LOCKHEED MARTIN CORP
Form 10-K
February 28, 2008
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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, 2007

Commission file number 1-11437

LOCKHEED MARTIN CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(Address and telephone number of principal executive offices)

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

Title of Each Class	**Name of each exchange on which registered**
Common Stock, $1 par value	New York Stock Exchange, Inc.

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 x 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 x

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, and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b2 of the Exchange Act). Yes ¨ No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second quarter.

Approximately $38.9 billion as of June 30, 2007.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date. Common Stock, $1 par value, 408,122,756 shares outstanding as of January 31, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Lockheed Martin Corporation s 2008 Definitive Proxy Statement are incorporated by reference in Part III of this Form 10-K.

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LOCKHEED MARTIN CORPORATION

FORM 10-K

For the Fiscal Year Ended December 31, 2007

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PART I

ITEM 1. BUSINESS

General

Lockheed Martin Corporation principally researches, designs, develops, manufactures, integrates, operates and sustains advanced technology systems and products, and provides a broad range of management, engineering, technical, scientific, logistic and information services. We serve both domestic and international customers with products and services that have defense, civil and commercial applications, with our principal customers being agencies of the U.S. Government. We were formed in 1995 by combining the businesses of Lockheed Corporation and Martin Marietta Corporation. We are a Maryland corporation.

In 2007, 84% of our net sales were made to the U.S. Government, either as a prime contractor or as a subcontractor. Our U.S. Government sales were made to both Department of Defense (DoD) and non-DoD agencies. Sales to foreign governments (including foreign military sales funded, in whole or in part, by the U.S. Government) amounted to 13% of net sales in 2007, while 3% of our net sales were made to commercial and other customers.

Our principal executive offices are located at 6801 Rockledge Drive, Bethesda, Maryland 20817-1877. Our telephone number is (301) 897-6000. Our website home page on the Internet is www.lockheedmartin.com. We make our website content available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference into this Form 10-K.

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

We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statement for our annual shareholders meeting, as well as any amendments to those reports, available free of charge through our website as soon as reasonably practical after we electronically file that material with, or furnish it to, the SEC. You can learn more about us by reviewing our SEC filings. Our SEC reports can be accessed through the investor relations page of our website, www.lockheedmartin.com/investor. The SEC also maintains a website at www.sec.gov that contains reports, proxy statements and other information regarding SEC registrants, including Lockheed Martin.

Business Segments

We operate in four principal business segments: Aeronautics, Electronic Systems, Information Systems & Global Services (IS&GS) and Space Systems. This structure reflects a realignment of our operations announced in early 2007 to enhance support for critical customer missions and increase our integration of resources. The realignment included the combination of our former Information Technology & Global Services (IT&GS) and Integrated Systems & Solutions (IS&S) business segments into the new IS&GS business segment, and the following additional changes:

- The Aircraft & Logistics Centers, which had been reported in IT&GS, became part of Aeronautics;
- Our contract to manage the Sandia National Laboratories and our ownership in the joint venture that manages the Atomic Weapons Establishment in the United Kingdom, which had been reported in IT&GS, became part of Electronic Systems; and
- Transportation and Security Solutions, which had been reported in Electronic Systems, became part of IS&GS.

The historical results, discussion and presentation of our business segments as set forth in this Form 10-K reflect this realignment. For more information concerning our segment presentation, including comparative segment sales, operating profits and related financial information for 2007, 2006 and 2005, see Note 15 Information on Business Segments beginning on page 90 of this Form 10-K.

Aeronautics

Aeronautics is engaged in the design, research and development, systems integration, production, sustainment, support and upgrade of advanced military aircraft, air vehicles and related technologies. Our customers include various government agencies and the military services of the

United States and allied countries around the world. Major products and programs include design, development, production and sustainment of the F-35 stealth multi-role international coalition fighter; the

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F-22 air dominance and multi-mission stealth fighter; the F-16 international multi-role fighter; the C-130J tactical transport aircraft; the C-5 strategic airlifter modernization; and support for the F-117 stealth fighter, P-3 maritime patrol aircraft, S-3 multi-mission aircraft and U-2 high-altitude reconnaissance aircraft. We also produce major components for Japan s F-2 fighter and are a co-developer of the T-50 advanced jet trainer. Our Skunk Works® advanced development organization provides next generation innovative system solutions using rapid prototyping and advanced technologies.

In 2007, Aeronautics net sales of $12.3 billion represented 29% of our total net sales. The major lines of business and the percentage that each contributed to Aeronautics 2007 net sales are:

The segment is dependent on the U.S. military and international governments as customers. In 2007, U.S. Government customers accounted for approximately 78% of the segment s net sales.

Combat Aircraft

Our Combat Aircraft business designs, develops, produces and provides systems support for fighter aircraft. Our major fighter aircraft programs include:

- The F-35 Lightning II Joint Strike Fighter stealth multi-role international coalition fighter;
- The F-22 Raptor air dominance and multi-mission stealth fighter; and
- The F-16 Fighting Falcon low-cost, combat-proven, international multi-role fighter.

Both the F-35 and F-22 are 5TH Generation fighters, combining stealth, supersonic speed, high maneuverability, sensor fusion and other attributes to achieve a level of capability and survivability unmatched by earlier generation combat aircraft. The F-16 is a 4TH Generation fighter which, as a result of multiple upgrades, continues to play an important role in the defense of the U.S. and its allies.

F-35

The F-35 Lightning II is designed to be a superior multi-role stealth aircraft offering profound improvements in lethality, survivability, affordability and supportability over all existing international multi-role aircraft. The United States and its international partners (the United Kingdom, Italy, the Netherlands, Turkey, Canada, Australia, Denmark and Norway) are working together on the System Development and Demonstration (SDD) program to design, test and build a family of aircraft and sustainment systems to meet joint and coalition requirements. Israel and Singapore are security cooperation participants on the SDD program**.** In 2007, the partner countries government-to-government Production, Sustainment and Follow-On Development memoranda of understanding were finalized. The memoranda provide a long-term business framework for partner aircraft production, sustainment and future upgrades.

The F-35 s multiple-variant designs include:

- The F-35A, a conventional takeoff and landing variant (CTOL);
- The F-35B, a short takeoff and vertical landing variant (STOVL); and
- The F-35C, a carrier-based variant (CV).

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The F-35 is planned to replace the F-16 and A-10 for the U.S. Air Force, the F/A-18A/C for the U.S. Navy, the AV-8B and F/A-18A/C/D for the U.S. Marine Corps, and the Harrier GR.7 and Sea Harrier short takeoff and vertical landing attack aircraft for the United Kingdom Royal Air Force and Royal Navy.

