L 3 COMMUNICATIONS HOLDINGS INC
Form 10-Q
May 03, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2006

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file numbers 001-14141 and 333-46983

L-3 COMMUNICATIONS HOLDINGS, INC.
L-3 COMMUNICATIONS CORPORATION

(Exact names of registrants as specified in their charters)

Delaware (State or other jurisdiction of incorporation or organization)	13-3937434 and 13-3937436 (I.R.S. Employer Identification Nos.)
600 Third Avenue, New York NY (Address of principal executive offices)	10016 (Zip Code)

(212) 697-1111

(Telephone number)

Indicate by check mark whether the registrants (1) have 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 registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, or non-accelerated filers. See definition of ''accelerated filer and large accelerated filer'' in Rule 12 b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act).
Yes No

There were 121,963,608 shares of L-3 Communications Holdings, Inc. common stock with a par value of $0.01 outstanding as of the close of business on April 28, 2006.

L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION

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For quarterly period ended March 31, 2006

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PART I — FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	March 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 172.6	$ 393.9
Contracts in process	3,187.5	2,904.4
Deferred income taxes	233.3	230.6
Other current assets	98.2	114.6
Total current assets	3,691.6	3,643.5
Property, plant and equipment, net	663.2	657.6
Goodwill	7,298.4	6,899.8
Identifiable intangible assets	435.7	412.8
Deferred debt issue costs	74.1	76.6
Other assets	211.3	218.8
Total assets	$ 12,374.3	$ 11,909.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$ 512.1	$ 476.1
Accrued employment costs	440.7	467.7
Accrued expenses	241.8	172.0
Billings in excess of costs and estimated profits	247.2	214.0
Customer advances	126.6	97.2
Income taxes	84.2	69.2
Other current liabilities	362.0	358.1
Total current liabilities	2,014.6	1,854.3
Pension and postretirement benefits	504.6	435.6
Deferred income taxes	169.6	119.1
Other liabilities	279.0	294.7
Long-term debt	4,633.8	4,633.5
Total liabilities	7,601.6	7,337.2
Commitments and contingencies (see Note 12)		
Minority interests	84.5	81.2
Shareholders' equity:		
L-3 Holdings' common stock; $.01 par value; authorized 300,000,000 shares, issued and outstanding 121,760,140 shares in 2006 and 120,372,394 shares in 2005 (L-3 Communications' common stock; $.01 par value, 100 shares authorized, issued and outstanding)	3,106.1	3,040.8
Retained earnings	1,661.1	1,545.0
Unearned compensation	—	(17.9)
Accumulated other comprehensive loss	(79.0)	(77.2)
Total shareholders' equity	4,688.2	4,490.7
Total liabilities and shareholders' equity	$ 12,374.3	$ 11,909.1

See notes to unaudited condensed consolidated financial statements.

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L-3 COMMUNICATIONS HOLDINGS, INC.
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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Sales:		
Contracts, primarily U.S. Government	$ 2,642.9	$ 1,750.1
Commercial, primarily products	260.9	212.4
Total sales	2,903.8	1,962.5
Costs and expenses:		
Contracts, primarily U.S. Government	2,382.3	1,565.3
Commercial, primarily products:		
Cost of sales	166.9	140.1
Selling, general and administrative expenses	48.0	43.5
Research and development expenses	18.2	14.4
Total costs and expenses	2,615.4	1,763.3
Operating income	288.4	199.2
Interest and other (income) expense, net	(5.9)	(2.7)
Interest expense	71.9	38.1
Minority interests in net income of consolidated subsidiaries	2.3	3.2
Income before income taxes	220.1	160.6
Provision for income taxes	81.2	58.2
Net income	$ 138.9	$ 102.4
L-3 Holdings' earnings per common share:		
Basic	$ 1.15	$ 0.88
Diluted	$ 1.13	$ 0.86
L-3 Holdings' weighted average common shares outstanding:		
Basic	121.2	116.3
Diluted	123.3	119.5

See notes to unaudited condensed consolidated financial statements.

