L 3 COMMUNICATIONS 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

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 10016 (Address of principal executive offices) (Zip Code)
(212) 697-1111
(Telephone number)

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

Title of each class Name of each exchange on which registered: L-3 Communications Holdings, Inc.
common stock, par value $0.01 per share New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of ''large accelerated filer,'' ''accelerated filer,'' and ''smaller reporting company'' in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

(do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the L-3 Communications Holdings, Inc. voting stock held by non-affiliates of the registrant as of June 30, 2007 was approximately $12.2 billion. For purposes of this calculation, the Registrants have assumed that their directors and executive officers are affiliates.

There were 122,399,070 shares of L-3 Communications Holdings, Inc. common stock with a par value of $0.01 outstanding as of the close of business on February 22, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed with Securities and Exchange Commission (''SEC'') pursuant to Regulation 14A relating to the Registrant's Annual Meeting of Shareholders, to be held on April 29, 2008, will be incorporated by reference in this Form 10-K in response to Items 10, 11, 12, 13 and 14 of Part III. Such proxy statement will be filed with the SEC not later than 120 days after the registrant's fiscal year ended December 31, 2007.

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

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For the Year Ended December 31, 2007

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PART I

For convenience purposes in this filing on Form 10-K, ‘‘L-3 Holdings’’ refers to L-3 Communications Holdings, Inc., and ‘‘L-3 Communications’’ refers to L-3 Communications Corporation, a wholly-owned operating subsidiary of L-3 Holdings. ‘‘L-3’’, ‘‘we’’, ‘‘us’’ and ‘‘our’’ refer to L-3 Holdings and its subsidiaries, including L-3 Communications.

Item 1. Business

Overview

L-3 Holdings, a Delaware corporation organized in April 1997, derives all of its operating income and cash flow from its wholly-owned subsidiary, L-3 Communications. L-3 Communications, a Delaware corporation, was organized in April 1997. L-3 is a prime system contractor in aircraft modernization and maintenance, Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C3ISR) systems, and government services. L-3 is also a leading provider of high technology products, subsystems and systems. Our customers include the U.S. Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), U.S. Department of Justice (DoJ), allied foreign governments, commercial customers and select other U.S. federal, state and local government agencies.

For the year ended December 31, 2007, we generated sales of approximately $14 billion, operating income of $1,448 million and net cash from operating activities of $1,270 million. The table below presents a summary of our 2007 sales by major category of end customer. For a more detailed presentation of our sales by end customer, see ‘‘Major Customers’’ on page 11.

	2007 Sales (in millions)	% of Total Sales
DoD	$ 10,268	74 %
International	2,094	15
Other U.S. Government	834	6
Commercial – domestic	765	5
Total sales	$ 13,961	100 %

We have the following four reportable segments: (1) C3ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Specialized Products. Financial information for our reportable segments, including financial information about geographic areas, is included in ‘‘Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations’’ and in Note 20 to our audited consolidated financial statements.

Business Strategy

Our business strategy is customer-focused and aims to increase shareholder value by providing products and services to our customers that create value for them with responsive, high-quality and affordable solutions. Financially, our emphasis is on sustainably growing earnings per share and cash flow. Our strategy involves a flexible and balanced combination of organic growth, cost reductions, business acquisitions, dividends and share repurchases, enabling us to grow the company and return cash to our shareholders. We intend to maintain and expand our position as a leading supplier of systems, subsystems, products and services to the DoD, other U.S. Government agencies, allied foreign governments and commercial customers, both domestic and international. Our strategy includes the objectives discussed below.

Expand Prime Contractor and Supplier Positions. We intend to expand our prime system contractor roles in select business areas where we have domain expertise, including C3ISR, aircraft modernization and maintenance and government services. We also will enter into ‘‘teaming’’ arrangements with other prime system contractors and platform original equipment manufacturers to compete for select new

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business opportunities. As an independent supplier of a broad range of products in several key business areas, our growth will partially be driven by expanding our share on existing programs and participating on new programs. We will also identify opportunities to use our customer relationships and leverage the capabilities of our various businesses, including their proprietary technologies, to expand the scope of our products and services to existing and new customers. We also intend to supplement our growth by participating in and competing for new programs internationally, particularly in Canada, the United Kingdom and Australia.

Align Research & Development, and Capital Expenditures. We intend to continue to align our internal investments in research and development, business development and capital expenditures to proactively address customer requirements and priorities with our products, services and solutions. We will also grow our sales through increased collaboration of our businesses, including combining select products into subsystems to offer competitive solutions to our customers.

Grow Sales Organically and with Business Acquisitions. We will use our existing prime contractor and supplier positions and internal investments to grow our sales organically. We expect to benefit from our positions as a supplier to multiple bidders on select prime contract bids. We plan to maintain our diversified and broad business mix with its limited reliance on any single program and significant follow-on and new business opportunities. We also will supplement our organic sales growth by selectively acquiring businesses that add new products, technologies, programs or customers to our existing businesses, with attractive returns on investment.

Favorable Contract Performance. A foundation for our objectives of expanding L-3’s prime contractor and supplier positions and growing sales organically is favorable performance on our existing contracts. We believe that a prerequisite for growing and winning new business is to retain our existing business with successful contract performance, including schedule, cost, technical and other performance criteria. Therefore, we will continue to focus on delivering superior contract performance to our customers to maintain our reputation as an agile and responsive contractor and to differentiate L-3 from its competitors.

Continuous Cost Improvement. We will continue to aggressively improve and reduce our direct contract costs and overhead costs, including general and administrative costs. Effective management of labor, material, subcontractor and other direct costs is a primary element of favorable contract performance. We also intend to grow sales at a faster rate than overhead costs. We believe continuous cost improvement will enable us to flexibly use costs savings to increase L-3’s value by expanding operating margin and selectively investing in new product development, bids and proposals and other business development activities to grow sales organically.

Selected Recent Business Acquisitions

During the year ended December 31, 2007, we used cash of $235 million for business acquisitions. See ‘‘Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Business Acquisitions’’ for additional details about our 2007 business acquisitions, including their aggregate purchase prices.

Products and Services

Our four reportable segments provide a wide range of products and services to various customers and are described below.

C3ISR Reportable Segment

In 2007, C3ISR net sales of $2,310 million represented 17% of our total net sales. The businesses in this segment provide products and services for the global ISR market, specializing in signals intelligence (SIGINT) and communications intelligence (COMINT) systems. These products and services provide to the warfighter in real-time, the unique ability to collect and analyze unknown electronic signals from command centers, communication nodes and air defense systems for real-time situational awareness and response. The businesses in this reportable segment also provide C3 systems, networked communications

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systems and secure communications products for military and other U.S. Government and foreign government intelligence, reconnaissance and surveillance applications. We believe that these products and services are critical elements for a substantial number of major command, control and 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. Major products and services for this reportable segment include:

• highly specialized fleet management sustainment and support, including procurement, systems integration, sensor development, modifications and periodic depot maintenance for SIGINT and ISR special mission aircraft and airborne surveillance systems;

• strategic and tactical SIGINT systems that detect, collect, identify, analyze and disseminate information;

• secure data links that enable real-time information collection and dissemination to users of networked communications for airborne, satellite, ground and sea-based remote platforms, both manned and unmanned;

• secure terminal and communication network equipment and encryption management; and

• communication systems for surface and undersea vessels and manned space flights.

The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our C3ISR reportable segment.

Systems/Products/Services Selected Applications Selected Platforms/End Users ISR Systems • Prime mission systems integration, sensor development and operations and support • Signal processing, airborne SIGINT applications, antenna technology, real-time process control and software development • U.S. Air Force (USAF), United Kingdom (U.K.) Ministry of Defence (MoD) and other allied foreign militaries ISR aircraft platforms • Fleet management of special mission aircraft, including avionics and mission system upgrades and logistics support • Measurement collection and signal intelligence, special missions • DoD and special customers within the U.S. Government • ISR operations and support • Data link support and services, special applications, classified projects, spares and repairs • USAF and U.S. Army ISR aircraft platforms Networked Communications • Airborne, space and surface data link terminals, ground stations, and transportable tactical SATCOM (satellite communications) systems • High performance, wideband secure communication links for relaying of intelligence and reconnaissance information • Manned aircraft, unmanned aerial vehicles (UAVs), naval ships, ground vehicles and satellites for the DoD
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Systems/Products/Services Selected Applications Selected Platforms/End Users • Multi-band Manpack Receivers • Portable, ruggedized terminals used for receiving reconnaissance video and sensor data from multiple airborne platforms • U.S. Special Operations Command (USSOCOM), USAF and other DoD customers • Satellite command and control sustainment and support • Software integration, test and maintenance support, satellite control network and engineering support for satellite launch systems • USAF Space Command (AFSC), USAF Satellite Control Network and launch ranges Secure Communications Products • Secure communication terminals and equipment, and secure network encryption products • Secure and non-secure voice, data and video communication for office, battlefield and secure internet protocol (IP) network applications • DoD and U.S. Government intelligence agencies • Ground-based satellite communication terminals and payloads • Interoperable, transportable ground terminals • DoD and U.S. Government intelligence agencies • Satellite communication and tracking systems • On-board satellite external communications, video systems, solid state recorders and ground support equipment • International Space Station, Space Shuttle and various satellites for National Aeronautics and Space Administration (NASA) • Shipboard communications systems • Internal and external communications (radio rooms) • U.S. Navy (USN), U.S. Coast Guard and allied foreign navies

Government Services Reportable Segment

In 2007, Government Services net sales of $4,334 million represented 31% of our total net sales. The businesses in this segment provide a full range of engineering, technical, information technology, advisory, training and support services to the DoD, DoS, DoJ and U.S. Government intelligence agencies and allied foreign governments. Major services for this reportable segment include:

- communication software support, information technology services and a wide range of engineering development services and integration support;
- high-end engineering and information systems support services used for command, control, communications and ISR architectures, as well as for air warfare modeling and simulation tools for applications used by the DoD, DHS and U.S. Government intelligence agencies, including missile and space systems, UAVs and manned military aircraft;
- developing and managing extensive programs in the United States and internationally that focus on teaching, training and education, logistics, strategic planning, organizational design, democracy transition and leadership development;
- human intelligence support and other services, including linguist and translation services and related management to support contingency operations and current intelligence-gathering requirements;
- aviation and maritime services in support of maritime and expedited warfare;

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- intelligence solutions support to the DoD, including the U.S. Armed Services combatant commands and the U.S. Government intelligence agencies, including those within the U.S. Armed Services;
- technical and management services, which provide support of intelligence, logistics, C3 and combatant commands; and
- conventional high-end enterprise information technology (IT) support, systems and other services to the DoD and other U.S. federal agencies.

The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our Government Services reportable segment.

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Training and Operational Support		
• Training systems, courseware and doctrine development	• Training, leadership development and education services for U.S. and allied foreign armed forces, counterintelligence and law enforcement personnel	• U.S. Army, U.S. Marine Corps (USMC), DoS, DoJ and allied foreign governments
• Acquisition management and staff augmentation	• Rapid fielding support for combatants and physical location management	• U.S. Army
• Weapons Training Systems	• Laser marksmanship training systems and advanced integrated technologies for security products and services	• DoD and law enforcement agencies
Information Technology Solutions		
• Communication systems and software engineering services	• Value-added, critical software support for C3ISR systems, electronic warfare and fire support systems	• U.S. Army Communications – Electronics Command (CECOM)
• Network and enterprise administration and management	• Systems engineering, assurance and risk management, network and systems administration, management, software development and life cycle support and systems integration	• U.S. Army, U.S. Joint Chiefs of Staff, USAF, USSOCOM and NASA
• Systems acquisition and advisory support and comprehensive operational support services	• Requirements definition, program management, planning and analysis, systems engineering and integration, intelligence analysis and managing and network engineering	• U.S. Army, USAF, USN and DHS

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Systems/Products/Services Selected Applications Selected Platforms/End Users Intelligence Solutions and Support • System support and concept operations (CONOPS) • C3ISR, modeling and simulation • DoD, U.S. Missile Defense Agency (MDA), U.S. Government intelligence agencies, and NASA • Information technology (IT) services • IT infrastructure modernization and operations • U.S. Government intelligence agencies and U.K. MoD • Information management and IT systems support and software design, development and systems integration • Intelligence and operations support, C3 systems, network centric operations and information operations • DoD and U.S. Government intelligence agencies • Linguistic, interpretation, translation and analyst services • Counterintelligence, threat protection and counter terrorism • U.S. Army Aviation, Maritime and Engineering Services • Systems engineering, operations analysis, research and technical analysis • Systems engineering and operational analysis of most aircraft and vessels in the USN fleet, C3 and Computers (C4) systems acquisitions, logistics and administrative support, as well as systems life cycle support • USN and USMC • Surveillance systems and products, including installation and logistics support • Automated security systems for bases and force protection, and remote surveillance for U.S. borders • DHS and USAF

Aircraft Modernization and Maintenance (AM&M) Reportable Segment

In 2007, AM&M net sales of $2,528 million represented 18% of our total net sales. The businesses in this segment provide modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. We sell these services primarily to the DoD, the Canadian Department of National Defense (DND) and other allied foreign governments. Major products and services for this reportable segment include:

- engineering, modification, maintenance, logistics and upgrades for aircraft, vehicles and personnel equipment;
- turnkey aviation life cycle management services that integrate custom developed and commercial off-the-shelf products for various military fixed and rotary wing aircraft, including heavy maintenance and structural modifications and interior modifications and construction; and
- aerospace and other technical services related to large fleet support, such as aircraft and vehicle modernization, maintenance, repair and overhaul, logistics, support and supply chain management, primarily for military training, tactical, cargo and utility aircraft, anti-missile defense systems and tanks.

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The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our AM&M reportable segment.

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
Aircraft and Base Support Services		
• Logistics support, maintenance and refurbishment	• Aircraft maintenance repair and overhaul, flight operations support for training, cargo and special mission aircraft	• U.S. Army, USAF, USN, USSOCOM, Canadian DND and other allied foreign militaries
• Contract Field Teams (CFT)	• Deployment of highly mobile, quick response field teams to customer locations to supplement the customer's resources for various ground vehicles and aircraft	• U.S. Army, USAF, USN and USMC
• Contractor operated and managed base supply (COMBS)	• Inventory management activities relating to flight support and maintenance, including procurement and field distribution	• Military training and cargo aircraft
Aircraft Modernization		
• Modernization and life extension maintenance upgrades and support	• Aircraft structural modifications and inspections, installation of mission equipment, navigation and avionics products	• USN, USAF, USSOCOM, Canadian DND, Royal Australian Air Force, other allied foreign governments, various military, fixed and rotary wing aircraft and Head of State aircraft

Specialized Products Reportable Segment

In 2007, Specialized Products net sales of $4,789 million represented 34% of our total net sales. The businesses in this reportable segment provide a broad range of products, including components, products, subsystems and systems, to military and commercial customers in several niche markets. The table below provides a summary of the segment's business areas and the percentage that each contributed to Specialized Products net sales in 2007.

Business Area	% of 2007 Segment Sales
Power & Control Systems	19 %
Microwave	14
Avionics & Displays	14
Training & Simulation	12
Electro-Optic/Infrared (EO/IR)	11
Precision Engagement	7
Security & Detection Systems	7
Propulsion Systems	6
Undersea Warfare	5
Telemetry and Advanced Technology	5
Total Specialized Products	100 %

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The table below provides additional information for the systems and products, selected applications and selected platforms or end users of our Specialized Products reportable segment.