Aeronautics was awarded the SDD contract for the F-35 in the fourth quarter of 2001. Calendar-year 2007 marked the sixth full year of performance on the planned 12-year development contract. Testing of airworthiness and systems evaluation using the first F-35 CTOL aircraft continued in 2007, and component production has begun on all of the remaining SDD flight test aircraft (all variants) and both CTOL production aircraft in Low Rate Initial Production Lot 1. The first STOVL test airplane moved from the factory to the flight line in December 2007 and, after extensive ground testing, is expected to fly mid-year 2008. The first flight of the CV aircraft is planned to occur in the 2009 timeframe.

Given the size of the F-35 program, we anticipate that there will be a number of studies related to the program schedule and production quantities over time as part of the normal DoD, Congressional and international partners oversight and budgeting processes.

F-22

We are the industry team leader for the F-22 Raptor. In production since 1997, the F-22 has unmatched capabilities compared with other operational U.S. Air Force aircraft. The capabilities include enhanced maneuverability, stealth, supercruise speed (speed in excess of Mach 1.5 without afterburner) and advanced integrated avionics that enable pilots to attack critical air and surface targets to gain and maintain air superiority against air-to-air and ground-to-air threats. The program is in full-rate production. Through 2007, a total of 110 F-22s have been delivered to the U.S. Air Force, including 24 Raptors delivered during 2007. In 2007, we received a 60-aircraft multi-year contract for Production Lots 7, 8 and 9. At December 31, 2007 there were 81 F-22s in backlog.

In 2007 we began delivering F-22s to the third operational squadron, the 90th Fighter Squadron at Elmendorf Air Force Base (AFB), Alaska, and we expect to deliver the first aircraft for the fourth operational unit, the 8th Fighter Squadron at Holloman AFB, New Mexico, in mid 2008. Also in 2007, the Raptor completed its deployment to Kadena Air Base, Japan, its first such deployment outside the U.S. and second deployment overall. The Raptor also participated in its first Red Flag exercise, a large-scale force-on-force exercise designed to prepare joint forces to respond to crises around the world. During the exercise, F-22s demonstrated exceptional performance, ensuring air dominance and enhancing the success of combat commanders by providing improved situational awareness for other ground and air assets. In December 2007, the U.S. Air Force declared Full Operational Capability for the F-22.

F-16

We produce the F-16 Fighting Falcon multi-role tactical fighter aircraft and continue to provide upgrades and support for the U.S. Air Force and our international customers. From the program s inception in the mid-1970s through 2007, 4,389 F-16s have been delivered worldwide, representing nearly 30 years of continuous production deliveries. As of year-end 2007, the aircraft had been selected by 24 countries, with 52 follow-on buys by 14 of these countries.

In 2007, a total of 41 F-16 aircraft were delivered worldwide. In July 2007, an Undefinitized Contractual Action (UCA) was signed for the foreign military sales procurement of 30 new F-16 Block 50 aircraft to the Government of Turkey. Backlog at year end was 107 F-16 aircraft, including the 30 aircraft under the Turkey UCA.

Many technologically advanced multi-role capability improvements have been incorporated into new F-16 production aircraft as well as modification programs for in-service aircraft. Air-to-air and precision attack capabilities have been improved through the inclusion of new systems, sensors and weapons. Advanced electronic warfare systems have improved survivability. New fuel tank configurations have increased range and endurance. Modernized, upgraded engines have increased aircraft performance and improved supportability. Advanced communication links have given the F-16 network-centric warfare capabilities.

Other Combat Aircraft

We also participate in joint production of the F-2 fighter aircraft, and are a co-developer of the T-50 supersonic jet trainer aircraft.

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Air Mobility

In Air Mobility, we design, develop, produce and provide full system support and sustainment of tactical and strategic airlift aircraft. Our major programs include production, support and sustainment of the C-130J Super Hercules, upgrade and support of the legacy C-130 fleet, support of the existing C-5A/B/C fleet and development, installation and support of the emerging C-5M Super Galaxy fleet.

C-130J

The C-130J Super Hercules is an advanced technology, tactical transport aircraft offering improved performance and reliability, and reduced operating and support cost, compared to earlier C-130 models. The C-130J incorporates state-of-the-art cockpit design and avionics, a more powerful and efficient propulsion system and other innovations into a proven, mission-tested airframe. It is designed primarily to support the military mission of tactical combat transport. It also is a multi-mission platform that has been purchased in support of electronic warfare, weather reconnaissance and sea surveillance missions, and as an aerial tanker. In 2007, we delivered 12 C-130Js, including seven aircraft to the U.S. Air Force, four aircraft to the U.S. Marine Corps and one to the Royal Danish Air Force. A total of 213 C-130Js have been ordered, with 54 remaining in backlog at the end of 2007. Orders received in 2007 included six aircraft for the U.S. Government, four for Norway and 17 for Canada.

The Super Hercules is the latest variant produced on the longest continuously operating military aircraft assembly line in history. Including all models of the aircraft, we have delivered a total of 2,313 C-130s from the program s inception in 1954 through 2007. In the U.S., the active-duty Air Force, Air Force Reserve Command and Air National Guard units fly C-130Js. The Marine Corps operates KC-130J tankers and the Coast Guard flies the HC-130J, which will soon be fully missionized for maritime patrol and search and rescue. International C-130J operators include the United Kingdom Royal Air Force, Royal Australian Air Force, Italian Air Force and the Royal Danish Air Force.

C-5

Three fully modernized C-5M Super Galaxy aircraft are performing in a flight test program and continue to be on schedule for completion of flight test in the third quarter of 2008. The C-5M is the product of two major modification programs to the C-5 strategic airlifter: the C-5 Avionics Modernization Program (AMP) and the C-5 Reliability Enhancement and Reengining Program (RERP). The C-5 AMP program replaces the 1960s and 1970s-era analog avionics system in the C-5 fleet with a digital suite along with an integrated architecture that allows for further upgrades as well as providing Global Air Traffic Management (GATM) capability. The RERP portion of C-5M modification, which is planned for 49 aircraft in addition to the three in flight test, replaces out-of-production components with commercially proven reliable systems. Together, the modification programs are expected to significantly extend the life of the C-5 fleet. A total of 111 C-5 aircraft are currently in the U.S. fleet, including the three C-5Ms in flight testing. Active duty U.S. Air Force, Air National Guard, and Air Force Reserve Command units operate the C-5.

Advanced Research and Development and Other

We are involved in advanced development programs incorporating advanced design and rapid prototype applications. Our Advanced Development Programs organization, known as the Skunk Works®, has made unmanned air systems one focus of its efforts, and is actively developing the operational concepts and enabling technologies to provide these assets to the DoD in a cost effective manner. Additional focus on future systems includes next generation capabilities for both long-range strike and air mobility.

Some notable accomplishments in 2007 include the phase two award of the Advanced Composite Cargo Aircraft (ACCA) Flight Demonstration contract, continued participation as a subcontractor on the Unmanned Combat Air System Demonstration (UCAS-D) effort, successful component and engine testing of the Revolutionary Approach to Time-critical Long Range Strike (RATTLRS) vehicle and continued focus on Falcon, a hypersonic technologies initiative.

