

L 3 COMMUNICATIONS HOLDINGS INC  
Form 10-Q  
November 09, 2006

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file numbers 001-14141 and 333-46983

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

(Exact names of registrants as specified in their charters)

Delaware

(State or other jurisdiction of  
incorporation or organization)

600 Third Avenue, New York NY

(Address of principal executive offices)

13-3937434 and 13-3937436

(I.R.S. Employer Identification Nos.)

10016

(Zip Code)

(212) 697-1111

(Telephone number)

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

Yes      No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act).

Yes      No

There were 124,935,289 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on October 27, 2006.

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

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For the quarterly period ended September 30, 2006

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PART I — FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

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

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	September 30, 2006	December 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 247.7	\$ 393.9
Contracts in process	3,321.9	2,904.4
Deferred income taxes	314.0	230.6
Other current assets	93.2	114.6
Total current assets	3,976.8	3,643.5
Property, plant and equipment, net	717.3	657.6
Goodwill	7,702.2	6,899.8
Identifiable intangible assets	478.1	412.8
Deferred debt issue costs	69.2	76.6
Other assets	178.1	218.8
Total assets	\$ 13,121.7	\$ 11,909.1
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable, trade	\$ 481.6	\$ 476.1
Accrued employment costs	531.6	467.7
Accrued expenses	255.0	172.0
Billings in excess of costs and estimated profits	224.9	214.0
Customer advances	194.1	97.2
Income taxes	114.5	69.2
Other current liabilities	504.5	358.1
Total current liabilities	2,306.2	1,854.3
Pension and postretirement benefits	495.0	435.6
Deferred income taxes	279.6	119.1
Other liabilities	260.9	294.7
Long-term debt	4,634.6	4,633.5
Total liabilities	7,976.3	7,337.2
Commitments and contingencies (see Note 13)		
Minority interests	83.8	81.2
Shareholders' equity:		
L-3 Holdings' common stock; \$.01 par value; authorized 300,000,000 shares, issued and outstanding 124,789,081 shares in 2006 and 120,372,394 shares in 2005 (L-3 Communications' common stock; \$.01 par value, 100 shares authorized, issued and outstanding)	3,312.1	3,040.8
Retained earnings	1,828.5	1,545.0
Unearned compensation	—	(17.9)
Accumulated other comprehensive loss	(79.0)	(77.2)
Total shareholders' equity	5,061.6	4,490.7
Total liabilities and shareholders' equity	\$ 13,121.7	\$ 11,909.1

See notes to unaudited condensed consolidated financial statements.

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AND L-3 COMMUNICATIONS CORPORATION

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Three Months Ended September 30,	
	2006	2005
Net sales:		
Products	\$ 1,431.3	\$ 1,159.6
Services	1,673.2	1,346.8
Total net sales	3,104.5	2,506.4
Cost of sales:		
Products	1,263.8	1,019.7
Services	1,507.4	1,220.2
Total cost of sales	2,771.2	2,239.9
Operating income	333.3	266.5
Interest and other (income) expense, net	(6.4)	(0.9)
Interest expense	76.8	59.9
Minority interests in net income of consolidated subsidiaries	3.5	2.6
Income before income taxes	259.4	204.9
Provision for income taxes	95.6	69.6
Net income	\$ 163.8	\$ 135.3
L-3 Holdings' earnings per common share:		
Basic	\$ 1.32	\$ 1.13
Diluted	\$ 1.31	\$ 1.11
L-3 Holdings' weighted average common shares outstanding:		
Basic	123.8	119.7
Diluted	125.3	122.1

See notes to unaudited condensed consolidated financial statements.

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

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Nine Months Ended September 30,	
	2006	2005
Net sales:		
Products	\$ 4,194.1	\$ 3,302.4
Services	4,897.6	3,242.1
Total net sales	9,091.7	6,544.5
Cost of sales:		
Products (excludes stock-based charge of \$23.8)	3,703.8	2,915.7
Services (excludes stock-based charge of \$15.4)	4,449.6	2,938.2
Total cost of sales	8,153.4	5,853.9
Litigation charge	129.0	—
Stock-based charge	39.2	—
Operating income	770.1	690.6
Interest and other (income) expense, net	(14.4)	(6.4)
Interest expense	221.6	136.5
Minority interests in net income of consolidated subsidiaries	8.4	7.9
Income before income taxes	554.5	552.6
Provision for income taxes	202.0	195.5
Net income	\$ 352.5	\$ 357.1
L-3 Holdings' earnings per common share:		
Basic	\$ 2.88	\$ 3.02
Diluted	\$ 2.84	\$ 2.95
L-3 Holdings' weighted average common shares outstanding:		
Basic	122.4	118.3
Diluted	124.3	120.9

See notes to unaudited condensed consolidated financial statements.

