company's matching contributions in L3's common stock and cash were \$115 million for 2017, \$118 million for 2016 and \$131 million for 2015. These matching contributions include amounts attributable to discontinued operations of \$8 million for 2017, \$12 million for 2016 and \$24 million for 2015.

*Multiemployer Benefit Plans.* Certain of the Company's businesses participate in multiemployer defined benefit pension plans. The Company makes cash contributions to these plans under the terms of collective-bargaining agreements that cover its union employees based on a fixed rate per hour of service worked by the covered employees. The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects: (1) assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers, (2) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers and (3) if the Company chooses to stop participating in some of its multiemployer plans, the Company may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

Under these plans, the Company contributed cash and recorded expenses for each of its individually significant plans and all of its other plans in aggregate as noted in the table below.

<u>Pension Fund</u>	<u>EIN/Pension Plan Number</u>	<u>Pension Protection Act Zone Status<sup>(1)</sup></u>		<u>FIP/RP<sup>(2)</sup> Status Pending/ Implemented</u>	<u>Contributions by L3<sup>(7)</sup></u>			<u>Surcharge Imposed</u>	<u>Expiration Date of Collective-Bargaining Agreement</u>
		<u>2017</u>	<u>2016</u>		<u>2017</u>	<u>2016</u>	<u>2015</u>		
IAM National Pension Fund . . .	51-6031295/002	Green	Green	No	\$27 <sup>(3)</sup>	\$26 <sup>(4)</sup>	\$23 <sup>(4)</sup>	No	4/29/2018 to 9/30/2020 <sup>(5)</sup>
Other Pension Funds <sup>(6)</sup> . . . . .					—	—	—		
<b>Total contributions.</b> . . . . .					<u>\$27</u>	<u>\$26</u>	<u>\$23</u>		

- (1) A zone status rating of green indicates the plan is at least 80% funded.
- (2) Funding improvement plan or rehabilitation plan.
- (3) At the date the audited financial statements for the Company were issued, the Form 5500 for the plan year ended December 31, 2017 was not available.
- (4) Represents 5% of total plan contributions for the years ended December 31, 2016 and 2015 based on Form 5500.
- (5) The Company is a party to multiple bargaining agreements for multiple projects that require contributions into the IAM National Pension Fund. The most significant of these agreements, expiring April 28, 2019, covers multiple programs in the Company's Aerospace Systems reportable segment and represents 61% of 2017 contributions.
- (6) Consists of three pension funds in which the Company's contributions are individually, and in the aggregate, insignificant.
- (7) These contributions include amounts attributable to discontinued operations of approximately \$26 million for the years ended December 31, 2017 and 2016 and \$22 million for the year ended December 31, 2015.

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**20. Supplemental Cash Flow Information**

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Interest paid . . . . .	\$165	\$162	\$182
Income tax payments . . . . .	\$163	\$120	\$130
Income tax refunds . . . . .	\$ 16	\$ 8	\$ 8

**21. Segment Information**

The Company has four reportable segments, which are described in Note 1. The Company evaluates the performance of its operating segments and reportable segments based on their sales, operating income and operating margin. Corporate expenses are allocated to the Company's operating segments using an allocation methodology prescribed by U.S. Government regulations for government contractors. Accordingly, segment results include all costs and expenses, except for goodwill impairment charges, gains or losses related to business divestitures, and certain other items that are excluded by management for purposes of evaluating the operating performance of the Company's business segments. Certain Corporate and segment expenses of \$32 million for 2017 and \$29 million for the years ended December 31, 2016 and 2015, that had previously been allocated to the Vertex Aerospace and NSS businesses were retained by the Company and were allocated to L3's four reportable segments.

The tables below present net sales, operating income, depreciation and amortization, capital expenditures and total assets by reportable segment.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
<b>Net Sales</b>			
<b>Products</b>			
Electronic Systems . . . . .	\$2,234	\$2,033	\$2,102
Aerospace Systems . . . . .	1,545	1,679	1,679
Communication Systems . . . . .	1,745	1,586	1,649
Sensor Systems . . . . .	1,292	1,266	1,298
Elimination of intercompany sales . . . . .	(83)	(111)	(128)
Total products sales . . . . .	<u>6,733</u>	<u>6,453</u>	<u>6,600</u>
<b>Services</b>			
Electronic Systems . . . . .	\$ 848	\$ 812	\$ 810
Aerospace Systems . . . . .	1,267	1,270	1,257
Communication Systems . . . . .	510	488	441
Sensor Systems . . . . .	273	235	193
Elimination of intercompany sales . . . . .	(58)	(48)	(70)
Total services sales . . . . .	<u>2,840</u>	<u>2,757</u>	<u>2,631</u>
Consolidated total . . . . .	<u>\$9,573</u>	<u>\$9,210</u>	<u>\$9,231</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