In addition, we continue to explore technology advancement and insertion in existing aircraft, such as the F-35, F-22, F-16 and C-130; are actively involved in numerous network enabled activities that allow separate systems to work together to increase effectiveness and lethality; and continue to invest in new technologies to maintain and enhance competitiveness in military aircraft design and development.

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Global Sustainment

As part of each of our businesses, we provide a full range of logistics support, sustaining engineering, upgrade modifications and services for our full line of aircraft, including the F-35 Lightning II, the F-22 Raptor, the F-16 Fighting Falcon, the C-130 Hercules and the C-5 Galaxy airlifters, the P-3 Orion, the S-3 Viking, the F-117 Nighthawk and the U-2 Dragon Lady.

For the F-35 Lightning II SDD program, we have developed an Autonomic Logistics and Global Sustainment solution, focused on performance-based logistics, to provide an affordable total air system life-cycle sustainment solution for the aircraft s multiple variants and worldwide customer base.

We will continue through mid-year 2008 to provide the U.S. Air Force with contractor-led support for the F-117 Nighthawk fleet through our Total System Sustainment Partnership. At that time, after a distinguished legacy that includes 26 years of operational service and over 250,000 flight hours accomplished, the F-117 fleet is planned to be retired. As winner of the first DoD performance-based logistics award for systems-level support, we are growing that heritage with a program for the sustainment of the F-22 called the Follow-On Agile Sustainment for the Raptor or FASTeR. Beginning in early 2008, we will be responsible for integrating and accomplishing all sustainment activities for the F-22 as the Product Support Integrator in partnership with the U.S. Air Force System Support Manager.

Under the Falcon 2020 program, we provide international F-16 operators with avionics and structural upgrade kits to enable those customers to keep their fleets viable for the future.

We have developed an extensive service life extension program, including the planned production of new wings, for the existing fleet of P-3 aircraft. The Royal Norwegian Air Force will be the first service life extension program customer, having signed a contract to upgrade its P-3 fleet in February 2007. We believe there are additional opportunities to implement this program with a number of domestic and international P-3 operators. We continue our nearly decade-long support effort for the U.S. Navy s fleet of S-3 Viking aircraft through the S-3 Prime Vendor Support contract, which will continue until the Navy s planned retirement of the fleet in 2009.

With regard to the C-130, we continue as a key member of a team, including Rolls Royce and Marshall Aerospace, that was awarded the Hercules Integrated Operational Support (HIOS) contract for the long-term support of the United Kingdom s fleet of C-130 aircraft. In addition, we signed a partnering agreement in 2007 to provide long-term support for the Italian C-130J fleet for a period of three years. We also offer center wing box modifications and avionics upgrades to customers who fly legacy versions of the Super Hercules in addition to the support and partnerships provided to sustain our newest tactical aircraft.

The U-2 has been the backbone of our nation s airborne intelligence collection operations for several decades, and continues to provide unmatched operational capabilities in support of Operation Enduring Freedom. As a result of the Reconnaissance Avionics Maintainability Program upgrade, which includes state of the art cockpit displays and controls along with other sensor modifications, the U-2 is expected to continue to provide leading-edge intelligence collection capabilities for years to come.

Through our Sustainment Services organization, we offer nose-to-tail aircraft maintenance, modifications and state-of-the-art upgrades, and provide the full range of depot services in addition to a full range of supply chain services. Under our Integrated Prime Vendor contract with the Defense Logistics Agency, we provide parts to the U.S. Air Force s three Air Logistics Center depots.

Through Kelly Aviation Center, L.P., a joint venture with GE-Aviation and Rolls-Royce, we provide engine maintenance, repair and overhaul and new engine assembly and testing for military and commercial customers.

Competition

We are a major worldwide competitor in combat aircraft, air mobility and military aircraft research and development. Military aircraft are subject to a wide variety of U.S. Government controls (*e.g.*, export restrictions, market access, technology transfer, industrial cooperation and contracting practices). Although a variety of criteria determine the results of different competitions, price is a major factor, as are past performance and customer confidence. Other critical factors are technical capabilities, release of technology, prior purchase experience, financing and total cost of ownership.

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In international sales, the purchasing government s relationship with the U.S. and its industrial cooperation programs are also important factors in determining the outcome of a competition. It is common for international customers to require contractors to comply with their industrial cooperation regulations, sometimes referred to as offset requirements. As a result, we have undertaken foreign offset agreements as part of securing some international business. For more information concerning offset agreements, see Contractual Commitments and Off-Balance Sheet Arrangements in Management s Discussion and Analysis beginning on page 54 of this Form 10-K.

With respect to military aircraft, we compete with both domestic and international companies. Some or all of these companies are competing, or preparing to compete, for unmanned military aircraft sales. Our military aircraft programs also face potential competition from the application of commercial-aircraft derivatives to missions that require large aircraft and the application of unmanned systems to various missions.

With respect to tactical fighters, the F-16 remains a formidable competitor especially on the basis of price and our continued ability to update its capabilities with changes in sensor and weapons systems. The F-22 and F-35 are recognized as the world s only 5th Generation fighter aircraft and are designed to be both lethal and survivable against emerging high-threat systems. The F-22 is designed to provide air-dominance, strike and multi-mission stealth combat capabilities required for conventional military operations. The U.S. Air Force is the only F-22 customer since international sales of the Raptor are presently prohibited by the U.S. Congress. The F-35 is a cornerstone of future global defense cooperation and is planned to replace several existing multi-role fighters for the U.S. and its allied partners. Due to the number of governments that have agreed to participate in the SDD phase, we anticipate that significant international demand will develop for purchasing the F-35.

Demand for air mobility aircraft is driven by the need to maintain or replace large numbers of aircraft for which maintenance costs have been increasing and by the high development costs for new replacement aircraft. In some cases, the choice has been to modernize and update the available aircraft. With some customers, new commercial aircraft derivatives may make suitable replacement platforms and may be the final choice. In other cases, existing platforms may perform the job more capably if modernized. In 2007, domestic and international customers opened numerous competitions for air mobility aircraft or elected to procure new C-130J aircraft. The C-130J provides intra-theater airlift and a full range of tactical mobility, refueling and humanitarian airlift capabilities.

In concert with changes in the way products are deployed, operated and supported, our customers are changing their approach to sustainment of our platforms. Historically, nearly all domestic and international users of our fighter, transport and special mission aircraft have sought to develop and maintain the capability to perform 100 percent of the necessary support functions. Due to the combined factors of defense budget constraints, increased component reliability and decreased (or eliminated) depot inspections, it is no longer cost effective for many customers to perform substantially all of their own support functions. As a result, sustainment and logistics support opportunities have increased.