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## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

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	Nine Months Ended September 30,	
	2006	2005
Operating activities:		
Net income	\$ 352.5	\$ 357.1
Depreciation	98.1	81.0
Amortization of intangibles and other assets	38.0	24.7
Deferred income tax provision	68.2	87.8
Stock-based employee compensation expense	34.2	3.3
Contributions to employee savings plans in L-3 Holdings' common stock	85.0	46.5
Non-cash portion of stock-based charge	31.1	—
Minority interests in net income of consolidated subsidiaries	8.4	7.9
Amortization of deferred debt issue costs (included in interest expense)	7.7	5.2
Other non-cash items	(5.4)	3.5
Subtotal	717.8	617.0
Changes in operating assets and liabilities, excluding acquired amounts:		
Contracts in process	(216.9)	(158.7)
Other current assets	16.9	(3.7)
Other assets	21.1	(26.6)
Accounts payable, trade	(34.0)	(24.8)
Accrued employment costs	25.2	15.9
Accrued expenses	38.2	5.4
Billings in excess of costs and estimated profits	6.0	4.1
Customer advances	34.1	30.5
Income taxes	97.5	74.4
Excess income tax benefits related to share-based payment arrangements	(54.7)	—
Other current liabilities	112.0	27.4
Pension and postretirement benefits	9.5	14.8
Other liabilities	(40.7)	6.4
All other operating activities	3.2	(2.5)
Subtotal	17.4	(37.4)
Net cash from operating activities	735.2	579.6
Investing activities:		
Business acquisitions, net of cash acquired	(873.5)	(3,380.6)
Capital expenditures	(103.0)	(71.2)
Dispositions of property, plant and equipment	1.8	2.2
Other investing activities	4.1	3.7
Net cash used in investing activities	(970.6)	(3,445.9)
Financing activities:		
Borrowings under revolving credit facility	835.0	40.0
Repayment of borrowings under revolving credit facility	(835.0)	(40.0)
Borrowings under term loan facility	—	750.0
Proceeds from sale of senior subordinated notes	—	990.9
Proceeds from sale of convertible contingent debt securities (CODES)	—	700.0
Debt issue costs	(0.3)	(45.2)
Cash dividends paid on L-3 Holdings' common stock	(69.0)	(44.3)
Proceeds from exercise of stock options	62.1	68.2
Proceeds from employee stock purchase plan	44.8	31.4
Excess income tax benefits related to share-based payment arrangements	54.7	—

Distributions paid to minority interests	(3.7)	(4.8)
Other financing activities	0.6	(7.0)
Net cash from financing activities	89.2	2,439.2
Net decrease in cash and cash equivalents	(146.2)	(427.1)
Cash and cash equivalents, beginning of the period	393.9	653.4
Cash and cash equivalents, end of the period	\$ 247.7	\$ 226.3

See notes to unaudited condensed consolidated financial statements.

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

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

##### 1. Description of Business

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

The Company has the following four reportable segments: (1) Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR); (2) Government Services; (3) Aircraft Modernization and Maintenance (AM&M); and (4) Specialized Products. Financial information relating to the Company's reportable segments is included in Note 16.

The C<sup>3</sup>ISR reportable segment provides products and services for the global ISR market, including C<sup>3</sup> systems and secure networked communication systems and equipment. The Company believes that these products and services are critical elements for a substantial number of major command, control, communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring and dissemination functions of these communication systems. The Government Services reportable segment provides communications systems support and engineering services, information technology services, teaching and training services,

marksmanship training systems and services, and intelligence support and analysis services. The AM&M reportable segment provides specialized aircraft modernization, upgrades and sustainment, maintenance and logistics support services. The Specialized Products reportable segment provides a broad range of products, including naval warfare products, security systems, simulation devices, telemetry and navigation products, sensors and imaging products, aviation products, premium fuzing products, microwave components and information products.

## 2. Basis of Presentation

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

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

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)

Communications. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and unconditionally guaranteed by L-3 Communications and certain of its domestic subsidiaries, and, accordingly, such debt has been reflected as debt of L-3 Communications in its consolidated financial statements in accordance with the U.S. Securities and Exchange Commission's (SEC) Staff Accounting Bulletin (SAB) No. 54. All issuances of and conversions into L-3 Holdings' equity securities, including grants of stock options and restricted stock by L-3 Holdings to employees of L-3 Communications and its subsidiaries, have been reflected in the consolidated financial statements of L-3 Communications. As a result, the consolidated financial positions, results of operations and cash flows of L-3 Holdings and L-3 Communications are substantially the same. See Note 18 for additional information regarding the unaudited financial information of L-3 Communications and its subsidiaries.

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



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

During the three months ended September 30, 2006, the Company changed the presentation of net sales and cost of sales on its statements of operations for the current and prior periods to separately present amounts for product sales and services.

### 3. Review of Past Stock Option Granting Practices

In June 2006, the Company voluntarily initiated a review of its historical stock-based compensation award practices and related accounting treatment. The review has been completed and was conducted by the Audit Committee of the Board of Directors with the assistance of outside legal counsel. In accordance with New York Stock Exchange requirements, the Audit Committee is composed solely of independent directors.

The scope of the review included all stock-based awards granted by the Company from May 1998, when we completed our initial public offering, through the present, with a focus on the period from May 1998 through July 2003, when stock-based awards were generally approved by unanimous written

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

consents of the Compensation Committee of the Board. Since July 2003, the Compensation Committee approved all stock-based compensation awards to employees, including officers, at Compensation Committee meetings and these approval/meeting dates for the stock option grants were correctly used as the accounting measurement date for the grant. In addition, the review focused on the exercises of stock options that may not be deductible under Section 162(m) of the Internal Revenue Code (Code) and on issues relating to amounts that may be considered deferred compensation under Section 409A of the Code.