Systems/Products Selected Applications Selected Platforms/End Users Power & Control Systems • Shipboard electrical power packages, electric drives and propulsion, automation, navigation and communication systems • Surface ships ranging from shipping vessels, container carriers, environmental and research ships, ferries and cruise liners • Commercial shipbuilders and allied foreign navies • Naval power delivery, conversion and switching products • Switching, distribution and protection, as well as frequency and voltage conversion • Naval submarines, surface ships and aircraft carriers • Shipboard electronics racks, rugged computers, rugged displays and communication terminals • Ruggedized displays, computers and electronic systems • Naval vessels and other DoD applications • Service life extensions • Landing craft air cushion amphibious vehicles • USN Microwave • Passive components, switches and wireless assemblies • Radio transmission, switching and conditioning, antenna and base station testing and monitoring • DoD, wireless communications service providers and original equipment manufacturers • Satellite and wireless components (channel amplifiers, transceivers, converters, filters and multiplexers) • Satellite transponder control, channel and frequency separation • SATCOM and wireless communications equipment for DoD and various government agencies • Traveling wave tubes, power modules, klystrons and digital broadcast • Microwave vacuum electron devices and power modules • DoD and allied foreign military manned/unmanned platforms, various missile programs and commercial broadcast • Quick-deploy flyaway very small aperture terminals (VSAT) and vehicular satellite systems • Satellite communication systems • U.S. Army, USAF and various DoD customers • Ultra-wide frequency and advanced radar antennas and radomes • Surveillance and radar detection • Military fixed and rotary winged aircraft, SATCOM Avionics & Displays • Solid state crash protected cockpit voice and flight data recorders • Aircraft voice and flight data recorders that continuously record voice and sounds from cockpit and aircraft intercommunications • Commercial transport, business, regional and military aircraft

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Systems/Products Selected Applications Selected Platforms/End Users • Airborne traffic and collision avoidance systems, terrain awareness warning systems • Reduce the potential for midair aircraft collisions and crashes into terrain by providing visual and audible warnings and maneuvering instructions to pilots • Commercial transport, business, regional and military aircraft • Advanced cockpit avionics • Pilot safety, navigation and situation awareness products • Commercial transport, business, regional and military aircraft • Cockpit and mission displays • High performance, ruggedized flat panel and cathode ray tube displays and processors • Various military aircraft Training & Simulation • Military aircraft flight simulators, reconfigurable training devices, distributed mission training (DMT) suites • Advanced simulation technologies and training for pilots, navigators, flight engineers, gunners and operators • Fixed and rotary winged aircraft and ground vehicles for USAF, USN, U.S. Army, Canadian DND and allied foreign militaries EO/IR • Targeted stabilized camera systems with integrated sensors and wireless communication systems • Intelligence Data Collection, Surveillance and Reconnaissance • DoD, intelligence and security agencies, law enforcement, manned/unmanned platforms • Airborne and ground based high energy laser beam directors and high tracking rate telescopes • Directed energy systems, space surveillance, satellite laser ranging and laser communications • USAF and NASA Precision Engagement • Global Positioning System (GPS) receivers • Location tracking • Guided projectiles and precision munitions • Navigation systems and positioning navigation units • Satellite launch and orbiting navigation and navigation for ground vehicles and fire control systems • USAF, U.S. Army, USMC and NASA • Premium fuzing products • Munitions and electronic and electromechanical safety arming devices (ESADs) • Various DoD and allied foreign military customers Security & Detection Systems • Explosives detection systems and airport security systems • Rapid scanning of passenger checked baggage and carry-on luggage, scanning of large cargo containers • DHS, including the U.S. Transportation and Security Administration (TSA), and domestic and international airports, state and local governments

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Systems/Products Selected Applications Selected Platforms/End Users • Non-invasive security systems and portals, and sophisticated sensors with threat detection capabilities • Aviation, rail and border crossing security • TSA, U.S. customs agency, various regulatory authorities and private security companies Propulsion Systems • Heavy fuel engines, cross drive variable transmissions, turret drive systems, vehicle suspension, advanced drive systems and auxiliary power generators • Power trains and suspension systems for military vehicles, power and energy management for military hybrid electric vehicles, non portable and under armor auxiliary power units, and heavy fueled engines for unmanned systems • U.S. Army, USMC and allied foreign ministries of defense, manned/unmanned military platforms Undersea Warfare • Airborne dipping sonars, submarine and surface ship towed arrays • Submarine and surface ship detection and localization • USN and allied foreign navies Telemetry and Advanced Technology • Telemetry and instrumentation systems • Real-time data acquisition, measurement, processing, simulation, distribution, display and storage for flight tracking, testing and termination • Aircraft, missiles and satellites • High power microwave sources, systems & effects, pulse power systems and electromagnetics hardened construction • Forensic analysis of weapons of mass destruction, active detection of special nuclear material and irradiation sytems for decontamination and industrial applications • U.K. MoD, U.S. Defense Threat Reduction Agency, U.S. Army and USAF

Backlog and Orders

We define funded backlog as the value of funded orders received from customers, less the cumulative amount of sales recognized on such orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. A table that presents our funded backlog, percent of December 31, 2007 funded backlog expected to be recorded as sales in 2008 and funded orders for each of our reportable segments is located in ‘‘Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Backlog and Orders’’ on page 51.

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Major Customers

The table below presents a summary of our 2007 sales by end customer and the percent contributed by each to our total 2007 sales. For additional information regarding domestic and foreign sales, see Note 20 to our audited consolidated financial statements.

	2007 Sales (in millions)	% of Total Sales
Army	$ 3,782	27 %
Air Force	2,667	19
Navy/Marines	2,075	15
Other Defense	1,744	13
Total DoD	$ 10,268	74 %
Other U.S. Government	834	6
Total U.S. Government	$ 11,102	80 %
Foreign governments	972	7
Commercial – foreign	1,122	8
Commercial – domestic	765	5
Total sales	$ 13,961	100 %

Approximately 76% of our DoD sales for 2007 were direct to the customer, and approximately 24% were indirect through other prime system contractors and subcontractors of the DoD.

Our sales are predominantly derived from contracts with agencies of, and prime contractors to, the U.S. Government. Various U.S. Government agencies and contracting entities exercise independent and individual purchasing decisions, subject to annual appropriations by the U.S. Congress. For the year ended December 31, 2007, our five largest contracts generated 16% of our consolidated sales. For the year ended December 31, 2007, our largest contract, the World Wide Linguist Support Services contract (Linguist Contract) with the U.S. Army Intelligence and Security Command (INSCOM), generated 5% of our sales. On December 9, 2007, the Linguist Contract period of performance was extended to March 8, 2008. On February 15, 2008, INSCOM announced that it did not select our proposal for the Translation and Interpretation Management Services (TIMS) contract, and on February 22, 2008, we filed a protest of INSCOM's selection with the U.S. Government Accountability Office (GAO). The TIMS contract is the successor contract to the portion of the Linguist Contract that provides translators and linguists in support of the U.S. military operations in Iraq.

Research and Development

We conduct research and development activities that consist of projects involving applied research, new product development and select concept studies. We employ scientific, engineering and other personnel to improve our existing product-lines and develop new products and technologies. As of December 31, 2007, we employed approximately 35,700 engineers and technicians, a substantial portion of whom hold advanced degrees, and work on company sponsored research and development efforts, customer funded research and development contracts and production and services contracts. A table that presents L-3's (i) company-sponsored (independent) research and development costs and (ii) customer-funded research and development costs is presented in ''Part II — Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Research and Development'' on page 52.

Competition

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

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

- the effectiveness and innovation of our technologies and research and development programs;
- our ability to offer better program performance than our competitors at a lower cost;

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- historical technical and schedule past performance;
- maintaining an effective supplier and vendor base;
- our ability to retain our employees and hire new ones, particularly those who have U.S. Government security clearances; and
- the capabilities of our facilities, equipment and personnel to undertake the business for which we compete.

Most of our sales are derived from contracts (revenue arrangements) awarded by customers on the basis of negotiations or competitive bids. In some instances, we are the incumbent supplier or have been the sole provider on a contract for many years, and we refer to these positions as ''sole-source''. On our sole-source contracts, there may be other suppliers who have the capability to compete for the contracts involved, but they can only enter the market if the customer chooses to reopen the particular contract to competition. Sole-source contracts are generally re-competed every three to five years and at times more frequently. For the year ended December 31, 2007, contracts where we held sole-source positions accounted for 47% of our total sales and contracts which we had competitively won accounted for 53% of our total sales.

We believe we are the defense supplier with one of the broadest and most diverse product portfolios. We supply our products and services to other prime system contractors. However, we also compete directly with other large prime system contractors for (i) certain products and subsystems where they have vertically integrated businesses and (ii) niche areas where we are a prime system contractor. We also compete with numerous other aerospace, defense and government technical services contractors, which generally provide similar products, subsystems or services. We believe that a majority of our businesses enjoy the number one or number two competitive positions in their market niches. We believe that the primary competitive factors for our businesses are technology, research and development capabilities, quality, cost, market position and past performance.

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

Patents and Licenses

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

Raw Materials

Generally, our businesses engage in limited manufacturing activities. In manufacturing our products, we use our own production capabilities as well as a diverse base of third party suppliers and subcontractors. Although aspects of certain of our businesses require relatively scarce raw materials, we have not experienced difficulty in our ability to procure raw materials, components, sub-assemblies and other supplies required in our manufacturing processes.

Contracts

A significant portion of our sales are derived from sole-source contracts as discussed above. We believe that our customers award sole-source contracts to the most capable supplier in terms of quality, responsiveness, design, engineering and program management competency and cost. However, as discussed above, we are increasingly competing against other prime system contractors for major subsystems business. As a consequence of our competitive position, for the year ended December 31, 2007, we won contract awards at a rate in excess of 63% on new competitive contracts that we bid on, and at a rate in excess of 95% on the number of contracts we rebid for when we were the incumbent supplier.

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Generally, the sales price arrangements for our contracts are either fixed-price, cost-reimbursable or time-and-material type. Generally, a fixed-price type contract offers higher profit margin potential than a cost-reimbursable type or time-and-material type contract, which is commensurate with the greater levels of risk we assume on a fixed-price type contract. Our operating margins (pretax operating income as a percentage of sales) on fixed-price type contracts generally range between 10% and 15%, while on cost-reimbursable type contracts they generally range between 5% and 10%, and on time-and-material type contracts they generally range between 8% and 12%.

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined sales price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract. Accounting for the sales on a fixed-price type contract requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work, and (3) the measurement of progress towards completion. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated total profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change. On a cost-reimbursable type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit which can be fixed or variable depending on the contract's fee arrangement up to predetermined funding levels determined by our customers. On a time-and-material type contract (revenue arrangement), we are paid on the basis of direct labor hours expended at specified fixed-price hourly rates (that include wages, overhead, allowable general and administrative expenses and profit) and materials at cost. Therefore, on cost-reimbursable type and time-and-material type contracts we do not bear the risks of unexpected cost overruns, provided that we do not incur costs that exceed the predetermined funded amounts. Our customer satisfaction and performance record is evidenced by our receipt of performance-based award fees achieving 90% of the available award fees on average during the year ended December 31, 2007. Cost-reimbursable type contracts with award fee provisions, known as cost-plus award fee (CPAF) contracts, provide for a fee based on actual performance relative to contractually specified performance criteria. Sales from CPAF contracts were approximately $1.1 billion for the year ended December 31, 2007.

We have a diverse business mix with limited reliance on any single contract, a favorable balance of fixed-price, cost-reimbursable and time-and-material type contracts, a significant sole-source follow-on business and an attractive customer profile. The table below presents the percentage of our total sales generated from each contract-type.

Year Ended December 31, Contract-Type	2007	2006	2005
Fixed-price	51 %	50 %	53 %
Cost-reimbursable	30 %	31 %	30 %
Time-and-material	19 %	19 %	17 %
Total sales	100 %	100 %	100 %

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

Regulatory Environment

Most of our revenue arrangements with agencies of the U.S. Government, including the DoD, are subject to unique procurement and administrative rules. These rules are based on both laws and regulations, including the U.S. Federal

Acquisition Regulation (FAR), that: (1) impose various profit and cost controls, (2) regulate the allocations of costs, both direct and indirect, to contracts and (3) provide for the non-reimbursement of unallowable costs. Unallowable costs include, but are not limited to, lobbying expenses, interest expenses and certain costs related to business acquisitions, including, for

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example, the incremental depreciation and amortization expenses arising from fair value increases to the historical carrying values of acquired assets. Our contract administration and cost accounting policies and practices are also subject to oversight by government inspectors, technical specialists and auditors. See ‘‘Part I — Item 1A — Risk Factors’’ below for a discussion of certain additional business risks specific to our government contracts.

As is common in the U.S. defense industry, we are subject to business risks, including changes in the U.S. Government’s procurement policies (such as greater emphasis on competitive procurement), governmental appropriations, national defense policies or regulations, service modernization plans, and availability of funds. A reduction in expenditures by the U.S. Government for products and services of the type we manufacture and provide, lower margins resulting from increasingly competitive procurement policies, a reduction in the volume of contracts or subcontracts awarded to us or the incurrence of substantial contract cost overruns could materially adversely affect our business.

Certain of our sales are under foreign military sales (FMS) agreements directly between the U.S. Government and allied foreign governments. In such cases, because we serve only as the supplier, we do not have unilateral control over the terms of the agreements. These contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance with these laws and regulations. Investigations could result in administrative, civil, or criminal liabilities, including repayments, disallowance of certain costs, or fines and penalties. Certain of our sales are direct commercial sales to allied foreign governments. These sales are subject to U.S. Government approval and licensing under the Arms Export Control Act. Legal restrictions on sales of sensitive U.S. technology also limit the extent to which we can sell our products to allied foreign governments or private parties.

Environmental Matters

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

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

Certain Acquired Pension Plans

In connection with our acquisition of ten business units from Lockheed Martin and the formation of L-3 in 1997, we assumed certain defined benefit pension plan liabilities for present and former employees and retirees of certain of these businesses from Lockheed Martin. Lockheed Martin had previously received a letter from the Pension Benefit Guaranty Corporation (PBGC) indicating that the pension plans of two of these businesses were under funded using the PBGC’s actuarial assumptions (Subject Plans).

With respect to the Subject Plans, Lockheed Martin entered into an agreement (Lockheed Martin Commitment) with L-3 and the PBGC dated as of April 30, 1997. The terms and conditions of the Lockheed Martin Commitment include a commitment by Lockheed Martin to the PBGC to, under certain circumstances, assume sponsorship of the Subject Plans or provide another form of financial support for the Subject Plans. The Lockheed Martin Commitment will continue until the Subject Plans are no longer under funded on a PBGC basis for two consecutive years, or immediately if we achieve investment grade credit ratings on all of our outstanding debt.

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If Lockheed Martin did assume sponsorship of the Subject Plans, it would be primarily liable for the costs associated with funding the Subject Plans or any costs associated with the termination of the Subject Plans. The terms and conditions of the Lockheed Martin Commitment would require us to reimburse Lockheed Martin for these costs. Lockheed Martin has not assumed sponsorship or provided another form of financial support for the Subject Plans.

We believe we have performed our obligations under the Lockheed Martin Commitment and have not received any communications from the PBGC concerning actions that the PBGC contemplates taking in respect of the Subject Plans.

For the year ended December 31, 2007, we contributed $8 million to the Subject Plans. For subsequent years, our funding requirements will depend upon prevailing interest rates, return on pension plan assets and underlying actuarial assumptions. At December 31, 2007, the aggregate projected benefit obligation was $238 million and the aggregate plan assets were $222 million for the Subject Plans. At December 31, 2007, we have recorded a liability of $16 million for the under funded status of the Subject Plans.

Employees

As of December 31, 2007, we employed approximately 64,600 full-time and part-time employees, 83% of whom were located in the United States. Of these employees, approximately 18% are covered by 91 separate collective bargaining agreements with various labor unions. The success of our business is primarily dependent upon the knowledge of our employees and on the management, contracting, engineering and technical skills of our employees. In addition, our ability to grow our businesses, obtain additional orders for our products and services and to satisfy contractual obligations under certain of our existing revenue arrangements is largely dependent upon our ability to attract and retain employees who have U.S. Government security clearances, particularly those with clearances of top-secret and above. We believe that relations with our employees are positive.

L-3 Holdings Obligations

The only obligations of L-3 Holdings at December 31, 2007 are: (1) its 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued by L-3 Holdings on July 29, 2005, (2) its guarantee of borrowings under the senior credit facility of L-3 Communications and (3) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and unconditionally guaranteed by L-3 Communications and certain of its wholly-owned domestic subsidiaries. In order to generate the funds necessary to repurchase common stock and pay dividends declared and principal and interest on its outstanding indebtedness, if any, L-3 Holdings relies on dividends and other payments from its subsidiaries or it must raise funds in public or private equity or debt offerings.

Available Information

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

You may also obtain a free copy of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statement for the annual shareholders' meeting, as well as any amendments to those reports as soon as reasonably practicable after electronic filing with the SEC through our website on the Internet at http://www.L-3com.com.

The Company also has a Corporate Governance webpage. You can access the Company's Corporate Governance Guidelines and charters for the audit, compensation and nominating/corporate governance

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committees of our Board of Directors through our Internet site, http://www.L-3com.com, by clicking on the ‘‘Corporate Governance’’ link under the heading ‘‘Investor Relations.’’ The Company posts a Code of Ethics and Business Conduct on its Corporate Governance webpage under the link ‘‘Code of Ethics and Business Conduct.’’ The Company’s Code of Ethics and Business Conduct applies to all directors, officers and employees, including our president and chief executive officer, our vice president and chief financial officer, and our corporate controller. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. (‘‘NYSE’’), on our Internet site. The information on the Company’s Internet site is not incorporated by reference into this report. You can request a copy of our Code of Ethics and Business Conduct or any other corporate governance document or periodic report at no cost by contacting (866) INFO-LLL (866-463-6555).

Item 1A. Risk Factors

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

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

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

Our government contracts are primarily dependent upon the U.S. defense budget. We, as most U.S. defense contractors, have benefited from the upward trend in overall DoD spending over recent years, including supplemental appropriations for military operations in Iraq, Afghanistan and the Global War on Terror (GWOT). The President’s DoD base defense budget request, for the government’s fiscal year ending September 30, 2009, excluding a fiscal year 2009 GWOT supplemental request, indicates continued growth over fiscal year 2008. However, the future DoD budgets could be negatively affected by several factors, including, but not limited to, the U.S. Government’s budget deficits, U.S. national security strategies, geopolitical events, a change in spending priorities and the costs of sustaining the U.S. military operations in Iraq and Afghanistan, which could cause the DoD budget to remain unchanged or to decline. A significant decline in or redirection of U.S. military expenditures in the future could result in a material decrease to our sales, earnings and cash flows. The loss or significant reduction in government funding of a large program in which we participate could also result in a material decrease to our future sales, earnings and cash flows. U.S. Government contracts are also conditioned upon the continuing approval by Congress of the amount of necessary spending. Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress for future fiscal years.