As the original equipment manufacturer for numerous platforms, we are focused on expanding our global sustainment services, an increasingly important portion of the Aeronautics business. We continue to provide support through depot partnerships and industrial cooperative relationships. Third-party providers offer competition within elements of the sustainment portfolio. However, in the major areas of sustaining engineering, modification and upgrade, and supply chain management, we, as the original equipment manufacturer, can spread development costs among multiple users and are in the best position to affordably integrate production improvements into a customer s existing complex systems.

Electronic Systems

Our Electronic Systems segment is engaged in the design, research, development, integration, production and sustainment of high performance systems and subsystems for undersea, shipboard, land and airborne applications. Major product lines include: tactical missiles and weapon fire control systems; air and sea-based missile defense systems; surface ship and submarine combat systems; anti-submarine and undersea warfare systems; ground combat vehicle integration; avionics, systems integration and program management for fixed and rotary-wing aircraft systems; radars; surveillance and reconnaissance systems; and simulation and training systems.

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In 2007, Electronic Systems net sales of $11.1 billion represented 27% of our total net sales. Electronic Systems three major lines of business and the percentage that each contributed to 2007 net sales are:

The segment is dependent on both military and civilian agencies of the U.S. Government as well as international governments as customers. In 2007, U.S. Government customers accounted for approximately 74% of the segment s total net sales.

Maritime Systems & Sensors

Maritime Systems & Sensors (MS2) provides ship systems integration services, including command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR) capability across shore-based command centers; surface ship and submarine combat systems, sea-based missile defense systems; sensors; tactical avionics; port traffic management systems; missile launching systems; aerostat surveillance systems; and supply chain management programs and systems.

The AEGIS weapon system is a fleet defense system and a sea-based element of the U.S. missile defense system. It is a radar and missile launching system, integrated with its own command and control system, designed to defend against advanced air, surface and subsurface threats. The AEGIS program encompasses activities in development, production, ship integration and test and lifetime support for ships of the U.S. Navy and international customers. We test and integrate these weapon systems for the U.S. Navy s Ticonderoga class cruiser and Arleigh Burke class destroyer, along with the Kongo class destroyer for Japan, the F100 and F105 class frigates for Spain, the Fridtjof Nansen class frigate for Norway, the KDX class destroyer for Korea and the Hobart class air warfare destroyer for Australia. Since program inception in 1978, MS2 has received contracts for 111 AEGIS weapons systems, including 27 for the Ticonderoga class cruiser, 62 for the Arleigh Burke class destroyer and 22 international systems. During 2007, our production workscope included four international systems and three domestic systems.

In 2007, the DoD s Missile Defense Agency (MDA) awarded MS2 a contract for continued development and evolution of the AEGIS Ballistic Missile Defense System (BMDS). There are 18 ships planned with BMDS technology and long-range surveillance and tracking capability. During the year, we performed a number of successful ballistic missile intercept tests. The latest test achieved an unprecedented result in which the BMDS successfully intercepted and destroyed two non-separating ballistic missile targets nearly simultaneously.

In early 2007, we were awarded a program to manage the logistics and warehousing for all tires used on U.S. Air Force and Army aircraft around the world, supporting the tire manufacturer and prime contractor on the program. This performance based contract will leverage our global supply chain management expertise as the U.S. military seeks to integrate the production and the logistics for aircraft tires.

The U.S. Navy has approved a revised ship delivery date of August 2008 for the Littoral Combat Ship *Freedom* (LCS-1), the first in a new class of ships designed to provide added flexibility to operate in coastal waters. Delivery is to be followed by a 60-day crew move aboard period in order to complete ship load-out activities and conduct ship crew familiarization training. At the end of 2007, the ship was over 80% complete, with compartment closeout and system testing proceeding. Our production activities continue to focus on preparing for a series of dockside tests in support of builder s sea

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trials to be held in Spring 2008. A second ship with a different design (LCS-2) is being built by a competitor. In 2007, work on the next two ships in the program (LCS-3, under contract to us, and LCS-4, under contract to our competitor) was terminated by the U.S. Navy. A competition to build the next ship in the program is expected to be held in 2008, with additional phases of the program to follow.

We were awarded a contract by the Portuguese Ministry of Defense to provide a full mission system avionics upgrade on five P-3C maritime surveillance aircraft The upgrades include electronic support measures, acoustics, communications, electro-optic and infrared systems as well as new data management software and hardware including controls, displays and mission computers. Delivery of the first upgraded aircraft is scheduled for late 2009.

Missiles & Fire Control

Missiles & Fire Control develops and produces land-based, air, and theater missile defense systems, tactical battlefield missiles, electro-optical systems, fire control and sensor systems, and precision-guided weapons and munitions.

The PAC-3 missile is an advanced defensive missile designed to intercept incoming airborne threats. During 2007, we delivered a total of 176 missiles, with deliveries to Japan and the Netherlands representing the first international PAC-3 deliveries. We were awarded a sixth production contract in December 2007 for 148 PAC-3 missiles including 108 U.S. missiles and 40 missiles for international customers.

The Terminal High Altitude Area Defense (THAAD) system is a transportable defensive missile system designed to engage targets both inside and outside of the Earth s atmosphere. The THAAD system is comprised of the THAAD fire control and communication units, missiles, radars, launchers and ground support equipment. The program, currently in the development phase, conducted four successful test flights in 2007 and has conducted eight successful flights overall. Progress continued on a production contract with the MDA, received in late 2006, for two fire control and communications units.

The Arrowhead fire control system provides modernized targeting and piloting capabilities for Apache helicopter crews to the U.S. Army and international customers, continuing our over 20-year legacy of providing pilot night-vision sensors and targeting capabilities for the Apache. More than 1,000 sensor systems have been delivered to the U.S. Army and foreign military customers since 1983. The Arrowhead kits will replace certain legacy hardware on the U.S. Army and other international customers Apache helicopters to provide a modernized sensor for safer flight in day, night and bad weather missions and improved weapons targeting capability. The initial Arrowhead production contract was awarded in 2003. Major new awards were received in 2007 for Arrowhead Lot 4, which authorized the production of 158 Arrowhead kits through December 2009 for the U.S. Army and international customers. A four-year performance-based logistics contract was also awarded in 2007.

Missiles & Fire Control received a number of new contracts and follow-on orders and achieved key program milestones in 2007. Significant orders included awards for several tactical missile and fire control programs from various international customers. In October, we delivered our 20,000th Hellfire missile. In addition, we lead a multinational venture that is developing the Medium Extended Air Defense System (MEADS), a mobile air defense system designed to replace Patriot systems used by the United States and Germany, and Nike Hercules systems in Italy. The MEADS program successfully completed the component preliminary design reviews. Product sustainment and logistic services continue to be a major focus for growth opportunities, resulting in significant orders in support of fire control and tactical missile programs.