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L-3 COMMUNICATIONS HOLDINGS, INC.
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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Operating activities:		
Net income	$ 138.9	$ 102.4
Depreciation	30.3	24.1
Amortization of intangibles and other assets	14.3	7.1
Deferred income tax provision	41.4	23.7
Minority interests in net income of consolidated subsidiaries	2.3	3.2
Stock-based employee compensation expense	11.4	1.1
Contributions to employee savings plans in L-3 Holdings' common stock	33.2	16.2
Amortization of deferred debt issue costs (included in interest expense)	2.5	1.5
Other non-cash items	(2.7)	0.4
Subtotal	271.6	179.7
Changes in operating assets and liabilities, excluding acquired amounts:		
Contracts in process	(152.6)	(136.6)
Other current assets	7.1	(26.8)
Other assets	—	(5.6)
Accounts payable, trade	12.4	42.1
Accrued employment costs	(54.6)	(18.2)
Accrued expenses	23.6	4.3
Billings in excess of costs and estimated profits	33.1	13.8
Customer advances	3.8	28.3
Income taxes	30.4	18.1
Excess income tax benefits related to share-based payment arrangements	(18.0)	—
Other current liabilities	11.6	6.0
Pension and postretirement benefits	27.0	21.5
Other liabilities	(9.2)	5.4
All other operating activities	1.3	(2.4)
Subtotal	(84.1)	(50.1)
Net cash from operating activities	187.5	129.6
Investing activities:		
Business acquisitions, net of cash acquired	(412.0)	(499.3)
Capital expenditures	(27.1)	(19.3)
Dispositions of property, plant and equipment	0.9	0.1
Other investing activities	1.0	(2.0)

Net cash used in investing activities	(437.2)	(520.5)
Financing activities:		
Borrowings under revolving credit facility	154.0	—
Repayment of borrowings under revolving credit facility	(154.0)	—
Debt issue costs	(0.1)	(4.1)
Cash dividends paid on L-3 Holdings' common stock	(22.8)	(14.5)
Proceeds from exercise of stock options	22.3	39.6
Proceeds from employee stock purchase plan	13.0	9.1
Excess income tax benefits related to share-based payment arrangements	18.0	—
Distributions paid to minority interests	(0.5)	(2.2)
Other financing activities	(1.5)	(4.2)
Net cash from financing activities	28.4	23.7
Net decrease in cash and cash equivalents	(221.3)	(367.2)
Cash and cash equivalents, beginning of the period	393.9	653.4
Cash and cash equivalents, end of the period	$ 172.6	$ 286.2

See notes to unaudited condensed consolidated financial statements.

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L-3 COMMUNICATIONS HOLDINGS, INC.
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NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS

1. Description of Business

L-3 Communications Holdings, Inc. conducts its operations and derives all of its operating income and cash flow from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a leading supplier of a broad range of products and services used in a substantial number of aerospace and defense platforms. L-3 also is a major supplier of systems, subsystems and products on many platforms, including those for secure communication networks and communications products, mobile satellite communications, information security systems, shipboard communications, naval power systems, missiles and munitions, telemetry and instrumentation and airport security systems. The Company also is a prime system contractor for aircraft modernization and operations & maintenance (O&M), Command, Control and Communications (C^3), Intelligence, Surveillance and Reconnaissance (ISR) collection systems and services, training and simulation, intelligence services and government support services. The Company's customers include the U.S. Department of Defense (DoD) and its prime contractors, the U.S. Department of Homeland Security (DHS), U.S. Government intelligence agencies, major aerospace and defense contractors, allied foreign government ministries of defense, commercial customers and certain other U.S. federal, state and local government agencies.

The Company has four reportable segments as follows: (1) Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR); (2) Government Services; (3) Aircraft Modernization and Maintenance

(AM&M); and (4) Specialized Products.

The C^3ISR reportable segment provides products and services for the global ISR market, C^3 systems and secure, high data rate communication systems and equipment primarily for intelligence, reconnaissance and surveillance applications. The Company believes that these products and services are critical elements for a substantial number of major command, control, communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring and dissemination functions of these communication systems. The Government Services reportable segment provides communications systems support and engineering services, information technology services, teaching and training services, marksmanship training systems and services, and intelligence support and analysis services. The AM&M reportable segment provides specialized aircraft modernization and upgrades, maintenance and logistics support services. The Specialized Products reportable segment provides a broad range of products, including naval warfare products, aviation products, telemetry and navigation products, sensors and imaging products, premium fuzing products, security systems, simulation devices, microwave components and information products.

