L 3 COMMUNICATIONS HOLDINGS INC
Form 10-K
March 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2005

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

For the transition period from to

Commission file numbers 001-14141 and 333-46983

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

(Exact names of registrants as specified in their charters)

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

(212) 697-1111
(Telephone number)

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

Title of each class	**Name of each exchange on which registered:**
L-3 Communications Holdings, Inc. common stock, par value $0.01 per share	New York Stock Exchange

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

None.

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

Yes No

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

Yes No

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

Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

The aggregate market value of the L-3 Communications Holdings, Inc. voting stock held by non-affiliates of the registrant as of June 30, 2005 was approximately $8,903 million. For purposes of this calculation, the Registrants have assumed that their directors and executive officers are affiliates.

There were 121,266,670 shares of L-3 Communications Holdings, Inc. common stock with a par value of $0.01 outstanding as of the close of business on March 3, 2006.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed with Securities and Exchange Commission (''SEC'') pursuant to Regulation 14A relating to the Registrant's Annual Meeting of Shareholders, to be held on April 25, 2006, will be incorporated by reference in this Form 10-K in response to Items 10, 11, 12, 13 and 14 of Part III. Such proxy statement will be filed with the SEC not later than 120 days after the registrant's fiscal year ended December 31, 2005.

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

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For the Year Ended December 31, 2005

PART I

For convenience purposes in this filing on Form 10-K, ''L-3 Holdings'' refers to L-3 Communications Holdings, Inc., and ''L-3 Communications'' refers to L-3 Communications Corporation, a wholly-owned operating subsidiary of L-3

Holdings. ‘‘L-3’’, ‘‘we’’, ‘‘us’’ and ‘‘our’’ refer to L-3 Holdings and its subsidiaries, including L-3 Communications.

Item 1. Business

L-3 Holdings, a Delaware corporation organized in 1997, derives all of its operating income and cash flow from its wholly-owned subsidiary, L-3 Communications. L-3 Communications, a Delaware corporation, was organized in April 1997. The only obligations of L-3 Holdings at December 31, 2005 are: (1) its 3% Convertible Contingent Debt Securities (CODES) due 2035, which are jointly and severally guaranteed by the existing and future domestic subsidiaries of L-3 Holdings that guarantee any other indebtedness of L-3 Holdings or any of its domestic subsidiaries, including L-3 Communications, and (2) its guarantee of the indebtedness under the bank credit facility of L-3 Communications. In order to generate the funds necessary to pay dividends declared and principal and interest on its outstanding indebtedness, if any, L-3 Holdings relies on dividends and other payments from its subsidiaries or it must raise funds in public or private equity or debt offerings.

Overview

We are a leading supplier of a broad range of products and services used in a substantial number of aerospace and defense platforms. We are also a major supplier of systems, subsystems and products on many platforms, including those for secure networked communications and communication products, mobile satellite communications, information security systems, shipboard communications, naval power systems, missiles and munitions, telemetry and instrumentation and airport security systems. We also are a prime system contractor for aircraft modernization and operations & maintenance (O&M), Command, Control & Communications (C^3), Intelligence, Surveillance and Reconnaissance (ISR) collection systems and services, training and simulation, intelligence services and government support services. Our 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. For the year ended December 31, 2005, direct and indirect sales to the DoD provided 73.7% of our consolidated sales. For the year ended December 31, 2005, we generated (1) sales of $9,444.7 million, of which U.S. customers accounted for 86.7% and foreign customers, including commercial export sales, accounted for 13.3%, (2) net cash from operating activities of $846.8 million, and (3) operating income of $996.7 million.

On July 29, 2005, we acquired all the outstanding shares of The Titan Corporation (Titan) for $23.10 per share in cash, or approximately $2,742.1 million, including the assumption of $626.0 million of Titan’s debt. Because Titan's business is largely comprised of lower margin (and lower risk) cost-reimbursable type and time-and-material type contracts, we expect that the Titan acquisition will reduce our consolidated operating margin. See ‘‘Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview’’ for a further discussion.

We have four reportable segments: (1) Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR), (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Specialized Products. Financial information for our reportable segments is included in ‘‘Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations’’ and in Note 17 to our audited consolidated financial statements.

Business Strategy

We intend to grow our sales, improve our profitability and cash flows and build on our position as a leading supplier of systems, subsystems, products and services to the DoD and other U.S. Government agencies, major aerospace and defense prime contractors and allied foreign governments. Our strategy to achieve our objectives includes:

Expanding Supplier Relationships. As an independent supplier, we anticipate that our growth will partially be driven by expanding our share of existing programs and by participating in new programs. We intend to identify opportunities where we are able to use our existing customer relationships and leverage the capabilities of our various businesses to expand the scope of our products and services and to obtain new customers. We also expect to benefit from continued outsourcing of subsystems and products by prime contractors, which positions us to be a supplier to multiple bidders on prime contract bids. We also intend to grow sales by combining certain of our products into subsystems that we can offer to our customers.