Platform, Training & Energy

Our Platform, Training & Energy (PT&E) business integrates mission-specific applications for fixed and rotary-wing platforms, including providing logistics and sustainment; develops and integrates postal automation and material handling systems; develops tactical wheeled vehicles; and provides simulation, training and support services. We also manage Sandia National Laboratories in the U.S. for the Department of Energy. Sandia National Laboratories supports the stewardship of the U.S. nuclear weapons stockpile, developing sophisticated research and technology in the areas of engineering sciences, materials and processes, pulsed power, microelectronics and photonics, micro-robotics, and computational and information sciences. In the United Kingdom, we own one-third of a joint venture that manages the Atomic Weapons Establishment program.

We lead an industry team to provide the new fleet of Marine One helicopters for the President of the United States. VH-71 is the Presidential Helicopter replacement program, and is planned to provide a command and control capability to enable the President to perform the full duties of the office while airborne. We are currently performing on Increment 1,

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which includes test vehicles and pilot production aircraft. Flight tests continue on the test aircraft at Naval Air Station Patuxent River, Maryland. We have stopped work on Increment 2 at our customer s request and are working with the U.S. Navy as it evaluates requirements and funding profiles for the next phase of the program.

In 2007, we were awarded a multi-year contract by the U.S. Navy to produce and integrate mission systems for the new MH-60R multi-mission helicopter over the next five years. Designed primarily for anti-submarine and anti-surface warfare, the MH-60R will replace the Navy s current fleet of SH-60B and SH-60F Seahawk helicopters.

Our tactical wheeled vehicle team delivered four Lightweight Prime Mover (LWPM) vehicles to the U.S. Marine Corps in 2007. Also in 2007, we delivered the Future Tactical Truck System (FTTS) prototype vehicle to the U.S. Army, which began road tests in 2007. The purpose of the U.S. Army s FTTS program was to demonstrate technologies expected to be used in future truck procurement programs such as the Joint Light Tactical Vehicle (JLTV) program. We developed a JLTV prototype and began a combination of on-road and off-road testing in 2007, and testing continues in 2008.

We received a 20-year contract to provide basic flight training to the Republic of Singapore Air Force in 2006, the same year that we were selected as the preferred bidder for the United Kingdom s Military Flight Training System. We expect to complete negotiations on a contract early in 2008. In 2007, we won a competition for a multi-year contract and will continue to provide aircrew training and rehearsal support services for the U.S. Air Force. This program will provide Air Force Special Operations Command crews with training on a variety of weapon systems. Additionally, we were awarded a program to develop the U.S. Marine Corps Embedded Platform Logistics system. This advanced embedded capability for Marine Corps vehicles is intended to use vehicle sensors to capture data to provide predictive information and failure analysis, allowing the Marines to deploy the best equipment available for mission success. These programs continue and build on our record of performance in providing logistics and sustainment.

Competition

Electronic Systems broad portfolio of products and services competes against the products and services of other large aerospace, defense and information technology companies, as well as numerous smaller competitors. We often form teams with other companies that are competitors in other areas to provide customers with the best mix of capabilities to address specific requirements. The principal factors of competition include technical and management capability, price, past performance and our ability to provide solutions to our customers requirements on a timely basis.

In international sales, the purchasing government s relationship with the U.S. and its industrial cooperation programs are also important factors in determining the outcome of competitions. It is common for international customers to require contractors to comply with their industrial cooperation regulations, sometimes referred to as offset requirements. As a result, we have undertaken foreign offset agreements as part of securing some international business. For more information concerning offset agreements, see Contractual Commitments and Off-Balance Sheet Arrangements in Management s Discussion and Analysis beginning on page 54 of this Form 10-K.

Information Systems & Global Services

Our IS&GS segment is engaged in providing federal services, Information Technology (IT) solutions and advanced technology expertise across a broad spectrum of applications and customers. IS&GS provides full life cycle support and highly specialized talent in the areas of software and systems engineering, including capabilities in space, air and ground systems, and also provides logistics, mission operations support, peacekeeping and nation-building services for a wide variety of U.S. defense and civil government agencies in the U.S. and abroad.

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In 2007, IS&GS had net sales of $10.2 billion, which represented 24% of our total net sales. IS&GS three major lines of business and the percentage that each contributed to its 2007 net sales are:

The segment is heavily dependent on both DoD and non-DoD agencies of the U.S. Government as customers. In 2007, U.S. Government customers accounted for approximately 94% of the segment s total net sales.

Mission Solutions

Mission Solutions combines our expertise with the requirements of Intelligence, Defense and Civil agency customers with significant research and development and engineering competencies to provide solutions that produce an operational effect or business outcome. Mission Solutions provides systems that gather, process, assimilate, fuse and distribute data from ground, air, and space assets. We are also responsible for complex systems integration support that provides real-time situational awareness information to the DoD. Key programs include a classified customer portfolio; transformational communications systems such as the Transformational Communications MILSATCOM Mission Operations Segment (TMOS) and the Warfighter Information Network-Tactical (WIN-T); mission and combat support solutions such as Global Command Support System (GCSS) and the Combatant Commanders Integrated Command & Control Systems (CCICCS); and mission critical civil agency programs including the U.S. Census, National Archives & Records Administration (NARA) and Transportation Worker Identification Credential (TWIC).

In 2007, the TMOS program, which provides the network management system and operations management system for the Government s Transformational Communications MILSATCOM system, completed a successful system design review with the U.S Air Force. We were also awarded the TWIC contract to support the enrollment and credential (card) issuance to at least 750,000 transportation workers for the DHS. In October, our customer accepted the En Route Automation Modernization (ERAM) system we developed and tested for the Federal Aviation Administration (FAA). Considered a critical part of the National Airspace System s future, ERAM is intended to be the backbone of the FAA s en route operations once it is fully operational. The system includes computer hardware, software and an extremely robust backup capability with four levels of redundancy.

Information Systems

Information Systems provides functional expertise in business systems, IT infrastructure and process outsourcing, systems based on the use of commercial technology, and solutions structured to deliver contractually specified levels of service. The contracts within this line of business are mostly task order vehicles (indefinite-delivery/indefinite-quantity (IDIQ) contracts) or Government Services Administration (GSA) schedules. Key programs include the FAA Automated Flight Service Station (AFSS) and large IT infrastructure programs such as FBI Sentinel.

In June 2007, the FBI deployed the first phase of their next-generation information management system as a part of the FBI Sentinel program, designed to provide FBI employees with a marked improvement in their ability to access, retrieve and move information. Also in 2007, in support of the FAA AFSS program, our flight specialists began using our Flight Service for the 21st Century (FS21) technology to provide flight services. FS21 streamlines flight planning and allows the sharing of weather and air space system status across the entire AFSS network.

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In addition to these contract milestones, IS&GS was awarded a contract in 2007 to support the Jet Propulsion Laboratory in its desktop infrastructure integration. IS&GS was also awarded the Information Technology Network Operations Virtual Alliance (IT NOVA) IDIQ contract with the Department of Homeland Security.