2. Basis of Presentation

These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of L-3 Holdings and L-3 Communications for the fiscal year ended December 31, 2005, which are included in their Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

The accompanying unaudited condensed consolidated financial statements comprise the unaudited condensed consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings' only asset is its investment in the common stock of L-3 Communications, its wholly-owned subsidiary, and its only obligations are the 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued on July 29, 2005, and its guarantee of borrowings under the senior credit facility of L-3 Communications. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and

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L-3 COMMUNICATIONS HOLDINGS, INC.
AND L-3 COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

unconditionally guaranteed by L-3 Communications and certain of its domestic subsidiaries, and accordingly, such debt has been reflected as debt of L-3 Communications in its consolidated financial statements in accordance with the U.S. Securities and Exchange Commission's (SEC) Staff Accounting Bulletin (SAB) No. 54. All issuances of and conversions into L-3 Holdings' equity securities, including grants of stock options and restricted stock by L-3 Holdings to employees of L-3 Communications and its subsidiaries, have been reflected in the consolidated financial statements of L-3 Communications. As a result, the consolidated financial positions, results of operations and cash flows of L-3 Holdings and L-3 Communications are substantially the same. See Note 17 for additional information.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the disclosures required by accounting principles generally accepted in the United States of America for a complete set of annual audited financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year. Certain reclassifications have been made to conform prior-year amounts to the current-year presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 and expenses during the reporting period. The most significant of these estimates and assumptions 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 postretirement benefit obligations, stock-based employee compensation expense, recoverability, useful lives, and valuation of recorded amounts of long-lived assets, identifiable intangible assets, goodwill, income taxes, including the valuations of deferred tax assets, litigation reserves and environmental obligations. Changes in estimates are reflected in the periods during which they become known. Actual amounts will differ from these estimates and could differ materially. For a more complete discussion of these estimates and assumptions, see the Annual Report of L-3 Holdings and L-3 Communications on Form 10-K for the fiscal year ended December 31, 2005.

The Company presents its sales and costs and expenses in two categories on the statements of operations: ‘‘Contracts, primarily U.S. Government’’ and ‘‘Commercial, primarily products.’’

Contracts, primarily U.S. Government.   Sales and costs and expenses for the Company’s businesses that are primarily U.S. Government contractors are presented as ‘‘Contracts, primarily U.S. Government.’’ The sales for the Company’s U.S. Government contractor businesses are transacted using written revenue arrangements, or contracts, which require the Company to produce tangible assets and/or provide services related to the production of tangible assets according to the buyer’s specifications and generally to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services. Such buyers are predominantly the DoD and other agencies of the U.S. Government, allied foreign government ministries of defense and defense prime contractors. A majority of these contracts are covered by the American Institute of Certified Public Accountants Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts (SOP 81-1), Accounting Research Bulletin No. 43, Chapter 11, Section A, Government Contracts, Cost-Plus-Fixed Fee Contracts (ARB 43) and Accounting Research Bulletin No. 45, Long-Term Construction Type Contracts (ARB 45). Sales reported under ‘‘Contracts, primarily U.S. Government’’ also include certain sales from contracts with domestic

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and foreign commercial customers, which are within the scope of SOP 81-1 and ARB 45, and certain fixed-price, cost-reimbursable and time-and-material type contracts that require the Company to perform services that are not related to the production of tangible assets, which are recognized in accordance with SAB No. 104, Revenue Recognition (SAB 104).

Commercial, primarily products. Sales and costs and expenses for the Company's businesses whose customers are primarily commercial business enterprises are presented as ‘‘Commercial, primarily products.’’ Most of these sales are recognized in accordance with SAB 104, and substantially all of the related revenue arrangements are not within the scope of SOP 81-1, ARB 43 or ARB 45. The Company's commercial businesses are substantially comprised of Aviation Communication & Surveillance Systems (ACSS), Aviation Recorders, Avionics Systems, Infrared Products, Microwave Components, Security and Detection Systems and SAM Electronics GmbH (SAM).

