

LOCKHEED MARTIN CORP

Form 10-Q

October 21, 2010

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 26, 2010

Commission file number 1-11437

LOCKHEED MARTIN CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND
(State or other jurisdiction of

52-1893632
(I.R.S. Employer Identification Number)

Edgar Filing: LOCKHEED MARTIN CORP - Form 10-Q

incorporation or organization)

6801 ROCKLEDGE DRIVE, BETHESDA, MD
(Address of principal executive offices)

20817
(Zip Code)

(301) 897-6000

(Registrant's telephone number, including area code)

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

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES NO

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class
Common stock, \$1 par value

Outstanding as of September 26, 2010
360,128,404

Table of Contents

LOCKHEED MARTIN CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 26, 2010

INDEX

	Page No.
<u>Part I. Financial Information</u>	
Item 1. <u>Financial Statements</u>	
<u>Unaudited Condensed Consolidated Statements of Earnings - Three Months and Nine Months Ended September 26, 2010 and September 27, 2009</u>	4
<u>Condensed Consolidated Balance Sheets - September 26, 2010 (unaudited) and December 31, 2009</u>	5
<u>Unaudited Condensed Consolidated Statements of Cash Flows - Nine Months Ended September 26, 2010 and September 27, 2009</u>	6
<u>Unaudited Condensed Consolidated Statements of Stockholders' Equity - Nine Months Ended September 26, 2010 and September 27, 2009</u>	7
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	8
<u>Report of Ernst & Young LLP, Independent Registered Public Accounting Firm</u>	22
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	39
Item 4. <u>Controls and Procedures</u>	39
<u>Part II. Other Information</u>	
Item 1. <u>Legal Proceedings</u>	42
Item 1A. <u>Risk Factors</u>	43
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	43
Item 3. <u>Defaults Upon Senior Securities</u>	43
Item 4. <u>(Removed and Reserved)</u>	43
Item 5. <u>Other Information</u>	43
Item 6. <u>Exhibits</u>	44
<u>Signature</u>	45

2

Table of Contents

LOCKHEED MARTIN CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 26, 2010

INDEX

Exhibit 10	Form of Restricted Stock Award Agreement under the Lockheed Martin Corporation Amended and Restated 2003 Incentive Performance Award Plan
Exhibit 12	Computation of Ratio of Earnings from Continuing Operations to Fixed Charges for the Nine Months Ended September 26, 2010
Exhibit 15	Acknowledgment of Ernst & Young LLP, Independent Registered Public Accounting Firm
Exhibit 31.1	Rule 13a-14(a) Certification of Robert J. Stevens
Exhibit 31.2	Rule 13a-14(a) Certification of Bruce L. Tanner
Exhibit 32.1	Certification Pursuant to 18 U.S.C. Section 1350 of Robert J. Stevens
Exhibit 32.2	Certification Pursuant to 18 U.S.C. Section 1350 of Bruce L. Tanner
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase Document
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Lockheed Martin Corporation****Unaudited Condensed Consolidated Statements of Earnings**

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions, except per share data)</i>			
Net Sales				
Products	\$ 8,965	\$ 8,688	\$ 26,327	\$ 25,913
Services	2,410	2,079	6,682	5,879
Total Net Sales	11,375	10,767	33,009	31,792
Cost of Sales				
Products	(8,045)	(7,727)	(23,548)	(23,071)
Services	(2,151)	(1,878)	(5,995)	(5,243)
Voluntary Executive Separation Charge	(178)		(178)	
Other Unallocated Corporate Costs	(203)	(176)	(529)	(502)
Total Cost of Sales	(10,577)	(9,781)	(30,250)	(28,816)
Gross Profit	798	986	2,759	2,976
Other Income, Net	91	82	210	195
Operating Profit	889	1,068	2,969	3,171
Interest Expense	(85)	(74)	(258)	(222)
Other Non-Operating Income, Net	37	54	46	97
Earnings from Continuing Operations before Income Taxes	841	1,048	2,757	3,046
Income Tax Expense	(276)	(262)	(941)	(883)
Earnings from Continuing Operations	565	786	1,816	2,163
Earnings from Discontinued Operations	6	11	127	34
Net Earnings	\$ 571	\$ 797	\$ 1,943	\$ 2,197
Earnings Per Common Share				
Basic				
Continuing Operations	\$ 1.57	\$ 2.06	\$ 4.95	\$ 5.59
Discontinued Operations	.02	.03	.35	.08

Edgar Filing: LOCKHEED MARTIN CORP - Form 10-Q

Basic Earnings Per Common Share	\$ 1.59	\$ 2.09	\$ 5.30	\$ 5.67
Diluted				
Continuing Operations	\$ 1.55	\$ 2.04	\$ 4.89	\$ 5.53
Discontinued Operations	.02	.03	.34	.08
Diluted Earnings Per Common Share	\$ 1.57	\$ 2.07	\$ 5.23	\$ 5.61
Cash Dividends Paid Per Common Share	\$.63	\$.57	\$ 1.89	\$ 1.71

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

Lockheed Martin Corporation
Condensed Consolidated Balance Sheets

	(Unaudited) September 26, 2010	December 31, 2009
	(In millions)	
Assets		
Current Assets		
Cash and Cash Equivalents	\$ 2,656	\$ 2,391
Short-term Investments	767	346
Accounts Receivable, Net	6,275	6,061
Inventories	2,093	2,183
Deferred Income Taxes	930	815
Assets of Discontinued Operations Held for Sale	805	
Other Current Assets	413	681
Total Current Assets	13,939	12,477
Property, Plant and Equipment, Net	4,347	4,520
Goodwill	9,588	9,948
Purchased Intangibles, Net	158	311
Prepaid Pension Asset	171	160
Deferred Income Taxes	3,339	3,779
Other Assets	4,009	3,916
Total Assets	\$ 35,551	\$ 35,111
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	\$ 2,352	\$ 2,030
Customer Advances and Amounts in Excess of Costs Incurred	5,060	5,049
Salaries, Benefits and Payroll Taxes	1,890	1,648
Liabilities of Discontinued Operations Held for Sale	344	
Other Current Liabilities	1,992	1,976
Total Current Liabilities	11,638	10,703
Long-term Debt, Net	5,019	5,052
Accrued Pension Liabilities	10,506	10,823
Other Postretirement Benefit Liabilities	1,292	1,308
Other Liabilities	3,178	3,096
Total Liabilities	31,633	30,982
Stockholders' Equity		
Common Stock, \$1 Par Value Per Share	358	373
Additional Paid-in Capital		
Retained Earnings	12,150	12,351
Accumulated Other Comprehensive Loss	(8,590)	(8,595)
Total Stockholders' Equity	3,918	4,129

Edgar Filing: LOCKHEED MARTIN CORP - Form 10-Q

Total Liabilities and Stockholders Equity	\$ 35,551	\$ 35,111
---	-----------	-----------

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Lockheed Martin Corporation****Unaudited Condensed Consolidated Statements of Cash Flows**