Global Services

In Global Services, we support mission services, global security and stability operations and provide facility services. In this arena, the key competencies are the people we provide to support the mission and our agility in responding to dynamic staffing requirements. Significant programs include mission planning and launch services for Orion and other National Aeronautics and Space Administration (NASA) programs, as well as military space efforts; in-transit visibility and other asset management and logistics programs; and infrastructure and operational support contracts.

Through our Pacific Architects and Engineers, Inc. (PAE) subsidiary, Global Services provides entire support infrastructures and staffing for overseas bases. This includes base camp construction, logistics, democratization services and management of embassies, air terminals, base camps and other facilities. These operations are increasingly global in nature as we are deployed with our customers and our services support their mission. Customers include the U.S. Department of State and international agencies such as the North Atlantic Treaty Organization (NATO) and the United Nations. The Global Services unit also includes Savi Technology, Inc., a subsidiary of ours, which provides radio frequency identification (RFID) solutions for both our government and commercial customers.

Competition

The range of products and services at IS&GS results in competition with other large aerospace, defense and information technology companies, as well as with numerous smaller competitors. The principal factors of competition include technical and management capability, the ability to develop and implement complex, integrated system architectures, price and past performance. Program requirements frequently result in the formation of teams such that companies teamed on one program are competitors for another, especially in our Mission Systems line of business. On some outsourcing procurements, which are more prevalent in our Information Systems line of business, we may also compete with a government-led bidding entity.

Space Systems

Space Systems is engaged in the design, research, development, engineering and production of satellites, strategic and defensive missile systems and space transportation systems. The Satellite product line includes both government and commercial satellites. Strategic & Defensive Missile Systems includes missile defense technologies and systems and fleet ballistic missiles. Space Transportation Systems includes the next generation human space flight system known as the Orion crew exploration vehicle, as well as the Space Shuttle s external tank and commercial launch services using the Atlas V launch vehicle. Through ownership interests in two joint ventures, Space Transportation Systems also includes Space Shuttle processing activities and expendable launch services for the U.S. Government.

In 2007, Space Systems net sales of $8.2 billion represented approximately 20% of our total net sales. Space Systems principal lines of business and the percentage that each contributed to 2007 net sales are:

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The segment is heavily dependent on both military and civilian agencies of the U.S. Government as customers. In 2007, U.S. Government customers accounted for approximately 94% of the segment s net sales.

Satellites

Our Satellites business designs, develops, manufactures and integrates advanced technology satellite systems for government and commercial applications. We are responsible for various classified systems and services in support of vital national security systems.

The Space-Based Infrared System (SBIRS) program is providing the nation with enhanced worldwide missile detection and tracking capabilities. The consolidated ground system, operational since 2001, processes data from the Defense Support Program satellites and manages the satellite constellation. The ground system also provides the foundation to evolve mission capabilities as SBIRS payloads and satellites are deployed. SBIRS is envisioned to operate with a total of four satellites in geo-synchronous earth orbit and two sensors in highly-elliptical orbit (HEO) to increase mission capabilities for missile warning, missile defense, technical intelligence and battlespace characterization. Our current contract includes two geo-synchronous orbit spacecraft and two highly-elliptical orbit payloads. The first HEO payload is on-orbit and is exceeding specifications following initial on-orbit checkout.

The Advanced Extremely High Frequency (AEHF) system is the DoD s next generation of highly secure communications satellites. The AEHF constellation is envisioned to include three networked satellites designed to provide improved secure data throughput capability and coverage flexibility to regional and global military operations and to be compatible with the Milstar I and II systems. The AEHF communication system includes the satellite constellation, mission control segment and terminal development. We are under contract to build the three space vehicles and develop the ground segment.

The Global Positioning System (GPS) is a space-based radio navigation and time distribution system. Its mission is to provide precise, continuous, and all-weather three-dimensional position, velocity, timing and information to properly equipped air, land, sea and space-based users. We are the prime contractor for the GPS IIR program, which includes 20 satellites that will improve navigation accuracy and provide longer autonomous satellite operation than current global positioning satellites. In 2007, we delivered the eighth and final satellite in the modernized Block IIR production program to the U.S. Air Force. We also successfully delivered in-orbit the fourth GPS Block IIR-M satellite in the series. The GPS Block IIR-M satellites include new features that enhance operations and navigation signal performance for military and civilian GPS users around the globe.

In 2007, we continued to perform work in preparation for the GPS III program. GPS III is intended to deliver major improvements in accuracy, assured service delivery, integrity, and flexibility for military and civil users. We have assessed mission needs and requirements, and developed innovative architecture recommendations, culminating in a successful systems design review and subsequent proposal submittal in August 2007. The U.S. Air Force is expected to award a multi-billion dollar development contract to a single contractor in 2008.

We also continued to conduct risk reduction and system trade studies supporting the U.S. Air Force s Transformational Satellite program. The program represents the next step toward transitioning the DoD wideband and protected communications satellite architecture into a single network comprised of multiple satellite, ground and user segment components. The system is being designed to network mobile warfighters, sensors, weapons, and communications command and control nodes located on the ground, in the air, at sea or in space. We executed a successful space segment design review and subsequently submitted our proposal in July 2007. The U.S. Air Force is expected to award a multi-billion dollar development contract to a single contractor in 2008.

The Mobile User Objective System (MUOS) is a next-generation narrowband tactical satellite communications system for the U.S. Navy that is envisioned to provide significantly improved and assured communications for the mobile warfighter. MUOS is planned to replace the current narrowband tactical satellite communications system known as the Ultra High Frequency Follow-On (UFO) system. The MUOS satellites are designed to be compatible with the existing UFO system and associated legacy terminals and provide increased military communications availability. The program calls for the delivery of five satellites, and operational turnover of the first MUOS satellite is planned for 2010.

We produce exploration spacecraft such as the Mars Reconnaissance Orbiter and Mars Phoenix Lander, as well as earth-orbiting satellites and sensors for Earth observation and environmental monitoring. Our Satellite business also designs, builds, markets and operates turnkey commercial satellite systems for space-based telecommunications and other applications. In 2007, we delivered four commercial satellites and were awarded one new commercial satellite contract.

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Strategic & Defensive Missile Systems

Our Strategic & Defensive Missile Systems business has been the sole supplier of strategic fleet ballistic missiles to the U.S. Navy since the program s inception in 1955. The Trident II D5 is the latest generation of submarine launched ballistic missiles, following the highly successful Polaris, Poseidon C3, and Trident I C4 programs. The Trident II D5 began initial production in 1988 and has achieved a mission-success track record of 120 consecutive successful test launches. The Trident II D5 is the only intercontinental ballistic missile in production in the United States.