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

Our sales are predominantly derived from contracts (revenue arrangements) with agencies of, and prime contractors to, the U.S. Government. The loss of all or a substantial portion of our sales to the U.S. Government would have a material adverse effect on our results of operations and cash flows. At December 31, 2007, we had approximately 2,000 contracts (revenue arrangements) with individual estimated contract values in excess of $1 million.

Approximately 80%, or $11 billion, of our sales for the year ended December 31, 2007 were made directly or indirectly to U.S. Government agencies, including the DoD. For the year ended December 31, 2007, our largest contract was the Linguist Contract and it represented 5% of our sales, and aggregate sales from our five largest contracts amounted to $2.2 billion, or 16% of our sales. On December 9, 2007, the Linguist Contract period of performance was extended to March 8, 2008. In addition, as discussed above under ''Major Customers,'' INSCOM made an award of the follow-on contract to another service provider.

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

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

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

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

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

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

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

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

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

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

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

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

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

We are from time to time subject to governmental investigations relating to our operations. We are currently cooperating with the U.S. Government on several investigations, including but not limited to, an investigation by the Department of Justice Criminal Antitrust Division regarding information technology services performed for the Air Force. For a discussion of this matter, see Note 17 to our audited consolidated financial statements.

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

At any given time, we are a defendant in various material legal proceedings and litigation matters arising in the ordinary course of business, including litigation, claims and assessments that have been asserted against acquired businesses, which we have assumed. Although we maintain insurance policies, we can make no assurance that this insurance will be adequate to protect us from all material judgments and expenses related to potential future claims or that these levels of insurance will be available in the future at economical prices or at all. A significant judgment against us, arising out of any of our current or future legal proceedings and litigation, could have a material adverse effect on our business, financial condition, results of operations and future prospects. For a discussion of the material litigation to which we are currently a party, see Note 17 to our audited consolidated financial statements.

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

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

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

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

The process of integrating the operations of acquired businesses into our existing operations may result in unforeseen difficulties and may require significant financial and managerial resources that would otherwise be available for the ongoing development or expansion of our existing operations. Possible future business acquisitions could result in the incurrence of additional debt and related interest expense and contingent liabilities, each of which could result in an increase to our already significant level of outstanding debt, as well as more restrictive covenants. We consider and execute strategic acquisitions on an ongoing basis and may be evaluating acquisitions or engage in acquisition negotiations at any given time. We regularly evaluate potential acquisitions and joint venture transactions, but we have not entered into any agreements with respect to any material transactions at this time. Furthermore, in certain of our business acquisitions we have assumed all claims against and liabilities of the acquired business, including both asserted and unasserted claims and liabilities.

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

Our sales are transacted using written revenue arrangements, or contracts, which are generally either fixed-price, cost-reimbursable or time-and-material. For a description of our revenue recognition policies, see ‘‘Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies.’’ For the year ended December 31, 2007, approximately 51% of our sales were generated from fixed-price type contracts, approximately 30% of our sales were generated from cost-reimbursable type contracts and approximately 19% of our sales were generated from time-and-material type contracts. Substantially all of our cost-reimbursable and time-and-material type contracts are with the U.S. Government, primarily with the DoD. Substantially all of our sales to commercial customers are transacted under fixed-price sales arrangements, and are included in our fixed-price type contract sales.

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

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

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

Intense competition in the industries in which our businesses operate could limit our ability to attract and retain customers.

The defense industry and the other industries in which our businesses operate and the market for defense applications is highly competitive. We expect that the DoD's increased use of commercial off-the-shelf products and components in military equipment will continue to encourage new competitors to enter the market. We also expect that competition for original equipment manufacturing business will increase due to the continued emergence of merchant suppliers. Our ability to compete for defense contracts depends on a variety of factors, including:

- the effectiveness and innovation of our technologies and research and development programs;
- our ability to offer better program performance than our competitors at a lower cost;
- our historical technical and schedule past performance;
- maintaining an effective supplier and vendor base;
- our ability to retain our employees and hire new ones, particularly those who have U.S. Government security clearances; and
- the capabilities of our facilities, equipment and personnel to undertake the business for which we compete.

Most of our sales are derived from contracts (revenue arrangements) awarded by customers on the basis of negotiations or competitive bids. In some instances, we are the incumbent supplier or have been the sole provider for many years. We refer to our position on such revenue arrangements as ''sole-source'' contracts. In those instances, there may be other suppliers who have the capability to compete for the programs involved, but they can only enter or re-enter the market if the customer chooses to reopen the particular program to competition. Additionally, some of our competitors are larger than us and have substantially greater financial and other resources than we have.

Our significant level of debt and our ability to make payments on or service our indebtedness may adversely affect our financial and operating activities or ability to incur additional debt.

In prior years we incurred substantial indebtedness to finance our business acquisitions. At December 31, 2007, we had approximately $4,550 million in aggregate principal amount of outstanding debt. In addition, we had additional borrowing capacity of $794.5 million at December 31, 2007 available to us under our senior credit facility, after reductions for outstanding letters of credit of $205.5 million. In the future, we may increase our borrowings, subject to limitations imposed on us by our debt agreements. The first scheduled maturity of our existing debt will occur on March 9, 2010 for $650 million.

Our ability to make scheduled payments of principal and interest on our indebtedness and to refinance our existing debt depends on our future financial performance. We do not have complete control over our future financial performance because it is subject to economic, political, financial (including credit market conditions), competitive, regulatory and other factors affecting the aerospace and defense industry. It is possible that in the future our business may not generate sufficient cash flow from operations to allow us to service our debt and make necessary capital expenditures. If this situation occurs, we may have to sell assets, restructure debt or obtain additional equity capital. We may not be able to do so in a timely manner or upon acceptable terms in accordance with the restrictions contained in our debt agreements.

Our level of indebtedness has important consequences to us. These consequences may include:

- requiring a substantial portion of our net cash flow from operations to be used to pay interest and principal on our debt and therefore be unavailable for other purposes, including acquisitions, capital expenditures, paying dividends to our shareholders, repurchasing shares of our common stock, research and development and other investments;
- limiting our ability to obtain additional financing for acquisitions, working capital, investments or other expenditures, which, in each case, may limit our ability to carry out our acquisition strategy;

- increasing interest expenses due to higher interest rates on our borrowings that have variable interest rates;
- heightening our vulnerability to downturns in our business or in the general economy and restricting us from making acquisitions, introducing new technologies and products or exploiting business opportunities; and
- impacting debt covenants that limit our ability to borrow additional funds, dispose of assets, pay cash dividends or repurchase shares of our common stock. Failure to comply with such covenants could result in an event of default which, if not cured or waived, could result in the acceleration of our outstanding indebtedness.

Additionally, on December 31, 2007, we had $9,672 million of contractual obligations (including outstanding indebtedness). For a detailed listing of the components of our contractual obligations, see ‘‘Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Contractual Obligations’’ on pages 49-50.

Our debt agreements restrict our ability to finance our future operations and, if we are unable to meet our financial ratios, could cause our existing debt to be accelerated.

Our debt agreements contain a number of significant covenants that, among other things, restrict our ability to:

- sell assets;
- incur more indebtedness;
- repay certain indebtedness;
- pay dividends on the common stock of L-3 Holdings;
- make certain investments or business acquisitions;
- repurchase or redeem capital stock;
- make certain capital expenditures;
- engage in business mergers or consolidations; and
- engage in certain transactions with subsidiaries and affiliates.

These restrictions could impair our ability to finance our future operations or capital needs or engage in other business activities that may be in our interest. In addition, some of our debt agreements also require us to maintain compliance with certain financial ratios, including (1) total consolidated earnings before interest, taxes, depreciation and amortization to total consolidated cash interest expense and (2) total consolidated funded indebtedness less designated cash balances to total consolidated earnings before interest, taxes, depreciation and amortization. Our ability to comply with these ratios and covenants may be affected by events beyond our control. A breach of any of these agreements or our inability to comply with the required financial ratios or covenants could result in a default under those debt agreements. In the event of any such default, the lenders under those debt agreements could elect to:

- declare all outstanding debt, accrued interest and fees to be due and immediately payable;
- require us to apply all of our available cash to repay our outstanding senior debt; and
- prevent us from making debt service payments on our other debt.

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

Our future success depends to a significant degree upon the continued contributions of our management, and our ability to attract and retain highly qualified management and technical personnel,

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including employees who have U.S. Government security clearances, particularly clearances of top-secret and above. We do not maintain any key person life insurance policies for members of our management. We face competition for management and technical personnel from other companies and organizations. Failure to attract and retain such personnel would damage our future prospects.

Environmental laws and regulations may subject us to significant liability.

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

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

Termination of our backlog of orders could negatively impact our results of operations and cash flows.

We currently have a backlog of funded orders, primarily under contracts with the U.S. Government. Our total funded backlog was $9,571 million at December 31, 2007. As described above, the U.S. Government may unilaterally modify or terminate its contracts. Accordingly, most of our backlog could be modified or terminated by the U.S. Government, which would negatively impact our results of operations and cash flows.

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

For the year ended December 31, 2007, sales to foreign customers, excluding our foreign sales made under foreign military sales (FMS) agreements directly between the U.S. Government and allied foreign governments represented approximately 13% of our consolidated sales. Consequently, our businesses are subject to a variety of risks that are specific to international operations, including the following:

- export regulations that could erode profit margins or restrict exports;
- compliance with the U.S. Foreign Corrupt Practices Act (FCPA);
- the burden and cost of compliance with foreign laws, treaties and technical standards and changes in those regulations;
- contract award and funding delays;
- potential restrictions on transfers of funds;
- foreign currency fluctuations;
- import and export duties and value added taxes;
- transportation delays and interruptions;

- uncertainties arising from foreign local business practices and cultural considerations; and
- potential military conflicts and political risks.

While we have and will continue to adopt measures to reduce the potential impact of losses resulting from the risks of our foreign business, we cannot ensure that such measures will be adequate.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

At December 31, 2007, we operated in 546 locations consisting of manufacturing facilities and properties throughout the United States and internationally. Of these, we owned 44 locations consisting of approximately 5.2 million square feet and leased space at 502 locations consisting of approximately 17.8 million square feet.

Our reportable segments have major operations at the following locations:

- C3ISR – Camden, New Jersey; Greenville and Waco, Texas; and Salt Lake City, Utah.
- Government Services – Huntsville, Alabama; Orlando, Florida; Annapolis, Maryland; and Alexandria, Arlington, Chantilly and Reston, Virginia.
- AM&M – Fairhope, Alabama; Crestview, Florida; Lexington, Kentucky; South Madison, Mississippi; Greenville and Waco, Texas; and Edmonton and Quebec, Canada.
- Specialized Products – Phoenix, Arizona; Anaheim, San Carlos, San Diego, San Leandro, Simi Valley, Sylmar and Torrance, California; Orlando, Sarasota and St. Petersburg, Florida; Muskegon, Michigan; Budd Lake, New Jersey; Binghamton and Hauppauge, New York; Cincinnati and Mason, Ohio; Philadelphia, Pittsburgh and Williamsport, Pennsylvania; Arlington, Texas; Toronto, Canada; Hamburg and Elmenhorst, Germany; and Bracknell, United Kingdom.

Corporate and other locations – New York, New York and Arlington, Virginia.

A summary of square footage by reportable segment as of December 31, 2007 is presented below.

	Leased	Owned	Total
	(Square feet in millions)		
C3ISR	4.4	0.6	5.0
Government Services	3.1	—	3.1
AM&M	3.0	1.3	4.3
Specialized Products	7.2	3.3	10.5
Corporate	0.1	—	0.1
Total	17.8	5.2	23.0

Item 3. Legal Proceedings

The information required with respect to this item can be found in Note 17 to our audited consolidated financial statements and is included in this Item 3 by reference.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

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

The common stock of L-3 Holdings is traded on the New York Stock Exchange (NYSE) under the symbol ''LLL''. On February 22, 2008, the closing price of L-3 Holdings' common stock, as reported by the NYSE, was $106.79 per share and the number of holders of L-3 Holdings' common stock was approximately 89,000. The table below sets forth the high and low closing price of L-3 Holdings' common stock as reported on the NYSE composite transaction tape and the amount of dividends paid per share during the past two calendar years.

Common Stock — Dividends Paid and Market Prices

Quarter Ended:	Dividends Paid 2007	Dividends Paid 2006	Closing Price (High-Low) 2007	Closing Price (High-Low) 2006
March 31	$ 0.25	$ 0.1875	$ 88.99-$ 80.02	$86.95-$74.41
June 30	0.25	0.1875	99.20- 87.81	85.35- 72.96
September 30	0.25	0.1875	102.68- 92.11	79.09- 66.58
December 31	0.25	0.1875	114.69- 103.69	83.86- 75.30
Year Ended December 31	$ 1.00	$ 0.75	114.69- 80.02	86.95- 66.58

On February 5, 2008, L-3 Holdings announced that its Board of Directors had increased L-3 Holdings' regular quarterly cash dividend by 20% to $0.30 per share, payable on March 17, 2008, to shareholders of record at the close of business on February 19, 2008.

L-3 Holdings relies on dividends received from L-3 Communications to generate the funds necessary to pay dividends on L-3 Holdings' common stock. See ''Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources'' and Note 10 to our audited consolidated financial statements for the financial and other restrictive covenants that limit the payment of dividends by L-3 Communications to L-3 Holdings.

Issuer Purchases of Equity Securities

In December 2007, L-3 completed its previously announced $500 million share repurchase program, which was approved by its Board of Directors on December 14, 2006. On December 11, 2007, L-3 announced that its Board of Directors approved a new share repurchase program. Under the provisions of this program, L-3 Holdings is authorized to repurchase up to an additional $750 million of its outstanding shares of common stock through December 31, 2009. Repurchases under the program may be made through open market purchases, private transactions, transactions structured through investment banking institutions or any combination thereof, in accordance with applicable federal securities laws. The timing of repurchases and the exact number of shares of common stock to be purchased will be determined by L-3's management and will depend upon market conditions, legal considerations affecting the amount and timing of repurchase activity, alternative investment opportunities and various other factors. The program is expected to be funded through L-3's cash on hand and cash generated from operations. The program may be extended, suspended or discontinued at any time without prior notice. All shares of L-3 Holdings common stock repurchased were recorded as treasury shares.

The following table provides information about share repurchases we made of L-3 Holdings common stock that are registered pursuant to Section 12 of the Exchange Act during the 2007 fourth quarter.

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
				(in millions)
October 1 – 31, 2007	—	$—	—	$ 185.7
November 1 – 30, 2007	1,254,303	110.77	1,254,303	$ 46.8
December 1 – 31, 2007	658,360	109.35	658,360	$ 724.8 (1)
Total	1,912,663	$110.28	1,912,663	

(1) Represents amounts available under the share repurchase program approved on December 11, 2007.

From January 1, 2008 through February 27, 2008, L-3 has repurchased 2,372,861 shares of L-3 Holdings common stock at an average price of $105.04 per share for an aggregate amount of $249.3 million.

The graph below compares the cumulative total returns of our common stock with the cumulative total return of the Standard & Poor’s 500 Composite Stock Index and the Standard & Poor’s 1500 Aerospace & Defense Index, for the period from December 31, 2002 to December 31, 2007. These figures assume that all dividends paid over the performance period were reinvested, and that the starting value of each index and the investment in our common stock was $100 on December 31, 2002.

We are one of the companies included in the Standard & Poor’s 1500 Aerospace & Defense Index and the Standard & Poor’s 500 Composite Stock Index. The starting point for the measurement of our common stock cumulative total return was our stock price of $44.91 per share on December 31, 2002. The graph is not, and is not intended to be, indicative of future performance of our common stock.

Item 6. Selected Financial Data

We derived the selected financial data presented below at December 31, 2007 and 2006 and for each of the three years in the period ended December 31, 2007 from our audited consolidated financial statements included elsewhere in this Form 10-K. We derived the selected financial data presented below at December 31, 2005, 2004 and 2003 and for the years ended December 31, 2004 and 2003 from our audited consolidated financial statements not included in this Form 10-K. The selected financial data should be read in conjunction with our ‘‘Management’s Discussion and Analysis of Financial Condition and Results of Operations’’ and our audited consolidated financial statements. Our results of operations, cash flows and financial position are affected significantly by our business acquisitions, the more significant of which are described elsewhere herein.