3. Acquisitions

2006 Business Acquisitions

During the three months ended March 31, 2006, in separate transactions, the Company acquired six businesses, for an aggregate purchase price of $430.7 million in cash, plus acquisition costs. Based on preliminary purchase price allocations, the aggregate goodwill recognized for these business acquisitions was $412.0 million, of which $18.6 million was assigned to the C^3ISR reportable segment, $28.0 million was assigned to the AM&M reportable segment and $365.4 million was assigned to the Specialized Products reportable segment. The goodwill from these business acquisitions is not expected to be deductible for income tax purposes. The 2006 business acquisitions were financed with a combination of cash on hand and revolving credit facility borrowings. The purchase price for each of these acquisitions is subject to adjustment based on the closing date net assets or net working capital of the respective businesses acquired. The Company completed the following business acquisitions during the three months ended March 31, 2006:

- All of the outstanding stock of SAM on January 31, 2006, for $180.3 million in cash, which includes a $30.3 million increase to the contractual purchase price for a preliminary purchase price adjustment based on SAM's preliminary closing date net assets. SAM, which has its principal operations in Germany, is a manufacturer and supplier of maritime electrical and electronic systems to shipyards (including commercial shipyards), shipping companies and international navies;
- All of the outstanding stock of SafeView, Inc. on March 9, 2006, and CyTerra Corporation on March 21, 2006, for an aggregate purchase price of $190.9 million in cash, plus additional consideration, not to exceed $35.1 million, which is contingent upon financial performance for the years ending December 31, 2006 through 2008. Any such additional consideration will be accounted for as goodwill. SafeView is a developer and manufacturer of non-invasive security systems and portals for military and public safety use, including airports. CyTerra is a leader in the development and manufacture of a number of sophisticated sensors with threat detection capabilities for the military and homeland security markets; and
- All of the outstanding stock of Advanced Systems Architectures Ltd. (ASA) on January 25, 2006, TCS Design and Management Services, Incorporated (TCS) on January 26, 2006, and Magnet-Motor GmbH on March 20, 2006, for an aggregate purchase price of $59.5 million in cash, plus additional consideration, not to exceed $12.0 million, which is contingent upon the financial performance of ASA and TCS for the years ending December 31, 2006 and 2007. Any such additional consideration will be accounted for as goodwill.

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The table below summarizes the preliminary purchase price allocation of the aggregate assets acquired and liabilities assumed in connection with the business acquisitions that were completed during the three months ended March 31, 2006.

	(in millions)
Cash and cash equivalents	$ 36.6
Contracts in process	120.8
Other current assets	7.1
Goodwill	412.0
Identifiable intangible assets	27.4
Property, plant and equipment	8.2
Other assets	0.2
Total assets acquired	612.3
Current liabilities	122.9
Other liabilities	55.1
Total liabilities assumed	178.0
Minority interests	0.5
Net assets acquired	$ 433.8

All of the business acquisitions are included in the Company's results of operations from their respective dates of acquisition. The assets and liabilities recorded in connection with the purchase price allocations for the acquisitions of SAM, SafeView, CyTerra, ASA, TCS and Magnet-Motor are based upon preliminary estimates of fair values for contracts in process, inventories, estimated costs in excess of estimated contract value to complete contracts in process in a loss position, contingent assets and liabilities, identifiable intangibles, goodwill, property, plant and equipment, and deferred income taxes. Actual adjustments will be based on the final purchase prices, including the payment of contingent consideration, if any, and final appraisals and other analyses of fair values which are in process. The Company expects to complete the purchase price allocations during 2006. The Company does not expect the differences between the preliminary and final purchase price allocations for these business acquisitions to have a material impact on its results of operations or financial position.

2005 Business Acquisitions

Acquisition of The Titan Corporation.   On July 29, 2005, the Company acquired all of the outstanding shares of Titan for approximately $2,742.1 million in cash, including the assumption of approximately $626.0 million of Titan's debt, plus $41.7 million of acquisition costs. Concurrent with the Titan acquisition, the Company repaid or redeemed all of Titan's outstanding debt. The Titan acquisition was financed using approximately $384.3 million of cash on hand, $750.0 million of term loan borrowings under L-3 Communications' senior credit facility and the net proceeds from the issuance by L-3 Holdings of $700.0 million of 3% Convertible Contingent Debt Securities and the issuance by L-3 Communications of $1.0 billion of 6 3/8% Senior Subordinated Notes (see Note 7). Titan is included in the

Company’s results of operations from its date of acquisition.

Titan is a leading provider of comprehensive national security solutions, including information and communications systems solutions and services to the DoD, intelligence agencies, the DHS and other United States federal government customers. Titan offers services, systems and products for C^3ISR, enterprise information technology and homeland security programs.