	Year Ended December 31,		
	2017	2016	2015
	(in millions)		
<b>Operating income</b>			
Electronic Systems . . . . .	\$ 403	\$ 360	\$ 337
Aerospace Systems . . . . .	210	255	193
Communication Systems . . . . .	212	195	190
Sensor Systems . . . . .	195	147	142
Segment total . . . . .	1,020	957	862
Goodwill impairment charges <sup>(1)</sup> . . . . .	—	—	(46)
Loss related to business divestitures <sup>(2)</sup> . . . . .	—	—	(31)
Consolidated total . . . . .	\$ 1,020	\$ 957	\$ 785
<b>Depreciation and amortization</b>			
Electronic Systems . . . . .	\$ 79	\$ 60	\$ 59
Aerospace Systems . . . . .	51	46	43
Communication Systems . . . . .	49	47	50
Sensor Systems . . . . .	46	45	51
Consolidated total . . . . .	\$ 225	\$ 198	\$ 203
<b>Capital Expenditures</b>			
Electronic Systems . . . . .	\$ 68	\$ 76	\$ 69
Aerospace Systems . . . . .	43	50	53
Communication Systems . . . . .	49	37	37
Sensor Systems . . . . .	42	37	30
Corporate . . . . .	22	10	6
Consolidated total . . . . .	\$ 224	\$ 210	\$ 195
<b>Total Assets</b>			
Electronic Systems . . . . .	\$ 4,796	\$ 4,369	\$ 3,968
Aerospace Systems . . . . .	2,014	2,084	2,190
Communication Systems . . . . .	2,063	2,031	1,984
Sensor Systems . . . . .	2,706	2,433	2,458
Corporate . . . . .	709	467	345
Assets held for sale . . . . .	135	—	—
Assets of discontinued operations . . . . .	306	481	1,124
Consolidated total . . . . .	\$12,729	\$11,865	\$12,069

<sup>(1)</sup> Represents non-cash goodwill impairment charges recorded during 2015 of \$46 million related to a business retained by L3 in connection with the sale of the NSS segment.

<sup>(2)</sup> See Note 3 for information regarding the Company's business divestitures.

Corporate assets not allocated to the reportable segments primarily include cash and cash equivalents, corporate office fixed assets, and deferred income tax assets.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

The table below presents property, plant and equipment, net by geographic area.

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
United States .....	\$ 936	\$ 960
All Other .....	174	147
Total .....	<u>\$1,110</u>	<u>\$1,107</u>

The Company's sales attributable to U.S. and international customers, based on location of the customer, are summarized in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
U.S. ....	\$7,344	\$6,947	\$6,734
International:			
United Kingdom .....	335	331	336
Canada .....	280	297	281
Australia .....	268	254	321
China .....	167	67	83
South Korea .....	134	127	207
Japan .....	125	81	95
France .....	84	75	62
Other .....	<u>836</u>	<u>1,031</u>	<u>1,112</u>
Total international .....	<u>2,229</u>	<u>2,263</u>	<u>2,497</u>
Consolidated .....	<u>\$9,573</u>	<u>\$9,210</u>	<u>\$9,231</u>

Net sales to principal customers are summarized in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
U.S. Government agencies <sup>(1)</sup> .....	\$6,697	\$6,399	\$6,120
Commercial .....	1,456	1,280	1,373
Foreign governments <sup>(1)</sup> .....	<u>1,420</u>	<u>1,531</u>	<u>1,738</u>
Consolidated .....	<u>\$9,573</u>	<u>\$9,210</u>	<u>\$9,231</u>

<sup>(1)</sup> Includes sales for which the Company is the prime contractor as well as sales based on the ultimate end customer for which the Company is a subcontractor.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

**22. Severance and Restructuring Related Costs**

Consistent with the Company’s strategy to continuously improve its cost structure and right-size its businesses, L3 is completing employment reduction actions across several of its businesses to reduce both direct and indirect costs, including overhead and general and administrative costs. As a result of these initiatives, the Company recorded employee severance and restructuring related costs of \$101 million with respect to approximately 1,500 employees during the year ended December 31, 2017, \$17 million with respect to approximately 700 employees during the year ended December 31, 2016 and \$18 million with respect to approximately 800 employees during the year ended December 31, 2015. Severance and restructuring related costs are reported within cost of sales on the consolidated statements of operations. Severance and restructuring related costs incurred by reportable segment are presented in the table below.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
Electronic Systems <sup>(1)</sup> .....	\$ 14	\$ 5	\$ 4
Aerospace Systems <sup>(1)</sup> .....	24	2	4
Communication Systems <sup>(2)</sup> .....	48	7	6
Sensor Systems <sup>(3)</sup> .....	<u>15</u>	<u>3</u>	<u>4</u>
Consolidated .....	<u>\$101</u>	<u>\$17</u>	<u>\$18</u>

<sup>(1)</sup> The severance and restructuring related costs incurred during the year ended December 31, 2017 include \$1 million and \$5 million of salaried employee pension plan curtailment losses for Electronic Systems and Aerospace Systems segments, respectively. See Note 19 for additional information.