Year Ended December 31,	2007	2006(1)	2005	2004	2003
	(in millions, except per share data)				
Statement of Operations Data:					
Net sales	$ 13,960.5	$ 12,476.9	$ 9,444.7	$ 6,897.0	$ 5,061.6
Cost of sales	12,512.4	11,197.8	8,448.0	6,148.4	4,480.6
Litigation charge(2)	—	129.0	—	—	—
Stock-based charge(3)	—	39.2	—	—	—
Operating income	1,448.1	1,110.9	996.7	748.6	581.0
Interest and other income, net	31.0	20.2	5.5	7.3	0.2
Interest expense	296.0	296.1	204.2	145.3	132.7
Minority interests in net income of consolidated subsidiaries	9.0	10.4	9.7	8.9	3.5
Loss on retirement of debt	—	—	—	5.0	11.2
Provision for income taxes	418.0	298.5	279.8	214.8	156.2
Net income	$ 756.1	$ 526.1	$ 508.5	$ 381.9	$ 277.6
L-3 Holdings’ earnings per common share:					
Basic	$ 6.05	$ 4.27	$ 4.28	$ 3.54	$ 2.89
Diluted	$ 5.98	$ 4.22	$ 4.20	$ 3.33	$ 2.62
L-3 Holdings’ weighted average common shares outstanding:					
Basic	124.9	123.1	118.8	107.8	96.0
Diluted	126.5	124.8	121.2	117.4	113.9
Cash dividends declared per share on L-3 Holdings’ common stock	$ 1.00	$ 0.75	$ 0.50	$ 0.40	$ —

(1) Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (SFAS 123R), which reduced 2006 operating income by $41.6 million, net income by $29.0 million and diluted earnings per share by $0.23. (2) The ‘‘Litigation Charge’’ of $129.0 million ($78.2 million after income taxes, or $0.63 per diluted share) represents an adverse jury verdict rendered on May 25, 2006, currently on appeal. (3) The ‘‘Stock-Based Charge’’ of $39.2 million ($25.5 million after income taxes, or $0.20 per diluted share) was recorded in the second quarter of 2006 in connection with L-3’s voluntary review of its past stock option granting practices and the related accounting.

Year Ended December 31,	2007	2006	2005	2004	2003
	(in millions)				
Balance Sheet Data (at year end):					
Working capital	$ 2,181.4	$ 1,553.4	$ 1,789.2	$ 1,632.5	$ 1,013.5
Total assets	14,390.7	13,286.7	11,909.1	7,780.8	6,505.3
Long-term debt	4,536.5	4,535.0	4,633.5	2,189.8	2,457.3
Minority interests	87.1	84.3	81.2	77.5	76.2
Shareholders’ equity	5,988.9	5,305.9	4,490.7	3,799.8	2,574.5
Cash Flow Data:					
Net cash from operating activities	$ 1,270.2	$ 1,074.3	$ 846.8	$ 620.7	$ 456.1
Net cash used in investing activities	(388.2)	(1,090.7)	(3,547.3)	(555.5)	(1,088.1)
Net cash (used in) from financing activities	(464.3)	(29.3)	2,441.0	453.3	632.0

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

Financial Section Roadmap

Management’s discussion and analysis (MD&A) can be found on pages 27 to 54, the report related to the financial statements and internal control over financial reporting can be found on page 55 and the financial statements and related notes can be found on pages F1 to F61. The following table is designed to assist in your review of MD&A.

Topic	Location
Overview and Outlook:	
L-3’s Business	Page 28
Business Strategy	Page 29
Industry Considerations	Pages 29-30
Key Performance Measures	Pages 30-31
Business Acquisitions	Pages 31-33
Critical Accounting Policies:	
Contract Revenue Recognition and Contract Estimates	Pages 33-35
Goodwill and Identifiable Intangible Assets	Pages 35-36
Pension Plan and Postretirement Benefit Plan Obligations	Pages 36-37
Valuation of Deferred Income Tax Assets and Liabilities	Page 37
Liabilities for Pending and Threatened Litigation	Page 37
Valuation of Long-Lived Assets	Page 37
Results of Operations, including business segments	Pages 38-44
Liquidity and Capital Resources:	
Anticipated Sources of Cash Flow	Page 44
Balance Sheet	Pages 44-45
Pension Plans	Pages 45-46
Statement of Cash Flows	Pages 46-49
Contractual Obligations	Pages 49-50
Off Balance Sheet Arrangements	Page 50
Legal Proceedings and Contingencies	Pages 50-51

Overview and Outlook

L-3's Business

L-3 is a prime system contractor in aircraft modernization and maintenance, Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C3ISR) systems, and government services. L-3 is also a leading provider of high technology products, subsystems and systems. Our customers include the U.S. Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS) and U.S. Department of Justice (DoJ), allied foreign governments, commercial customers and select other U.S. federal, state and local government agencies.

We have the following four reportable segments: (1) C3ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Specialized Products. Financial information for our reportable segments is included in Note 20 to our audited consolidated financial statements.

The C3ISR reportable segment provides products and services for the global ISR market, networked communications systems and secure communications products. We believe 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 training and operational support services, information technology solutions, intelligence solutions and support, aviation, maritime and engineering services and other technical services. The AM&M reportable segment provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. The Specialized Products reportable segment provides a broad range of products across several business areas that include power & control systems, microwave, avionics & displays, training & simulation, electro-optic/infrared (EO/IR), precision engagement, security & detection systems, propulsion systems, undersea warfare and telemetry and advanced technology.

For the year ended December 31, 2007, we generated sales of $13,961 million. Our primary customer is the DoD. The table below presents a summary of our 2007 sales by end customer and the percent contributed by each to our total 2007 sales.

	2007 Sales (in millions)	% of Total Sales
Army	$ 3,782	27 %
Air Force	2,667	19
Navy/Marines	2,075	15
Other Defense	1,744	13
Total DoD	$ 10,268	74 %
Other U.S. Government	834	6
Total U.S. Government	$ 11,102	80 %
Foreign governments	972	7
Commercial – foreign	1,122	8
Commercial – domestic	765	5
Total sales	$ 13,961	100 %

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

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Business Strategy

Our business strategy is customer-focused and aims to increase shareholder value by providing products and services to our customers that advantage them with responsive, high-quality and affordable solutions. Financially, our emphasis is on sustainably growing earnings per share and cash flow. Our strategy involves a flexible and balanced combination of organic growth, cost reductions, business acquisitions, dividends and share repurchases, enabling us to grow the company and return cash to our shareholders. We intend to maintain and expand our position as a leading supplier of systems, subsystems, products and services to the DoD, other U.S. Government agencies, allied foreign governments and commercial customers, both domestic and international. Our strategy includes the objectives discussed below.

We intend to expand our prime system contractor roles in select business areas where we have domain expertise, including C3ISR, aircraft modernization and maintenance and government technical services. We also will enter into ‘‘teaming’’ arrangements with other prime system contractors and platform original equipment manufacturers to compete for select new business opportunities. As an independent supplier of a broad range of products in several business areas, our growth will partially be driven by expanding our share on existing programs and participating on new programs. We will also identify opportunities to use our customer relationships and leverage the capabilities of our various businesses, including their proprietary technologies, to expand the scope of our products and services to existing and new customers. We also intend to supplement our growth by participating in and competing for new programs internationally, particularly in Canada, the United Kingdom and Australia.

We intend to continue to align our internal investments in research and development, business development and capital expenditures to proactively address customer requirements and priorities with our products, services and solutions. We will also grow our sales through increased collaboration of our businesses, including combining select products into subsystems to offer competitive solutions to our customers.

We will use our existing prime contractor and supplier positions and internal investments to grow our sales organically. We expect to benefit from our positions as a supplier to multiple bidders on select prime contract bids. We plan to maintain our diversified and broad business mix with its limited reliance on any single program and significant follow-on and new business opportunities. We also will supplement our organic sales growth by selectively acquiring businesses that add new products, technologies, programs or customers to our existing businesses, with attractive returns on investment.

A foundation for our objectives of expanding L-3’s prime contractor and supplier positions and growing sales organically is favorable performance on our existing contracts. We believe that a prerequisite for growing and winning new business is to retain our existing business with successful contract performance, including schedule, cost, technical and other performance criteria. Therefore, we will continue to focus on delivering superior contract performance to our customers to maintain our reputation as an agile and responsive contractor and to differentiate L-3 from its competitors.

We will continue to aggressively improve and reduce our direct contract costs and overhead costs, including general and administrative costs. Effective management of labor, material, subcontractor and other direct costs is a primary element of favorable contract performance. We also intend to grow sales at a faster rate than overhead costs. We believe continuous cost improvement will enable us to flexibly use costs savings to increase L-3’s value by expanding operating margin and selectively investing in new product development, bids and proposals and other business development activities to grow sales organically.

Industry Considerations

In recent years, domestic and geo-political developments have significantly affected the markets for defense systems, products and services. There has been a fundamental and philosophical shift in focus from a ‘‘threat-based’’ model to one that emphasizes the capabilities needed to defeat a full spectrum of adversaries, which has transformed the U.S. defense posture to a capabilities-based orientation. This approach involves creating the ability for (1) a more flexible response, with greater force, agility and stronger space capabilities, and (2) improved missile defense systems, networked communications and information systems, and security systems. This transformation also includes an increased emphasis on homeland defense. We anticipate that the U.S. Quadrennial Defense Review to be completed in 2010 will incorporate lessons learned from the U.S. military operations in Iraq, Afghanistan and the Balkans, and promote additional special operations, intelligence gathering, language and cultural capabilities, improved communications and enhanced security cooperation activities.

Over the past several years, the DoD budgets have experienced increased focus on C3ISR, precision-guided weapons, UAVs, network-centric communications, Special Operations Forces (SOF) and missile defense. In addition, the DoD philosophy has focused on a transformation strategy that balances modernization and recapitalization (or upgrading existing platforms) while enhancing readiness and joint operations. As a result, defense budget program allocations continue to favor advanced information technologies related to C3 and ISR. Furthermore, the DoD's emphasis on system interoperability, force multipliers and providing battlefield commanders with real-time data is increasing the electronic content of nearly all major military procurement and research programs. Therefore, it is expected that the DoD's budget for communications and defense electronics will continue to grow. We believe L-3 is well positioned to benefit from the expected increased spending in those areas. While there is no assurance that the requested DoD budget increases will continue to be approved by Congress, the current outlook is one of increased DoD spending, which we believe will continue to positively affect L-3's future orders and sales, operating results and cash flows. Conversely, a decline in the DoD budget would generally have a negative effect on future orders, sales, operating profits and cash flows of defense contractors, including L-3, depending on the weapons platforms and programs affected by such budget reductions.

In addition, increased emphasis on U.S. homeland security may increase demand for our capabilities in areas such as security systems, information security, crisis management, preparedness and prevention services, and civilian security operations.

Key Performance Measures

The key financial performance measures that L-3 uses to manage its businesses and monitor results of operations are sales growth and operating income growth. Combined, these financial performance measures are the primary growth drivers for L-3's earnings per share and net cash from operating activities. We define organic sales growth as the increase or decrease in sales for the current period compared to the prior period, excluding sales in the current period from business acquisitions that have been included in L-3's actual results of operations for less than twelve months. The two main determinants of our operating income growth are sales growth and improvements in operating margin. We define operating margin as operating income as a percentage of sales.

Sales Growth. Our average annual sales growth for the five years ended December 31, 2007, was 29%, with average annual organic sales growth of approximately 10%, and average annual sales growth from business acquisitions of approximately 19%. Organic sales growth was 9.6% for the year ended December 31, 2007. Sales growth from business acquisitions for the year ended December 31, 2007 was 2.3%. Prior to January 1, 2007, the larger portion of our historical sales growth has been generated from business acquisitions. We made our largest acquisition on July 29, 2005, when we acquired Titan for a purchase price of approximately $2.8 billion. Generally, we expect that our sales growth rate from business acquisitions will decline from pre-2007 levels for the foreseeable future. Our largest contract in terms of annual sales was the Linguist Contract and it generated sales of $738 million for the year ended December 31, 2007. On December 9, 2007, the Linguist Contract period of performance was extended to March 8, 2008. As discussed above in ''Major Customers,'' INSCOM made an award of the follow-on contract to another service provider.

We, as most U.S. defense contractors, have benefited from the upward trend in DoD budget authorization and spending outlays over recent years, including supplemental appropriations for military operations in Iraq, Afghanistan and the Global War on Terror (GWOT). We believe that our businesses should be able to generate organic sales growth for the foreseeable future because we anticipate the defense budget will continue its focus on areas that match certain of the core competencies of L-3:

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communications and persistent ISR, precision engagement, SOF, wartime support services and simulation & training. The increased DoD spending during recent years has included supplemental appropriations for military operations in Iraq and Afghanistan. These appropriations have enabled the DoD to proceed with its recapitalization and reconstitution programs that are directly related to the U.S. military operations in Iraq and Afghanistan, which allows for the focus of the base budget resources on transformational modernization programs.

The substantial majority of L-3's sales are made to U.S. Government agencies, primarily the DoD, as discussed above. In addition to the current DoD budget and level of future Congressional supplemental appropriations for U.S. military operations in Iraq and Afghanistan, our sales to the U.S. Government may be affected by changes in U.S. procurement policies, budget considerations, changing national security and defense requirements, and geo-political developments, which are beyond our control. Any of these factors could impact L-3's future results of operations, including our organic sales growth rate. Additionally, L-3's future results of operations and sales growth are affected by our ability to retain our existing business and to successfully compete for new business, which largely depend on 1) our successful performance on existing contracts, 2) the effectiveness and innovation of our technologies and research and development activities, 3) our ability to offer better program performance than our competitors at a lower cost, and 4) our ability to retain our employees and hire new ones, particularly those employees who have U.S. Government security clearances.

Operating Income Growth.   Our consolidated operating income was $1,448.1 million for the year ended December 31, 2007, an increase of 30.4% from $1,110.9 million for the year ended December 31, 2006. Our consolidated operating margin was 10.4% for the year ended December 31, 2007 and 8.9% for the year ended December 31, 2006. For the year ended December 31, 2006, our operating income and operating margin was reduced by two matters totaling $168.2 million ($103.7 million after income taxes or $0.83 per share) as follows: (1) a pre-tax litigation charge of $129.0 million ($78.2 million after income taxes, or $0.63 per share) in connection with an adverse jury verdict currently on appeal and (2) a pre-tax charge of $39.2 million ($25.5 million after income taxes or $0.20 per share) in connection with our voluntary review of past stock option granting practices. These two charges are collectively referred to herein as the ''Q2 2006 Charges''. Excluding the reductions from the Q2 2006 Charges, consolidated operating income for the year ended December 31, 2006 would have been $1,279.1 million and operating margin would have been 10.3%.

Prospectively, we expect to continue to generate modest increases in operating margin as we expect to increase sales, grow sales faster than indirect costs and improve our overall contract performance. However, in the future, select business acquisitions and select new business could reduce our operating margins, if the margins for them are lower than L-3's existing operating margin. Our business objectives include sustainably growing earnings per share and cash flow, and improving operating margins is one method for achieving this growth but it is not the only one.

Business Acquisitions

As discussed above, a portion of our growth strategy is to selectively acquire businesses that add new products, technologies, programs or customers to our existing businesses. We intend to continue acquiring select businesses for reasonable valuations that will provide attractive returns to L-3. Our business acquisitions, depending on their business-type, contract-type sales mix or other factors, could reduce L-3's consolidated operating margin while still increasing L-3's operating income, earnings per share, and net cash from operating activities.

The table below summarizes the acquisitions that we have completed during the years ended December 31, 2005, 2006 and 2007, referred to herein as business acquisitions. See Note 4 to our audited consolidated financial statements. During 2007, we used cash of $235.0 million for business acquisitions.

Business Acquisitions	Date Acquired	Purchase Price(1)
		(in millions)
2005		
Marine Controls division of CAE	February 3, 2005	$ 189
Propulsion Systems business unit of General Dynamics	February 25, 2005	197
Electron Dynamics Devices business of the Boeing Company	February 28, 2005	97
The Titan Corporation	July 29, 2005	2,736
EOTech Acquisition Corp.	October 31, 2005	50
InfraredVision Technology Corporation, Mobile-Vision, Inc., Sonoma Design Group, Inc., Advanced Laser Systems Technology, Inc., Joseph Sheairs Associates, Inc., Hitec O, and Applied Signal and Image Technologies, Inc. (ASIT).	Various	153 (2)
Total 2005		$ 3,422
2006		
SAM Electronics GmbH (SAM)	January 31, 2006	$ 189 (3)
SafeView, Inc. (SafeView) and CyTerra Corporation	March 2006	190 (4)
Medical Education Technologies, Inc. (METI)	April 4, 2006	11 (5)
SSG Precision Optronics, Inc. (SSG)	June 1, 2006	68 (6)
Nautronix Defence Group (Nautronix)	June 1, 2006	69 (6)(7)
Crestview Aerospace Corporation	June 29, 2006	153
TRL Electronics plc	July 12, 2006	171
Nova Engineering (Nova)	October 25, 2006	47 (8)
Advanced Systems Architecture Ltd., TCS Design and Management Services, Incorporated, Magnet-Motor GmbH, gForce Technologies, Inc. and TACNET	Various	67 (6)(9)
Total 2006		$ 965
2007		
Geneva Aerospace, Inc. (Geneva)	January 31, 2007	$ 15 (6)(10)
Global Communication Solutions, Inc.	May 4, 2007	153 (6)
APSS S.r.l.	August 31, 2007	12
MKI Systems, Inc.	December 3, 2007	38 (6)
Total 2007		$ 218

(1) The purchase price represents the contractual consideration for the acquired business, excluding adjustments for net cash acquired and acquisition transaction costs. (2) Excludes additional purchase price, not to exceed $7 million, which is contingent primarily upon the financial performance of ASIT for the year ending December 31, 2008. (3) The final purchase price includes a $39 million increase to the contractual purchase price based on SAM's closing date net assets, of which $31 million was for cash acquired at foreign locations. (4) Excludes additional purchase price for SafeView, not to exceed $35 million, in the aggregate, which is contingent upon its financial performance through December 31, 2008. (5) We increased our ownership interest in METI from approximately 47% to 80%. (6) The final purchase price is subject to adjustment based on final closing date net assets or net working capital of the acquired business. (7) Excludes additional purchase price, not to exceed $6 million, in the aggregate, which is contingent upon certain contract awards to Nautronix through 2010. (8) Excludes additional purchase price, not to exceed $8 million, in the aggregate, which is contingent upon the financial performance of Nova for the years ending December 31, 2008 through 2010. (9) Excludes additional purchase price, not to exceed $1 million, in the aggregate, which is contingent upon the financial performance of TACNET for the years ending December 31, 2009 and 2010. (10) Excludes additional purchase price, not to exceed $24 million, in the aggregate, which is contingent on financial performance of Geneva for the years ending December 31, 2008 and 2009.