Supporting Customer Requirements. We intend to continue to align our research and development expenditures and business development efforts to address our customers' requirements and provide them with state-of-the-art products, services and solutions. In addition, we also intend to grow our sales by entering into ''teaming'' arrangements with select prime system contractors and platform providers.

Improving Operating Margins. We intend to continue to improve our operating performance by continuing to reduce overhead expenses, consolidating certain of our businesses and business processes and increasing the productivity of our businesses. However, as noted above, because Titan's business is largely comprised of lower margin (and lower risk) cost-reimbursable type and time-and-material type contracts, we expect that the Titan acquisition will reduce our consolidated operating margins.

Leveraging Technical and Market Leadership Positions. We are applying our technical knowledge, expertise and capabilities to expand our core defense businesses and apply them to certain closely aligned defense markets and applications, such as homeland security.

Maintaining Diversified Business Mix. We have an attractive customer profile and a diverse and broad business mix, with limited reliance on any single program. We also have a favorable balance of cost-reimbursable type and fixed-price type contracts with significant follow-on business opportunities.

Capitalizing on Strategic Acquisition Opportunities. In addition to expanding our existing product base through new product development efforts and bid and proposal efforts, we intend to continue to acquire select businesses that will add new products, services or customers in areas that complement our present businesses and technologies.

Selected Recent Business Acquisitions

During the year ended December 31, 2005, we used cash of $3,434.8 million for business acquisitions. See ''Part II – Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Business Acquisitions'' for additional details about our 2005 business acquisitions, including details of their purchase prices. The table below summarizes our 2005 business acquisitions in chronological order that had a purchase price greater than $50.0 million.

Business	Date Acquired	Acquired From	Purchase Price ($ millions)	Business Description
Marine Controls, division of CAE	February 3, 2005	CAE	$ 196.8	Supplies integrated marine controls systems and products for

				warships, submarines and high-end ocean going commercial vessels worldwide.
Propulsion Systems business unit of General Dynamics	February 25, 2005	General Dynamics Corporation	$ 196.8	Engineers, designs, and manufactures engines, transmissions, suspension and turret drive systems for combat vehicles.

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Business	Date Acquired	Acquired From	Purchase Price ($ millions)	Business Description
Electron Dynamics Devices business of the Boeing Company	February 28, 2005	The Boeing Company	$ 82.3	Designs and produces space-qualified microwave devices, traveling wave tubes, amplifiers and electric propulsion and radio frequency products utilized in communications satellites, manned space programs and key commercial and defense systems.
The Titan Corporation	July 29, 2005	Shareholders of The Titan Corporation	$ 2,742.1	Provides information and communications systems solutions and services and offers services, systems and products for Command, Control, Communications, Intelligence, Surveillance and Reconnaissance, enterprise information technology and homeland security programs.

Products and Services

Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR) Reportable Segment

The businesses in this reportable segment provide products and services for the global ISR market, specializing in signals intelligence (SIGINT) and communications intelligence (COMINT) systems. These products and services provide to the warfighter in real-time the unique ability to collect and analyze unknown electronic signals from command centers, communication nodes and air defense systems for real-time situation awareness and response. The businesses in this reportable segment also provide C^3 systems and secure, high data rate communications systems and equipment for military and other U.S. Government and foreign government intelligence, reconnaissance and surveillance applications. We believe that our products and services are critical elements for a substantial number of major communication, command and control, intelligence gathering and space systems. Our 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. Additionally, the businesses in the C^3ISR reportable segment also provide intelligence, logistics and other support services to the DoD and U.S. Government intelligence agencies. Major products and services for this reportable segment include:

- highly specialized fleet management sustainment and support, including procurement, systems integration, sensor development, modifications and periodic depot maintenance for signals intelligence and ISR special mission aircraft and airborne surveillance systems;
- strategic and tactical signals intelligence systems that detect, collect, identify, analyze and disseminate information;

- secure data links that enable networked communications for airborne, satellite, ground and sea-based remote platforms, both manned and unmanned, for real-time information collection and dissemination to users;
- secure terminal and communication network equipment and encryption management;
- communication systems for surface and undersea vessels and manned space flights;
- intelligence solutions support to the DoD, including the U.S. Armed Services combatant commands and the U.S. Government intelligence agencies, including those within the U.S. Armed Services; and
- technical and management services, which provides support of intelligence, logistics, C^3 and combatant commands.