We are integrally involved with several missile defense programs. Under the Targets and Countermeasures Program, we manage the overall missile defense targets hardware and software portfolio for the MDA, providing realistic test environments for the system being developed by the MDA to defend against all classes of ballistic missiles. We are the prime contractor for the MDA s Multiple Kill Vehicles (MKV) payload system. In the event of an enemy launch, a single interceptor equipped with the MKV payload system is designed to destroy the enemy lethal reentry vehicle along with any countermeasures deployed to confuse the missile defense system. We are part of the industry team that is developing the Airborne Laser to detect, track and destroy hostile ballistic missiles in the vulnerable boost phase of flight. We provide the beam control fire control system, which is designed to accurately point and focus the high-energy laser beam. In 2007, the beam control fire control system successfully completed a series of flight tests.

Space Transportation Systems

Our Space Transportation Systems business provides human space flight systems.

We lead an industry team supporting NASA in the design, test, build, integration and operational capability of the Orion Crew Exploration Vehicle. Orion is an advanced crew capsule design utilizing state-of-the-art technology, and is planned to succeed the Space Shuttle in transporting a new generation of human explorers to and from the International Space Station, the Moon and eventually Mars and beyond.

We also manufacture the NASA Space Shuttle external tank. The tank is the only major non-reusable element of the Space Shuttle. One tank is used for each launch. Our existing contract for the external tanks will continue through the final Space Shuttle flight, currently scheduled for 2010.

Our Space Transportation Systems business also includes a 50% ownership interest in two joint ventures. United Space Alliance, LLC (USA) is responsible for the day-to-day operation and management of the Space Shuttle fleet for NASA. USA also performs the modification, testing and checkout operations required to prepare Space Shuttles for launch. United Launch Alliance, LLC (ULA) performs the engineering, production, test and launch operations associated with U.S. Government launches of the Atlas and Delta families of launch vehicles. We continue to market commercial Atlas launch services.

Competition

U.S. Government purchases of satellite systems, strategic missiles and space transportation systems are characterized by major competitions governed by DoD or NASA procurement regulations. While the evaluation criteria for selection vary from competition to competition, they are generally characterized by the customer s best value determination, which includes several important elements, such as price, technical capability, schedule and past performance. We compete worldwide for sales of satellites and commercial launch services against several competitors.

Based on current projected DoD, NASA and other government spending profiles and budget priorities, we believe we are well-positioned to compete for government satellites, strategic and defensive missile systems and space transportation systems programs. Future competitions for government systems include initiatives for transformational communications, global positioning, and planetary exploration and science.

Commercial demand for geo-stationary telecommunications satellites has been flat and manufacturing remains in an overcapacity situation. This has created significant price and competitive pressures. For further discussion of competitive factors in the sales of commercial satellites, see Management s Discussion & Analysis U.S. Government Non-Department of Defense Business beginning on page 34 of this Form 10-K.

Patents

We routinely apply for, and own a substantial number of, U.S. and foreign patents related to the products and services our business segments provide. In addition to owning a large portfolio of intellectual property, we also license intellectual property to and from third parties. The U.S. Government has licenses in our patents that are developed in performance of

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government contracts, and it may use or authorize others to use the inventions covered by such patents for government purposes. Unpatented research, development and engineering skills also make an important contribution to our business. While our intellectual property rights in the aggregate are important to the operation of our business segments, we do not believe that any existing patent, license or other intellectual property right is of such importance that its loss or termination would have a material adverse effect on our business taken as a whole.

Raw Materials and Seasonality

Aspects of our business require relatively scarce raw materials. We have been successful in obtaining the raw materials and other supplies needed in our manufacturing processes. We seek to manage raw materials supply risk through long-term contracts and by maintaining a stock of key materials in inventory.

Aluminum and titanium are important raw materials used in certain of our Aeronautics and Space Systems programs. Long-term agreements have helped enable a continued supply of aluminum and titanium. Carbon fiber is an important ingredient in the composite material that is used in our Aeronautics programs, such as the F-22 and F-35. Nicalon fiber also is a key material used on the F-22 aircraft. One type of carbon fiber and the nicalon fiber that we use are currently only available from single-source suppliers**.** Aluminum lithium, which we use to produce the Space Shuttle s external tank and for F-16 structural components, also is currently only available from limited sources. We have been advised by some suppliers that pricing and the timing of availability of materials in some commodities markets can fluctuate widely. These fluctuations may negatively affect price and the availability of certain materials, including titanium. While we do not anticipate material problems regarding the supply of our raw materials and believe that we have taken appropriate measures to mitigate these variations, if key materials become unavailable or if pricing fluctuates widely in the future, it could result in delay to one or more of our programs, increased costs or reduced award fees.

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

Government Contracts and Regulation

Our businesses are heavily regulated in most of our fields of endeavor. We deal with numerous U.S. Government agencies and entities, including all of the branches of the U.S. military, NASA, the U.S. Postal Service, the Social Security Administration, and the Departments of Defense, Energy, Justice, Health and Human Services, Homeland Security, State and Transportation. Similar government authorities exist with respect to our international efforts.

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

- require certification and disclosure of all cost or pricing data in connection with certain contract negotiations;
- impose specific and unique cost accounting practices that may differ from Generally Accepted Accounting Principles and therefore require reconciliation;
- impose acquisition regulations that define allowable and unallowable costs and otherwise govern our right to reimbursement under certain cost-based U.S. Government contracts; and
- restrict the use and dissemination of information classified for national security purposes and the export of certain products and technical data.

U.S. Government contracts are conditioned upon the continuing availability of Congressional appropriations. Long-term government contracts and related orders are subject to cancellation if appropriations for subsequent performance periods become unavailable. Congress usually appropriates funds on a fiscal-year basis even though contract performance may extend over many years. Consequently, at the outset of a program, the contract is usually partially funded, and Congress annually determines if additional funds are to be appropriated to the contract.

The U.S. Government, and other governments, may terminate any of our government contracts and, in general, subcontracts, at their convenience, as well as for default based on performance.

A portion of our business is classified by the U.S. Government and cannot be specifically described. The operating results of these classified programs are included in our consolidated financial statements. The business risks associated with classified programs, as a general matter, do not differ materially from those of our other government programs and products.

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Backlog

At December 31, 2007, our total negotiated backlog was $76.7 billion compared with $75.9 billion at the end of 2006. Of our total 2007 year-end backlog, approximately $48.5 billion, or 63%, is not expected to be filled within one year.

These amounts include both funded backlog (unfilled firm orders for our products and services for which funding has been both authorized and appropriated by the customer Congress, in the case of U.S. Government agencies) and unfunded backlog (firm orders for which funding has not been appropriated). We do not include unexercised options or potential indefinite-delivery/ indefinite-quantity (IDIQ) orders in our backlog. If any of our contracts are terminated by the U.S. Government, our backlog would be reduced by the expected value of the remaining terms of such contracts. Funded backlog was $42.3 billion at December 31, 2007. The backlog for each of our business segments is provided as part of Management s Discussion and Analysis Discussion of Business Segments beginning on page 44 of this Form 10-K.