	Nine Months Ended	
	September 26, 2010	September 27, 2009
	<i>(In millions)</i>	
Operating Activities		
Net earnings	\$ 1,943	\$ 2,197
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization of plant and equipment	539	544
Amortization of purchased intangibles	74	81
Stock-based compensation and related amounts	111	96
Changes in operating assets and liabilities		
Accounts receivable, net	(515)	(720)
Inventories	60	(107)
Accounts payable	354	189
Customer advances and amounts in excess of costs incurred	25	350
Other	796	1,148
Net cash provided by operating activities	3,387	3,778
Investing Activities		
Expenditures for property, plant and equipment	(394)	(481)
Net cash used for short-term investment transactions	(421)	(389)
Acquisition of businesses / investments in affiliates	(41)	(420)
Other	(11)	11
Net cash used for investing activities	(867)	(1,279)
Financing Activities		
Repurchases of common stock	(1,566)	(1,362)
Issuances of common stock and related amounts	57	48
Common stock dividends	(700)	(668)
Cash premium and transaction costs for debt exchange	(47)	
Net cash used for financing activities	(2,256)	(1,982)
Effect of exchange rate changes on cash and cash equivalents	1	24
Net increase in cash and cash equivalents	265	541
Cash and cash equivalents at beginning of period	2,391	2,168
Cash and cash equivalents at end of period	\$ 2,656	\$ 2,709

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

Lockheed Martin Corporation
Unaudited Condensed Consolidated Statements of
Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Retained Earnings <i>(In millions)</i>	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2008	\$ 393	\$	\$ 11,621	\$ (9,149)	\$ 2,865
Net earnings			2,197		2,197
Common stock dividends declared			(908)		(908)
Stock-based awards and ESOP activity	3	315			318
Common stock repurchases	(18)	(315)	(1,029)		(1,362)
Other comprehensive income				30	30
Net activity	(15)		260	30	275
Balance at September 27, 2009	\$ 378	\$	\$ 11,881	\$ (9,119)	\$ 3,140
Balance at December 31, 2009	\$ 373	\$	\$ 12,351	\$ (8,595)	\$ 4,129
Net earnings			1,943		1,943
Common stock dividends declared			(973)		(973)
Stock-based awards and ESOP activity	5	375			380
Common stock repurchases	(20)	(375)	(1,171)		(1,566)
Other comprehensive income				5	5
Net activity	(15)		(201)	5	(211)
Balance at September 26, 2010	\$ 358	\$	\$ 12,150	\$ (8,590)	\$ 3,918

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

September 26, 2010

NOTE 1 BASIS OF PRESENTATION

We prepared the condensed consolidated financial statements in this Form 10-Q in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. We followed the accounting policies used and disclosed in the consolidated financial statements included in our 2009 Form 10-K filed with the Securities and Exchange Commission.

We close our books and records on the Sunday prior to the end of the calendar quarter to align our financial closing with our business processes. The interim financial statements and tables of financial information included herein are labeled based on that convention. This practice only affects interim periods, as our fiscal years end on December 31.

The interim financial information in this Form 10-Q reflects all adjustments, consisting of normal recurring adjustments except as otherwise disclosed, necessary for a fair presentation of our results of operations for the interim periods. The results of operations for the quarter or nine months ended September 26, 2010 are not necessarily indicative of results to be expected for the full year.

NOTE 2 PLANNED BUSINESS DIVESTITURES

In June 2010, we announced plans to divest Pacific Architects and Engineers, Inc. (PAE) and most of our Enterprise Integration Group (EIG), two businesses within our Information Systems & Global Solutions (IS&GS) reporting segment.

PAE's and EIG's operating results are included in discontinued operations on our Statements of Earnings for all periods presented, and their assets and liabilities are classified as held for sale on our 2010 Balance Sheet. We believe it is probable that a transaction to sell PAE will close around the end of 2010. On October 13, 2010, we announced that we entered into a definitive agreement to sell EIG for \$815 million. We expect this transaction will close by the end of the year, pending review under the Hart-Scott-Rodino Antitrust Improvements Act and other customary closing conditions.

In the third quarter of 2010, most of EIG was classified as discontinued operations after management determined that a sale of EIG was economically preferable to a spin-off of the EIG business to our stockholders. As a result of our decision to sell PAE and include its results in discontinued operations in the second quarter of 2010, we recorded a \$96 million deferred tax asset which reflects the tax benefit that we expect to realize on the sale of PAE because our tax basis is higher than our book basis.

The plan to divest PAE is a result of changes in customer priorities. When we acquired the business, we envisioned it as an entry point to a new customer set that would need additional services, primarily in the areas of information technology and systems integration. Those customers, however, are seeking a different mix of services, such as the construction of facilities and provision of physical security, which does not fit with our long-term strategy.

Our decision to divest EIG was based on our analysis of the U.S. Government's increased concerns about perceived organizational conflicts of interest within the defense contracting community. EIG provides systems engineering, architecture, and integration services and support to a broad range of government customers.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

In the following tables of financial information, we have combined the results of operations and assets and liabilities of PAE and EIG as the amounts for the individual businesses are not material. Summary financial information related to discontinued operations is as follows:

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions)</i>			
Net sales	\$ 262	\$ 289	\$ 856	\$ 873
Earnings before income taxes	11	26	50	59
Earnings from discontinued operations:				
Earnings after income taxes	6	11	31	34
Tax benefit from recognition of deferred tax asset related to planned PAE sale			96	
	\$ 6	\$ 11	\$ 127	\$ 34

The major classes of assets and liabilities related to discontinued operations and classified as held for sale on our Balance Sheet as of September 26, 2010 are listed in the table below.

	September 26, 2010 <i>(In millions)</i>
Assets	
Accounts receivable, net	\$ 301
Goodwill and other intangible assets	445
Other assets	59
Assets of Discontinued Operations Held for Sale	\$ 805
Liabilities	
Accounts payable	\$ 33
Accrued expenses	210
Other liabilities	101
Liabilities of Discontinued Operations Held for Sale	\$ 344

NOTE 3 EARNINGS PER SHARE

We compute basic and diluted per share amounts based on net earnings for the periods presented. We use the weighted average number of common shares outstanding during the period to calculate basic earnings per share. Our calculation of diluted per share amounts includes the dilutive effects of stock options and restricted stock units based on the treasury stock method in the weighted average number of common shares. Unless otherwise noted, we present all per share amounts cited in these consolidated financial statements on a per diluted share basis.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

The calculations of basic and diluted earnings per share are as follows:

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions, except per share data)</i>			
Net earnings:				
Earnings from continuing operations	\$ 565	\$ 786	\$ 1,816	\$ 2,163
Earnings from discontinued operations	6	11	127	34
Net earnings for basic and diluted computations	\$ 571	\$ 797	\$ 1,943	\$ 2,197
Weighted average common shares outstanding:				
Average number of common shares outstanding for basic computations	360.1	381.4	367.1	387.2
Dilutive stock options and restricted stock units	3.8	4.1	4.0	4.1
Average number of common shares outstanding for diluted computations	363.9	385.5	371.1	391.3
Earnings per common share:				
Basic				
Continuing operations	\$ 1.57	\$ 2.06	\$ 4.95	\$ 5.59
Discontinued operations	.02	.03	.35	.08
Basic earnings per common share	\$ 1.59	\$ 2.09	\$ 5.30	\$ 5.67
Diluted				
Continuing operations	\$ 1.55	\$ 2.04	\$ 4.89	\$ 5.53
Discontinued operations	.02	.03	.34	.08
Diluted earnings per common share	\$ 1.57	\$ 2.07	\$ 5.23	\$ 5.61

Stock options to purchase 14.6 million and 11.1 million shares of common stock for the quarter and nine months ended September 26, 2010 and stock options to purchase 11.2 million shares of common stock for the quarter and nine months ended September 27, 2009 had exercise prices that were in excess of the average market price of our common stock for the respective periods. As such, we did not include these stock options in our calculation of diluted earnings per share, as their effect would have been anti-dilutive.

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

NOTE 4 BUSINESS SEGMENT INFORMATION

We operate in four principal business segments: Aeronautics, Electronic Systems, IS&GS, and Space Systems. We organize our business segments based on the nature of the products and services offered.

In June 2010, we announced the realignment of two IS&GS businesses, Readiness & Stability Operations (RSO) and Savi Technology, Inc., with our simulation, training and support business to form the Global Training & Logistics line of business within Electronic Systems. The realignment had no effect on our consolidated results of operations, financial position, or cash flows. The financial information in the table on the next page has been reclassified to reflect this realignment and to exclude the PAE and EIG businesses from the IS&GS business segment information (see Note 2) for all periods presented.

The table on the next page presents net sales and operating profit of our four business segments. Net sales exclude intersegment revenue, as these activities are eliminated in consolidation. Intercompany transactions are generally negotiated and accounted for under terms and conditions similar to other government and commercial contracts. Operating profit of the business segments includes the equity earnings or losses from investees in which certain of our business segments hold equity interests, because the activities of the investees are closely aligned with the operations of those segments.

Operating profit of the business segments excludes the FAS/CAS pension adjustment discussed below; expense for certain stock-based compensation programs including costs for stock options and restricted stock units; the effects of items not considered part of management's evaluation of segment operating performance, such as the charge related to the Voluntary Executive Separation Program (VESP) in the third quarter of 2010 (see Note 9); gains or losses from divestitures; the effects of legal settlements; Corporate costs not allocated to the business segments; and other miscellaneous Corporate activities. The items other than the charge related to the VESP are included in Other unallocated Corporate expense, net in the table on the next page which reconciles operating profit from the business segments to operating profit in our Statements of Earnings. The charge related to the VESP is presented as a separate reconciling item.

The results of operations of our segments include pension expense only as determined and funded in accordance with U.S. Government Cost Accounting Standards (CAS) rules. The FAS/CAS pension adjustment represents the difference between pension expense or income calculated in accordance with GAAP and pension costs calculated and funded in accordance with CAS. CAS is a major factor in determining our pension funding requirements, and governs the extent to which pension costs can be allocated to and recovered on U.S. Government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts and, therefore, is recognized in each of our segments' net sales and cost of sales.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions)</i>			
Net sales				
Aeronautics	\$ 3,300	\$ 3,084	\$ 9,379	\$ 8,951
Electronic Systems	3,583	3,254	10,387	9,818
Information Systems & Global Solutions	2,524	2,356	7,277	6,976
Space Systems	1,968	2,073	5,966	6,047
Total	\$ 11,375	\$ 10,767	\$ 33,009	\$ 31,792
Operating profit				
Aeronautics	\$ 396	\$ 397	\$ 1,092	\$ 1,151
Electronic Systems	425	404	1,261	1,229
Information Systems & Global Solutions	217	212	635	636
Space Systems ⁽¹⁾	235	236	693	672
Total business segments	\$ 1,273	\$ 1,249	\$ 3,681	\$ 3,688
Voluntary executive separation charge	(178)		(178)	
Other unallocated Corporate expense, net	(206)	(181)	(534)	(517)
Total	\$ 889	\$ 1,068	\$ 2,969	\$ 3,171
Intersegment revenue				
Aeronautics	\$ 16	\$ 53	\$ 90	\$ 152
Electronic Systems	249	232	698	640
Information Systems & Global Solutions	239	208	690	615
Space Systems	28	28	88	95
Total	\$ 532	\$ 521	\$ 1,566	\$ 1,502
			September 26, 2010	December 31, 2009
			<i>(In millions)</i>	
Assets				
Aeronautics			\$ 4,844	\$ 4,356
Electronic Systems			10,174	9,106
Information Systems & Global Solutions			5,488	7,457
Space Systems			3,103	3,097
Total business segments			23,609	24,016
Corporate assets ⁽²⁾			11,137	11,095
Assets of discontinued operations held for sale			805	

Total	\$ 35,551	\$ 35,111
-------	-----------	-----------

- (1) Equity earnings of United Launch Alliance, LLC and United Space Alliance, LLC represented 33% and 28% of Space Systems operating profit for the quarter and nine month periods ended September 26, 2010, and 33% and 26% for the quarter and nine month periods ended September 27, 2009.
- (2) Corporate assets primarily include cash and cash equivalents, short-term investments, deferred income taxes, the prepaid pension asset, deferred environmental assets, and investments held in a Rabbi Trust.

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

NOTE 5 INVENTORIES

Inventories consisted of the following components:

	September 26, 2010	December 31, 2009
	<i>(In millions)</i>	
Work-in-process, primarily related to long-term contracts and programs in progress	\$ 6,491	\$ 5,565
Less: Customer advances and progress payments	(4,717)	(3,941)
	1,774	1,624
Other inventories	319	559
	\$ 2,093	\$ 2,183

NOTE 6 POSTRETIREMENT BENEFIT PLANS

The net pension cost and the net postretirement benefit cost related to our qualified defined benefit pension plans and our retiree medical and life insurance plans include the following components:

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions)</i>			
<u>Qualified defined benefit pension plans</u>				
Service cost	\$ 226	\$ 217	\$ 677	\$ 652
Interest cost	469	453	1,407	1,359
Expected return on plan assets	(506)	(507)	(1,520)	(1,521)
Amortization of prior service cost	21	20	62	60
Recognized net actuarial losses	148	76	446	227
Total net pension expense	\$ 358	\$ 259	\$ 1,072	\$ 777
<u>Retiree medical and life insurance plans</u>				
Service cost	\$ 9	\$ 8	\$ 27	\$ 26
Interest cost	42	42	124	124
Expected return on plan assets	(32)	(26)	(96)	(80)
Amortization of prior service cost	(4)	(6)	(12)	(18)
Recognized net actuarial losses	6	10	19	32
Total net postretirement expense	\$ 21	\$ 28	\$ 62	\$ 84

Edgar Filing: LOCKHEED MARTIN CORP - Form 10-Q

We made discretionary contributions related to our qualified defined benefit pension plans of \$1,400 million during the first nine months of 2010, including \$1,050 million during the third quarter of 2010. We plan to make additional discretionary contributions of \$800 million to those plans in the fourth quarter of 2010. In the fourth quarter of 2009, we made discretionary contributions of \$1,480 million related to our qualified defined benefit pension plans. Contributions to our qualified defined benefit pension plans are included in Other in operating activities on our Statements of Cash Flows.