<sup>(2)</sup> The severance and restructuring related costs incurred during the year ended December 31, 2017 exclude a pre-tax gain of \$42 million on the sale of the Company’s property in San Carlos, California in the second quarter of 2017.

<sup>(3)</sup> The severance and restructuring related costs incurred during the year ended December 31, 2017 include a \$12 million loss on the sale of a building in Garland, Texas in the fourth quarter of 2017.

The Company had severance and restructuring related liabilities of \$23 million and \$9 million included in other current liabilities on the Company’s balance sheets at December 31, 2017 and 2016, respectively. The remaining liability balance at December 31, 2017 is expected to be paid in 2018. The table below presents the change to the Company’s severance and restructuring related liability during the year ended December 31, 2017.

	<u>December 31, 2017</u>
	(in millions)
Balance at beginning of period .....	\$ 9
Additional provisions .....	101
Cash payments .....	<u>(87)</u>
Balance at end of period .....	<u>\$ 23</u>



**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

**23. Unaudited Quarterly Financial Data**

Unaudited summarized financial data by quarter for the years ended December 31, 2017 and 2016 is presented in the table below. The Company’s unaudited quarterly results of operations are affected, significantly in some periods, by the Company’s business acquisitions and divestitures. See Note 3 for additional information.

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter<sup>(1)</sup></u>	<u>Fourth Quarter<sup>(2)</sup></u>
	(in millions, except per share data)			
<b>2017</b>				
Sales.....	\$2,321	\$2,385	\$2,293	\$2,574
Operating income .....	236	292	229	263
Income from continuing operations .....	157	195	146	271
Net income .....	168	207	25	293
Net income attributable to L3 .....	164	202	22	289
Basic EPS from continuing operations <sup>(3)</sup> .....	1.97	2.44	1.83	3.42
Basic EPS <sup>(3)</sup> .....	2.11	2.59	0.28	3.70
Diluted EPS from continuing operations <sup>(3)</sup> .....	1.93	2.39	1.79	3.34
Diluted EPS <sup>(3)</sup> .....	2.07	2.54	0.28	3.62
<b>2016</b>				
Sales.....	\$2,065	\$2,318	\$2,184	\$2,643
Operating income .....	244	220	211	282
Income from continuing operations .....	163	134	149	187
Net income .....	230	151	151	192
Net income attributable to L3 .....	227	147	148	188
Basic EPS from continuing operations <sup>(3)</sup> .....	2.06	1.68	1.89	2.37
Basic EPS <sup>(3)</sup> .....	2.92	1.90	1.91	2.43
Diluted EPS from continuing operations <sup>(3)</sup> .....	2.02	1.66	1.85	2.32
Diluted EPS <sup>(3)</sup> .....	2.87	1.88	1.88	2.38

<sup>(1)</sup> The Company recorded a goodwill impairment charge of \$187 million or \$1.67 per diluted share for the Vertex Aerospace reporting unit in 2017, which is reported in discontinued operations.

<sup>(2)</sup> Provision for income taxes for the fourth quarter of 2017, includes estimated tax benefits of \$79 million or \$0.99 per diluted share, related to the enactment of the U.S. Tax Cuts and Jobs Act (U.S. Tax Reform) in December 2017.

<sup>(3)</sup> EPS in each quarter is computed using the weighted-average number of shares outstanding during that quarter, while EPS for the full year is computed using the weighted-average number of shares outstanding during the year. Therefore, the sum of the four quarters’ EPS may not equal the full year computed EPS.

**24. Financial Information of L3 and Its Subsidiaries**

The debt of L3, including the Senior Notes and borrowings under amounts drawn against the Credit Facility are guaranteed, on a joint and several, full and unconditional basis, by certain of its domestic subsidiaries (the Guarantor Subsidiaries). See Note 9 for additional information. The foreign subsidiaries and certain domestic subsidiaries of L3 (the Non-Guarantor Subsidiaries) do not guarantee the debt of L3. None of the debt of L3 has been issued by its subsidiaries.

Under the terms of the indentures governing the Senior Notes, the guarantees of the Senior Notes will automatically and unconditionally be released and discharged: (1) upon the release of all guarantees of all other outstanding indebtedness of L3, or (2) upon the determination that such guarantor is no longer a “domestic subsidiary.” In addition, the guarantees of the Senior Notes will be automatically and unconditionally released and discharged in the event of a sale or other disposition of all of the assets of any guarantor, by way of merger, consolidation or otherwise, or a sale of all of the capital stock of such guarantor. There are no restrictions on the payment of dividends from the Guarantor Subsidiaries to L3.