The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our C^3ISR reportable segment at December 31, 2005.

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
ISR Systems		
• Prime mission systems integration, sensor development and operations and support	• Signal processing, airborne SIGINT applications, antenna technology, real-time process control and software development	• U.S. Air Force (USAF) and allied foreign militaries ISR aircraft platforms

• Fleet management of special mission aircraft, including avionics and mission system upgrades and logistics support	• Measurement collection and signal intelligence, special missions	• DoD and special customers within the U.S. Government
Networked Communications		
• Airborne, space and surface data link terminals, ground stations, and transportable tactical SATCOM (satellite communications) systems	• High performance, wideband secure communication links for relaying of intelligence and reconnaissance information	• Manned aircraft, unmanned aerial vehicles (UAVs), naval ships, ground vehicles and satellites
• Multi-band Manpack Receivers	• Portable, ruggedized terminals used for receiving reconnaissance video and sensor data from multiple airborne platforms	• U.S. Special Operations Command (USSOCOM), USAF and other DoD customers
• Satellite command and control sustainment and support	• Software integration, test and maintenance support, satellite control network and engineering support for satellite launch systems	• USAF Space Command (AFSC), USAF Satellite Control Network and launch ranges

Systems/Products/Services	Selected Applications	Selected Platforms/End Users
C^3ISR Support Services		
• Full spectrum systems acquisition support and comprehensive operational support services	• Requirements definition, program management, planning and analysis, systems engineering and integration, intelligence analysis and managing and network engineering	• U.S. Army, USAF, U.S. Navy (USN) and DHS
• ISR operations and support	• Data link support and services, special applications, classified projects, spares and repairs	• USAF and U.S. Army ISR aircraft platforms
• Information management and IT systems support and software design, development and systems integration	• Intelligence and operations support, C^3ISR systems, network centric operations and information operations	• DoD and U.S. Government intelligence agencies
Communications Products		
• Secure communication terminals and equipment, and secure network encryption products	• Secure and non-secure voice, data and video communication for office, battlefield and secure internet protocol (IP) network applications	• DoD and U.S. Government intelligence agencies

• Ground-based satellite communication terminals and payloads	• Interoperable, transportable ground terminals	• DoD and U.S. Government intelligence agencies
• Satellite communication and tracking systems	• On-board satellite external communications, video systems, solid state recorders and ground support equipment	• International Space Station, Space Shuttle and various satellites
• Shipboard communications systems	• Internal and external communications (radio rooms)	• USN, U.S. Coast Guard and allied foreign navies

Government Services Reportable Segment

The businesses in this reportable segment provide a full range of communications systems support, engineering services, information technology services, teaching and training services, marksmanship training systems and services, and intelligence support and analysis services. We sell these services primarily to the DoD, U.S. Government intelligence agencies and allied foreign governments. Major services for this reportable segment include:

- communication software support, information technology services and a wide range of engineering development services and integration support;

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

The table below provides additional information for the products and services, selected applications and selected platforms or end users of our Government Services reportable segment at December 31, 2005.

Products/Services	Selected Applications	Selected Platforms/End Users
Training and Operations		
• Training systems, courseware and doctrine development	• Training, leadership development and education services for U.S. and allied foreign armed forces, counterintelligence and law enforcement personnel	• U.S. Army, U.S. Marine Corps (USMC), U.S. Department of State, U.S. Department of Justice (DoJ) and allied foreign governments

• Crisis Incident Management System	• Emergency operations support associated with natural disasters, industrial accidents and acts of terrorism	• Federal, state and local government agencies for homeland defense
• Weapons Training	• Laser marksmanship training systems and advanced integrated technologies for security products and services	• DoD and law enforcement agencies
Government Services		
• Surveillance systems and products, including installation and logistics support	• Automated security systems for bases and force protection, and remote surveillance for U.S. borders	• DHS and USAF
• Communication systems and software engineering services	• Value-added, critical software support for C^3ISR systems, electronic warfare and fire support systems	• U.S. Army Communications – Electronics Command (CECOM)
• Acquisition management and staff augmentation	• Rapid fielding support for combatants and physical location management	• U.S. Army