The review found that from May 1998 through July 2003, the price of L-3 Holdings' stock on the date selected as the grant date and accounting measurement date was less than the stock price on the formal approval date in substantially all cases. In addition, the review found that the date selected by management as (i) the grant date, which was in most

cases the date specified in the unanimous written consent, (ii) the date used to determine the exercise price for the stock options, and (iii) the accounting measurement date, preceded the date of formal approval for the stock options, and in many cases also preceded the date of submission of the grants for approval by the Company's Compensation Committee or entire Board of Directors. The Company has concluded that a number of the unanimous written consents may not have been effective on the date specified in the unanimous written consent because there was insufficient evidence to conclude that all the signatures were received by the Company on that date. Therefore, the use of the date specified in the unanimous written consent as the accounting measurement date, as well as in certain circumstances the option exercise price, was incorrect. The review also found that the accounting measurement dates used for stock option grants to one future employee and employees of three acquired businesses were incorrectly the dates specified in the unanimous written consent and not the employee's hire date or the acquisition dates, which occurred later.

Based on the review's findings, during the 2006 second quarter, the Company recorded a charge of \$39.2 million (\$25.5 million after income taxes) pertaining to the years ended December 31, 1998 to 2005 and the 2006 first quarter (the "Stock-Based Charge"). This charge includes non-cash compensation expense of \$31.1 million (\$20.4 million after income taxes) primarily related to stock option grants made during the period from May 1998 to July 2003 that should have been measured as compensation cost at the requisite stock option grant dates, and subsequently amortized to expense over the three-year vesting period for each stock option grant. The Stock-Based Charge also includes \$8.1 million (\$5.1 million after income taxes) relating to amounts that would be considered deferred compensation under Section 409A of the Code and an accrual for external legal and accounting costs incurred for the review through June 30, 2006. The impact of the non-cash compensation expense by year and for the three months ended March 31, 2006 on the Company's previously reported net income is presented in the table below.

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

Period	Net Income	Net Income	Decrease	% Decrease
	as Reported	if Adjusted		
		(in millions)		
1998	\$ 32.6	\$ 32.3	\$ 0.3	0.9%
1999	58.7	57.8	0.9	1.5
2000	82.7	81.7	1.0	1.2
2001	115.5	113.4	2.1	1.8
2002	178.1	173.1	5.0	2.8
2003	277.6	271.8	5.8	2.1
2004	381.9	377.5	4.4	1.2
2005	508.5	507.8	0.7	0.1
Q1 2006	138.9	138.7	0.2	0.1

Total	\$ 1,774.5	\$ 1,754.1	\$ 20.4
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In addition, the Stock-Based Charge reduced retained earnings as of June 30, 2006 by \$25.5 million, and increased additional paid-in-capital by \$20.4 million. The findings did not identify any compensation deductions related to the exercises of stock options that were improperly deducted on the Company's tax returns in violation of Section 162(m) of the Code.

With respect to the portion of the Stock-Based Charge that relates to amounts that would be deferred compensation under Section 409A of the Code, the Company expects to modify stock options, subject to certain limitations, for employees who were issued stock options with an exercise price less than the fair market value on the date of grant that have vested after December 31, 2004 and are outstanding. The Company expects that this modification will allow the affected employees to avoid adverse tax consequences by increasing the exercise price to the fair market value of such option on the date of grant and paying the difference in exercise prices in cash during 2007. The Stock-Based Charge includes an estimated cost resulting from such modifications of approximately \$3.6 million (\$2.2 million after income taxes) that should have been recorded as a liability during 2005, which is not included in the non-cash compensation expense in the table above. In addition, for employees with stock options that have vested after December 31, 2004, and are exercised during 2006 before the modification is made, the employees are subject to an incremental 20% income tax on the amount considered deferred compensation plus interest charges. The Company expects to pay the affected employees an amount equal to such incremental taxes and interest. The Stock-Based Charge includes such expected payments of approximately \$2.3 million (\$1.5 million after income taxes).

The Company does not believe that a restatement of its prior-period financial statements is required for the Stock-Based Charge. Based on the materiality guidelines contained in SAB No. 99, Materiality (SAB 99), the Company believes that the Stock-Based Charge is not material to any of the individual prior periods affected or to L-3's expected results for the year ending December 31, 2006.

The review also determined that certain Form 4 securities filings (Statement of Changes in Beneficial Ownership) required under Section 16 of the Exchange Act were not made on behalf of executives and directors and in some cases they were not filed accurately or on a timely basis.

Beginning in July 2006, the Compensation Committee determined that it would, subject to limited exceptions, grant stock-based compensation awards on pre-determined annual dates. The Company has implemented procedures and controls and has provided additional resources to ensure that reportable transactions under Section 16 of the Exchange Act are filed with the SEC on a timely basis. The Company also intends to continue to evaluate its compliance processes and evaluate the effectiveness of its controls to determine whether additional improvements should be made.

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

4. Acquisitions

## 2006 Business Acquisitions

During the nine months ended September 30, 2006, in separate transactions, the Company acquired ownership interests in eleven businesses, for an aggregate purchase price of \$904.3 million, plus acquisition costs. Based on preliminary purchase price allocations, the aggregate goodwill recognized for these business acquisitions was \$808.6 million, of which \$162.5 million was assigned to the C<sup>3</sup>ISR reportable segment, \$125.8 million was assigned to the AM&M reportable segment and \$520.3 million was assigned to the Specialized Products reportable segment. The goodwill from these business acquisitions is not expected to be deductible for income tax purposes. The 2006 business acquisitions were initially financed with a combination of cash on hand and revolving credit facility borrowings, which have subsequently been repaid. The purchase prices for the acquisitions of TCS Design and Management Services, Incorporated (TCS), Magnet-Motor GmbH (Magnet-Motor), CyTerra Corporation (CyTerra), SSG Precision Optronics, Inc. (SSG), Nautronix Defense Group (Nautronix) and Crestview Aerospace Corporation (Crestview) are subject to adjustment based on the closing date net assets or net working capital of the respective businesses acquired. In addition, in certain instances, the purchase price is subject to adjustment based on post-acquisition financial performance or certain other performance conditions as discussed below. The Company completed the following business acquisitions during the nine months ended September 30, 2006:

- All of the outstanding stock of SAM Electronics GmbH (SAM) on January 31, 2006, for \$188.7 million in cash, including a \$38.7 million increase to the final contractual purchase price based on closing date net assets, of which \$30.8 million was for cash acquired at foreign locations. SAM, which has its principal operations in Germany, is a manufacturer and supplier of maritime electrical and electronic systems to shipyards (including commercial shipyards), shipping companies and international navies;
- All of the outstanding stock of SafeView, Inc. (SafeView) on March 9, 2006, and CyTerra on March 21, 2006, for an aggregate purchase price of \$190.6 million in cash, plus additional consideration, not to exceed \$35.1 million, which is contingent upon their financial performance for the years ending December 31, 2006 through 2008. Any such additional consideration will be accounted for as goodwill. SafeView is a developer and manufacturer of non-invasive security systems and portals for military and public safety use, including airports. CyTerra is a leader in the development and manufacture of a number of sophisticated sensors with threat detection capabilities for the military and homeland security markets;
- Increased the Company's ownership in Medical Education Technologies, Inc. (METI) on April 4, 2006 from approximately 47% to 80% for a purchase price of \$10.6 million in cash. METI is a supplier of human patient and surgical simulators, as well as related educational products;
- All of the outstanding stock of SSG on June 1, 2006, for \$67.9 million in cash. SSG specializes in optics, telescopes and precision optical subsystems for government, military and commercial customers;
- All of the outstanding stock of Nautronix on June 1, 2006 for \$69.0 million in cash, plus additional consideration, not to exceed \$6.0 million, which is contingent upon certain contract awards to Nautronix through June 2010. Any such additional consideration will be accounted for as goodwill. Nautronix is a leader in through-water communications, acoustic ranges and positioning technology;

L-3 COMMUNICATIONS HOLDINGS, INC.  
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FINANCIAL STATEMENTS (Continued)

- All of the outstanding stock of Crestview on June 29, 2006 for \$146.3 million in cash, part of which was used for the payoff of mortgages on facilities. Crestview provides aircraft structures, major airframe assemblies and military aircraft modifications for leading prime contractors and original equipment manufacturers;
- All of the outstanding stock of TRL Electronics plc (TRL) for \$165.8 million in cash and \$5.6 million in notes payable issued by the Company to certain shareholders of TRL, which are due and payable on March 30, 2007. The Company acquired a controlling ownership interest in TRL on July 12, 2006. TRL offers advanced radio and satellite communications systems, providing governments and defense organizations around the world with the ability to trace, locate, monitor and defend transmissions, as well as to communicate securely; and
- All of the outstanding stock of Advanced Systems Architectures Ltd. (ASA) on January 25, 2006, TCS on January 26, 2006, and Magnet-Motor on March 20, 2006, for an aggregate purchase price of \$59.8 million in cash, plus additional consideration, not to exceed \$12.0 million, which is contingent upon the financial performance of ASA and TCS for the years ending December 31, 2006 and 2007. Any such additional consideration will be accounted for as goodwill.

The table below summarizes the preliminary purchase price allocations for the aggregate assets acquired, and liabilities assumed, including acquisition costs, in connection with all of the Company's business acquisitions that were completed during the nine months ended September 30, 2006.

	(in millions)
Cash and cash equivalents	\$ 60.7
Contracts in process	206.2
Other current assets	31.5
Goodwill	808.6
Identifiable intangible assets	57.4
Property, plant and equipment	47.9
Other assets	2.2
Total assets acquired	1,214.5
Current liabilities	224.1
Other liabilities	82.9
Total liabilities assumed	307.0
Minority interests	1.1
Net assets acquired	\$ 906.4

All of the business acquisitions are included in the Company's results of operations from their respective dates of acquisition. The assets and liabilities recorded in connection with the purchase price allocations for the acquisitions of SAM, SafeView, CyTerra, ASA, TCS, Magnet-Motor, METI, SSG, Nautronix, Crestview and TRL are based upon preliminary estimates of fair values for contracts in process, inventories, estimated costs in excess of estimated contract value to complete contracts in process in a loss position, contingent assets and liabilities, identifiable intangibles, goodwill, property, plant and equipment, and deferred income taxes. Actual adjustments will be based on the final purchase prices, including the payment of contingent consideration, if any, and final appraisals and other

analyses of fair values which are in process. The Company does not expect the differences between the preliminary and final purchase price allocations for these business acquisitions to have a material impact on its results of operations or financial position.

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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2005 Business Acquisitions

**Acquisition of The Titan Corporation.** On July 29, 2005, the Company acquired all of the outstanding shares of Titan for approximately \$2,735.9 million in cash, including the assumption of approximately \$626.0 million of Titan's debt, plus \$42.2 million of acquisition costs. Concurrent with the Titan acquisition, the Company repaid or redeemed all of Titan's outstanding debt. The Titan acquisition was financed using cash on hand, \$750.0 million of term loan borrowings under L-3 Communications' senior credit facility and the net proceeds from the issuance by L-3 Holdings of \$700.0 million of 3% Convertible Contingent Debt Securities and the issuance by L-3 Communications of \$1.0 billion of 6 3/8% Senior Subordinated Notes (see Note 8). Titan is included in the Company's results of operations from its date of acquisition.