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

In lieu of providing separate audited financial statements for the Guarantor Subsidiaries, the Company has included the accompanying condensed combining financial statements based on Rule 3-10 of SEC Regulation S-X. The Company does not believe that separate financial statements of the Guarantor Subsidiaries are material to users of the financial statements.

The following condensed combining financial information presents the results of operations, financial position and cash flows of: (1) L3 excluding its consolidated subsidiaries (the Parent), (2) the Guarantor Subsidiaries, (3) the Non-Guarantor Subsidiaries and (4) the eliminations to arrive at the information for L3 on a consolidated basis.

	<u>L3</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated L3</u>
	(in millions)				
<b><u>Condensed Combining Balance Sheets:</u></b>					
<b><u>At December 31, 2017:</u></b>					
Current assets:					
Cash and cash equivalents . . . . .	\$ 432	\$ 14	\$ 287	\$ (71)	\$ 662
Billed receivables, net . . . . .	266	232	225	—	723
Contracts in process . . . . .	706	891	336	—	1,933
Prepaid expenses and other current assets . . . . .	330	231	128	—	689
Assets held for sale . . . . .	—	118	17	—	135
Assets of discontinued operations . . . . .	—	<u>306</u>	—	—	<u>306</u>
Total current assets . . . . .	1,734	1,792	993	(71)	4,448
Goodwill . . . . .	2,248	2,652	1,715	—	6,615
Other assets . . . . .	658	556	452	—	1,666
Investment in and amounts due from consolidated subsidiaries . . . . .	<u>5,593</u>	<u>5,270</u>	—	<u>(10,863)</u>	—
Total assets . . . . .	<u>\$10,233</u>	<u>\$10,270</u>	<u>\$3,160</u>	<u>\$(10,934)</u>	<u>\$12,729</u>
Current liabilities . . . . .	\$ 811	\$ 800	\$ 596	\$ (71)	\$ 2,136
Liabilities held for sale . . . . .	—	16	1	—	17
Liabilities of discontinued operations . . . . .	—	226	—	—	226
Amounts due to consolidated subsidiaries . . . . .	—	—	352	(352)	—
Other long-term liabilities . . . . .	1,009	714	146	—	1,869
Long-term debt . . . . .	<u>3,330</u>	—	—	—	<u>3,330</u>
Total liabilities . . . . .	<u>5,150</u>	<u>1,756</u>	<u>1,095</u>	<u>(423)</u>	<u>7,578</u>
L3 shareholders' equity . . . . .	5,083	8,514	2,065	(10,579)	5,083
Noncontrolling interests . . . . .	—	—	—	68	68
Total equity . . . . .	<u>5,083</u>	<u>8,514</u>	<u>2,065</u>	<u>(10,511)</u>	<u>5,151</u>
Total liabilities and equity . . . . .	<u>\$10,233</u>	<u>\$10,270</u>	<u>\$3,160</u>	<u>\$(10,934)</u>	<u>\$12,729</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

	<u>L3</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated L3</u>
			(in millions)		
<b><u>At December 31, 2016:</u></b>					
Current assets:					
Cash and cash equivalents . . . . .	\$ 291	\$ 1	\$ 207	\$ (136)	\$ 363
Billed receivables, net . . . . .	261	254	185	—	700
Contracts in process . . . . .	694	928	236	—	1,858
Prepaid expenses and other current assets . . . . .	236	144	125	—	505
Assets of discontinued operations . . . . .	<u>—</u>	<u>481</u>	<u>—</u>	<u>—</u>	<u>481</u>
Total current assets . . . . .	1,482	1,808	753	(136)	3,907
Goodwill . . . . .	2,258	2,613	1,503	—	6,374
Other assets . . . . .	705	567	312	—	1,584
Investment in and amounts due from consolidated subsidiaries . . . . .	<u>5,721</u>	<u>5,272</u>	<u>—</u>	<u>(10,993)</u>	<u>—</u>
Total assets . . . . .	<u>\$10,166</u>	<u>\$10,260</u>	<u>\$2,568</u>	<u>\$(11,129)</u>	<u>\$11,865</u>
Current liabilities . . . . .	\$ 789	\$ 846	\$ 460	\$ (136)	\$ 1,959
Liabilities of discontinued operations . . . . .	—	235	—	—	235
Amounts due to consolidated subsidiaries . . . . .	—	—	763	(763)	—
Other long-term liabilities . . . . .	1,499	191	32	—	1,722
Long-term debt . . . . .	<u>3,325</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>3,325</u>
Total liabilities . . . . .	<u>5,613</u>	<u>1,272</u>	<u>1,255</u>	<u>(899)</u>	<u>7,241</u>
L3 shareholders' equity . . . . .	4,553	8,988	1,313	(10,301)	4,553
Noncontrolling interests . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>71</u>	<u>71</u>
Total equity . . . . .	<u>4,553</u>	<u>8,988</u>	<u>1,313</u>	<u>(10,230)</u>	<u>4,624</u>
Total liabilities and equity . . . . .	<u>\$10,166</u>	<u>\$10,260</u>	<u>\$2,568</u>	<u>\$(11,129)</u>	<u>\$11,865</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