Products/Services	Selected Applications	Selected Platforms/End Users
• Battlefield and weapon simulation	• Missile system modeling and simulation and design and manufacture custom ballistic missile targets	• U.S. Missile Defense Agency (MDA)
• System support and concept operations (CONOPS)	• C^3ISR, modeling and simulation	• DoD, MDA, U.S. Government intelligence agencies, NASA
• Information technology (IT) services	• IT infrastructure modernization and operations	• U.S. Government intelligence agencies
• Worldwide linguist and analyst services	• Counterintelligence, threat protection and counter terrorism	• U.S. Army
• Systems engineering, operations analysis, research and technical analysis	• Systems engineering and operational analysis of most aircraft and vessels in the USN fleet, C^4 systems acquisitions, logistics and administrative support, as well as systems life cycle support	• USN and USMC
• Network and enterprise administration and management	• Systems engineering, assurance and risk management, network and systems administration, management, software development and life cycle support and systems	• U.S. Army, U.S. Joint Chiefs of Staff, USAF, USSOCOM and National Aeronautics and Space Administration (NASA)

integration

Aircraft Modernization and Maintenance (AM&M) Reportable Segment

The businesses in this reportable segment provide specialized aircraft modernization and upgrades, maintenance and logistics support services. We sell these services primarily to the DoD and the Canadian Department of National Defense (DND). Major products and services for this reportable segment include:

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

The table below provides additional information for the systems, products and services, selected applications and selected platforms or end users of our AM&M reportable segment at December 31, 2005.

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

distribution

Specialized Products Reportable Segment

The businesses in this reportable segment provide a broad range of products, including components, subsystems and systems, to military and commercial customers in several diverse niche markets. Major products for this reportable segment include:

- naval warfare products, including acoustic undersea warfare products for mine hunting, dipping and anti-submarine sonars and naval power distribution, conditioning, switching and protection equipment for surface and undersea platforms;
- naval ship modernization, modification, repair and overhaul;
- security systems for aviation and port applications, including those for detection of explosives, concealed weapons, contraband and illegal narcotics, and to inspect agricultural products and to examine cargo;
- telemetry, instrumentation, space and navigation products, including products for tracking and flight termination;
- premium fuzing products and safety and arming devices for missiles and munitions;
- imaging products including precision stabilized electro-optic/infrared (EO/IR) sensors for ISR systems, including high magnification lowlight, daylight and forward looking infrared sensors, laser range finders, illuminators and designators, and digital and wireless communication systems;

- information products and microwave components used in radar communication satellites, wireless communication equipment, electronic surveillance, communication and electronic warfare applications and countermeasure systems;
- high performance antennas and ground based radomes;
- training devices and motion simulators, which produce advanced virtual reality simulation and high-fidelity representations of cockpits and mission stations for fixed and rotary wing aircraft and land vehicles;
- advanced cockpit avionics products and specialized avionics repair and overhaul for various segments of the aviation market;
- airborne traffic and collision avoidance systems (TCAS) and terrain awareness warning systems (TAWS) for commercial and military applications;
- commercial, solid-state, crash-protected cockpit voice recorders, flight data recorders and cruise ship hardened voyage recorders; and
- ruggedized custom cockpit displays for military and high-end commercial applications.

The table below provides additional information for the products, selected applications and selected platforms or end users of our Specialized Products reportable segment at December 31, 2005.

Products	Selected Applications	Selected Platforms/End Users
Naval Products		
• Airborne dipping sonars, submarine and surface ship	• Submarine and surface ship detection and localization	• USN and allied foreign navies

towed arrays		
• Naval power delivery, conversion and switching products	• Switching, distribution and protection, as well as frequency and voltage conversion	• Naval submarines, surface ships and aircraft carriers
• Shipboard electronics racks, rugged computers, rugged displays and communication terminals	• Ruggedized displays, computers and electronic systems	• Naval vessels and other DoD applications
Security		
• Explosives detection systems and airport security systems	• Rapid scanning of passenger checked baggage and carry-on luggage, scanning of large cargo containers	• DHS, including the U.S. Transportation and Security Administration (TSA), and domestic and foreign airports, state and local governments
Training Devices and Motion Simulators		
• Military aircraft flight simulators, reconfigurable training devices, distributed mission training (DMT) suites	• Advance simulation technologies and training for pilots, navigators, flight engineers, gunners and operators	• Fixed and rotary winged aircraft and ground vehicles for USAF, USN, U.S. Army, Canadian DND and allied foreign militaries