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

In addition, at the date of acquisition Titan had over 8,000 employees with U.S. Government security clearances, including over 4,000 employees with top secret and above clearances and more than 2,400 employees with special access clearances that focus on communications, secure networks, cryptology, signal intelligence, electronic warfare, data fusion, electromagnetic pulse science and analysis of weapons of mass destruction and simulation. Employees with U.S. Government security clearances are necessary (i) to perform work under a substantial portion of Titan's existing contracts (revenue arrangements) and (ii) to compete for new classified contracts with the U.S. Government. Titan had approximately 12,500 employees at the date of acquisition.

The table below presents a summary of (1) the preliminary purchase price allocation for the Titan acquired assets and assumed liabilities as reported in the Company's unaudited condensed consolidated financial statements as of September 30, 2005, (2) the changes made to the initial purchase price allocation during the twelve month period ended September 30, 2006, and (3) the final purchase price allocation, which includes the results from the final appraisals and other valuations of fair value for the Titan acquired assets and assumed liabilities. As illustrated, the substantial majority of Titan's purchase price was allocated to goodwill. The primary factors that contributed to the recognition of Titan's goodwill are similar to those discussed in Note 6 under "Goodwill and Identifiable Intangible Assets."

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	Final	Preliminary (in millions)	Change
Cash and cash equivalents	\$ 25.2	\$ 25.2	—
Contracts in process	533.0	543.0	(10.0) <sup>(a)</sup>
Current deferred income taxes	91.5	86.8	4.7 <sup>(b)</sup>
Other current assets	37.7	39.8	(2.1) <sup>(c)</sup>
Goodwill	2,239.5	2,292.1	(52.6) <sup>(d)</sup>
Identifiable intangible assets	240.1	225.0	15.1 <sup>(e)</sup>
Non-current deferred income taxes	13.6	—	13.6 <sup>(b)</sup>
Other assets	111.1	82.4	28.7 <sup>(f)</sup>
Total assets acquired	3,291.7	3,294.3	(2.6)
Current liabilities	374.7	345.6	29.1 <sup>(g)</sup>
Non-current deferred income taxes	—	49.6	(49.6) <sup>(b)</sup>
Other liabilities	139.0	119.5	19.5 <sup>(h)</sup>
Total liabilities assumed	513.7	514.7	(1.0)
Net assets acquired <sup>(i)</sup>	\$ 2,778.0	\$ 2,779.6	\$ (1.6)

<sup>(a)</sup>The reductions to contracts in process are primarily to reduce the value of unbilled contract costs, existing at the date of acquisition, which are related to previously completed contracts for which there is no remaining contract value or unsupportable contracts costs which cannot be invoiced to customers.

<sup>(b)</sup>The adjustments to current and non-current deferred income taxes primarily represent final revisions to Titan's net operating loss carryforwards, the elimination of Titan's historical deferred taxes on goodwill and the deferred tax impact of changes to the final Titan acquisition date balance sheet.

<sup>(c)</sup>The decrease to other current assets is primarily to reduce certain prepaid expenses related to employee travel advances, existing at the date of acquisition, for which there is no supporting documentation, and which cannot be invoiced to customers to be recovered.

<sup>(d)</sup>The decrease to goodwill represents the effect of the final adjustments to the purchase price allocation. Goodwill in the amount of \$953.9 million was assigned to the C<sup>3</sup>ISR reportable segment, \$892.9 million to the Government Services reportable segment and \$392.7 million to the Specialized Products reportable segment, and \$108.6 million of the Titan goodwill is expected to be deductible for income tax purposes.

<sup>(e)</sup>The increase to identifiable intangible assets is primarily due to increases for customer contractual relationships and favorable leasehold interests. Customer contractual relationships represent \$224.0 million of the Titan identifiable intangible assets. We estimated the fair value of the customer contractual relationships utilizing the excess earnings method, which is a form of the income approach. This method is based on projecting revenues and expenses attributable to customer contractual relationships over their remaining economic lives, and then subtracting the required return on the

contributory assets used in the business to generate such income, in order to attribute any residual “excess earnings” to the customer contractual relationships intangible assets. The estimated after-tax excess earnings (cash flows) are then discounted to their present value equivalents using a discount rate commensurate with the risk associated with the financial projections.

- (f) The increase in other assets is primarily related to a \$27.8 million gross-up adjustment to separately recognize an asset for insurance recoveries for certain pre-acquisition securities claims, which were netted against other liabilities in the preliminary purchase price allocation (as discussed below in Note (h)). These claims and insurance recovery settled in the second quarter of 2006 at the amounts recorded.
- (g) The increase in current liabilities includes \$9.0 million for the estimated fair value of a preacquisition contractual performance obligation with the U.S. Navy, \$8.8 million for a preacquisition obligation for the indemnification of legal defense costs for former Titan directors and officers in certain ongoing investigations, and \$4.4 million for the current portion of unfavorable leasehold interests.
- (h) Other liabilities increased primarily due to the \$27.8 million gross up adjustment for insurance recoveries (as discussed above in Note (f)), partially offset by \$10.3 million in reduced litigation and environmental reserves.
- (i) Excludes additional purchase price, not to exceed \$28.5 million, relating to a previous business acquisition made by Titan prior to its acquisition by L-3. The additional purchase price, if any, is contingent primarily upon the financial performance of International Systems L.L.C. for the years ending December 31, 2006 through 2011.