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

NOTE 7 LEGAL PROCEEDINGS AND CONTINGENCIES

We are a party to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment. We believe the probability is remote that the outcome of these matters will have a material adverse effect on the Corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our net earnings in any particular quarter. We cannot predict the outcome of legal proceedings with certainty. These matters include the following items which have been previously reported.

Legal Proceedings

On June 24, 2009, the U.K. Ministry of Defence (MoD) sent us a letter alleging that we were in default on the Soothsayer contract under which we were providing electronic warfare equipment to the British military. The total value of the contract is UK £144 million, of which UK £39 million has been paid to date (representing approximately US \$228 million and US \$62 million, based on the exchange rate as of September 26, 2010). The MoD has demanded repayment of amounts paid under the contract, liquidated damages of UK £2 million (representing approximately US \$3 million based on the exchange rate as of September 26, 2010), interest on those amounts, and has reserved the right to collect any excess future re-procurement costs. We dispute the MoD's position. Following an unsuccessful mediation effort in October 2009, we served notice of arbitration on the MoD pursuant to the contract terms. We plan to seek damages for wrongful termination of the contract, including costs incurred but not paid.

On April 24, 2009, we filed a declaratory judgment action against the N.Y. Metropolitan Transportation Authority and its Capital Construction Company (collectively, the MTA) asking the U.S. District Court for the Southern District of N.Y. to find that the MTA is in material breach of our agreement based on the MTA's failure to provide access to sites where work must be performed and customer-furnished equipment necessary to complete the contract. The contract provides for the design and installation of an integrated electronic security system for the MTA and has a total value of \$323 million, of which \$241 million has been paid to date. The MTA filed an answer and counterclaim on May 26, 2009, alleging that we breached the contract, and subsequently terminated the contract for alleged default. The MTA is seeking monetary damages and other relief under the contract, including the cost to complete the contract and potential reprocurement costs. We dispute the MTA's allegations and are defending against them. On July 2, 2009, the sureties under the performance bond that we posted for the contract filed their own declaratory judgment action seeking to be excused from performing for the MTA, noting that they were unable to conclude that we were in material default under the contract or, in the alternative, seeking indemnification from us. On July 7, 2009, we filed an amended complaint against the MTA adding claims for wrongful termination and for breach of contract damages, including costs incurred but not paid. The MTA has filed an amended counterclaim. Discovery is proceeding in the action.

On November 30, 2007, the Department of Justice (DoJ) filed a complaint in partial intervention in a lawsuit filed under the qui tam provisions of the Civil False Claims Act in the U.S. District Court for the Northern District of Texas, United States ex rel. Becker and Spencer v. Lockheed Martin Corporation et al., alleging that we should have known that a subcontractor falsified and inflated invoices submitted to us that were passed through to the government. We dispute the allegations and are defending against them.

On September 11, 2006, we and Lockheed Martin Investment Management Company (LMIMCo), our wholly-owned subsidiary, were named as defendants in a lawsuit filed in the U.S. District Court for the Southern District of Illinois, seeking to represent a class of purportedly

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

similarly situated participants and beneficiaries in our Salaried Savings Plan and the Hourly Savings Plan (the Plans). Plaintiffs allege that we or LMIMCo caused the Plans to pay expenses that were higher than reasonable by, among other actions, permitting service providers of the Plans to engage in revenue sharing, paying investment management fees for the company stock funds, and causing the company stock funds to hold cash for liquidity, thus reducing the return on those funds. The plaintiffs further allege that we or LMIMCo failed to disclose information appropriately relating to the fees associated with managing the Plans. In August 2008, plaintiffs filed an amended complaint, adding allegations that we or LMIMCo breached fiduciary duties under ERISA by providing inadequate disclosures with respect to the Stable Value Fund offered under our 401(k) plans. In April 2009, the Judge dismissed the plaintiffs' claims that were based on revenue sharing but let stand the claims about the company stock funds, the Stable Value Fund, and the overall fees paid by the plans. The Judge also certified a class for each plan for the claims concerning the Stable Value Fund and the overall fees paid by the plans. We are appealing that order. We dispute the allegations and are defending against them.

On February 6, 2004, we submitted a certified contract claim to the United States requesting contractual indemnity for past and future remediation and litigation costs related to our former facility in Redlands, California. We submitted the claim consistent with a claim sponsorship agreement with The Boeing Company (Boeing), executed in 2001, in Boeing's role as the prime contractor on the Short Range Attack Missile (SRAM) program. The contract for the SRAM program, which formed a significant portion of our work at the Redlands facility, had special contractual indemnities from the U.S. Air Force, as authorized by Public Law 85-804. On August 31, 2004, the United States denied the claim. Our appeal of that decision is pending with the Armed Services Board of Contract Appeals.

On August 28, 2003, the DoJ filed complaints in partial intervention in two lawsuits filed under the qui tam provisions of the Civil False Claims Act in the United States District Court for the Western District of Kentucky, United States ex rel. Natural Resources Defense Council, et al., v. Lockheed Martin Corporation, et al., and United States ex rel. John D. Tillson v. Lockheed Martin Energy Systems, Inc., et al. The DoJ alleges that we committed violations of the Resource Conservation and Recovery Act at the Paducah Gaseous Diffusion Plant by not properly handling, storing, and transporting hazardous waste and that we violated the False Claims Act by misleading Department of Energy officials and state regulators about the nature and extent of environmental noncompliance at the plant. We dispute the allegations and are defending against them.

As described in the Environmental Matters discussion below, we are subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites. As a result, we are a party to or have property subject to various other lawsuits or proceedings involving environmental matters and remediation obligations.

We have been in litigation with certain residents of Redlands, California since 1997 before the California Superior Court for San Bernardino County regarding allegations of personal injury, property damage, and other tort claims on behalf of individuals arising from our alleged contribution to regional groundwater contamination. On July 11, 2006, the California Court of Appeal dismissed the plaintiffs' punitive damages claim. On September 23, 2008, the trial court dismissed the remaining first tier plaintiffs, ending the first round of individual trials; the California Court of Appeal affirmed this dismissal, and the California Supreme Court denied plaintiffs' petition for review in January 2010. The parties are now working with the trial court to establish the procedures for the litigation of the next round of individual plaintiffs, and pre-trial proceedings are now underway.