The Company has completed the Titan purchase price allocation except for (i) the identifiable intangible assets acquired, (ii) liabilities for excess leased facilities, (iii) liabilities for certain litigation matters, (iv) deferred tax assets, (v) the recoverability assessments of certain contract costs incurred by

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Titan prior to the acquisition, and (vi) pre-acquisition contingencies for performance and other guarantees related to businesses that were divested or discontinued by Titan whose estimated fair values are assessed as preliminary estimates. The Company expects that the differences between the preliminary and final purchase price allocations for these items will not have a material impact on the Company's results of operations for the year ending December 31, 2006, or any year thereafter. However, differences between the preliminary and final purchase price allocations could be material to the Company's financial position. The Company has engaged a third party valuation consultant who is currently assisting management with the valuation of the Titan identifiable intangible assets. Additionally, the likelihood and estimates of buyout settlements with lessors and estimated future sublease income for excess facilities and the disposition, resolution plans and estimated losses for certain litigation matters, the fair value estimates for performance guarantees, and the analysis and net realizable assessments of certain contract costs and deferred tax assets, are based on preliminary estimates. The final purchase price allocations of these Titan acquired assets and liabilities will be based on final estimates of fair value, assessments and analyses of facts and disposition plans. The Company expects to complete the purchase price allocation for these Titan items by June 30, 2006.

Based upon the preliminary purchase price allocation for Titan, goodwill in the amount of approximately $947.6 million was assigned to the C^3ISR reportable segment, approximately $886.8 million to the Government Services reportable segment and approximately $390.0 million to the Specialized Products reportable segment. Approximately $108.6 million of the Titan goodwill is expected to be deductible for income tax purposes.

Other 2005 Business Acquisitions.   During 2005, in separate transactions, the Company acquired eleven businesses, excluding Titan. The remaining acquisitions that are still subject to final purchase price allocations include Advanced Laser Systems Technology, Inc. (ALST), Joseph Sheairs Associates, Inc. (JSA), Hitec O, EOTech Acquisition Corp., and Applied Signal and Image Technology, Inc. (ASIT), for an aggregate purchase price of $103.3 million in cash, excluding acquisition costs, plus additional consideration, not to exceed $30.4 million, which is contingent primarily upon the financial performance of these acquired businesses for fiscal years ending on various dates in 2006 through 2008. Any such additional consideration will be accounted for as goodwill. Based on preliminary purchase price allocations, the aggregate goodwill recognized for these business acquisitions was $90.8 million, of which $19.5

million was assigned to the C^3ISR reportable segment, \$19.5 million was assigned to the Government Services reportable segment and \$51.8 million was assigned to the Specialized Products reportable segment. Goodwill of \$41.6 million is expected to be deductible for income tax purposes. These business acquisitions were financed with cash on hand.

The purchase prices for ALST, JSA, Hitec O, EO Tech, and ASIT, all of which were acquired in 2005, are subject to adjustment based on the closing date net assets or net working capital of the respective business acquired. The assets and liabilities recorded in connection with the purchase price allocations for these acquisitions are based upon preliminary estimates of fair values for contracts in process, inventories, estimated costs in excess of estimated contract value to complete contracts in process in a loss position, contingent assets and liabilities, identifiable intangibles, goodwill, property, plant and equipment, and deferred income taxes. Actual adjustments will be based on the final purchase prices, including the payment of contingent consideration, if any, and final appraisals and other analyses of fair values, which are in process. The Company expects to complete the purchase price allocations during 2006. The Company does not expect the differences between the preliminary and final purchase price allocations for these business acquisitions to have a material impact on its results of operations or financial position.

The Company has completed the purchase price allocations for InfraredVision Technology Corporation, Mobile-Vision, Inc. and Sonoma Design Group, Inc. The final purchase price allocations for these businesses did not have a material impact on the Company's results of operations or financial position.

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FINANCIAL STATEMENTS (Continued)

Aircraft Integration Systems Acquisition. In connection with the Company's acquisition of Aircraft Integration Systems (AIS) in March 2002, the purchase price submitted by Raytheon Company (Raytheon) to the Company amounted to approximately \$1,163.0 million. In accordance with the asset purchase agreement, the Company and Raytheon engaged a neutral accountant to arbitrate the final purchase price. In January 2006, the arbitrator ruled that the final purchase price was \$1,153.3 million, and accordingly, in January 2006, Raytheon paid L-3 \$9.7 million, representing a reduction to the purchase price, plus interest income of \$3.5 million. The reduction to the purchase price was recorded as a reduction to goodwill.