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

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Titan identifiable intangible assets of \$240.1 million are all subject to amortization and have an average useful life of approximately 28.5 years. The Titan identifiable intangible assets are comprised of customer contractual relationships of \$224.0 million (30-year useful life), technology of \$8.1 million (5.8-year average useful life) and favorable leasehold interests of \$8.0 million (9.5-year average useful life).

**Other 2005 Business Acquisitions.** During 2005, in addition to the acquisition of Titan, the Company acquired eleven other businesses in separate transactions. The Company has completed the purchase price allocations for ten of these acquisitions. The final purchase price allocations for these business acquisitions did not have a material impact on the Company's results of operations or financial position. The Company expects to complete the purchase price allocation for the remaining business acquisition in the fourth quarter of 2006. The Company does not expect the final purchase price allocations for the remaining business acquisition to have a material impact on its results of operations or financial position.

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



representing a reduction to the purchase price, plus interest income of \$3.5 million. The reduction to the purchase price was recorded as a reduction to goodwill.

Unaudited Pro Forma Statement of Operations Data

The following unaudited pro forma Statement of Operations data presents the combined results of the Company and its business acquisitions completed during the nine months ended September 30, 2006 and the year ended December 31, 2005, assuming that the business acquisitions completed during these periods had occurred on January 1, 2005.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions, except per share data)			
Pro forma sales	\$ 3,104.5	\$ 2,882.4	\$ 9,247.4	\$ 8,539.1
Pro forma net income	\$ 160.3	\$ 128.0	\$ 340.9	\$ 285.2
Pro forma diluted earnings per share	\$ 1.28	\$ 1.05	\$ 2.74	\$ 2.36

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

The unaudited pro forma results include charges for costs related to Titan's internal review and shareholder settlements related to the securities law class action and derivative action lawsuits, each arising out of Titan's alleged violations of the Foreign Corrupt Practices Act (FCPA) (see Note 13 for a further discussion of Titan's FCPA investigation). The unaudited pro forma results also include costs related to the acquisition of Titan by the Company. These charges, which were recorded by Titan prior to the July 2005 acquisition, amounted to approximately \$0.4 million for the three months ended September 30, 2005 and \$80.5 million for the nine months ended September 30, 2005.

Other Business Acquisition Transactions

On May 19, 2006, the Company increased its ownership percentage in Army Fleet Support (AFS) LLC from 80% to 90% for a purchase price of \$10.8 million paid in cash.

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L-3 COMMUNICATIONS HOLDINGS, INC.  
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5. Contracts in Process

The components of contracts in process are presented in the table below. The unbilled contract receivables, inventoried contract costs and unliquidated progress payments are principally related to contracts with the U.S. Government and prime contractors or subcontractors of the U.S. Government. Identifiable intangible assets related to contracts in process assumed by the Company in its business acquisitions and the underlying contractual customer relationships are separately recognized at the date of acquisition, and are discussed and presented in Note 6.

	September 30, 2006	December 31, 2005
	(in millions)	
Billed receivables, net of allowances of \$15.8 million and \$19.6 million	\$ 1,172.0	\$ 1,071.2
Unbilled contract receivables, gross	1,647.5	1,414.1
Less: unliquidated progress payments	(312.6)	(235.6)
Unbilled contract receivables, net	1,334.9	1,178.5
Inventoried contract costs, gross	591.4	529.8
Less: unliquidated progress payments	(68.3)	(64.5)
Inventoried contract costs, net	523.1	465.3
Inventories at lower of cost or market	291.9	189.4
Total contracts in process	\$ 3,321.9	\$ 2,904.4

**Inventoried Contract Costs.** In accordance with SOP 81-1 and the AICPA Audit and Accounting Guide, Audits of Federal Government Contractors, the Company's inventoried contract costs include general and administrative (G&A) costs, independent research and development (IRAD) costs and bid and proposal (B&P) costs allocated to contracts (revenue arrangements) for which the U.S. Government is the end customer, because they are reimbursable indirect contract costs on revenue arrangements pursuant to the contractual terms of the revenue arrangements and U.S. Government procurement regulations. The Company accounts for the portion of its G&A, IRAD and B&P costs that are allowable indirect costs under U.S. Government procurement regulations on its U.S. Government contracts as inventoried contract costs. These costs are charged to costs of sales when sales on the related contracts (revenue arrangements) are recognized. The Company's unallowable portion of its G&A, IRAD and B&P costs for its U.S. Government contractor businesses are expensed as incurred and are not included in inventoried contract costs.

The table below presents a summary of G&A, IRAD and B&P costs included in inventoried contract costs and the changes to them, including amounts charged to cost of sales for U.S. Government contracts for the period presented.

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	(in millions)			
Amounts included in inventoried contract costs at beginning of the period	\$ 62.3	\$ 49.9	\$ 55.6	\$ 43.7
Add: Amounts included in acquired inventoried contract costs	—	2.2	0.3	2.2
Contract costs incurred <sup>(1)</sup>	264.0	205.4	768.7	554.3
Less: Amounts charged to costs of sales during the period	(263.2)	(198.5)	(761.5)	(541.2)
Amounts included in inventoried contract costs at end of the period	\$ 63.1	\$ 59.0	\$ 63.1	\$ 59.0

(1)

Incurred costs include IRAD and B&P costs of \$63.0 million for the three months ended September 30, 2006, \$47.5 million for the three months ended September 30, 2005, \$180.9 million for the nine months ended September 30, 2006 and \$128.7 million for the nine months ended September 30, 2005.