Products	Selected Applications	Selected Platforms/End Users
Navigation & Sensors		
• Global Positioning System (GPS) receivers	• Location tracking	• Guided projectiles and precision munitions
• Navigation systems and positioning navigation units	• Satellite launch and orbiting navigation and navigation for ground vehicles and fire control systems	• USAF, U.S. Army, USMC and NASA
• Ultra-wide frequency and advanced radar antennas and radomes	• Surveillance and radar detection	• Military fixed and rotary winged aircraft, SATCOM
• Targeted stabilized camera systems with integrated sensors and wireless communication systems	• Intelligence Data Collection, Surveillance and Reconnaissance	• DoD, intelligence and security agencies, law enforcement, manned and unmanned platforms
• Telemetry and instrumentation systems	• Real-time data acquisition, measurement, processing, simulation, distribution, display and storage for flight testing	• Aircraft, missiles and satellites
• Airborne and ground based high energy laser beam directors and high tracking rate telescopes	• Directed energy systems, space surveillance, satellite laser ranging and laser communications	• USAF and NASA
Aviation Products		

• Solid state crash protected cockpit voice and flight data recorders	• Aircraft voice and flight data recorders that continuously record voice and sounds from cockpit and aircraft intercommunications	• Commercial transport, business, regional and military aircraft
• TCAS, TAWS	• Reduce the potential for midair aircraft collisions and crashes into terrain by providing visual and audible warnings and maneuvering instructions to pilots	• Commercial transport, business, regional and military aircraft
• Advanced cockpit avionics	• Pilot safety, navigation and situation awareness products	• Commercial transport, business, regional and military aircraft

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Products	Selected Applications	Selected Platforms/End Users
• Cockpit and mission displays	• High performance, ruggedized flat panel and cathode ray tube displays and processors	• Various military aircraft
Premium Fuzing Products		
• Fuzing Products	• Munitions and electronic and electromechanical safety arming devices (ESADs)	• Various DoD and allied foreign military customers
Microwave Components		
• Passive components, switches and wireless assemblies	• Radio transmission, switching and conditioning, antenna and base station testing and monitoring	• DoD, wireless communications service providers and original equipment manufacturers
• Satellite and wireless components (channel amplifiers, transceivers, converts, filters and multiplexers)	• Satellite transponder control, channel and frequency separation	• SATCOM and wireless communications equipment
• Traveling wave tubes, power modules, klystrons and digital broadcast	• Microwave vacuum electron devices and power modules	• DoD and allied foreign military manned/unmanned platforms, various missile programs and commercial broadcast

Backlog and Orders

We define funded backlog as the value of funded orders received from customers, less the amount of sales recognized on those funded orders. We define funded orders as the value of contract awards received from the U.S. Government, for which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government. For additional information on our backlog and orders, see ‘‘Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations — Backlog and Orders.’’

Major Customers

For the year ended December 31, 2005, direct and indirect sales to the DoD provided approximately 73.7% of our total sales, of which approximately 52.2% were direct to the customer, and approximately 47.8% were indirect through prime system contractors and subcontractors of the DoD. Additionally, our sales to the DoD were distributed among the U.S. Armed Services, and as a percentage of total 2005 sales, 21.2% was to the U.S. Air Force, 20.2% to the U.S. Army, 15.2% to the U.S. Navy, 0.4% to the U.S. Marines and 16.7% to other defense-wide customers. All U.S. Government customers, including the DoD and federal, state and local agencies, accounted for 79.9% of our total sales for 2005. For the year ended December 31, 2005, allied foreign governments provided 8.0% of our total sales, and commercial customers, domestic and foreign, provided 12.1% of our total sales. For additional information regarding domestic and foreign sales, see Note 17 to our audited consolidated financial statements.

Our U.S. Government sales are predominantly derived from contracts with agencies of, and prime contractors to, the U.S. Government. Various U.S. Government agencies and contracting entities exercise independent and individual purchasing decisions, subject to annual appropriations by the U.S. Congress. For the year ended December 31, 2005, our largest contract represented 4.5% of our sales and our five largest contracts represented 15.2% of our sales.

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Research and Development

We conduct research and development activities that consist of projects involving basic research, applied research, development, and systems and other concept studies. We employ scientific, engineering and other personnel to improve our existing product-lines and develop new products and technologies. As of December 31, 2005, we employed approximately 30,012 engineers, a substantial portion of whom hold advanced degrees, and work on company sponsored research and development efforts, customer funded research and development contracts and production and services contracts. For an analysis of L-3's research and development costs, see ''Part II – Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Research and Development.''

Competition

We encounter intense competition in all of our businesses. We believe that we are a significant supplier for many of the products that we manufacture and services we provide in our DoD, government and commercial businesses.

Our ability to compete for defense contracts depends on a variety of factors, including:

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

In some instances, we are the incumbent supplier or have been the sole provider for many years for certain programs. We refer to such contracts as ''sole-source'' contracts. In such cases, there may be other suppliers who have the capability to compete for the programs involved, but they can only enter or reenter the market if the customer chooses to reopen the particular program to competition. Sole-source contracts are generally recompeted every three to five years. Sole-source contracts accounted for 54.3% and competitive contracts accounted for 45.7% of our total sales for the year ended December 31, 2005. The majority of our sales are derived from contracts with the U.S. Government and its prime contractors, which are principally awarded on the basis of negotiations or competitive bids.