All of our business acquisitions are included in our consolidated results of operations from their dates of acquisition. We regularly evaluate potential business acquisitions and joint venture transactions and, at this time, we have not entered into any other agreements for transactions that would be considered significant business acquisitions.

Critical Accounting Policies

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and cost of sales 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 post-retirement benefit obligations, stock-based employee compensation expense, valuation of deferred taxes, litigation reserves and environmental obligations, and the recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Actual amounts will differ from these estimates and could differ materially. We believe that our critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are uncertain and inherently judgmental at the time of the estimate; (2) use of reasonably different assumptions could have changed our estimates, particularly with respect to estimates of contract revenues and costs, and recoverability of assets, and (3) changes in the estimate could have a material effect on our financial condition or results of operations. We believe the following critical accounting policies contain the more significant judgments and estimates used in the preparation of our financial statements.

Contract Revenue Recognition and Contract Estimates.   A large portion of our revenue is generated using written contracts (revenue arrangements) that require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services according to the buyer’s specifications. These revenue arrangements or contracts are generally fixed price, cost-reimbursable, or time-and-material. 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) and Accounting Research Bulletin No. 45, Long-Term Construction-Type Contracts (ARB 45). Cost-reimbursable type contracts are also specifically covered by Accounting Research Bulletin No. 43, Chapter 11, Section A, Government Contracts, Cost-Plus-Fixed Fee Contracts (ARB 43). Substantially all of our cost-reimbursable type and time and material type contracts are with the U.S. Government, primarily with the DoD. Certain of our contracts with the U.S. Government are multi-year contracts that are funded annually by the customer, and sales on these multi-year contracts are based on amounts appropriated (funded) by the U.S. Government.

Sales and profits on fixed-price type contracts that are covered by SOP 81-1, ARB 43 and ARB 45 are substantially recognized using percentage-of-completion (POC) methods of accounting. Sales and profits on fixed-price production contracts under which units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their contractual selling prices (the ‘‘units-of-delivery’’ method). Sales and profits on each fixed-price production contract under which units are not produced and delivered in a continuous or sequential process, or under which a relatively few number of units are produced, are recorded based on the ratio of actual cumulative costs incurred to total estimated costs at completion of the contract multiplied by the total estimated contract revenue, less cumulative sales recognized in prior periods (the ‘‘cost-to-cost’’ method). Under the POC methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

Accounting for the sales on a fixed-price contract, included in the scope of SOP 81-1, requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract’s statement of work, and (3) the measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units-of-delivery method, sales on a fixed-price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost-to-cost method, sales on a fixed-price type contract are recorded at amounts equal to the ratio of actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (i) the total estimated contract revenue, less (ii) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to (i) the current estimated total profit margin multiplied by the cumulative sales recognized, less (ii) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenues, a loss arises, and a provision for the entire loss is recorded in the period that the loss becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded as a component of other current liabilities entitled ‘‘Estimated cost in excess of estimated contract value to complete contracts in process in a loss position.’’

Adjustments to estimates for a contract’s revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. The impact of revisions in profit (loss) estimates for all types of contracts subject to percentage of completion accounting are recognized on a cumulative catch-up basis in the period in which the revisions are made. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as reduce the valuations of receivables and inventories, and in some cases result in liabilities to complete contracts in a loss position.

Sales and profits on cost-reimbursable type contracts that are within the scope of ARB 43, in addition to SOP 81-1, are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. The estimated profit on a cost-reimbursable contract is fixed or variable based on the contractual fee arrangement. Incentive and award fees on cost-reimbursable type contracts are included as an element of total estimated contract revenues and recorded to sales in accordance with SOP 81-1 when a basis exists for the reasonable prediction of performance in relation to established contractual targets and we are able to make reasonably dependable estimates for them. Sales and profits on time-and-material type contracts are recognized on the basis of direct labor hours expended multiplied by the contractual fixed rate per hour, plus the actual costs of material and other direct non-labor costs. On a time-and-material type contract, the fixed hourly rates include amounts for the cost of direct labor, indirect contract costs and profit. Cost-reimbursable type or time-and-material type contracts generally contain less estimation risks than fixed-price type contracts.

Sales on arrangements for (1) fixed-price type contracts that require us to perform services that are not related to production of tangible assets (Fixed-Price Service Contracts), and (2) certain commercial customers are recognized in accordance with the U.S. Securities and Exchange Commission’s (SEC) Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (SAB 104). Sales for our businesses whose customers are primarily commercial business enterprises are substantially generated from single element revenue arrangements. Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectibility is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on a straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are generally recognized when the units of work are completed. Sales and profit on cost-reimbursable type contracts that require us to perform services that are not related to production of tangible assets are recognized in the same manner as those within the scope of ARB 43 and SOP 81-1, except that award fees on the contracts covered by SAB 104 are recorded as sales when awarded by the customer. Sales and profits on time and material type contracts that are within the scope of SAB 104 are recognized in the same manner as described above under SOP 81-1. Sales and profit in connection with contracts to provide services to the U.S. Government within the scope of SAB 104 that may be at risk of collection because the contracts are incrementally funded and subject to the availability of funds appropriated are deferred until the contract modification is obtained, indicating that adequate funds are available to the contract or task order.

Goodwill and Identifiable Intangible Assets. In accordance with SFAS No. 141, Business Combinations (SFAS 141), we allocate the cost of business acquisitions to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). As part of the purchase price allocations for our business acquisitions, identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged. However, in accordance with SFAS 141, we do not recognize any intangible assets apart from goodwill for the assembled workforces of our business acquisitions.

Generally, the largest separately identifiable intangible asset from the businesses that we acquire is the value of their assembled workforces, which includes the human capital of the management, administrative, marketing and business development, scientific, engineering and technical employees of the acquired businesses. The success of our businesses, including their ability to retain existing business (revenue arrangements) and to successfully compete for and win new business (revenue arrangements), is primarily dependent on the management, marketing and business development, contracting, engineering and technical skills and knowledge of our employees, rather than on productive capital (plant and equipment, and technology and intellectual property). Additionally, for a significant portion of our businesses, our ability to attract and retain employees who have U.S. Government security clearances, particularly those with top-secret and above clearances, is critical to our success, and is often a prerequisite for retaining existing revenue arrangements and pursuing new ones. Generally, patents, trademarks and licenses are not material for our acquired businesses. Furthermore, our U.S. Government contracts (revenue arrangements) generally permit other companies to use our patents in most domestic work performed by such other companies for the U.S. Government. Therefore, because intangible assets for assembled workforces are part of goodwill in accordance with paragraph 39 of SFAS 141, the substantial majority of the intangible assets for our acquired business acquisitions are recognized as goodwill. Additionally, the value assigned to goodwill for our business acquisitions also includes the value that we expect to realize from cost reduction measures that we implement for our acquired businesses. Goodwill equals the amount of the purchase price of the business acquired in excess of the sum of the amounts assigned to identifiable acquired assets, both tangible and intangible, less liabilities assumed. At December 31, 2007, we had goodwill of $8,165 million and identifiable intangible assets of $441 million.

The most significant identifiable intangible asset that is separately recognized in accordance with SFAS 141 for our business acquisitions is customer contractual relationships. All of our customer relationships are established through written customer contracts (revenue arrangements). The fair value for customer contractual relationships is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows from working capital) arising from the follow-on sales on contract (revenue arrangement) renewals expected from customer contractual relationships over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory assets charge, all of which is discounted to present value. If actual future after-tax cash flows are significantly lower than our estimates, we may be required to record an impairment charge to write down the identifiable intangible assets to their realizable values. All identifiable intangible assets are amortized over their estimated useful lives as the economic benefits are consumed, ranging from 5 to 30 years.

We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also review goodwill annually (during the first quarter) in accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 142 requires that goodwill be tested, at a minimum, annually for each reporting unit using a two-step process. A reporting unit is an operating segment, as defined in paragraph 10 of SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, or a component of an operating segment. A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and is reviewed by operating segment

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management. Two or more components of an operating segment may be aggregated and deemed a single reporting unit for goodwill impairment testing purposes if the components have similar economic characteristics. The first step is to identify any potential impairment by comparing the carrying value of the reporting unit to its fair value. If a potential impairment is identified, the second step is to measure the impairment loss by comparing the implied fair value of goodwill with the carrying value of goodwill of the reporting unit. Our methodology for determining the fair value of a reporting unit is estimated using a discounted cash flow (DCF) valuation approach, and is dependent on estimates for future sales, operating income, depreciation and amortization, income tax payments, working capital changes, and capital expenditures, as well as, expected growth rates for cash flows and long-term interest rates, all of which are affected by economic conditions related to the industries in which we operate, as well as, conditions in the U.S. capital markets.

The most significant assumptions used in a DCF valuation regarding the estimated fair values of our reporting units in connection with goodwill valuation assessments are: (1) detailed five year cash flow projections for each of our reporting units, (2) a risk adjusted discount rate including the estimated risk-free rate of return, and (3) the expected long-term growth rate of our businesses, which approximates the expected long-term growth rate for the U.S. economy and the industries in which we operate. The risk adjusted discount rate represents the estimated weighted-average cost of capital (WACC). The WACC represents the estimated required rate of return on L-3's total market capitalization. It is comprised of (1) an estimated required rate of return on equity, based on publicly traded companies with business characteristics comparable to L-3's reporting units, including a risk free rate of return and an equity risk premium, and (2) the current after-tax market rate of return on L-3's debt, each weighted by the relative market value percentages of L-3's equity and debt. The valuation of our reporting units performed as of January 1, 2007 in connection with our annual impairment test used a weighted average risk adjusted discount rate of approximately 9%. If the risk adjusted discount rate used was 25 basis points higher, the aggregate estimated fair value of our reporting units would have decreased by approximately 4% or $759 million. Had we used an expected long-term growth rate that was 25 basis points lower, the aggregate estimated fair value of our reporting units would have decreased by approximately 3% or $444 million. Had the annual after-tax cash flows contained in our five year cash flow projections each been lower by 1%, the aggregate estimated fair value of our reporting units would have decreased by $73 million, or less than 1%. A decline in the estimated fair value of a reporting unit could result in a goodwill impairment, and a related non-cash impairment charge against earnings, if estimated fair value for the reporting unit is less than the carrying value of the net assets of the reporting unit, including its goodwill. A large decline in estimated fair value of a reporting unit could possibly have a material adverse effect on our business, financial condition and results of operations.

Pension Plan and Postretirement Benefit Plan Obligations. The obligations for our pension plans and postretirement benefit plans and the related annual costs of employee benefits are calculated based on several long-term assumptions, including discount rates for employee benefit liabilities, rates of return on plan assets, expected annual rates for salary increases for employee participants in the case of pension plans, and expected annual increases in the costs of medical and other health care benefits in the case of postretirement benefit obligations. These long-term assumptions are subject to revision based on changes in interest rates, financial market conditions, expected versus actual returns on plan assets, participant mortality rates and other actuarial assumptions, including future rates of salary increases, benefit formulas and levels, and rates of increase in the costs of benefits. Changes in the assumptions, if significant, can materially affect the amount of annual net periodic benefit costs recognized in our results of operations from one year to the next, the liabilities for the pension plans and postretirement benefit plans, and our annual cash requirements to fund these plans.

Discount rates are used to determine the present value of our pension obligations and also affect the amount of pension expense in any given period. In accordance with SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158), we have adopted a December 31 measurement date for the year ended December 31, 2007. Previously, we used a November 30 measurement date for our pension and post-retirement benefit plans. The discount rate assumptions used to determine our pension and postretirement benefit obligations at December 31, 2007 and November 30, 2006 were based on a hypothetical double A yield curve represented by a series of annualized individual discount rates. Each bond issue underlying the yield curve is required to have a rating of AA or better by Moody's Investors Service, Inc. The resulting discount rate reflects the matching of plan liability cash flows to the yield curve. For a sensitivity analysis projecting the impact of a change in the discount rate on our projected benefit obligation and pension expense, see ''Liquidity and Capital Resources — Pension Plans.''

Valuation of Deferred Income Tax Assets and Liabilities. At December 31, 2007, we had net deferred tax assets of $1.4 million, including $27.1 million for loss carryforwards and $7.1 million for tax credit carryforwards which are subject to various limitations and will expire if unused within their respective carryforward periods. Deferred income taxes are determined separately for each of our tax-paying entities in each tax jurisdiction. The future realization of our deferred income tax assets ultimately depends on our ability to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law and, to a lesser extent, our ability to execute successful tax planning strategies. Based on our estimates of the amounts and timing of future taxable income and tax planning strategies, we believe that L-3 will be able to realize its deferred tax assets. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement desired tax planning strategies, could affect our ability to realize the future tax deductions underlying our net deferred tax assets, and require us to provide a valuation allowance against our net deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and, if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

Liabilities for Pending and Threatened Litigation. We are subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business or assumed in connection with certain business acquisitions. In accordance with SFAS No. 5, Accounting for Contingencies, we accrue a charge for a loss contingency when we believe it is both probable that a liability has been incurred, and the amount of the loss can be reasonably estimated. If the loss is within a range of specified amounts, the most likely amount is accrued, and if no amount within the range represents a better estimate we accrue the minimum amount in the range. Generally, we record the loss contingency at the amount we expect to pay to resolve the contingency and the amount is generally not discounted to the present value, or in the case of the 2006 litigation charge, the amount awarded by the jury verdict. Amounts recoverable under insurance contracts are recorded as assets when recovery is deemed probable. Contingencies that might result in a gain are not recognized until realizable. Changes to the amount of the estimated loss, or resolution of one or more contingencies could have a material impact on our results of operations, financial position and cash flows.

Valuation of Long-Lived Assets. In addition to goodwill and identifiable intangible assets recognized in connection with our business acquisitions, our long-lived assets also include property, plant and equipment, capitalized software development costs for software to be sold, leased or otherwise marketed, and certain long-term investments. As of December 31, 2007, the consolidated carrying values of our property, plant and equipment was $754 million, capitalized software development costs was $64 million and certain long-term investments was $23 million. As of December 31, 2007, the carrying value of our property, plant and equipment represented 5.2% of total assets and the carrying value of our capitalized software development costs and certain long-term investments each represented less than 1.0% of total assets. We review the valuation of our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value or net realizable value expected to result from the asset's use and eventual disposition. We use a variety of factors to assess valuation, depending upon the asset. Long-lived assets are evaluated based upon the expected period the asset will be utilized, and other factors depending on the asset, including estimated future sales, profits and related cash flows, estimated product acceptance and product life cycles, changes in technology and customer demand, and the performance of invested companies and joint ventures, as well as volatility in external markets for investments. Changes in estimates and judgments on any of these factors could have a material impact on our results of operations and financial position.

Results of Operations

The following information should be read in conjunction with our audited consolidated financial statements. Our results of operations for certain periods presented are affected significantly by our business acquisitions. See Note 4 to our audited consolidated financial statements for a discussion of our business acquisitions.

Consolidated Results of Operations

The table below provides selected financial data for L-3 for the years ended December 31, 2007, 2006 and 2005.

	Year Ended December 31,		Increase / (decrease)	Year Ended December 31,		Increase / (decrease)
	2007	2006		2006	2005	
($ in millions, except per share data)						
Net sales	$ 13,961	$ 12,477	$ 1,484	$ 12,477	$ 9,445	$ 3,032
Segment operating income	$ 1,448	$ 1,279	$ 169	$ 1,279	$ 997	$ 282
Q2 2006 Charges (1)	—	(168)	168	(168)	—	(168)
Operating income	$ 1,448	$ 1,111	$ 337	$ 1,111	$ 997	$ 114
Operating margin	10.4 %	8.9 %	150 bpts	8.9 %	10.6 %	(170)bpts
Interest and other income, net	$ 31	$ 20	$ 11	$ 20	$ 5	$ 15
Interest expense	$ 296	$ 296	$ —	$ 296	$ 204	$ 92
Effective income tax rate	35.6 %	36.2 %	(60)bpts	36.2 %	35.5 %	70 bpts
Net income	$ 756	$ 526	$ 230	$ 526	$ 508	$ 18
Diluted EPS	$ 5.98	$ 4.22	$ 1.76	$ 4.22	$ 4.20	$ 0.02
Diluted shares	126.5	124.8	1.7	124.8	121.2	3.6

(1) See Notes 3 and 17 to our audited consolidated financial statements.