	<u>L3</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiaries</u> (in millions)	<u>Eliminations</u>	<u>Consolidated L3</u>
<b>Condensed Combining Statements of Operations:</b>					
<b>For the year ended December 31, 2017:</b>					
Total net sales . . . . .	\$ 3,519	\$ 4,748	\$ 1,690	\$(384)	\$ 9,573
Total cost of sales . . . . .	<u>(3,179)</u>	<u>(4,350)</u>	<u>(1,408)</u>	<u>384</u>	<u>(8,553)</u>
Operating income . . . . .	340	398	282	—	1,020
Interest expense . . . . .	(168)	—	(1)	—	(169)
Interest and other income, net . . . . .	<u>17</u>	<u>—</u>	<u>3</u>	<u>—</u>	<u>20</u>
Income from continuing operations before income taxes . . . . .	189	398	284	—	871
Provision for income taxes . . . . .	(22)	(47)	(33)	—	(102)
Equity in net income of consolidated subsidiaries . . . . .	<u>511</u>	<u>—</u>	<u>—</u>	<u>(511)</u>	<u>—</u>
Income from continuing operations . . . . .	678	351	251	(511)	769
Loss from discontinued operations, net of income tax . . . . .	<u>(1)</u>	<u>(75)</u>	<u>—</u>	<u>—</u>	<u>(76)</u>
Net income . . . . .	677	276	251	(511)	693
Net income attributable to noncontrolling interests . . . . .	—	—	—	(16)	(16)
Net income attributable to L3 . . . . .	<u>\$ 677</u>	<u>\$ 276</u>	<u>\$ 251</u>	<u>\$(527)</u>	<u>\$ 677</u>
Comprehensive income attributable to L3 . . . . .	<u>\$ 712</u>	<u>\$ 278</u>	<u>\$ 378</u>	<u>\$(656)</u>	<u>\$ 712</u>
<b>For the year ended December 31, 2016:</b>					
Total net sales . . . . .	\$ 3,350	\$ 4,809	\$ 1,381	\$(330)	\$ 9,210
Total cost of sales . . . . .	<u>(3,069)</u>	<u>(4,378)</u>	<u>(1,136)</u>	<u>330</u>	<u>(8,253)</u>
Operating income . . . . .	281	431	245	—	957
Interest expense . . . . .	(164)	—	—	—	(164)
Interest and other income, net . . . . .	<u>15</u>	<u>—</u>	<u>3</u>	<u>—</u>	<u>18</u>
Debt retirement charges . . . . .	<u>(7)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(7)</u>
Income from continuing operations before income taxes . . . . .	125	431	248	—	804
Provision for income taxes . . . . .	(26)	(92)	(53)	—	(171)
Equity in net income of consolidated subsidiaries . . . . .	<u>611</u>	<u>—</u>	<u>—</u>	<u>(611)</u>	<u>—</u>
Income from continuing operations . . . . .	710	339	195	(611)	633
Income from discontinued operations, net of income tax . . . . .	<u>—</u>	<u>91</u>	<u>—</u>	<u>—</u>	<u>91</u>
Net income . . . . .	710	430	195	(611)	724
Net income attributable to noncontrolling interests . . . . .	—	—	—	(14)	(14)
Net income attributable to L3 . . . . .	<u>\$ 710</u>	<u>\$ 430</u>	<u>\$ 195</u>	<u>\$(625)</u>	<u>\$ 710</u>
Comprehensive income attributable to L3 . . . . .	<u>\$ 558</u>	<u>\$ 440</u>	<u>\$ 118</u>	<u>\$(558)</u>	<u>\$ 558</u>
<b>For the year ended December 31, 2015:</b>					
Total net sales . . . . .	\$ 3,267	\$ 4,866	\$ 1,449	\$(351)	\$ 9,231
Total cost of sales . . . . .	<u>(3,031)</u>	<u>(4,441)</u>	<u>(1,248)</u>	<u>351</u>	<u>(8,369)</u>
Goodwill impairment charges . . . . .	—	(26)	(20)	—	(46)
(Loss) gain related to business divestitures . . . . .	<u>(13)</u>	<u>(31)</u>	<u>13</u>	<u>—</u>	<u>(31)</u>
Operating income . . . . .	223	368	194	—	785
Interest expense . . . . .	(161)	(1)	—	—	(162)
Interest and other income, net . . . . .	<u>17</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>17</u>
Debt retirement charge . . . . .	<u>(1)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(1)</u>
Income from continuing operations before income taxes . . . . .	78	367	194	—	639
Provision for income taxes . . . . .	(16)	(76)	(40)	—	(132)
Equity in net loss of consolidated subsidiaries . . . . .	<u>(302)</u>	<u>—</u>	<u>—</u>	<u>302</u>	<u>—</u>
(Loss) income from continuing operations . . . . .	(240)	291	154	302	507
Loss from discontinued operations, net of income tax . . . . .	<u>—</u>	<u>(732)</u>	<u>—</u>	<u>—</u>	<u>(732)</u>
Net (loss) income . . . . .	(240)	(441)	154	302	(225)
Net income attributable to noncontrolling interests . . . . .	—	—	—	(15)	(15)
Net (loss) income attributable to L3 . . . . .	<u>\$ (240)</u>	<u>\$ (441)</u>	<u>\$ 154</u>	<u>\$ 287</u>	<u>\$ (240)</u>
Comprehensive (loss) income attributable to L3 . . . . .	<u>\$ (230)</u>	<u>\$ (445)</u>	<u>\$ 43</u>	<u>\$ 402</u>	<u>\$ (230)</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