We believe that the U.S. defense industry structure contains three tiers of defense contractors. The first tier is dominated by five large prime system contractors: The Boeing Company, Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon Company and General Dynamics Corporation, all of whom compete for major platform programs. The second tier defense contractors are generally smaller products and niche subsystems contractors and is comprised of traditional aerospace and defense companies, as well as the non-core aerospace and defense businesses of certain larger industrial conglomerates. Some of the defense contractors in the second tier also compete for platform programs. We believe the second tier includes L-3, Honeywell International Inc., Rockwell Collins Inc., Harris Corporation, ITT Industries, Inc., the North American operations of BAE Systems PLC, Alliant Techsystems Inc., United Technologies Corporation, Computer Sciences Corporation and Science Applications International Corporation. The third tier represents the vendor base and supply chain for niche products and is comprised of numerous smaller publicly and privately owned aerospace and defense contractors.

We believe we are the aerospace and defense supplier with the broadest and most diverse product portfolio. We primarily compete with second and third tier defense contractors. We supply our products and services to all of the five prime system contractors. However, we also compete directly with the large prime system contractors for (i) certain products and subsystems where they have vertically integrated businesses and (ii) niche areas where we are a prime system contractor, including aircraft modernization and maintenance, ISR systems, simulation and training, and government services. We believe that most

of our businesses enjoy the number one or number two competitive position in their respective market niches. We believe that the primary competitive factors for our businesses are technology, research and development capabilities, quality, cost, market position and past performance. In addition, our ability to compete for non ‘‘sole-source’’ contracts often requires us to ‘‘team’’ with one or more of the prime system contractors that bid and compete for major platform programs. Furthermore, our ability to ‘‘team’’ with a prime system contractor is often dependent upon the outcome of a competitive process for subcontracts awarded by the prime contractors. We believe that we will continue to be a successful participant in the business areas in which we compete, based upon the quality and cost competitiveness of our products and services.

Patents and Licenses

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

Raw Materials

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

Contracts

A significant portion of our sales are derived from sole-source contracts (revenue arrangements with periods of performance exceeding one year) as discussed above. Our customer satisfaction and performance record is evidenced by our receipt of performance-based award fees exceeding 90% of the available award fees on average during the year ended December 31, 2005. We earn award fees on cost plus award fee (CPAF) contracts. Sales from CPAF contracts were $841.3 million for the year ended December 31, 2005. We believe that our customers award sole-source contracts to the most capable supplier in terms of quality, responsiveness, design, engineering and program management competency and cost. However, as discussed above, we are increasingly competing against large prime system contractors for major subsystems business. As a consequence of our competitive position, for the year ended December 31, 2005, we won contract awards at a rate in excess of 51% on new competitive contracts that we bid on, and at a rate in excess of 95% on the contracts we rebid for which we were the incumbent supplier.

Generally, our contracts are either fixed-price, cost-reimbursable or time-and-material. Generally, a fixed-price type contract offers higher profit margins than a cost-reimbursable type or time-and-material type contract, which is commensurate with the greater levels of risk assumed on a fixed-price type contract. Our operating profit margins on fixed-price type contracts generally range between 10% and 15%, while on cost-reimbursable type contracts they generally range between 7% and 10%, and on time-and-material type contracts they generally range between 8% and 12%. See ‘‘Part I – Item 1A – Risk Factors’’ below for a more detailed description of fixed-price, cost-reimbursable and time-and-material type contracts.

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

	Year Ended December 31,		
Contract-Type	2005	2004	2003
Fixed-price	53.2%	60.6%	63.1%
Cost-reimbursable	30.4%	26.9%	29.8%
Time-and-material	16.4%	12.5%	7.1%
Total Sales	100.0%	100.0%	100.0%

Excluding the Titan business, which largely performs under lower margin (and lower risk) cost-reimbursable type and time-and-material type contracts, the contract-type sales mix as a percentage of total sales for the year ended December 31, 2005, would have been 57.6% for fixed-price type contracts, 28.1% for cost-reimbursable type contracts and 14.3% for time-and-material type contracts.