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
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The table below presents a summary of selling, general and administrative expenses and research and development expenses for the Company's commercial businesses, which are expensed as incurred and not included in inventoried contracts costs.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Selling, general and administrative expenses	\$ 57.5	\$ 40.0	\$ 159.7	\$ 124.8
Research and development expenses	19.6	16.3	56.8	49.8
Total	\$ 77.1	\$ 56.3	\$ 216.5	\$ 174.6

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

	September 30, 2006	December 31, 2005
	(in millions)	
Raw materials, components and sub-assemblies	\$ 105.1	\$ 81.0
Work in process	133.4	54.1
Finished goods	53.4	54.3
Total	\$ 291.9	\$ 189.4

6. Goodwill and Identifiable Intangible Assets

**Goodwill.** In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations (SFAS 141), the Company allocates 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, the Company does not recognize any intangible assets apart from goodwill for the assembled workforces of its business acquisitions. At September 30, 2006, the Company had approximately 63,000 employees, and the substantial majority of the sales generated by the Company's businesses are from the productive labor efforts of its employees, as compared to selling manufactured products or right-to-use technology.

Generally, the largest intangible asset from the businesses that the Company acquires are 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 the Company's businesses, including their ability to retain existing business (revenue arrangements) and to successfully compete for and win new business (revenue arrangements), is primarily dependent on the management, marketing and business development, contracting, engineering and technical skills and knowledge of our employees, rather than on productive capital (plant and equipment, and technology and intellectual property). Additionally, for a significant portion of its businesses, in particular the Titan businesses, the Company's ability to attract and retain employees who have U.S. Government security clearances, particularly those of top-secret and above, is critical to 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

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

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 the Company's business acquisitions is recognized as goodwill. Additionally, the value assigned to goodwill for the Company's business acquisitions also includes the value that the Company expects to realize from cost reduction measures that it implements for its acquired businesses.

During the three months ended March 31, 2006, the Company completed its annual impairment test for the goodwill of each of the Company's reporting units. The annual impairment test resulted in no impairment losses.

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

	C <sup>3</sup> ISR	Government Services	AM&M (in millions)	Specialized Products	Consolidated Total
Balance at January 1, 2006	\$ 1,719.6	\$ 1,384.0	\$ 1,013.6	\$ 2,782.6	\$ 6,899.8

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Business acquisitions	165.9	(4.3)	130.8	510.0	802.4
Balance at September 30, 2006	\$ 1,885.5	\$ 1,379.7	\$ 1,144.4	\$ 3,292.6	\$ 7,702.2

Goodwill increased by \$802.4 million to \$7,702.2 million at September 30, 2006 from \$6,899.8 million at December 31, 2005. The increase was due to (i) \$808.6 million for business acquisitions completed during the nine months ended September 30, 2006, (ii) \$1.9 million for final estimates of fair value for acquired assets and liabilities assumed in connection with certain business acquisitions completed prior to January 1, 2006, including Titan, (iii) \$8.1 million related to the purchase of an additional 10% interest in the Army Fleet Support joint venture (increasing the Company's ownership interest from 80% to 90%), and (iv) a net decrease of \$16.2 million for certain business acquisitions completed prior to January 1, 2006, primarily related to final purchase price determinations, including AIS. This net decrease included an increase of \$6.9 million due to additional purchase price payments on certain business acquisitions related to contingent purchase price adjustments or earnouts based on post-acquisition financial performance of the acquired business, which were resolved during the period.

**Identifiable Intangible Assets.** The most significant identifiable intangible asset that is separately recognized in accordance with SFAS 141 for the Company's business acquisitions is customer contractual relationships. All of the Company's customer relationships are established through written customer contracts (revenue arrangements). The fair value for customer contract relationships is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows for working capital) arising from the follow-on sales on contract (revenue arrangement) renewals expected from the customer contractual relationships over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory assets charge, all of which is discounted to present value.

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

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	Weighted Average Amortization Period (in Years)	September 30, 2006			December 31, 2005		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Identifiable intangible assets:	23.2	\$474.3	\$54.4	\$419.9	\$396.6	\$35.6	\$361.0

(dollars in millions)

Customer contractual relationships							
Technology	8.1	68.6	17.6	51.0	61.1	9.5	51.6
Other, primarily favorable leasehold interests	9.4	11.0	3.8	7.2	2.0	1.8	0.2
Total	21.4	\$553.9	\$75.8	\$478.1	\$459.7	\$46.9	\$412.8

The Company recorded amortization expense for its identifiable intangible assets of \$6.5 million for the three months ended September 30, 2006 and \$6.4 million for the three months ended September 30, 2005. The Company recorded amortization expense for its identifiable intangible assets of \$29.0 million for the nine months ended September 30, 2006 and \$17.0 million for the nine months ended September 30, 2005. Based on gross carrying amounts at September 30, 2006, the Company's estimate of amortization expense for identifiable intangible assets for the years ending December 31, 2006 through 2010 are presented in the table below.

	Years Ending December 31,				
	2006	2007	2008	2009	2010
	(in millions)				
Estimated amortization expense	\$ 38.3	\$ 46.2	\$ 43.4	\$ 43.3	\$ 43.6

#### 7. Other Current Liabilities and Other Liabilities

The table below presents the components of other current liabilities.