	<u>L3</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated L3</u>
			(in millions)		
<b>Condensed Combining Statements of Cash</b>					
<b>Flows: For the year ended December 31, 2017:</b>					
<b>Operating activities:</b>					
Net cash from operating activities from continuing operations . . . . .	\$ 374	\$ 438	\$ 251	\$ (78)	\$ 985
<b>Investing activities:</b>					
Business acquisitions, net of cash acquired . . . . .	(316)	—	—	—	(316)
Proceeds from sale of businesses, net of closing date cash balances . . . . .	17	—	1	—	18
Other investing activities . . . . .	(84)	(41)	(30)	—	(155)
Net cash used in investing activities from continuing operations . . . . .	(383)	(41)	(29)	—	(453)
<b>Financing activities:</b>					
Common stock repurchased . . . . .	(180)	—	—	—	(180)
Dividends paid on L3's common stock . . . . .	(236)	—	—	—	(236)
Other financing activities . . . . .	565	(496)	(162)	143	50
Net cash from (used in) financing activities from continuing operations . . . . .	149	(496)	(162)	143	(366)
Effect of foreign currency exchange rate changes on cash . . . . .	—	—	20	—	20
Net increase in cash and cash equivalents of discontinued operations . . . . .	1	112	—	—	113
Net increase in cash . . . . .	141	13	80	65	299
Cash and cash equivalents, beginning of the year . . . . .	291	1	207	(136)	363
Cash and cash equivalents, end of the year . . . . .	<u>\$ 432</u>	<u>\$ 14</u>	<u>\$ 287</u>	<u>\$ (71)</u>	<u>\$ 662</u>

**L3 TECHNOLOGIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED**

	<u>L3</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated L3</u>
			(in millions)		
<b>For the year ended December 31, 2016:</b>					
<b>Operating activities:</b>					
Net cash from operating activities from continuing operations . . . . .	\$ 441	\$ 509	\$ 258	\$(186)	\$ 1,022
<b>Investing activities:</b>					
Business acquisitions, net of cash acquired . . . . .	(388)	—	—	—	(388)
Proceeds from sale of businesses, net of closing date cash balances . . . . .	563	—	(2)	—	561
Other investing activities . . . . .	(60)	(80)	(43)	—	(183)
Net cash from (used in) investing activities from continuing operations . . . . .	115	(80)	(45)	—	(10)
<b>Financing activities:</b>					
Proceeds from sale of senior notes . . . . .	547	—	—	—	547
Redemption of senior notes . . . . .	(856)	—	—	—	(856)
Common stock repurchased . . . . .	(373)	—	—	—	(373)
Dividends paid on L3's common stock . . . . .	(220)	—	—	—	(220)
Other financing activities . . . . .	496	(441)	(158)	149	46
Net cash used in financing activities from continuing operations . . . . .	(406)	(441)	(158)	149	(856)
Effect of foreign currency exchange rate changes on cash . . . . .	—	—	(13)	—	(13)
Net increase in cash and cash equivalents of discontinued operations . . . . .	—	13	—	—	13
Net increase in cash . . . . .	150	1	42	(37)	156
Cash and cash equivalents, beginning of the year . . . . .	141	—	165	(99)	207
Cash and cash equivalents, end of the year . . . . .	<u>\$ 291</u>	<u>\$ 1</u>	<u>\$ 207</u>	<u>\$(136)</u>	<u>\$ 363</u>
<b>For the year ended December 31, 2015:</b>					
<b>Operating activities:</b>					
Net cash from operating activities from continuing operations . . . . .	\$ 634	\$ 425	\$ 161	\$(185)	\$ 1,035
<b>Investing activities:</b>					
Business acquisitions, net of cash acquired . . . . .	(320)	—	—	—	(320)
Proceeds from sale of businesses, net of closing date cash balances . . . . .	14	28	276	—	318
Other investing activities . . . . .	(75)	(78)	(35)	—	(188)
Net cash (used in) from investing activities from continuing operations . . . . .	(381)	(50)	241	—	(190)
<b>Financing activities:</b>					
Repurchases of senior notes . . . . .	(297)	—	—	—	(297)
Common stock repurchased . . . . .	(740)	—	—	—	(740)
Dividends paid on L3's common stock . . . . .	(214)	—	—	—	(214)
Other financing activities . . . . .	781	(463)	(420)	148	46
Net cash used in financing activities from continuing operations . . . . .	(470)	(463)	(420)	148	(1,205)
Effect of foreign currency exchange rate changes on cash . . . . .	—	—	(19)	—	(19)
Net increase in cash and cash equivalents of discontinued operations . . . . .	—	83	—	—	83
Change in cash balance in assets held for sale . . . . .	—	1	60	—	61
Net (decrease) increase in cash . . . . .	(217)	(4)	23	(37)	(235)
Cash and cash equivalents, beginning of the year . . . . .	358	4	142	(62)	442
Cash and cash equivalents, end of the year . . . . .	<u>\$ 141</u>	<u>\$ —</u>	<u>\$ 165</u>	<u>\$(99)</u>	<u>\$ 207</u>