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

Environmental Matters

We are involved in environmental proceedings and potential proceedings relating to soil and groundwater contamination, disposal of hazardous waste, and other environmental matters at several of our current or former facilities, or at third-party sites where we have been designated as a potentially responsible party. Environmental cleanup activities usually span many years, which make estimating liabilities a matter of judgment because of such factors as changing remediation technologies, assessments of the extent of contamination, and continually evolving regulatory environmental standards. We consider these and other factors in estimates of the timing and amount of any future costs that may be required for remediation actions.

We perform quarterly reviews of environmental remediation sites and record liabilities and related assets in the period it becomes probable that a liability has been incurred and the amounts can be reasonably estimated. The amount of the liability recorded is based on a range of estimates for a particular environmental site, and represents the amount within the range that we determine to be our best estimate of the cost of remediation. If no amount within the range is better than another, we record an amount at the low end of the range. We do not discount the recorded liabilities, as the amount and timing of future cash payments are not fixed or cannot be reliably determined.

At September 26, 2010 and December 31, 2009, the aggregate amount of liabilities recorded relative to environmental matters was \$959 million and \$877 million. Of those amounts, \$830 million and \$748 million were recorded in other liabilities on our Balance Sheets, with the remainder recorded in other current liabilities. A majority of environmental costs is eligible for future recovery in the pricing of our products and services in U.S. Government contracts. We have recorded assets totaling \$825 million and \$740 million at September 26, 2010 and December 31, 2009 for the estimated future recovery of these costs, as we consider the recovery probable based on government contracting regulations and our history of receiving reimbursement for such costs. Of those amounts, \$714 million and \$630 million were recorded in other assets on our Balance Sheets, with the remainder recorded in other current assets.

We cannot reasonably determine the extent of our financial exposure in all cases at this time. There are a number of former operating facilities that we are monitoring or investigating for potential future remediation. In some cases, although a loss may be probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation activities because of uncertainties with respect to assessing the extent of the contamination or the applicable regulatory standard. We also are pursuing claims for contribution to site cleanup costs against other potentially responsible parties (PRPs), including the U.S. Government.

We are conducting remediation activities, including under various consent decrees and orders relating to soil or groundwater contamination at certain sites of former or current operations. Under an agreement related to our Burbank and Glendale, California sites, the U.S. Government reimburses us an amount equal to approximately 50% of expenditures for certain remediation activities in its capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

Letters of Credit and Other Arrangements

We have entered into standby letter of credit agreements, surety bonds, and other arrangements with financial institutions and other third parties primarily relating to advances received from customers and/or the guarantee of future performance on certain contracts. We have total outstanding letters of credit, surety bonds, and other arrangements aggregating \$3.7 billion and \$3.6 billion at September 26, 2010 and December 31, 2009. Letters of credit and surety bonds are generally available for draw down in the event we do not perform.

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

Investment in United Launch Alliance

In connection with our ownership of United Launch Alliance, L.L.C. (ULA), we and Boeing each committed to provide up to \$200 million in financial support to ULA, as required, until at least December 1, 2011. To satisfy this commitment, we had a revolving credit agreement with ULA in place through September 26, 2010. No amounts had been drawn on the credit agreement through that date.

On September 27, 2010, ULA entered into its own \$400 million revolving credit agreement with a group of banks which expires on October 1, 2013. At the same time, the revolving credit agreement we and Boeing had in place was terminated. The new revolving credit agreement satisfies Boeing's and our commitment to provide financial support of up to \$200 million each to ULA so long as the total amount of the new agreement remains at \$400 million or above until at least December 1, 2011.

We and Boeing have received distributions totaling \$197 million each which are subject to agreements between us, Boeing, and ULA, whereby, if ULA does not have sufficient cash resources and/or credit capacity to make payments under the inventory supply agreement it has with Boeing, both we and Boeing would provide to ULA, in the form of an additional capital contribution, the level of funding required for ULA to make those payments. Any such capital contributions would not exceed the amount of the distributions subject to the agreements. We currently believe that ULA will have sufficient operating cash flows and credit capacity to meet its obligations such that we would not be required to make a contribution under these agreements.

In addition, both we and Boeing have cross-indemnified ULA related to certain financial support arrangements (*e.g.*, letters of credit, surety bonds, or foreign exchange contracts provided by either party) and guarantees by us and Boeing of the performance and financial obligations of ULA under certain launch service contracts. We believe ULA will be able to fully perform its obligations, as it has done through September 26, 2010, and that it will not be necessary to make payments under the cross-indemnities.

NOTE 8 FAIR VALUE MEASUREMENTS

The accounting standard for fair value measurements defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. The standard is applicable whenever assets and liabilities are measured and included in the financial statements at fair value.

The fair value hierarchy established in the standard prioritizes the inputs used in valuation techniques into three levels as follows:

Level 1 – Observable inputs – quoted prices in active markets for identical assets and liabilities. Level 1 assets in the following table include equity securities and interests in mutual funds which are valued using quoted market prices.

Level 2 – Observable inputs other than the quoted prices in active markets for identical assets and liabilities – includes quoted prices for similar instruments, quoted prices for identical or similar instruments in inactive markets, and amounts derived from valuation models where all significant inputs are observable in active markets.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Condensed Consolidated Financial Statements (continued)**

Level 2 assets in the following table include U.S. Government securities, corporate debt securities, U.S. Government-sponsored enterprise securities, mortgage-backed securities, and other securities which are valued based on inputs other than quoted prices that are observable for the asset (*e.g.*, interest rates and yield curves observable at commonly quoted intervals). The Level 2 derivative assets and liabilities relate to foreign currency exchange contracts and are valued based on observable market prices, but are not exchanged in an active market.

Level 3 Unobservable inputs includes amounts derived from valuation models where one or more significant inputs are unobservable and require us to develop relevant assumptions. At September 26, 2010, we have no assets or liabilities measured and recorded at fair value on a recurring basis that are categorized as Level 3, or that were transferred in or out of the Level 3 category during 2010.

Assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of September 26, 2010 were as follows:

	Level 1	Level 2 (In millions)	Balance as of September 26, 2010
Assets			
Equity securities	\$ 79	\$	\$ 79
Mutual funds	324		324
U.S. Government securities		996	996
Corporate debt securities		33	33
U.S. Government-sponsored enterprise securities		27	27
Mortgage-backed securities		27	27
Other securities		12	12
Derivative assets		30	30
Total assets	\$ 403	\$ 1,125	\$ 1,528
Derivative liabilities		24	24
Net assets	\$ 403	\$ 1,101	\$ 1,504

We maintain a Rabbi Trust which includes investments to fund certain of our non-qualified deferred compensation plans. Investments in the trust are classified as trading securities and, accordingly, changes in their fair values are recorded in other non-operating income (expense), net. As of September 26, 2010, investments in the trust totaled \$731 million and are included in the investment securities categories listed in the table above.