2007 Compared with 2006

Net sales: For the year ended December 31, 2007, consolidated net sales increased by 11.9% compared to the year ended December 31, 2006. Consolidated organic sales growth of 9.6%, or $1,193 million, was driven primarily by continued strong demand for ISR systems, government services, networked communications systems, aircraft and base support services, aircraft modernization and several specialized product areas, including power & control systems, electro-optic/infrared (EO/IR), undersea warfare, training & simulation and propulsion systems. The increase in consolidated net sales from acquired businesses was $291 million, or 2.3%. Sales from services increased by $845 million to $7,389 million, representing approximately 53% of consolidated net sales for the year ended December 31, 2007, compared to $6,544 million, or 52% of consolidated net sales for the year ended December 31, 2006. The increase in service sales was primarily due to organic sales growth in government services, ISR systems, aircraft and base support services and aircraft modernization. Sales from products increased by $639 million to $6,572 million for the year ended December 31, 2007, compared to $5,933 million for the year ended December 31, 2006. The increase in product sales was primarily due to organic sales growth in several product areas in the Specialized Products reportable segment. See the reportable segment discussions below for more analysis of our sales growth.

Operating income and operating margin: For the year ended December 31, 2007 compared to the year ended December 31, 2006, consolidated operating income increased by $337 million, and consolidated operating margin increased to 10.4% from 8.9%. Excluding the Q2 2006 Charges, consolidated operating income increased by $169 million, or 13.2%, for the year ended December 31, 2007 compared to $1,279 million for the year ended December 31, 2006, and consolidated operating margin increased by 10 basis points from 10.3% for the year ended

December 31, 2006. The changes in operating margin are further explained in our reportable segment results discussed below.

Interest and other income, net: Interest and other income increased for the year ended December 31, 2007 compared to the year ended December 31, 2006 primarily due to interest income on higher cash balances. The year ended December 31, 2006 included $4 million of interest income on the settlement of a claim.

Interest expense: Interest expense for the year ended December 31, 2007 remained at $296 million compared to December 31, 2006.

Effective income tax rate: The effective income tax rate for the year ended December 31, 2007 of 35.6% includes a benefit of $12.1 million, or $0.10 per share for the reversal of previously accrued amounts, primarily interest, related to the 2002 and 2003 U.S. Federal income tax returns, and without these benefits, the tax rate was 36.6%. Before giving effect to the Q2 2006 Charges, the tax rate for the year ended December 31, 2006 was 36.6%.

Diluted earnings per share and net income: For the year ended December 31, 2007, diluted EPS increased to $5.98 per share compared to $4.22 per share for the year ended December 31, 2006. Net income for the year ended December 31, 2007 increased to $756 million compared to $526 million for the year ended December 31, 2006. Excluding the Q2 2006 Charges, diluted EPS for the year ended December 31, 2007 increased by $0.93, or 18.4%, compared to $5.05 per share for the year ended December 31, 2006. Similarly, net income for the year ended December 31, 2007 increased by $126 million, or 20.1%, from $630 million for the year ended December 31, 2006.

Diluted shares outstanding: Diluted shares outstanding for the year ended December 31, 2007 increased by 1.7 million shares, compared to the year ended December 31, 2006. The increases were primarily due to additional shares issued in connection with various employee stock based compensation programs and contributions to employee savings plans made in common stock. These increases were partially offset by repurchases of our common stock in connection with our share repurchase programs authorized by our Board of Directors.

2006 Compared with 2005

Net sales: For the year ended December 31, 2006, consolidated net sales increased by 32.1% compared to the year ended December 31, 2005. Consolidated organic sales growth was 9.3%, or $875 million, driven primarily by strong demand for government services, ISR systems, networked communications systems, base support services, aircraft modernization, and several specialized product areas, partially offset by volume declines for aircraft support services, secure terminal equipment and airport security systems. The increase in consolidated net sales from acquired businesses was $2,157 million, or 22.8%, including $1,477 million from the Titan acquired businesses. Sales from services increased by $1,765 million to $6,544 million, representing approximately 52% of consolidated net sales for the year ended December 31, 2006, compared to $4,779 million, or 51% of consolidated net sales for the year ended December 31, 2005. The increase in service sales was primarily due to sales from the Titan acquired businesses and organic sales growth in the AM&M and Government Services reportable segment. Sales from products increased by $1,267 million to $5,933 million for the year ended December 31, 2006, compared to $4,666 million for the year ended December 31, 2005. The increase in product sales was primarily due to organic sales growth in several product areas, mostly in the Specialized Products and C3ISR reportable segments, as well as the business acquisitions that we completed during 2006.

Operating income and operating margin: For the year ended December 31, 2006, consolidated operating income increased by 11.5% compared to the year ended December 31, 2005, and consolidated operating margin declined by 170 basis points to 8.9%. Excluding the Q2 2006 Charges, consolidated operating income increased by $282 million, or 28.3%, for the year ended December 31, 2006 compared to $997 million for the year ended December 31, 2005, and consolidated operating margin declined by 30 basis points to 10.3% for the year ended December 31, 2006, compared to 10.6% for the year ended December 31, 2005. Although consolidated operating margin declined, improved contract performance, higher sales volume and lower indirect costs increased operating margin by 30 basis points. This increase was offset by lower margins from acquired businesses, including those for Titan, which reduced consolidated operating margin by 30 basis points, and SFAS 123R stock-based compensation expense, which reduced consolidated operating margin by 30 basis points.

Interest and other income, net: Interest and other income increased for the year ended December 31, 2006 compared to the year ended December 31, 2005. The increase was primarily due to a charge of $9 million to write-down the carrying value of certain investments in the 2005 third quarter that did not recur in 2006 and $4 million of interest income from the favorable settlement of a claim during the 2006 first quarter.

Interest expense: Interest expense for the year ended December 31, 2006 increased by $92 million, or 45.0%, compared to the year ended December 31, 2005. This increase was primarily due to the full year effect in 2006 of the interest expense on debt incurred to finance the Titan acquisition in July 2005.

Effective income tax rate: The effective income tax rate for the year ended December 31, 2006 increased to 36.2% from 35.5% for the year ended December 31, 2005. Excluding the Q2 2006 Charges, the effective income tax rate for the year ended December 31, 2006 would have been 36.6%. The increase in the effective income tax rate was primarily due to the favorable disposition of certain tax contingencies in the 2005 third quarter (which did not recur in 2006), partially offset by higher income tax benefits in 2006 from foreign tax credits resulting from the repatriation of certain foreign earnings.

Diluted earnings per share and net income: For the year ended December 31, 2006, diluted EPS increased by 0.5% to $4.22 per share compared to $4.20 per share for the year ended December 31, 2005. Excluding the Q2 2006 Charges, diluted EPS increased by $0.85, or 20.2%, to $5.05 for the year ended December 31, 2006, compared to $4.20 per share for the year ended December 31, 2005. SFAS 123R stock-based compensation expense reduced the diluted EPS for the year ended December 31, 2006 by $0.23, compared to the year ended December 31, 2005. Net income for the year ended December 31, 2006 increased by 3.5%, to $526 million compared to $508 million for the year ended December 31, 2005. Excluding the Q2 2006 charges, net income increased by $122 million, or 23.9%, to $630 million for the year ended December 31, 2006, compared to $508 million for the year ended December 31, 2005.

Reportable Segment Results of Operations

The table below presents selected data by reportable segment reconciled to consolidated totals. See Note 20 to our audited consolidated financial statements for our reportable segment data.

Year Ended December 31,	2007	2006	2005
	(dollars in millions)		
Net sales: (1)			
C3ISR	$ 2,310.4	$ 2,025.3	$ 1,801.6
Government Services	4,333.5	3,834.4	2,188.3
AM&M	2,527.7	2,327.5	2,195.4
Specialized Products	4,788.9	4,289.7	3,259.4
Consolidated net sales	$ 13,960.5	$ 12,476.9	$ 9,444.7
Operating income:			
C3ISR	$ 231.6	$ 215.8	$ 216.7
Government Services	403.5	342.9	201.8
AM&M	246.6	232.6	219.8
Specialized Products	566.4	487.8	358.4
Segment operating income	$ 1,448.1	$ 1,279.1	$ 996.7
Q2 2006 Charges(2)	—	(168.2)	—
Consolidated operating income	$ 1,448.1	$ 1,110.9	$ 996.7
Operating margin:			
C3ISR	10.0 %	10.7 %	12.0 %
Government Services	9.3 %	8.9 %	9.2 %
AM&M	9.8 %	10.0 %	10.0 %
Specialized Products	11.8 %	11.4 %	11.0 %
Segment operating margin	10.4 %	10.3 %	10.6 %
Q2 2006 Charges(2)	—	(1.4)%	—
Consolidated operating margin	10.4 %	8.9 %	10.6 %

(1) Net sales are after intercompany eliminations. (2) See Notes 3 and 17 to our audited consolidated financial statements.

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C3ISR

($ in millions)	Year Ended December 31, 2007	Year Ended December 31, 2006	Increase / (decrease)	Year Ended December 31, 2006	Year Ended December 31, 2005	Increase / (decrease)
Net sales	$ 2,310.4	$ 2,025.3	$ 285.1	$ 2,025.3	$ 1,801.6	$ 223.7
Operating income	231.6	215.8	15.8	215.8	216.7	(0.9)
Operating margin	10.0 %	10.7 %	(70)bpts	10.7 %	12.0 %	(130)bpts

2007 Compared with 2006

For the year ended December 31, 2007, C3ISR net sales increased by 14.1% compared to the year ended December 31, 2006, driven by higher sales volume of $225.8 million primarily for airborne surveillance and ISR systems, and continued strong demand from the DoD for networked communications systems. These increases were partially offset by $4.9 million for lower sales volume for Secure Terminal Equipment (STE), a product with declining demand as it continues to approach full deployment in the marketplace. The increase in net sales from acquired businesses was $64.2 million, or 3.2%.

C3ISR operating income for the year ended December 31, 2007 increased by 7.3% compared to the year ended December 31, 2006 primarily because of higher sales volume, partially offset by a lower operating margin. Operating margin for the year ended December 31, 2007 decreased by 70 basis points of which 80 basis points are primarily due to higher development costs for new secure communications products and a decrease in higher margin STE sales. Acquired businesses reduced operating margin by 10 basis points. These decreases were partially offset by an increase of 20 basis points primarily due to higher sales volume and improved contract performance for networked communications systems.

2006 Compared with 2005

For the year ended December 31, 2006, C3ISR net sales increased by 12.4% compared to the year ended December 31, 2005, driven by $206.3 million in higher sales volume primarily for transportable satellite communication, terminals and new business awards for airborne mission and ISR systems, partially offset by lower sales of $50.3 million for secure terminal equipment. The increase in net sales from acquired businesses was $67.7 million.

C3ISR operating income for the year ended December 31, 2006 decreased by 0.4% compared to the year ended December 31, 2005. The decrease in operating income was due to lower operating margins of 130 basis points partially offset by higher sales volume. The operating margin decline of 130 basis points was primarily due to higher development costs for new secure communications products and higher sales volume on contracts with greater material and subcontractor content, which generally have lower margins, and by 40 basis points for SFAS 123R stock-based compensation expense. These decreases were partially offset by an increase of 40 basis points due to higher margins from acquired businesses.

Government Services

	Year Ended December 31,		Increase / (decrease)	Year Ended December 31,		Increase / (decrease)
	2007	2006		2006	2005	
	($ in millions)					
Net sales	$ 4,333.5	$ 3,834.4	$ 499.1	$ 3,834.4	$ 2,188.3	$ 1,646.1
Operating income	403.5	342.9	60.6	342.9	201.8	141.1
Operating margin	9.3 %	8.9 %	40 bpts	8.9 %	9.2 %	(30)bpts

2007 Compared with 2006

For the year ended December 31, 2007, Government Services net sales increased by 13.0% compared to the year ended December 31, 2006, driven primarily by (1) volume increases of $326.5 million on existing contracts and recent new business awards for several services including linguists and translators, training and operational support for the U.S. military operations in Iraq and Afghanistan as well as broader U.S. national security objectives on a global basis and (2) higher sales of $166.3 million for information technology solutions to support U.S. Army communications and surveillance activities and support services for the U.S. Special Operations Command because of growth on existing contracts. The Linguist Contract generated sales of $738.0 million for the year ended December 31, 2007, an increase of $127.1 million compared with $610.9 million for 2006. The increase in net sales from acquired businesses was $6.3 million, or 0.2%.

Government Services operating income increased by 17.7% compared to the year ended December 31, 2006 due to higher sales volume and higher operating margin. Operating margin for the year ended December 31, 2007 increased by 40 basis points due to higher sales volume, lower overhead costs as a percentage of sales, and improved contract performance, partially offset by higher sales volume on the Linguist Contract.

2006 Compared with 2005

For the year ended December 31, 2006, Government Services net sales increased by 75.2% compared to the year ended December 31, 2005. The increase in net sales from acquired businesses was $1,306.8 million, primarily related to the Titan acquired businesses. Organic sales growth was $339.3 million, or 15.5%, primarily due to increased sales volume of (1) $129.0 million for intelligence support services because of competitive contract awards primarily to support the global war on terrorism, (2) $58.4 million for training and leadership development services, primarily for the Iraq and Afghanistan governments' ministries of defense, (3) $90.9 million for communication software support, systems engineering and other technical services to support U.S. Army communications and surveillance activities, and (4) $61.0 million primarily for the Linguist Contract. The Linguist Contract generated sales of $610.9 million for the year ended December 31, 2006.

Government Services operating income for the year ended December 31, 2006 increased by 69.9% compared to the year ended December 31, 2005. The increase in operating income was due to higher sales volume, partially offset by lower operating margin of 30 basis points. Operating margin increased by 20 basis points due to improved contract performance and lower indirect costs, which were partially offset by the 2006 fourth quarter severance costs of $4.1 million, and costs and expenses for the introduction of security video products. Operating margin also decreased by 20 basis points because of lower margins from the Titan acquired businesses and by 30 basis points due to SFAS 123R stock-based compensation expense.

Aircraft Modernization and Maintenance (AM&M)

($ in millions)	Year Ended December 31, 2007	2006	Increase / (decrease)	Year Ended December 31, 2006	2005	Increase
Net sales	$ 2,527.7	$ 2,327.5	$ 200.2	$ 2,327.5	$ 2,195.4	$ 132.1
Operating income	246.6	232.6	14.0	232.6	219.8	12.8
Operating margin	9.8 %	10.0 %	(20)bpts	10.0 %	10.0 %	— bpts

2007 Compared with 2006

For the year ended December 31, 2007, AM&M net sales increased by 8.6% compared to the year ended December 31, 2006, driven by increased volume of (1) $104.1 million for aircraft and base support services related to continued support of U.S. military operations in Iraq and Afghanistan, partially offset by lower sales volume due to a loss of a contract in June 2006 to provide maintenance and support for U.S. Navy fixed-wing training aircraft and (2) $34.0 million for aircraft modernization, primarily to modify C-130 aircraft for international customers, U.S. Presidential helicopter and head-of-state aircraft for foreign government customers. The increase in net sales from acquired businesses was $62.1 million, or 2.7%.

AM&M operating income for the year ended December 31, 2007 increased by 6.0% compared to the year ended December 31, 2006 primarily because of higher sales volume, partially offset by lower operating margin. Operating margin decreased by 20 basis points primarily due to lower incentive fees on a contract related to a reduction in the annual contractual target costs.

2006 Compared with 2005

For the year ended December 31, 2006, AM&M net sales increased by 6.0% compared to the year ended December 31, 2005, driven by increased sales volume of $85.4 million for base support services and $14.4 million for the completion of performance milestones on the Canadian Maritime Helicopter Program (MHP) contract. The increase in net sales from acquired businesses was $85.6 million primarily due to the acquisition of Crestview and TCS Design and Management Services. These increases were partially offset by lower sales volume of $53.3 million due to the competitive loss of two contracts.

AM&M operating income for the year ended December 31, 2006 increased by 5.8% compared to the year ended December 31, 2005. The increase in operating income was due to higher sales volume. Operating margin for 2006 was unchanged compared with 2005. Higher margins primarily from acquired businesses were offset by a 20 basis point reduction for SFAS 123R stock-based compensation expense.

Specialized Products

	Year Ended December 31,		Increase	Year Ended December 31,		Increase
	2007	2006		2006	2005	
($ in millions)						
Net sales	$ 4,788.9	$ 4,289.7	$ 499.2	$ 4,289.7	$ 3,259.4	$ 1,030.3
Operating income	566.4	487.8	78.6	487.8	358.4	129.4
Operating margin	11.8 %	11.4 %	40 bpts	11.4 %	11.0 %	40 bpts

2007 Compared with 2006

For the year ended December 31, 2007, Specialized Products net sales increased by 11.6% compared to the year ended December 31, 2006, reflecting higher sales volume of (1) $138.4 million for EO/IR and undersea warfare products, simulation devices and advanced mine detection systems, primarily related to new contracts, (2) $118.2 million for power & control systems due to recent new business awards to provide marine control systems and products to foreign allied navies, higher volume for commercial shipbuilding, power conversion and switching products, and service life extensions for landing craft air cushion amphibious vehicles, (3) $60.1 million primarily due to higher volumes for precision engagement, telemetry and advanced technology, and aviation products on existing contracts, and (4) $23.9 million for combat vehicle propulsion systems for U.S. military reset and replacement of equipment consumed in the U.S. military operations in Iraq. The increase in net sales from acquired businesses was $158.6 million, or 3.7%.