Unaudited Pro Forma Statement of Operations Data

The following unaudited pro forma Statement of Operations data presents the combined results of the Company and its business acquisitions completed during the three months ended March 31, 2006 and the year ended December 31, 2005 assuming that the business acquisitions completed during these periods had occurred on January 1, 2005.

	Three Months Ended March 31,

	2006	2005
	(in millions, except per share data)	
Pro forma sales	$ 2,934.4	$ 2,698.6
Pro forma net income	$ 135.8	$ 101.1
Pro forma diluted earnings per share	$ 1.10	$ 0.85

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2005.

The unaudited pro forma results also include charges for costs related to Titan's internal review and shareholder settlements related to the securities law class action and derivative action lawsuits each arising out of Titan's alleged violations of the Foreign Corrupt Practices Act. These charges, which were recorded by Titan prior to the July 2005 acquisition, amounted to approximately $5.8 million for the three months ended March 31, 2005.

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 are principally related to contracts with the U.S. Government and prime contractors or subcontractors of the U.S. Government.

	March 31, 2006	December 31, 2005
	(in millions)	
Billed receivables, net of allowances of $19.1 million and $19.6 million	$ 1,107.1	$ 1,071.2
Unbilled contract receivables, gross	1,571.9	1,414.1
Less: unliquidated progress payments	(230.2)	(235.6)
Unbilled contract receivables, net	1,341.7	1,178.5
Inventoried contract costs, gross	550.6	529.8
Less: unliquidated progress payments	(61.6)	(64.5)
Inventoried contract costs, net	489.0	465.3
Inventories at lower of cost or market	249.7	189.4
Total contracts in process	$ 3,187.5	$ 2,904.4

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Inventoried Contract Costs. In accordance with SOP 81-1 and the AICPA Audit and Accounting Guide, Audits of Federal Government Contractors, the Company's inventoried contract costs include general and administrative (G&A) costs, independent research and development (IRAD) costs and bid and proposal (B&P) costs allocated to contracts (revenue arrangements) for which the U.S. Government is the end customer, because they are reimbursable indirect contract costs on revenue arrangements pursuant to the contractual terms of the revenue arrangements and U.S. Government procurement regulations. The Company accounts for its G&A, IRAD and B&P costs allocated to U.S. Government contracts as product costs, instead of period expenses, and charges them to costs of sales when sales related to those contracts (revenue arrangements) are recognized. Therefore, such allocated indirect costs are included in inventoried contract costs prior to the recognition of cost of sales for the related contracts (revenue arrangements).

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 used to determine costs and expenses for ''Contracts, primarily U.S. Government'' for the periods presented. The cost data in the table below does not include the selling, general and administrative expenses and research and development expenses for the Company's businesses that are primarily not U.S. Government contractors, which are separately presented on the statements of operations under the caption for costs and expenses for ''Commercial, primarily products'' and are expensed as incurred.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(in millions)	
Amounts included in inventoried contract costs at beginning of the period	$ 55.7	$ 43.7
Add: Amounts included in acquired inventoried contract costs	0.3	—
Contract costs incurred[1]	236.3	174.5
Less: Amounts charged to costs and expenses during the period	(231.1)	(168.9)
Amounts included in inventoried contract costs at end of the period	$ 61.2	$ 49.3

[1] Incurred costs include IRAD and B&P costs of $54.7 million for the three months ended March 31, 2006 and $40.5 million for the three months ended March 31, 2005.

Inventories at Lower of Cost or Market. The table below presents the components of Inventories at Lower of Cost or Market.

	March 31, 2006	December 31, 2005
	(in millions)	
Raw materials, components and sub-assemblies	$ 98.6	$ 81.0
Work in process	89.4	54.1
Finished goods	61.7	54.3
Total	$ 249.7	$ 189.4

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L-3 COMMUNICATIONS HOLDINGS, INC.
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5. Goodwill and Identifiable Intangible Assets

Goodwill. The table below presents the changes in goodwill allocated to the Company's reportable segments.