Derivative assets and liabilities included in the table above relate to derivative financial instruments we use to manage our exposure to fluctuations in foreign currency exchange rates. Foreign currency exchange contracts are entered into to manage the exchange rate risk of forecasted foreign currency denominated cash receipts and cash payments. The majority of our foreign currency exchange contracts are designated as cash flow hedges. We may also use derivative financial instruments to manage our exposure to changes in interest rates, although we had none outstanding at September 26, 2010 or December 31, 2009. Our financial instruments that are subject to interest rate risk principally include fixed rate long-term debt. We do not hold or issue derivative financial instruments for trading or speculative purposes.

Edgar Filing: LOCKHEED MARTIN CORP - Form 10-Q

The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on our intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives attributable to the effective portion of hedges that we

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

consider highly effective hedges are either reflected in earnings and largely offset by corresponding adjustments to the hedged items, or reflected net of income taxes in accumulated other comprehensive income (loss) until the hedged transaction is recognized in earnings. Changes in the fair value of the derivatives that are attributable to the ineffective portion of the hedges, or of derivatives that are not considered to be highly effective hedges, if any, are immediately recognized in earnings. The aggregate notional amount of the outstanding foreign currency exchange contracts at September 26, 2010 and December 31, 2009 was \$1.8 billion and \$1.9 billion.

The effect of our derivative instruments on our Statements of Earnings for the three months and nine months ended September 26, 2010 and September 27, 2009, and on our Balance Sheets as of September 26, 2010 and December 31, 2009, was not material.

Our cash equivalents include highly liquid instruments with original maturities of 90 days or less. Due to the short maturity of these instruments, the carrying amount on our Balance Sheets approximates fair value. Our accounts receivable and accounts payable are carried at cost, which approximates fair value. At September 26, 2010, the estimated fair values of our long-term debt instruments aggregated \$6,512 million, compared with a carrying amount of \$5,525 million which excludes the \$506 million unamortized discount. The fair values were estimated based on quoted market prices of debt with terms and due dates similar to our long-term debt instruments.

NOTE 9 OTHER

Matters Included in Earnings

Voluntary Executive Separation Program

In the third quarter of 2010, we recorded a charge, net of state income tax benefits, of \$178 million related to a Voluntary Executive Separation Program (VESP) we announced in July 2010. The charge, which included the anticipated lump-sum special payments for qualifying executives, reduced our net earnings by \$116 million (\$.32 per share for the third quarter and \$.31 per share for the nine-month period). Approximately 600 executives, or about 25% of our total executive population, applied to voluntarily participate in the program and were subsequently approved. Approved VESP participants will receive a lump-sum special payment upon termination. The effective date of termination of employment for most participants will be February 1, 2011, with the lump-sum cash special payments made within 90 days from separation of service.

Change in Medicare Part D Reimbursement

In March 2010, the President signed into law the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. Beginning January 1, 2013, these laws change the tax treatment for retiree prescription drug expenses by eliminating the tax deduction available to the extent that those expenses are reimbursed under Medicare Part D. Because the tax benefits associated with these future deductions were reflected as deferred tax assets in the financial statements included in our 2009 Form 10-K, the elimination of the tax deductions resulted in a reduction in deferred tax assets and an increase in income tax expense in the first quarter of 2010. This increase in income tax expense reduced 2010 net earnings by \$96 million (\$.26 per share).

Table of Contents

Lockheed Martin Corporation

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

Resolution and Settlement of IRS Examination

In the third quarter of 2009, the IRS examination of our U.S. Federal Income Tax Returns for the years 2005-2007 was resolved and settled. As a result, we recognized additional tax benefits and reduced our income tax expense for the third quarter by \$58 million (\$.15 per share), including related interest. This reduction in income tax expense reduced our effective income tax rate by 5.5% and 1.9% for the quarter and nine months ended September 27, 2009.

Long-term Debt

In May 2010, we issued \$728 million of new 5.72% Notes due 2040 (the New Notes) in exchange for \$611 million of our then outstanding debt securities (the Old Notes). We paid a premium of \$158 million in the exchange, of which \$117 million was in the form of New Notes. The remaining \$41 million, along with \$6 million in expenses associated with the transaction, was paid in cash and is included in the Statement of Cash Flows in financing activities. The premium was recorded as a discount and will be amortized as additional interest expense over the life of the New Notes, using the effective interest method. The New Notes are included on our Balance Sheet net of the unamortized discount.

Stockholders' Equity

Share Repurchase Program

We have a share repurchase program which provides for the repurchase of up to 178.0 million shares of our common stock from time-to-time at management's discretion. We used cash to repurchase shares under the program as follows:

In the first nine months of 2010, \$1,566 million to repurchase 19.8 million common shares that were executed and settled during the nine-month period; and

In the first nine months of 2009, \$1,362 million to repurchase 18.3 million common shares that were executed and settled during the nine-month period.

As we repurchase our common shares, we reduce common stock for the \$1 of par value of the shares repurchased, with the remainder of the purchase price over par value recorded as a reduction of additional paid-in capital. If additional paid-in capital is reduced to zero, we record the remainder of the excess of purchase price over par value as a reduction of retained earnings.

As of September 26, 2010, we had repurchased a total of 169.0 million shares under the program, and there remained approximately 9.0 million shares authorized for repurchase in the future.

Dividends

During the first nine months of 2010, we declared and paid quarterly dividends totaling \$700 million (\$.63 per share per quarter). In September 2010, we also declared our fourth quarter dividend which was increased to \$.75 per share. The fourth quarter dividend totaled \$273 million and was recorded as a current liability and a reduction of retained earnings. This dividend will be paid in December 2010. During the first nine months of 2009, we declared and paid quarterly dividends totaling \$668 million (\$.57 per share per quarter).

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Condensed Consolidated Financial Statements (continued)***Comprehensive Income*

The components of comprehensive income consisted of the following:

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions)</i>			
Net earnings	\$ 571	\$ 797	\$ 1,943	\$ 2,197
Other comprehensive income (loss)	24	(10)	5	30
Comprehensive income	\$ 595	\$ 787	\$ 1,948	\$ 2,227

Income Tax and Interest Payments

We made federal and foreign income tax payments, net of refunds received, of \$326 million and \$702 million during the first nine months of 2010 and 2009. The 2010 payments included a \$325 million refund received in the first quarter of 2010 from the Internal Revenue Service (IRS) related to estimated taxes paid for the 2009 calendar year. Income tax payments and refunds are included in Other in operating activities on our Statements of Cash Flows.

We have protested to the IRS Appeals Division certain proposed adjustments related to tax years 2003-2004,

2005-2007, and 2008, and we expect these issues to be resolved over the next year. It is reasonably possible that resolution of these proposed adjustments and other matters, as well as the divestiture of PAE, over the next year could cause a reduction in our unrecognized tax benefits of up to \$270 million, only a portion of which may affect net earnings.

Our total interest payments on long-term debt were \$215 million and \$194 million during the first nine months of 2010 and 2009.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued an accounting standard that changed the approach to determining the primary beneficiary of a variable interest entity (VIE) and requires companies to continuously assess whether they must consolidate VIEs. We adopted this standard on January 1, 2010, and it did not have an impact on our financial statements.