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**Exhibit 21**



**L3 Technologies, Inc. and Subsidiaries**  
As of December 31, 2017

<u>Name</u>	<u>Jurisdiction</u>
AeroElite Limited	United Kingdom
Aerosim Academy, Inc	Florida
Aerosim Bangkok Company Limited	Thailand
Aerosim Technologies, Inc.	Minnesota
Aerosim Thai Company Limited	Thailand
Airline Placement Limited	United Kingdom
Airline Recruitment Limited	United Kingdom
Asian Aviation Training Centre Ltd.	Thailand
Aviation Communication & Surveillance Systems, LLC*	Delaware
Beijing MAPPS-SERI Technology Company Ltd.*	China
Calzoni S.r.l.	Italy
Combat Advanced Propulsion, LLC*	Delaware
CTC Aviation Group Limited	United Kingdom
CTC Aviation Holdings Limited	United Kingdom
CTC Aviation International Limited	United Kingdom
CTC Aviation Services Limited	United Kingdom
CTC Aviation Training (UK) Limited.	United Kingdom
DMRAC – Aviation Corporation-SGPS, Unipessoal Lda	Portugal
EAA – Escola de Aviação Aerocondor, S.A.	Portugal
Electrodynamics, Inc.	Arizona
ESSCO Collins Limited	Ireland
Exmac Automation Limited	United Kingdom
FAST Holdings Limited*	United Kingdom
FAST Training Services Limited*	United Kingdom
Flight Training Acquisitions LLC	Delaware
ForceX, Inc.	Tennessee
G4U – Gestão de Activos Aeronáuticos, Sociedade, Lda	Portugal
G Air Advanced Training, Lda	Portugal
G Air II Maintenance, Lda	Portugal
Honeywell TCAS Inc.*	Delaware
Kigre, Inc.	Ohio
Interstate Electronics Corporation	California
L3 Adaptive Methods, Inc.	Delaware
L3 Advanced Programs, Inc.	Delaware
L-3 Afghanistan, LLC	Delaware
L3 Applied Technologies, Inc.	Delaware
L-3 Army Sustainment, LLC	Delaware
L3 Australia Group Pty Ltd	Australia
L3 Aviation Products, Inc.	Delaware
L-3 Brasil Importação, Exportação e Comércio Ltda.	Brazil
L-3 Centaur, LLC	Delaware
L3 Chesapeake Sciences Corporation	Maryland
L3 Cincinnati Electronics Corporation	Ohio
L3 Commercial Training Solutions Limited	United Kingdom
L-3 Communications AIS GP Corporation	Delaware
L-3 Communications ASA Limited	United Kingdom
L-3 Communications Australia Pty Ltd	Australia