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

Regulatory Environment

Most of our revenue arrangements with agencies of the U.S. Government, including the DoD, are subject to unique procurement and administrative rules. These rules are based on both laws and regulations, including the U.S. Federal Acquisition Regulation (FAR), that (1) impose various profit and cost controls, (2) regulate the allocations of costs, both direct and indirect, to contracts and (3) provide for the non-reimbursement of unallowable costs. Unallowable costs include, but are not limited to, lobbying expenses, interest expenses and certain costs related to business acquisitions, including, for example, the incremental depreciation and amortization expenses arising from fair value increases to the historical carrying values of acquired assets. Our contract administration and cost accounting policies and practices are also subject to oversight by government inspectors, technical specialists and auditors. See ''Part I – Item 1A – Risk Factors'' below for a discussion of certain additional business risks specific to our government contracts.

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

Certain of our sales are under foreign military sales (FMS) agreements directly between the U.S. Government and allied foreign governments. In such cases, because we serve only as the supplier, we do not have unilateral control over the terms of the agreements. These contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance with these laws and regulations. Investigations could result in administrative, civil, or criminal liabilities, including repayments, disallowance of certain costs, or fines and penalties.

Certain of our sales are direct commercial sales to allied foreign governments. These sales are subject to U.S. Government approval and licensing under the Arms Export Control Act. Legal restrictions on sales of sensitive U.S. technology also limit the extent to which we can sell our products to allied foreign governments or private parties.

Environmental Matters

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

We have also assessed the risk of environmental contamination for our various manufacturing facilities, including our acquired businesses and, where appropriate, have obtained indemnification, either

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

Pension Plans

In connection with our 1997 acquisition of the ten business units from Lockheed Martin and the formation of L-3, we assumed certain defined benefit pension plan liabilities for present and former employees and retirees of certain businesses, which were transferred from Lockheed Martin to us. Prior to this acquisition, Lockheed Martin received a letter from the Pension Benefit Guaranty Corporation (the ‘‘PBGC’’) that requested information regarding the transfer of such pension plans and indicated that the PBGC believed certain of such pension plans were underfunded using the PBGC’s actuarial assumptions. The PBGC assumptions result in a larger liability for accrued benefits than the assumptions used for financial reporting under Statement of Financial Accounting Standards (SFAS) No. 87, Employee's Accounting for Pensions (SFAS 87). The PBGC underfunding is related to the Communication Systems — West and Aviation Recorders pension plans (the ‘‘Subject Plans’’).

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

Upon the occurrence of certain events, Lockheed Martin, at its option, has the right to decide whether to cause us to transfer sponsorship of any or all of the Subject Plans to Lockheed Martin, even if the PBGC has not sought to terminate the Subject Plans. If Lockheed Martin did assume sponsorship of these plans, it would be primarily liable for the costs associated with funding the Subject Plans or any costs associated with the termination of the Subject Plans, but we would be required to reimburse Lockheed Martin for these costs. To date, there has been no impact on pension expense and funding requirements resulting from this arrangement. In the event Lockheed Martin assumes sponsorship of the Subject Plans we would be required to reimburse Lockheed Martin for all amounts that it contributes to, or costs it incurs with respect to, the Subject Plans. For the year ended December 31, 2005, we contributed $21.9 million to the Subject Plans. For subsequent years, our funding requirements will depend upon prevailing interest rates, return on pension plan assets and underlying actuarial assumptions. At December 31, 2005, the aggregate projected benefit obligation was $241.3 million and the aggregate plan assets were $181.5 million for the Subject Plans.

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

Employees

As of December 31, 2005, we employed approximately 59,500 full-time and part-time employees, 86.1% of whom were located in the United States. Of these employees, approximately 16.1% are covered by 82 separate collective bargaining agreements with various labor unions. The success of our business is primarily dependent upon the knowledge of our employees and on the management, contracting, engineering and technical skills of our employees. In addition, our ability to grow our businesses, obtain additional orders for our products and services and to satisfy contractual obligations under certain of our existing revenue arrangements is largely dependent upon our ability to attract and retain employees who have U.S. Government security clearances, particularly those with top-secret and above clearances. We believe that relations with our employees are positive.

Available Information

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

You may also obtain a free copy of our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports on the day of filing with the SEC through our website on the Internet at http://www.L-3com.com.

The Company also has a Corporate Governance webpage. You can access the Company's Corporate Governance Guidelines and charters for each of our board committees through our Internet site, http://www.L-3com.com, by clicking on the ''Investor Information'' link under the heading ''Investor Relations.'' The Company posts a Code of Ethics and Business Conduct on its Investor Information webpage under the link ''Corporate Ethics Guidelines.'' The Company's Code of Ethics and Business Conduct applies to all directors, officers and employees, including our chief executive officer, our chief financial officer, our principal accounting officer and our controller. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. (''NYSE''), on our Internet site. The information on the Company's Internet site is not incorporated by reference into this report. You can request a copy of our code of ethics and any other corporate governance documents and periodic reports at no cost by contacting Investor Relations at (212) 850-5600.