In October 2009, the FASB issued an accounting standard which revised its accounting guidance related to revenue arrangements with multiple deliverables. The standard relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting and modifies the manner in which the transaction consideration is allocated across the individual deliverables, thereby affecting the timing of revenue recognition. Also, the standard expands the disclosure requirements for revenue arrangements with multiple deliverables. The standard will be effective for us beginning on January 1, 2011, and will apply prospectively to multiple-element arrangements entered into or materially modified after the adoption date. We are currently assessing the potential effect on our financial statements.

Table of Contents

Lockheed Martin Corporation

Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

Board of Directors

Lockheed Martin Corporation

We have reviewed the condensed consolidated balance sheet of Lockheed Martin Corporation as of September 26, 2010, and the related condensed consolidated statements of earnings for the three-month and nine-month periods ended September 26, 2010 and September 27, 2009, and the condensed consolidated statements of cash flows and stockholders' equity for the nine-month periods ended September 26, 2010 and September 27, 2009. These financial statements are the responsibility of the Corporation's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Lockheed Martin Corporation as of December 31, 2009, and the related consolidated statements of earnings, stockholders' equity, and cash flows for the year then ended (not presented herein) and in our report dated February 25, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2009, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

McLean, Virginia

October 21, 2010

Table of Contents

Lockheed Martin Corporation

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

We are a global security company that principally is engaged in the research, design, development, manufacture, integration, and sustainment of advanced technology systems and products. We provide a broad range of management, engineering, technical, scientific, logistic, and information services. We serve both domestic and international customers with products and services that have defense, civil, and commercial applications, with our principal customers being agencies of the U.S. Government. Net sales to our U.S. Government customers accounted for 85% of our total net sales in 2009. Our U.S. Government sales were made to both Department of Defense (DoD) and non-DoD agencies. Of the remaining 15% of net sales in 2009, approximately 13% related to sales to foreign government customers (including foreign military sales funded, in whole or in part, by the U.S. Government), with the remainder attributable to commercial and other customers. Our main areas of focus are in defense, space, intelligence, homeland security, and government information technology.

We operate in four principal business segments: Aeronautics, Electronic Systems, Information Systems & Global Solutions (IS&GS), and Space Systems. As a systems integrator, our products and services range from electronics and information systems (including integrated net-centric solutions), to missiles, aircraft, and spacecraft. We organize our business segments based on the nature of the products and services offered.

The following discussion should be read with our 2009 Form 10-K filed with the Securities and Exchange Commission, and with the unaudited condensed consolidated financial statements included in this Form 10-Q.

CONSOLIDATED RESULTS OF OPERATIONS

Since our operating cycle is long-term and involves many types of design, development, and production contracts with varying production delivery schedules, the results of operations of a particular quarter, or quarter-to-quarter comparisons of recorded sales and profits, may not be indicative of our future operating results. The following discussions of comparative results among periods should be viewed in this context. All per share amounts cited in the following discussions are presented on a per diluted share basis.

The following discussion of operating results provides an overview of our operations by focusing on key elements in our unaudited Statements of Earnings. Amounts in prior periods have been reclassified to reflect the planned divestitures of Pacific Architects and Engineers, Inc. (PAE) and Enterprise Integration Group (EIG), which are two businesses within IS&GS, as discontinued operations (see Note 2). The Discussion of Business Segments section that follows describes the contributions of each of our business segments to our consolidated net sales and operating profit for the quarter and nine-month periods ended September 26, 2010 and September 27, 2009.

Table of Contents

Lockheed Martin Corporation
Management's Discussion and Analysis of Financial Condition
and Results of Operations (continued)

Continuing Operations

Net sales for the third quarter of 2010 were \$11.4 billion, a 6% increase over the third quarter 2009 sales of \$10.8 billion. Net sales for the first nine months of 2010 were \$33.0 billion, a 4% increase over the \$31.8 billion recorded in the comparable 2009 period. Net sales increased during the quarter and nine months ended September 26, 2010 from the comparable 2009 period in every business segment except Space Systems.

Other income, net was \$91 million for the third quarter of 2010 compared to \$82 million recorded in the comparable 2009 period. The increase primarily was due to decreased expenses associated with various corporate items. Other income, net was \$210 million for the first nine months of 2010 compared to \$195 million in the comparable 2009 period. This increase mainly was due to higher equity earnings in affiliates recorded in 2010 as compared to 2009.

Our operating profit for the third quarter of 2010 was \$889 million, a decrease of \$179 million, or 17%, from the \$1,068 million recorded in the comparable 2009 period. Operating profit for the nine months ended September 26, 2010 was \$2,969 million, a decrease of \$202 million, or 6%, from the \$3,171 million recorded in the comparable 2009 period. In both 2010 periods, the decline in operating profit primarily was attributable to the impact of a charge, net of state income tax benefits, of \$178 million related to the Voluntary Executive Separation Program (VESP), as discussed further below.

The VESP charge more than offset increases in operating profit at the Electronic Systems and IS&GS business segments during the third quarter of 2010. Operating profit at Aeronautics and Space Systems remained essentially unchanged between the third quarter periods. During the first nine months of 2010, the VESP charge and a decline in Aeronautics' operating profit more than offset increases in operating profit at the Electronic Systems and Space Systems. Operating profit at IS&GS remained essentially unchanged between the nine-month periods.

We announced the VESP for qualifying company executives in July 2010 (see Note 9). Approximately 600 executives, or about 25% of our total executive population, applied to voluntarily participate in the program and were subsequently approved. Approved VESP participants will receive a lump-sum special payment upon termination which will be made within 90 days from separation of service, which for most participants will be February 1, 2011. The program represents one of several initiatives we have undertaken to address the new reality of our changing business environment consistent with our customers' need to improve efficiency and deliver cost savings. We expect that a substantial amount of the costs of the VESP will be recovered in future periods through pricing of our products and services in U.S. Government contracts.

Interest expense for the third quarter and nine months ended September 26, 2010 was \$85 million and \$258 million, respectively, as compared to \$74 million and \$222 million in the comparable 2009 periods. This increase mainly was driven by interest expense on the \$1.5 billion in long-term notes issued in the fourth quarter of 2009.

Other non-operating income, net was \$37 million in the third quarter of 2010 as compared to \$54 million in the third quarter of 2009. Other non-operating income, net was \$46 million in the first nine months of 2010 as compared to \$97 million in the comparable 2009 period. The decrease in both 2010 periods primarily was due to a decrease in the net unrealized gains on marketable securities held to fund certain non-qualified employee benefit obligations.