Specialized Products operating income for the year ended December 31, 2007 increased by 16.1% compared to the year ended December 31, 2006, due to higher sales volume and higher operating margin. Operating margin for the year ended December 31, 2007 increased by 40 basis points. Improved contract performance and higher sales in several business areas including EO/IR products, display systems and precision engagement, increased operating margins by 70 basis points. A smaller gain on a settlement of a claim of $7 million during 2007, compared to an unrelated gain from a settlement of a claim against a third party of $12 million during 2006, reduced operating margin by 10 basis points. Additionally, lower margins from acquired businesses reduced operating margin by 20 basis points.

2006 Compared with 2005

For the year ended December 31, 2006, Specialized Products net sales increased by 31.6% compared to the year ended December 31, 2005. The increase in net sales from acquired businesses was $697.0 million. Acquired businesses primarily include SAM, which was acquired on January 31, 2006, and certain divisions of Titan, Electron Technologies and Combat Propulsion Systems, all of which were acquired in 2005. Organic sales growth was $333.3 million, or 10.2%, primarily due to higher sales volume of (1) $84.9 million for combat vehicle propulsion systems for U.S. military and replacement of equipment consumed in U.S. military operations in Iraq, (2) $85.2 million for simulation devices primarily for contract awards, (3) $36.8 million for EO/IR products due to increased demand and timing of scheduled deliveries, (4) $29.9 million for acoustic undersea anti-submarine warfare products driven by sales of the company's airborne dipping sonars, (5) $27.8 million for precision and navigation systems primarily related to a program awarded in 2006 and (6) $108.9 million primarily for microwave components and displays mostly due to increased production and scheduled deliveries. These increases were partially offset by volume declines of $40.2 million for airport security systems.

Specialized Products operating income for the year ended December 31, 2006 increased by 36.1% compared to the year ended December 31, 2005. The increase in operating income was primarily due to higher sales volume and operating margins. Operating margin increased by 140 basis points, primarily due to improved contract performance and lower indirect costs for airport security systems and EO/IR products, and 30 basis points for the settlement of a claim against a third party for patent infringement in 2006 and charges recorded in 2005 that did not recur in 2006. These increases in operating margin were partially offset by a decline of 90 basis points because of lower margins from acquired businesses and by 40 basis points due to SFAS 123R stock-based compensation expense.

Liquidity and Capital Resources

Anticipated Sources of Cash Flow

Our primary source of liquidity is cash flow generated from operations. We also have funds of $794.5 million available to use under our revolving credit facility subject to certain conditions, as of December 31, 2007. We believe that our cash from operating activities, together with available borrowings under the revolving credit facility, will be adequate to meet our anticipated requirements for working capital, capital expenditures, defined benefit plan contributions, commitments, contingencies, research and development expenditures, contingent purchase price payments on previous business acquisitions, program and other discretionary investments, interest payments, income tax payments, L-3 Holdings' dividends and share repurchase program for the foreseeable future. There can be no assurance, however, that our business will continue to generate cash flow at current levels, or that currently anticipated improvements will be achieved. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing and there is no assurance we will be able to do so on a timely basis or on satisfactory terms. Our ability to make scheduled principal payments or to pay interest on or to refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

Balance Sheet

Contracts in process increased by $345.9 million to $3,378.3 million at December 31, 2007 from $3,032.4 million at December 31, 2006. The increase included: (1) $239.3 million to support the Company's sales growth, (2) $48.0 million to reclassify credit amounts from receivables and inventories to billings in excess of costs incurred within current liabilities, (3) $28.3 million primarily for acquired receivables and inventory balances from business acquisitions, and (4) $30.3 million for foreign currency translation adjustments.

The increase of $239.3 million to support the Company's sales growth included:

- Increases of $153.5 million in unbilled contract receivables primarily due to sales exceeding billings for ISR systems, aircraft modernization, simulation devices, undersea warfare products and power and control systems sold to commercial shipbuilders. These increases were partially offset by collections of progress billings for ISR systems and microwave products for contractual milestones;

• Increases of $50.6 million in billed receivables primarily due to billings for ISR systems, the Linguist Contract and training and operational support services. These increases were partially offset by collections for aircraft modernization from international customers and information technology solutions due to timing; and

• Increases of $35.2 million in inventoried contract costs primarily for networked communications, aircraft support services, EO/IR products and precision engagement products to support demand. These increases were partially offset by deliveries of ISR systems.

L-3’s receivables days sales outstanding (DSO) was 72 at December 31, 2007, compared with 72 at December 31, 2006. We calculate our DSO by dividing (1) our aggregate end of period billed receivables and net unbilled contract receivables, by (2) our trailing 12 month sales adjusted, on a pro forma basis, to include sales from business acquisitions that we completed as of the end of the period, multiplied by 365. Our trailing 12 month pro forma sales were $14,042 million at December 31, 2007 and $12,657 million at December 31, 2006.

The increase in property, plant and equipment (PP&E) during the year ended December 31, 2007 was principally due to capital expenditures and business acquisitions completed during the year ended December 31, 2007, partially offset by depreciation expense. The percentage of depreciation expense to average gross PP&E was 11.2% for the year ended December 31, 2007 compared to 11.7% for the year ended December 31, 2006. We did not change any of the depreciation methods or assets estimated useful lives that L-3 uses to calculate its depreciation expense.

Goodwill increased by $294.8 million to $8,165.1 million at December 31, 2007 from $7,870.3 million at December 31, 2006. The net increase in goodwill included: (1) $173.4 million for business acquisitions completed during the year ended December 31, 2007, (2) $122.7 million for foreign currency translation, (3) $16.8 million due to the adoption of FASB Interpretation No. 48 ‘‘Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement 109’’ (FIN 48) during the year ended December 31, 2007, (4) a decrease of $21.9 million due to the reduction of unrecognized income tax benefits in connection with the completion of the IRS audit of the pre-acquisition Federal income tax returns of Titan for the 2002 and 2003 tax years, and (5) a net increase of $3.8 million for certain business acquisitions completed prior to January 1, 2007, related primarily to final purchase price determinations and earnouts.

The increases in accounts payable and accrued expenses were primarily due to increased purchases of materials, components and services required for the increase in sales during the year ended December 31, 2007 and to the timing of payments and invoices received for purchases from third-party vendors and subcontractors. The increase in accrued employment costs was due to the increase in the number of employees and to the timing of payroll dates for salaries, wages and bonuses. The increase in advance payments and billings in excess of costs incurred was primarily due to reclassifications of certain amounts from contracts in process and the effect of foreign currency translation, partially offset by a decrease due to revenue recognized on certain contracts with foreign customers for aircraft modernization. Income taxes decreased primarily due to the implementation of FIN 48 on January 1, 2007, which required a $151.2 million reclassification of reserves for uncertain income tax positions to non-current income taxes payable, a component of other liabilities. Other current liabilities decreased primarily due to payments of accrued purchase prices payable for certain acquired businesses. Non-current deferred income tax liabilities increased primarily due to tax amortization of certain goodwill and other identifiable intangible assets.

Pension Plans

L-3 maintains defined benefit pension plans covering employees at certain of its businesses. In September 2006, the FASB issued SFAS 158. In accordance with SFAS 158, we recognize the unfunded status of our pension plans in our consolidated financial statements. See Note 18 to our audited consolidated financial statements. At December 31, 2007, L-3’s projected benefit obligation, which includes accumulated benefits plus the incremental benefits attributable to projected future salary increases for covered employees, was $1,687.6 million and exceeded the fair value of L-3’s pension plan assets of $1,406.7 million by $280.9 million. At the end of 2006, L-3’s projected benefit obligation was $1,657.8 million and exceeded the fair value of L-3’s pension plan assets of $1,298.1 million by $359.7 million. At December 31, 2007, our unfunded status decreased by $78.8 million from $359.7 million at December 31, 2006. The decrease was primarily due to (1) employer pension contributions of $94.0 million and (2) a decrease in the net loss and prior service cost that is recorded as a component of accumulated other comprehensive income (loss) of $87.8 million. These decreases were partially offset by pension expenses of $93.0 million for the year ended December 31, 2007 and $7.3 million for the impact of the change in our measurement date from November 30 to December 31 in accordance with SFAS 158 as discussed below.

Our contributions for the full year 2007 were $94.0 million, of which $39.6 million represented a pre-funding of contributions that were previously scheduled for 2008. We currently expect to contribute approximately $65 million to our pension plans in 2008. Actual 2008 pension contributions will be affected by L-3's actual amount of net cash from operating activities for the year ending December 31, 2008. A substantial portion of our pension plan contributions for L-3's businesses that are U.S. Government contractors are recoverable as allowable indirect contract costs at amounts generally equal to the annual pension contributions.

The decrease in the net loss and prior service cost of $87.8 million was principally due to the $101.3 million actuarial gain that we experienced in 2007. Our 2007 actuarial gain was primarily due to the increase in the weighted average discount rate to 6.36% at the end of 2007 from 5.85% at the end of 2006, which decreased the present value of L-3's projected benefit obligation at the end of 2007 by $123 million. The actuarial gains and losses that our pension plans experience are not recognized in pension expense in the year incurred, but rather are recorded as a component of accumulated other comprehensive income and amortized to pension expense in future periods over the estimated average remaining service periods of the covered employees. See Note 18 to our audited consolidated financial statements.

Our pension expense for 2007 was $93.0 million. We currently expect pension expense for 2008 to be approximately $87.0 million. As discussed above, at the end of 2007 we increased our weighted average discount rate to 6.36% from 5.85%, which will decrease the service cost component and amortization of net loss component of pension expense for 2008. In addition, our actual pension expense for 2008 will be based upon a number of factors, including the effect of any future business acquisitions for which we assume liabilities for pension benefits, changes in headcount at our businesses that sponsor pension plans, actual pension plan contributions and changes (if any) to our pension assumptions for 2008, including the discount rate, expected long-term return on plan assets and salary increases.

SFAS 158 requires us to measure pension plan assets and benefit obligations as of December 31, beginning no later than the year ending December 31, 2008. L-3 has adopted a December 31 measurement date for the year ended December 31, 2007. Previously, L-3 used a November 30 measurement date to determine its end of year pension benefit obligations and fair value of pension plan assets, and to determine its annual pension expense, including actual returns on plan assets. In connection with the change in measurement date, L-3 elected to remeasure its plan assets and benefit obligations as of January 1, 2007 and recorded a $7.3 million increase to pension liabilities, which represents the pension expense attributable to the month of December 2006. L-3's actual return on plan assets for 2007, based on the year ended December 31, 2007, was $32.8 million, or 2.5%, on the fair value of plan assets at the beginning of the year.

Our projected benefit obligation and annual pension expense are significantly affected by the discount rate assumption we use. For example, an additional reduction to the discount rate of 25 basis points would have increased our projected benefit obligation at December 31, 2007 by approximately $57 million, and our estimated pension expense for 2008 by approximately $6 million. Conversely, an increase to the discount rate of 25 basis points would have decreased our projected benefit obligation at December 31, 2007 by approximately $55 million, and our estimated pension expense for 2008 by approximately $6 million.

Statement of Cash Flows

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

Year Ended December 31, 2007 2006 2005 (in millions) Net cash from operating activities $ 1,270.2 $ 1,074.3 $ 846.8 Net cash used in investing activities (388.2) (1,090.7) (3,547.3) Net cash (used in) from financing activities (464.3) (29.3) 2,441.0

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Operating Activities

2007 Compared with 2006. We generated $1,270.2 million of cash from operating activities during the year ended December 31, 2007, an increase of $195.9 million compared with $1,074.3 million generated during the year ended December 31, 2006. The Q2 2006 Charges, discussed above under ‘‘Overview and Outlook,’’ reduced 2006 net income by $103.7 million, deferred income taxes by $63.7 million, and increased non-cash expenses by $31.1 million and cash flow from changes in operating assets and liabilities by $136.3 million because the cash payment for the Q2 2006 Charges have not yet been made. The increase in net cash from operating activities for the year ended December 31, 2007 compared to the year ended December 31, 2006, excluding the effect of the Q2 2006 Charges was due to: (1) an increase in net income of $126.3 million and (2) an increase of $94.4 million because of less cash used for changes in operating assets and liabilities primarily for accrued expenses, pension and post-retirement benefits and accounts payable, partially offset by (3) lower non-cash expenses of $24.8 million, primarily due to lower deferred income taxes of $78.7 million, partially offset by an increase of $53.9 million comprised of higher contributions to employee savings plans in L-3 Holdings' common stock, depreciation and amortization expense, and other non-cash items. The cash generated from changes in operating assets and liabilities is discussed above under ‘‘Liquidity and Capital Resources — Balance Sheet.’’

2006 Compared with 2005. We generated $1,074.3 million of cash from operating activities during the year ended December 31, 2006, an increase of $227.5 million from the $846.8 million generated during the year ended December 31, 2005 due to (1) an increase in net income of $17.6 million, (2) an increase in non-cash expenses of $141.3 million, and (3) changes in operating assets and liabilities, excluding acquired amounts, which increased by $68.6 million. The increase in non-cash expenses was primarily due to the non-cash portion of the Stock-Based Charge of $31.1 million, higher contributions to employee savings plans in L-3 Holdings' common stock of $47.6 million, higher employee stock-based compensation expense of $41.6 million due to the implementation of SFAS 123R and higher depreciation and amortization expense of $45.5 million. These increases in non-cash expenses were partially offset by $24.5 million primarily for lower deferred income tax expense due to the deferred income tax benefits related to the Q2 2006 charges.

Interest Payments. Our cash from operating activities includes interest payments on debt of $280.0 million for the year ended December 31, 2007, $287.0 million for the year ended December 31, 2006 and $163.6 million for the year ended December 31, 2005. Our interest expense also includes amortization of deferred debt issue costs and deferred gains on terminated interest rate swap agreements, which are non-cash items.

Investing Activities

During 2007, we used $235.0 million of cash for business acquisitions. We paid $206.8 million in connection with our 2007 business acquisitions discussed under ‘‘Business Acquisitions.’’ We also paid $17.0 million for earnouts and $11.2 million primarily for the remaining contractual purchase prices, for the Crestview and TRL business acquisitions made prior to January 1, 2007. We also used $153.2 million primarily for capital expenditures.

During 2006, we used $942.7 million of cash for business acquisitions. We paid $899.6 million in connection with our 2006 business acquisitions discussed above under ‘‘Business Acquisitions.’’ We also paid $20.7 million for the remaining contractual purchase price for the ASIT acquisition and $10.8 million for an additional 10% interest in the Army Fleet Support joint venture, which increased our total ownership interest to 90%. We also paid $10.5 million for earnouts and $24.9 million primarily for adjustments to the contractual purchase prices for certain business acquisitions. We received $23.8 million, in the aggregate, for reductions to the contractual purchase prices for the AIS, MAPPS and Titan acquired businesses.

During 2005, we used $3,434.8 million of cash for business acquisitions. We paid $3,405.6 million in connection with our 2005 business acquisitions, primarily for The Titan Corporation, and our other 2005 business acquisitions discussed above under ‘‘Business Acquisitions.’’ We also paid $28.8 million primarily for the contractual purchase price adjustments relating to businesses acquired prior to 2005 and $0.4 million for earnout payments on certain business acquisitions.

Financing Activities

Debt

Senior Credit Facility. Our senior credit facility provides for a term loan facility and a $1.0 billion revolving credit facility.

At December 31, 2007, borrowings under the term loan facility were $650.0 million, and available borrowings under our revolving credit facility were $794.5 million, after reduction for outstanding letters of credit of $205.5 million. The outstanding letters of credit include $138.8 million in connection with an adverse jury verdict currently on appeal, plus accrued interest. There were no outstanding revolving credit borrowings under our senior credit facility at December 31, 2007. Total debt outstanding was $4,536.5 million at December 31, 2007, compared to $4,535.0 million at December 31, 2006.

Debt Issuances. The table below presents a summary of our issuances of debt obligations during 2005. During 2007 and 2006, we did not issue any debt obligations. For additional details about the terms of our debt, see Note 10 to our audited consolidated financial statements.

Description of Debt Issuances	Issue Date	Principal Amount	Discount	Commissions and Other Offering Expenses	Net Proceeds	Semi-Annual Interest Payment Dates
L-3 Communications		(in millions)				
6 3/8% Senior Subordinated Notes due October 15, 2015	July 29, 2005	$ 1,000	$ 9.1	$ 18.9	$ 972.0 (1)	April 15 and October 15
L-3 Holdings						
3% Convertible Contingent Debt Securities (CODES) due August 1, 2035	July 29, 2005	700	—	18.8	681.2 (1)	February 1 and August 1

(1) The net proceeds from these offerings were used to pay a portion of the aggregate consideration for the Titan acquisition.

Credit Ratings. Our credit ratings as of February 2008 are as follows:

Rating Agency	Senior Debt	Subordinated Debt
Standard & Poor's	BBB−	BB+
Fitch Ratings	BBB−	BB
Moody's Investors Service	Ba2	Ba3

Debt Covenants and Other Provisions. The senior credit facility and senior subordinated notes agreements contain financial covenants and other restrictive covenants. See Note 10 to our audited consolidated financial statements for a description of our debt and related financial covenants, including dividend payment and share repurchase restrictions and cross default provisions, under our senior credit facility. As of December 31, 2007, we were in compliance with our financial and other restrictive covenants.