Research and Development

We conduct research and development activities under customer-funded contracts and with our own independent research and development funds. Our independent research and development costs include basic research, applied research, development, systems and other concept formulation studies, and bid and proposal efforts related to government products and services. These costs are generally allocated among all contracts and programs in progress under U.S. Government contractual arrangements. Corporation-sponsored product development costs not otherwise allocable are charged to expense when incurred. Under certain arrangements in which a customer shares in product development costs, our portion of the unreimbursed costs is generally expensed as incurred. Total independent research and development costs charged to costs of sales, including costs related to bid and proposal efforts, were $1.2 billion in 2007, $1.1 billion in 2006 and $1.0 billion in 2005. See Research and development and similar costs in Note 1 Significant Accounting Policies on page 68 of this Form 10-K.

Employees

At December 31, 2007, we had approximately 140,000 employees, the majority of whom were located in the U.S. We have a continuing need for numerous skilled and professional personnel to meet contract schedules and obtain new and ongoing orders for our products. The majority of our employees possess a security clearance. The demand for workers with security clearances who have specialized engineering, information technology and technical skills within the aerospace, defense and information technology industries is likely to remain high for the foreseeable future, while growth of the pool of trained individuals with those skills has not matched demand. As a result, we are competing with other companies with similar needs in hiring skilled employees. Management considers employee relations to be good.

Approximately 15% of our employees are covered by any one of nearly one hundred separate collective bargaining agreements with various unions. A number of our existing collective bargaining agreements expire in any given year. Historically, we have been successful in renegotiating expiring agreements without any material disruption of operating activities.

Forward-Looking Statements

This Form 10-K contains statements which, to the extent they are not recitations of historical fact, constitute forward-looking statements within the meaning of federal securities law. The words believe, estimate, anticipate, project, intend, expect, plan, outlook, scheduled, forecast and similar expressions are intended to help identify forward-looking statements.

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

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ITEM 1A. RISK FACTORS

An investment in our common stock or debt securities involves risks and uncertainties. While we attempt to identify, manage and mitigate risks to our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. You should consider the following factors carefully, in addition to the other information contained in this Form 10-K, before deciding to purchase our securities.

Our existing U.S. Government contracts are subject to continued appropriations by Congress and may be terminated or delayed if future funding is not made available. Reduced funding for defense procurement and research and development programs could result in terminated or delayed contracts and adversely affect our ability to grow or maintain our sales and profitability.

We rely heavily upon sales to the U.S. Government including both DoD and non-DoD agencies, obtaining 84% of our sales from U.S. Government customers in 2007. Future sales from orders placed under our existing U.S. Government contracts are conditioned upon the continuing availability of Congressional appropriations. Congress usually appropriates funds on a fiscal-year basis even though contract performance may extend over many years.

We and other U.S. defense contractors have benefited from an upward trend in overall U.S. defense spending in the last few years. This trend continued with the President s budget request for fiscal year 2009, which reflects the continued commitment to modernize the Armed Forces and sustain current capabilities while prosecuting the war on terrorism.

Although the ultimate size of future defense budgets remains uncertain, current indications are that overall defense spending will continue to increase over the next few years, albeit at lower rates of growth. However, DoD programs in which we participate, or in which we may seek to participate in the future, must compete with other programs for consideration during our nation s budget formulation and appropriation processes. Budget decisions made in this environment may have long-term consequences for our size and structure and that of the defense industry. While we believe that our programs are a high priority for national defense, there remains the possibility that one or more of our programs will be reduced, extended, or terminated. Reductions in our existing programs, unless offset by other programs and opportunities, could adversely affect our ability to grow our sales and profitability.

We provide a wide range of defense, homeland security and information technology products and services to the U.S. Government. While we believe that this diversity makes it less likely that cuts in any specific contract or program will have a long-term impact on us, termination of multiple or large programs or contracts could adversely affect our business and future financial performance. In addition, termination of large programs or multiple contracts affecting a particular business site could require us to evaluate the continued viability of operating that site.

Changes in military strategy and planning may affect future procurement priorities and existing programs.

We cannot predict whether potential changes in defense priorities will afford new or additional opportunities for our businesses in terms of existing, follow-on or replacement programs, or whether we would have to close existing manufacturing facilities or incur expenses beyond those that would be reimbursed if one or more of our existing contracts were terminated for convenience due to lack of funding. See Management s Discussion and Analysis Industry Considerations beginning on page 33 of this report.

We are continuing to invest in business opportunities where we can use our customer knowledge, technical strength and systems integration capabilities to win new business. Whether we are successful in continuing to grow sales and profits will depend, in large measure, on whether we are able to deliver the best value solutions for our customer.

As a U.S. Government contractor, we are subject to a number of procurement rules and regulations.

We must comply with and are affected by laws and regulations relating to the award, administration and performance of U.S. Government contracts. Government contract laws and regulations affect how we do business with our customers and, in some instances, impose added costs on our business. A violation of specific laws and regulations could result in the imposition of fines and penalties or the termination of our contracts or debarment from bidding on contracts.

In some instances, these laws and regulations impose terms or rights that are more favorable to the government than those typically available to commercial parties in negotiated transactions. For example, the U.S. Government may terminate any of our government contracts and, in general, subcontracts, at its convenience, as well as for default based on performance. Upon termination for convenience of a fixed-price type contract, we normally are entitled to receive the

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purchase price for delivered items, reimbursement for allowable costs for work-in-process and an allowance for profit on the contract or adjustment for loss if completion of performance would have resulted in a loss. Upon termination for convenience of a cost reimbursement contract, we normally are entitled to reimbursement of allowable costs plus a portion of the fee. Such allowable costs would include our cost to terminate agreements with our suppliers and subcontractors. The amount of the fee recovered, if any, is related to the portion of the work accomplished prior to termination and is determined by negotiation.

A termination arising out of our default could expose us to liability and have a material adverse effect on our ability to compete for future contracts and orders. In addition, on those contracts for which we are teamed with others and are not the prime contractor, the U.S. Government could terminate a prime contract under which we are a subcontractor, irrespective of the quality of our services as a subcontractor.

In addition, our U.S. Government contracts typically span one or more base years and multiple option years. The U.S. Government generally has the right to not exercise option periods and may not exercise an option period if the agency is not satisfied with our performance on the contract.

Our business could be adversely affected by a negative audit by the U.S. Government.

U.S. Government agencies, including the Defense Contract Audit Agency and various agency Inspectors General, routinely audit and investigate government contractors. These agencies review a contractor s performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The U.S. Government also reviews the adequacy of, and a contractor s compliance with, its internal control systems and policies, including the contractor s management, purchasing, property, estimating, compensation, accounting and information systems. Any costs found to be misclassified may be nonreimbursed, while such costs already reimbursed may be subject to repayment. If an audit or investigation uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. Government. In addition, we could suffer serious reputational harm if allegations of impropriety were made against us.

The nature of our business involves significant risks and uncertainties that may not be covered by indemnity or insurance.

Elements of our business provide products and services where insurance or indemnification may not be availabl