	C^3ISR	Government Services	AM&M	Specialized Products	Consolidated Total
			(in millions)		
Balance at January 1, 2006	$ 1,719.6	$ 1,384.0	$ 1,013.6	$ 2,782.6	$ 6,899.8
Business acquisitions	13.6	1.4	24.9	358.7	398.6
Balance at March 31, 2006	$ 1,733.2	$ 1,385.4	$ 1,038.5	$ 3,141.3	$ 7,298.4

Goodwill increased by $398.6 million to $7,298.4 million at March 31, 2006 from $6,899.8 million at December 31, 2005. The increase was due to (i) $412.0 million for business acquisitions completed during the 2006 first quarter and (ii) $1.8 million primarily for a contingent purchase price adjustment or earnout, which was resolved during the period. These increases to goodwill were partially reduced by $9.7 million relating to the favorable resolution of the AIS purchase price and a $5.5 million decrease for final estimates of fair value for acquired assets and liabilities assumed in connection with certain business acquisitions completed prior to January 1, 2006. See Note 3 for additional information.

Identifiable Intangible Assets. Information on the Company's identifiable intangible assets that are subject to amortization is presented in the table below. The Company has no indefinite-lived identifiable intangible assets.

		March 31, 2006			December 31, 2005		
	Weighted Average Amortization Period (in Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Identifiable intangible assets:				(in millions)			
Customer relationships	20.7	$ 424.4	$ 45.8	$ 378.6	$ 396.6	$ 35.6	$ 361.0
Technology	13.7	67.3	10.8	56.5	61.1	9.5	51.6
Other	8.8	2.5	1.9	0.6	2.0	1.8	0.2
Total	19.8	$ 494.2	$ 58.5	$ 435.7	$ 459.7	$ 46.9	$ 412.8

The Company recorded amortization expense for its identifiable intangible assets of $11.6 million for the three months ended March 31, 2006 and $5.2 million for the three months ended March 31, 2005. Based on gross carrying amounts at March 31, 2006, the Company's estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2006 through 2010 are presented in the table below.

	Years Ending December 31,				
	2006	2007	2008	2009	2010
			(in millions)		
Estimated Amortization Expense	$ 44.9	$ 40.9	$ 36.5	$ 33.0	$ 30.7

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6. Other Current Liabilities and Other Liabilities

The table below presents the components of other current liabilities.

	March 31, 2006	December 31, 2005
Other Current Liabilities:	(in millions)	
Accrued product warranty costs	$ 73.2	$ 61.8
Estimated cost in excess of estimated contract value to complete contracts in process in a loss position	71.4	76.6
Accrued interest	71.1	68.2
Aggregate purchase price payable for acquired businesses	14.2	36.8
Deferred revenues	16.8	15.0
Other	115.3	99.7
Total other current liabilities	$ 362.0	$ 358.1

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

	Three Months Ended March 31	
	2006	2005
Accrued product warranty costs:	(in millions)	
Balance at January 1	$ 61.8	$ 49.8
Acquisitions during this period	13.1	2.0
Accruals for product warranties issued during the period	5.6	4.2

Accruals for product warranties existing before January 1[1]	1.4	0.5
Settlements made during the period	(8.7)	(4.6)
Balance at March 31	$ 73.2	$ 51.9

[1]Represents changes to estimated product warranty costs related to sales recognized prior to January 1, 2006 and January 1, 2005, respectively.

The table below presents the components of other liabilities.

	March 31, 2006	December 31, 2005
Other Liabilities:	(in millions)	
Non-current portion of net deferred gains from terminated interest rate swap agreements	$ 17.4	$ 18.2
Accrued workers compensation	28.6	25.8
Notes payable and capital lease obligations	10.3	10.5
Deferred compensation	60.3	59.0
Other non-current liabilities	162.4	181.2
Total other liabilities	$ 279.0	$ 294.7

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7. Debt

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

	March 31, 2006	December 31, 2005
L-3 Communications:	(in millions)	
Borrowings under Revolving Credit Facility[1]	$ —	$ —
Borrowings under Term Loan Facility maturing 2010	750.0	750.0
7 5/8% Senior Subordinated Notes due 2012	750.0	750.0
6 1/8% Senior Subordinated Notes due 2013	400.0	400.0
6 1/8% Senior Subordinated Notes due 2014	400.0	400.0
5 7/8% Senior Subordinated Notes due 2015	650.0	