	September	December
	30,	31,
	2006	2005
	(in millions)	
Other Current Liabilities:		
Accrued product warranty costs	\$ 73.8	\$ 61.8
Estimated costs in excess of estimated contract value to complete contracts in process in a loss position	78.2	76.6
Accrued interest	71.4	68.2
Aggregate purchase price payable for acquired businesses	4.0	36.8
Deferred revenues	8.4	15.0
Liabilities for pending and threatened litigation (see Note 13)	145.4	3.2
Other	123.3	96.5
Total other current liabilities	\$ 504.5	\$ 358.1

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

	Nine Months Ended September 30,	
	2006	2005
	(in millions)	
Accrued product warranty costs:		
Balance at January 1	\$ 61.8	\$ 49.8
Acquisitions during this period	14.0	7.2
Accruals for product warranties issued during the period	20.0	10.5
Accruals for product warranties existing before January 1 <sup>(1)</sup>	2.7	1.8
Settlements made during the period	(24.7)	(14.2)
Balance at September 30	\$ 73.8	\$ 55.1

<sup>(1)</sup>Represents changes to estimated product warranty costs related to sales recognized prior to January 1, 2006 and January 1, 2005, respectively.

The table below presents the components of other liabilities.

	September 30, 2006	December 31, 2005
	(in millions)	
Other Liabilities:		
Non-current portion of net deferred gains from terminated interest rate swap agreements	\$ 15.8	\$ 18.2
Accrued workers compensation	36.2	25.8
Notes payable and capital lease obligations	11.5	10.5
Deferred compensation	65.8	59.0
Liabilities for pending and threatened litigation (see Note 13)	12.0	46.4
Other non-current liabilities	119.6	134.8
Total other liabilities	\$ 260.9	\$ 294.7

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)

## 8. Debt

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

	September 30, 2006	December 31, 2005
	(in millions)	
L-3 Communications:		
Borrowings under Revolving Credit Facility <sup>(1)</sup>	\$ —	\$ —
Borrowings under Term Loan Facility maturing 2010	750.0	750.0
7 5/8% Senior Subordinated Notes due 2012	750.0	750.0
6 1/8% Senior Subordinated Notes due 2013	400.0	400.0
6 1/8% Senior Subordinated Notes due 2014	400.0	400.0
5 7/8% Senior Subordinated Notes due 2015	650.0	650.0
6 3/8% Senior Subordinated Notes due 2015	1,000.0	1,000.0
Subtotal	3,950.0	3,950.0
L-3 Holdings:		
3% Convertible Contingent Debt Securities due 2035	700.0	700.0
Principal amount of long-term debt	4,650.0	4,650.0
Less: Unamortized discounts	(15.4)	(16.5)
Carrying amount of long-term debt	\$ 4,634.6	\$ 4,633.5

<sup>(1)</sup>The Company's five-year revolving credit facility allows for total aggregate borrowings of up to \$1.0 billion. At September 30, 2006, available borrowings under the revolving credit facility were \$923.0 million after reductions for outstanding letters of credit of \$77.0 million.

Debt Covenants. The senior credit facility and indentures governing the senior subordinated notes contain financial covenants and other restrictive covenants. See Note 9 to the Company's consolidated financial statements for the year ended December 31, 2005 for a description of our debt and related financial covenants. On October 25, 2006, the Company entered into an amendment (the "First Amendment") to its Amended and Restated Credit Agreement dated July 29, 2005 with the Guarantors and Lenders party thereto and Bank of America, N.A., as administrative agent (the "Credit Agreement") to amend certain provisions of the Credit Agreement. The First Amendment (1) permits the Company to exclude, as a non-recurring cost, the \$125.6 million litigation charge related to the OSI Systems, Inc. matter, which is more fully described in Note 13, from the calculation of the Company's consolidated leverage ratio and consolidated interest coverage ratio, for the purpose of eliminating the temporary impact on the Company's financial covenants, (2) excludes certain non-recurring costs incurred by the Company's acquired businesses prior to the acquisition date from the pro forma results of operations of those acquired businesses, (3) deletes the Senior Leverage Ratio covenant in its entirety, and (4) clarifies that L-3 Communications Holdings, Inc. may guarantee the indebtedness and other obligations of the Company and its subsidiaries.



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AND L-3 COMMUNICATIONS CORPORATIONNOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)

## 9. Comprehensive Income

A reconciliation of net income to comprehensive income is presented in the table below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Net income	\$ 163.8	\$ 135.3	\$ 352.5	\$ 357.1
Other comprehensive income (loss):				
Foreign currency translation adjustments <sup>(1)</sup>	(0.4)	2.6	3.6	(1.1)
Unrealized gains (losses) on hedging instruments <sup>(2)</sup>	(1.6)	—	(5.4)	2.9
Comprehensive income	\$ 161.8	\$ 137.9	\$ 350.7	\$ 358.9

<sup>(1)</sup>Amounts are net of income taxes of \$0.3 million and \$1.7 million for the three month periods ended September 30, 2006 and 2005, respectively, and \$2.3 million and \$0.7 million for the nine month periods ended September 30, 2006 and 2005, respectively.

<sup>(2)</sup>Amounts are net of income taxes of \$1.1 million for the three month period ended September 30, 2006, and \$3.5 million and \$1.9 million for the nine month periods ended September 30, 2006 and 2005, respectively.

The changes in the accumulated other comprehensive income (loss) balances, net of related tax effects are presented in the table below.

	Unrealized gains (losses)	Minimum pension liability	Total accumulated other comprehensive income (loss)
	(in millions)		
Foreign currency translation	on hedging instruments		