The borrowings under the senior credit facility are guaranteed by L-3 Holdings and by substantially all of the material wholly-owned domestic subsidiaries of L-3 Communications on a senior basis. The payment of principal and premium, if any, and interest on the senior subordinated notes are unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by substantially all of L-3 Communications' wholly-owned domestic subsidiaries. The guarantees of the senior subordinated notes rank pari passu with one another and are junior to the guarantees of the senior credit facility. The payment of principal and premium, if any, and interest on the CODES are fully and unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by certain of L-3 Holdings' wholly-owned domestic subsidiaries. The guarantees of the CODES rank pari passu with all of the guarantees of the senior subordinated notes and are junior to the guarantees of the senior credit facility.

Equity

During 2007 and 2006, L-3 Holdings' Board of Directors authorized the following quarterly cash dividends:

Date Declared	Record Date	Cash Dividends Per Share	Date Paid	Total Dividends Paid
				(in millions)
2007				
February 6	February 21	$ 0.25	March 15	$ 31.3
April 24	May 16	$ 0.25	June 15	$ 31.5
July 10	August 16	$ 0.25	September 17	$ 31.6
October 9	November 16	$ 0.25	December 17	$ 31.4
2006				
February 7	February 22	$ 0.1875	March 15	$ 22.8
April 25	May 17	$ 0.1875	June 15	$ 23.0
July 11	August 17	$ 0.1875	September 15	$ 23.2
October 10	November 17	$ 0.1875	December 15	$ 23.6

On February 5, 2008, L-3 Holdings announced that its Board of Directors had increased L-3 Holdings' regular quarterly cash dividend by 20% to $0.30 per share, payable on March 17, 2008, to shareholders of record at the close of business on February 19, 2008.

On February 22, 2008, the closing price of L-3 Holdings common stock, as reported by the NYSE, was $106.79 per share and the number of holders of L-3 Holdings' common stock was approximately 89,000.

For the year ended December 31, 2007, L-3 repurchased $499.7 million of its common stock compared to $25.5 million for the year ended December 31, 2006.

Contractual Obligations

The table below presents our estimated total contractual obligations at December 31, 2007, including the amounts expected to be paid or settled for each of the periods indicated below.

		Years Ending December 31,			
	Total	2008	2009-2010	2011-2012	2013 and thereafter
Contractual Obligations	(in millions)				
L-3 Communications long-term debt(1)	$ 3,850	$ —	$ 650	$ 750	$ 2,450
L-3 Holdings long-term debt(1)(2)	700	—	—	—	700
Interest payments(3)	1,974	271	507	427	769
Non-cancelable operating leases(4)	860	159	264	167	270
Notes payable and capital lease obligations	12	1	1	1	9
Purchase obligations(5)	2,034	1,698	312	21	3
Other long-term liabilities(6)	242	77 (7)	69	10	86
Total(8)	$ 9,672	$ 2,206	$ 1,803	$ 1,376	$ 4,287

(1) Represents principal amount of long-term debt and only includes scheduled principal payments. (2) The conversion feature of the CODES may require L-3 Holdings to settle the $700 million principal amount with the holders of the CODES if L-3 Holdings common stock price is more than 120% of the then current conversion price (currently $122.04) for a specified period (see Note 10 to our audited consolidated financial statements). L-3 Holdings stock price on February 22, 2008 was $106.79. (3) Represents expected interest payments on L-3's long-term debt balance as of December 31, 2007 using the stated interest rate on our fixed rate debt and the variable interest rate in effect at December 31, 2007 on the outstanding borrowings under our term loan facility, assuming that current borrowings remain outstanding to the contractual maturity date. (4) Non-cancelable operating leases are presented net of sublease

rental income. (5) Represents open purchase orders at December 31, 2007 for amounts expected to be paid for goods or services that are legally binding. (6) Other long-term liabilities primarily consist of workers compensation and deferred compensation for the years ending December 31, 2009 and thereafter and also includes pension and postretirement benefit plan contributions that we expect to pay in 2008.

(7) Our pension and postretirement benefit plan funding policy is generally to contribute in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations thereon. For 2008, we expect to contribute approximately $65 million to our pension plans and approximately $12 million to our postretirement benefit plans. Due to the current uncertainty of the amounts used to compute our expected pension and postretirement benefit plan funding, we believe it is not practicable to reasonably estimate such future funding for periods in excess of one year. (8) Excludes all income tax obligations, a portion of which represents unrecognized tax benefits in connection with uncertain tax positions taken, or expected to be taken on our income tax returns as of December 31, 2007 since we cannot determine the time period of future tax consequences. For additional information regarding income taxes, see Note 15 to our audited consolidated financial statements.

Off Balance Sheet Arrangements

The table below presents our estimated total contingent commitments and other guarantees at December 31, 2007, including the amounts expected to be paid or settled for each of the periods indicated below.

Years Ending December 31,	Total	2008	2009-2010	2011-2012	2013 and thereafter
Contingent Commitments	(in millions)				
Standby letters of credit under our Senior Credit Facility(1)	$ 206	$ 66	$ 140 (2)	$ —	$ —
Other standby letters of credit(1)	229	179	35	15	—
Other guarantees(3)	64	2	59	—	3
Contingent commitments for earnout payments on business acquisitions(4)	81	28	50	3	—
Total	$ 580	$ 275	$ 284	$ 18	$ 3

(1) Represent outstanding letters of credit with financial institutions covering performance and financial guarantees per contractual requirements with certain customers. (2) Includes $139 million in connection with an adverse jury verdict currently on appeal, plus accrued interest. (3) Represents the minimum guarantees made by L-3 or lessee (i) under the purchase option for certain operating leases in which the lease renewal is not exercised, (ii) for 50% of certain bank debt related to a joint venture arrangement, and (iii) for operating lease guarantees related to certain Titan discontinued operations (see Note 17 to our audited consolidated financial statements for a description of these guarantees). (4) Represents potential additional contingent purchase payments for business acquisitions that are contingent upon the post-acquisition financial performance of the acquired businesses.

For a discussion of the conversion and contingent interest features of our codes, see Note 10 to our audited consolidated financial statements.

Legal Proceedings and Contingencies

We are engaged in providing products and services under contracts with the U.S. Government and, to a lesser degree, under foreign government contracts, some of which are funded by the U.S. Government. All such contracts are subject to extensive legal and regulatory requirements, and, periodically, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. Under U.S. Government procurement regulations, an indictment by a federal grand jury could result in the suspension for a period of time from eligibility for awards of new government contracts. A conviction could result in debarment from contracting with the federal government for a specified term. Additionally, in the event that U.S. Government budget and expenditures for products and services of the type we manufacture and provide are reduced, there may be a reduction in our sales volume. We are currently cooperating with the U.S. Government on several investigations, none of which we anticipate will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

We continually assess our obligations with respect to applicable environmental protection laws. While it is difficult to determine the timing and ultimate cost that we will incur to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which we are aware, we believe that even without considering potential insurance recoveries, if any, there are no environmental loss contingencies that, in the aggregate, would be material to our consolidated financial position, results of operations or cash flows. Also, we have been periodically subject to litigation, government investigations, proceedings, claims or assessments and various contingent liabilities incidental to our business. We accrue for these contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. For a description of our legal proceedings and contingencies, see Note 17 to our audited consolidated financial statements.

Derivative Financial Instruments

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

Interest Rate Risk. The borrowings under our senior revolving credit facility and term loan facility contain variable interest only and are sensitive to changes in interest rates. The interest rates on the senior subordinated notes and CODES are fixed-rate and are not affected by changes in interest rates.

Additional data on our debt obligations and our applicable borrowing spreads included in the interest rates we pay on borrowings under the Senior Credit Facility are provided in Note 10 to our audited consolidated financial statements.

Foreign Currency Exchange Risk. Our U.S. and foreign businesses enter into contracts with customers, subcontractors or vendors, and certain of these contracts are denominated in currencies other than the functional currencies of our businesses. To protect the functional currency equivalent cash flows associated with certain of these contracts denominated in a foreign currency, we have entered into foreign currency forward contracts, which are accounted for as cash flow hedges. At December 31, 2007, the notional value of foreign currency forward contracts was $288.1 million and the fair value of these contracts was $12.4 million, which represented a liability. The notional values of our foreign currency forward contracts with maturities ranging through 2012 and thereafter are as follows: $168.4 million in 2008, $52.1 million in 2009, $25.7 million in 2010, $14.4 million in 2011 and $27.5 million in 2012 and thereafter.

Backlog and Orders

We define funded backlog as the value of funded orders received from customers, less the amount of sales recognized on those funded orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. The table below presents our funded backlog; percent of funded backlog at December 31, 2007 expected to be recorded as sales in 2008 and funded orders for each of our reportable segments.

Funded Backlog
at December 31, Percentage of
December 31, 2007
Funded Backlog
Expected to be
Recorded as

Reportable Segment:	2007	2006	Sales in 2008	2007	2006
	(in millions)			Funded Orders (in millions)	
C3ISR	$ 1,935	$ 1,741	72 %	$ 2,505	$ 2,170
Government Services	1,989	1,895	94	4,412	4,246
AM&M	1,496	1,628	79	2,395	2,631
Specialized Products	4,151	3,479	72	5,429	4,606
Consolidated	$ 9,571	$ 8,743	77 %	$ 14,741	$ 13,653

Our funded backlog does not include the full value of our contract awards including those pertaining to multi-year, cost-plus reimbursable contracts, which are generally funded on an annual basis. Funded backlog also excludes the sales value of unexercised priced contract options that may be exercised by customers under existing contracts and the sales value of purchase orders that we may receive under indefinite quantity contracts or basic ordering agreements.

Research and Development

The following table presents L-3's (i) company-sponsored (independent) research and development costs and (ii) customer-funded research and development costs, which are incurred on revenue arrangements to perform research and development type activities for customers. See Note 2 to our audited consolidated financial statements for a discussion of L-3's accounting policies for research and development costs.

Year Ended December 31,	2007	2006	2005
Company-Sponsored Research and Development Costs:	(in millions)		
U.S. Government Contractor Businesses	$ 263	$ 243	$ 186
Commercial Businesses	93	77	66
Total	$ 356	$ 320	$ 252
Customer-Funded Research and Development Costs	$ 1,027	$ 1,052	$ 883

Accounting Standards Issued and Not Yet Implemented

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

Inflation

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

Forward-Looking Statements

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

Statements that are predictive in nature, that depend upon or refer to events or conditions or that include words such as ''expects,'' ''anticipates,'' ''intends,'' ''plans,'' ''believes,'' ''estimates'' and similar expressions are forward-looking stateme Although we believe that these statements are based upon reasonable assumptions, including projections of total sales growth, sales growth from business acquisitions, organic sales growth, consolidated operating margins, total segment operating margins, interest expense earnings, cash flow, research and development costs, working capital, capital expenditures and other projections, they are subject to several risks and uncertainties, and therefore, we can give no assurance that these statements will be achieved. Such statements will also be influenced by factors which include, among other things:

- our dependence on the defense industry and the business risks peculiar to that industry, including changing priorities or reductions in the U.S. Government defense budget;
- our reliance on contracts with a limited number of agencies of, or contractors to, the U.S. Government and the possibility of termination of government contracts by unilateral government action or for failure to perform;

- the extensive legal and regulatory requirements surrounding our contracts with the U.S. or foreign governments and the results of any investigation of our contracts undertaken by the U.S. or foreign governments;
- our ability to retain our existing business and related contracts (revenue arrangements);
- our ability to successfully compete for and win new business and related contracts (revenue arrangements) and to win re-competitions of our existing contracts;

- our ability to identify and acquire additional businesses in the future with terms, including the purchase price, that are attractive to L-3 and to integrate acquired business operations;
- our ability to maintain and improve our consolidated operating margin and total segment operating margin in future periods;
- our ability to obtain future government contracts (revenue arrangements) on a timely basis;
- the availability of government funding or cost-cutting initiatives and changes in customer requirements for our products and services;
- our significant amount of debt and the restrictions contained in our debt agreements;
- our ability to continue to retain and train our existing employees and to recruit and hire new qualified and skilled employees, as well as our ability to retain and hire employees with U.S. Government security clearances that are a prerequisite to compete for and to perform work on classified contracts for the U.S. Government;
- actual future interest rates, volatility and other assumptions used in the determination of pension, benefits and stock options amounts;
- our collective bargaining agreements, our ability to successfully negotiate contracts with labor unions and our ability to favorably resolve labor disputes should they arise;
- the business and economic conditions in the markets in which we operate, including those for the commercial aviation and communications markets;
- our ability to perform contracts on schedule;
- economic conditions, competitive environment and political conditions (including acts of terrorism) and timing of international awards and contracts;
- our international operations, including sales to foreign customers;
- our extensive use of fixed-price type contracts as compared to cost-reimbursable type and time-and-material type contracts;
- the rapid change of technology and high level of competition in the defense industry and the commercial industries in which our businesses participate;
- our introduction of new products into commercial markets or our investments in civil and commercial products or companies;
- the outcome of current or future litigation matters and governmental investigation(s) of our businesses, including acquired businesses;
- costs or difficulties related to the integration of our acquired businesses may be greater than expected;
- anticipated cost savings from business acquisitions may not be fully realized or realized within the expected time frame;
- Titan's compliance with its plea agreement and consent to entry of judgment with the U.S. Government relating to the Foreign Corrupt Practices Act, including Titan's ability to maintain its export licenses;
- ultimate resolution of contingent matters, claims and investigations relating to acquired businesses, and the impact on the final purchase price allocations;

- competitive pressure among companies in our industry may increase significantly;
- pension, environmental or legal matters or proceedings and various other market, competition and industry factors, many of which are beyond our control; and
- the fair values of our assets, including identifiable intangible assets and the estimated fair value of the goodwill balances for our reporting units, which can be impaired or reduced by other factors, some of which are discussed above.

In addition, for a discussion of other risks and uncertainties that could impair our results of operations or financial condition, see ‘‘Part I — Item 1A — Risk Factors’’ and Note 17 to our audited consolidated financial statements.

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

As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainties of estimates, forecasts and projections and may be better or worse than projected and such differences could be material. Given these uncertainties, you should not place any reliance on these forward-looking statements. These forward-looking statements also represent our estimates and assumptions only as of the date that they were made. We expressly disclaim a duty to provide updates to these forward-looking statements, and the estimates and assumptions associated with them, after the date of this filing to reflect events or changes or circumstances or changes in expectations or the occurrence of anticipated events.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

For data regarding quantitative and qualitative disclosures related to our market risk sensitive financial instruments, see ‘‘Item 7 — Management’s Discussion and Analysis of Results of Operations and Financial Condition — Liquidity and Capital Resources — Derivative Financial Instruments’’ and Note 12 to our audited consolidated financial statements.

Item 8. Financial Statements and Supplementary Data

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

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Conclusions Regarding Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934 related to L-3 Holdings and L-3 Communications is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission’s (SEC) rules and forms, and that such information is accumulated and communicated to our management, including our President and Chief Executive Officer, and our Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, with the participation of our President and Chief Executive Officer, and our Vice President and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2007. Based upon that evaluation and subject to the foregoing, our President and Chief Executive Officer, and our Vice President and Chief Financial Officer concluded that, as of

December 31, 2007, the design and operation of our disclosure controls and procedures provided reasonable assurance that the disclosure controls and procedures are effective to accomplish their objectives.

During the year ended December 31, 2007, certain of our businesses, which generated 3.6% of our consolidated net sales for the year ended December 31, 2007, migrated to new enterprise resource planning (ERP) systems to replace their stand-alone legacy general ledger systems. These changes were made as part of ongoing process improvements and were not in response to an identified internal control deficiency. There were no changes in our internal control over financial reporting that occurred during the year or quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

As required by the SEC rules and regulations for the implementation of Section 404 of the Sarbanes-Oxley Act, our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of L-3, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements in our consolidated financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of L-3 Holdings' and L-3 Communications' internal control over financial reporting as of December 31, 2007. In making these assessments, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. Based on our assessments and those criteria, management determined that L-3 Holdings and L-3 Communications maintained effective internal control over financial reporting as of December 31, 2007.

Our independent registered public accounting firm has audited and issued their attestation report on the Company's internal control over financial reporting as of December 31, 2007. See page F-2 to our audited consolidated financial statements for their report.

Item 9B:

Other Information

None.

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PART III

Item 10.

Directors, Executive Officers and Corporate Governance

The following table provides information concerning the directors and executive officers of the Registrants as of February 22, 2008.

Name	Age	Position
Michael T. Strianese	51	President, Chief Executive Officer and Director
Jimmie V. Adams	71	Senior Vice President — Washington D.C. Operations
Curtis Brunson	60	Senior Vice President — Corporate Strategy and Development
David T. Butler III	51	Senior Vice President — Business Operations
Robert W. Drewes	65	Senior Vice President and President of the Integrated Systems Group
James W. Dunn	64	Senior Vice President and President of the Sensors and Simulation Group
Kathleen E. Karelis		