<b>Name</b>	<b>Jurisdiction</b>
L-3 Communications Flight Capital LLC	Delaware
L-3 Communications Flight International Aviation LLC	Delaware
L-3 Communications Holding GmbH	Germany
L-3 Communications Hong Kong Limited	Hong Kong
L-3 Communications India Private Limited	India
L-3 Communications Integrated Systems L.P.	Delaware
L-3 Communications Investments Inc.	Delaware
L-3 Communications Korea Co., Ltd.	South Korea
L-3 Communications Limited	United Kingdom
L-3 Communications Link Simulation and Training UK (Overseas) Limited	United Kingdom
L-3 Communications Magnet-Motor GmbH	Germany
L-3 Communications MAPPS Inc.	Canada
L-3 Communications MAPPS Malaysia Sdn. Bhd.	Malaysia
L-3 Communications Marine Systems UK Ltd.	United Kingdom
L-3 Communications Singapore Pte. Ltd.	Singapore
L-3 Communications U.K. Ltd.	United Kingdom
L-3 Communications Vector International Aviation LLC	Delaware
L-3 Communications Vertex Aerospace LLC	Delaware
L-3 CTC Aviation Leasing (US) Inc.	Delaware
L-3 CTC Aviation Training (US) Inc.	Delaware
L3 CTS Airline Academy (NZ) Limited	New Zealand
L3 CTS Airline and Academy Training Limited	United Kingdom
L3 Domestic Holdings, Inc.	Delaware
L3 Doss Aviation, Inc.	Texas
L3 Electron Devices, Inc.	Delaware
L3 ESSCO, Inc.	Delaware
L3 Foreign Holdings, Inc.	Delaware
L3 Fuzing and Ordnance Systems, Inc.	Delaware
L-3 Global Holding UK Ltd.	United Kingdom
L-3 International UK Ltd	United Kingdom
L-3 Investments, LLC	Delaware
L3 MariPro, Inc.	California
L3 Micro Pty Limited	Australia
L3 Mobile-Vision, Inc.	New Jersey
L3 Oceania Pty Limited	Australia
L3 OceanServer, Inc.	Massachusetts
L3 Open Water Power, Inc.	Delaware
L-3 Saudi Arabia LLC	Saudi Arabia
L3 Security & Detection Systems, Inc.	Delaware
L-3 Security Equipment Trading (Beijing) Co., Ltd.*	China
L-3 Societa Srl.	Italy
L3 Technologies Australia Group Pty Ltd	Australia
L3 Technologies Canada Group Inc.	Canada
L3 Technologies Canada Inc.	Canada
L3 Technologies ESS Inc.	Canada
L3 Technologies Investments Limited	Cyprus
L3 Technologies MAS Inc.	Canada
L3 Technologies UK Group Ltd	United Kingdom
L-3 Technology & Services UK Ltd	United Kingdom

<b>Name</b>	<b>Jurisdiction</b>
L3 Unidyne, Inc.	Delaware
L3 Unmanned Systems, Inc.	Texas
L3 Westwood Corporation	Nevada
L-Tres Comunicaciones Costa Rica, S.A.	Costa Rica
MacDonald Humfrey (Automation) India Private Limited	India
MacDonald Humfrey (Automation) Limited	United Kingdom
MacDonald Humfrey (Automation) SEA PTE. Ltd.	Singapore
MacDonald Humfrey Automation Middle East Control Systems LLC	United Arab Emirates
MHA-Stopford Limited *	United Kingdom
Mustang Technology Group, L.P.	Texas
Narda Safety Test Solutions GmbH	Germany
Narda Safety Test Solutions S.r.l.	Italy
Power Paragon, Inc.	Delaware
SPD Electrical Systems, Inc.	Delaware
SPD Switchgear Inc.	Delaware
TRL Electronics Limited	United Kingdom
TRL Technology Limited	United Kingdom
Wescam Inc.	Canada
Wescam USA, Inc.	Florida

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\* Represents a non-wholly owned subsidiary.

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**Exhibit 23**



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-212152) and Form S-8 (Nos. 333-183353, 333-168467, 333-160359, 333-144135, 333-103752, 333-64389, 333-212151, 333-188450, 333-168466, 333-151964, 333-123424, 333-120393, 333-78317, 333-216192 and 333-221805) of L3 Technologies, Inc. of our report dated February 22, 2018 relating to the financial statements and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP  
New York, New York  
February 22, 2018

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**Exhibit 31.1**



**CERTIFICATION**

I, Christopher E. Kubasik, certify that:

1. I have reviewed this report on Form 10-K for the year ended December 31, 2017 of L3 Technologies, Inc.;
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; and
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.

Date February 22, 2018

/s/ Christopher E. Kubasik

Christopher E. Kubasik  
Chief Executive Officer and President

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**Exhibit 31.2**



**CERTIFICATION**

I, Ralph G. D'Ambrosio, certify that:

1. I have reviewed this report on Form 10-K for the year ended December 31, 2017 of L3 Technologies, Inc.;
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; and
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.

Date: February 22, 2018

/s/ Ralph G. D'Ambrosio

Ralph G. D'Ambrosio  
Senior Vice President and Chief Financial Officer

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**Exhibit 32**



**CERTIFICATION 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 L3 Technologies, Inc. (“L3”) on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), Christopher E. Kubasik, Chief Executive Officer and President and Ralph G. D’Ambrosio, Senior Vice President and Chief Financial Officer, of L3, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (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 L3.

Date: February 22, 2018

/s/ Christopher E. Kubasik  
Christopher E. Kubasik  
Chief Executive Officer and President

/s/ Ralph G. D’Ambrosio  
Ralph G. D’Ambrosio  
Senior Vice President and Chief Financial Officer