Table of Contents

Lockheed Martin Corporation

Management's Discussion and Analysis of Financial Condition

and Results of Operations (continued)

Our effective income tax rates were 32.8% and 34.1% for the quarter and nine months ended September 26, 2010 and 25.0% and 29.0% for the quarter and nine months ended September 27, 2009. The effective tax rate for the nine-month period of 2010 was higher than the comparable period in 2009, primarily due to the enactment of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. The tax rates for the third-quarter and nine-month periods of 2009 included the effect of the resolution of an IRS examination in the third quarter of 2009 that reduced income tax expense and increased net income from continuing operations by \$58 million (\$.15 per share), and benefits related to the research and development credit, which expired on December 31, 2009. The effective tax rates for both periods included tax benefits for U.S. manufacturing activities and dividends related to the Corporation's employee stock ownership plans.

The 2010 Health Care Acts eliminated the tax deduction for company-paid retiree prescription drug expenses to the extent they are reimbursed under Medicare Part D, beginning in 2013. Since the tax benefits associated with these future deductions were reflected as deferred tax assets in the Corporation's 2009 financial statements, the elimination of the tax deductions resulted in a reduction in deferred tax assets and an increase in income tax expense in the first quarter of 2010. This increase in income tax expense reduced 2010 net earnings by \$96 million (\$.26 per share).

Earnings from continuing operations for the third quarter of 2010 were \$565 million (\$1.55 per share) compared to \$786 million (\$2.04 per share) reported in the third quarter of 2009. Earnings from continuing operations for the nine months ended September 26, 2010 were \$1,816 million (\$4.89 per share) compared to \$2,163 million (\$5.53 per share) reported in the comparable 2009 period. The VESP charge reduced our net earnings by \$116 million (\$.32 per share for the third quarter and \$.31 per share for the nine-month period).

Discontinued Operations

Discontinued operations included the operating results for PAE and EIG for all periods presented. Earnings from discontinued operations for the third quarter of 2010 were \$6 million (\$.02 per share) compared to \$11 million (\$.03 per share) reported in the third quarter of 2009. Earnings from discontinued operations for the nine months ended September 26, 2010 were \$127 million (\$.34 per share) compared to \$34 million (\$.08 per share) reported in the comparable 2009 period. Earnings from discontinued operations for the nine months ended September 26, 2010, included the effects of recording a \$96 million deferred tax asset in the second quarter of 2010 when the decision was made to dispose of PAE, which reflects the tax benefit we expect to realize when we sell PAE because our tax basis is higher than our book basis.

DISCUSSION OF BUSINESS SEGMENTS

The following tables of financial information and related discussions of the results of operations of our business segments are consistent with the presentation of segment information in Note 4. The equity earnings (losses) from investees in which certain business segments hold equity interests are included in the operating profit of the respective segments since the activities of the investees are closely aligned with the operations of those segments. Our largest equity investees are United Launch Alliance (ULA) and United Space Alliance (USA), which are included in Space Systems.

We follow an integrated approach for managing the performance of our business, and focus the discussion of our results of operations around major products and lines of business versus

Table of Contents

Lockheed Martin Corporation

Management's Discussion and Analysis of Financial Condition

and Results of Operations (continued)

distinguishing between products and services. Product sales are predominantly generated in the Aeronautics, Electronic Systems, and Space Systems segments, while most of our services revenues are generated in our IS&GS segment. When we discuss our comparative results, we typically identify whether changes in sales and operating profit were caused by changes in volume and/or performance.

We use the percentage-of-completion method of accounting for our long-term design, development and production contracts, which we refer to as products in our Statements of Earnings. Products represent approximately 80% of our net sales. Under this method of accounting, we record sales on contracts based upon our progress towards completion on a particular contract as well as our estimate of the profit to be earned at completion.

Changes in volume refer to increases or decreases in sales resulting from varying production activity levels, deliveries, or service levels on individual contracts. Volume changes typically include a corresponding change in operating profit based on the estimate of profit at completion for a particular contract. For example, if the cost volume on a cost-reimbursement-type contract increased or decreased compared with a prior period, sales and operating profit for that contract will also be increased or decreased.

Changes in performance refer to increases or decreases in the estimated profit booking rates on our contracts for products. Performance changes usually relate to revisions in the total estimated costs at completion that reflect improved or deteriorated operating or award fee performance on a particular contract. Such changes in estimated profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes. For example, if we increase the estimated profit booking rate on a cost reimbursable contract, the increase in sales and operating profit for that contract will reflect a higher return on sales in the current period due to the recognition of the higher booking rate on both current period costs as well as previously incurred costs. Accordingly, such changes in the estimated profit booking rates may affect the comparison of segment operating results.

For our services contracts, changes in volume are reflective of increases or decreases in the level of services being provided under each contract. Performance refers to changes in the levels of operating profit. Sales are recognized as the services are performed, typically on a straight-line basis. Award and incentive fees related to the performance on these contracts are recognized when communicated to us by the customer. Costs associated with these contracts are expensed as incurred. Accordingly, the timing for recognizing the impact of costs and award and incentive fees on our services contracts may affect the comparison of segment operating results.

The Aeronautics segment generally includes fewer programs that have much larger sales and operating results than programs included in the other segments. Due to the large number of comparatively smaller programs in the remaining segments, the discussion of the results of operations of those business segments generally focuses on lines of business within the segment rather than on specific programs. We have a number of programs that are classified by the U.S. Government and cannot be specifically described. The operating results of these classified programs are included in our consolidated and business segment results, and are subjected to the same oversight and internal controls as our other programs.

Table of Contents

Lockheed Martin Corporation
Management's Discussion and Analysis of Financial Condition
and Results of Operations (continued)

Aeronautics

Aeronautics' operating results included the following:

	Quarter Ended		Nine Months Ended	
	September 26, 2010	September 27, 2009	September 26, 2010	September 27, 2009
	<i>(In millions)</i>			
Net sales	\$ 3,300	\$ 3,084	\$ 9,379	\$ 8,951
Operating profit	396	397	1,092	1,151

Net sales for Aeronautics increased by 7% for the third quarter of 2010 from the comparable 2009 period. Sales increased in Air Mobility and Combat Aircraft but were essentially unchanged between the periods in Other Aeronautics Programs. The increase in Air Mobility primarily was attributable to higher volume on C-130J programs including deliveries and support activities. There were seven C-130J deliveries in the third quarter of 2010 compared to four in the third quarter of 2009. The increase in Combat Aircraft principally was due to higher volume on the F-35 production contracts. This increase partially was offset by a decrease in volume on the F-35 System Development and Demonstration (SDD) contract, lower volume on the F-22 program and a decline in sales on F-16 and other combat aircraft programs. There were six F-16 deliveries in the third quarter of 2010 compared to eight in the third quarter of 2009.

Operating profit for Aeronautics was essentially unchanged in the third quarter from the comparable 2009 period. Declines in operating profit in Air Mobility and Combat Aircraft, partially were offset by an increase in Other Aeronautics Programs. The decrease in Air Mobility operating profit primarily was due to a lower level of favorable performance adjustments on C-130J deliveries in 2010 as compared to 2009. The decrease in Combat Aircraft's operating profit primarily was due to the lower volume on the F-