Item 1A. Risk Factors

You should carefully consider the following factors and other information contained or incorporated by reference in this Form 10-K. Any of these risks could materially adversely affect our business and our financial condition, results of operations and cash flow, which could in turn materially adversely affect the price of our common stock.

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

We have incurred substantial indebtedness to finance our business acquisitions, including indebtedness incurred in connection with the Titan acquisition. At December 31, 2005, we had approximately $4,650.0 million in aggregate principal amount of outstanding debt, excluding $104.8 million of outstanding letters of credit under our senior credit facility. In addition, we had additional borrowing capacity under our senior credit facility, after reductions for outstanding letters of credit, of approximately $895.2 million at December 31, 2005. In the future, we may borrow more money, subject to limitations imposed on us by our debt agreements.

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

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

- requiring a substantial portion of our net cash flow from operations to be used to pay interest and principal on our debt and therefore be unavailable for other purposes, including capital expenditures, research and development and other investments;
- limiting our ability to obtain additional financing for acquisitions, working capital, investments or other expenditures, which, in each case, may limit our ability to carry out our acquisition strategy;
- higher interest expenses due to increases in interest rates on our borrowings that have variable interest rates;
- heightening our vulnerability to downturns in our business or in the general economy and restricting us from making acquisitions, introducing new technologies and products or exploiting business opportunities; and
- impacting debt covenants that limit our ability to borrow additional funds, dispose of assets or pay cash dividends. Failure to comply with such covenants could result in an event of default which, if not cured or waived, could result in the acceleration of our outstanding indebtedness.

Additionally, on December 31, 2005, we had $7,140.5 million of contractual obligations (including outstanding indebtedness). For a detailed listing of the components of contractual obligations, see ‘‘Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operation – Contractual Obligations.’’

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

We seek to acquire companies that complement our existing businesses. We may not be able to continue to identify acquisition candidates on commercially reasonable terms or at all. If we make additional acquisitions, we may not realize the benefits anticipated from these acquisitions, including cost synergies and improving margins. Furthermore, we may not be able to obtain additional financing for acquisitions, since such additional financing could be restricted by the terms of our debt agreements.

The process of integrating the operations of acquired businesses, including Titan and other recent business acquisitions, into our existing operations may result in unforeseen difficulties and may require significant financial and managerial resources that would otherwise be available for the ongoing development or expansion of our existing operations. Possible future business acquisitions could result in the incurrence of additional debt and related interest expense and contingent liabilities, each of which could result in an increase to our already significant level of outstanding debt. We consider and execute strategic acquisitions on an ongoing basis and may be evaluating acquisitions or engage in acquisition negotiations at any given time. We regularly evaluate potential acquisitions and joint venture transactions, and, except as disclosed in ‘‘Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Business Acquisitions'', we have not entered into any other agreements with respect to any material transactions. Furthermore, in certain of our business acquisitions we have assumed all claims against and liabilities of the acquired business, including both asserted or unasserted claims and liabilities.

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

Our sales are predominantly derived from contracts (revenue arrangements) with agencies of, and prime contractors to, the U.S. Government. At December 31, 2005, we had approximately 1,500 contracts (revenue arrangements) with individual estimated contract values in excess of $1.0 million. Approximately 79.9%, or $7,542.2 million, of our sales for the year ended December 31, 2005 were made directly or indirectly to U.S. Government agencies, including the DoD. For the year ended December 31, 2005, our largest contract represented 4.5% of our sales, and sales from our five largest programs amounted to $1,433.9 million, or 15.2% of our sales. The loss of all or a substantial portion of our sales to the U.S. Government would have a material adverse effect on our results of operations and cash flows.

A substantial majority of our total sales are for products and services under contracts with various agencies and procurement offices of the DoD or with prime contractors to the DoD. Although these

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various parts of the DoD are subject to common budgetary pressures and other factors, our customers exercise independent purchasing decisions. Because of this concentration of contracts, if a significant number of our DoD contracts and subcontracts are simultaneously delayed or cancelled for budgetary performance or other reasons, it would have a material adverse effect on our revenues, operating income and cash flows.

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

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

These or other factors could cause U.S. defense and other federal agencies to reduce their purchases under contracts, to exercise their right to terminate contracts or not to exercise options to renew contracts or limit our ability to obtain new contract awards. Any of these actions or any of the other actions described above could significantly reduce our revenues, operating income and cash flows.

Our results of operations and cash flows, as well as our valuation of contracts in process are substantially affected by our fixed-price, cost reimbursable and time-and-material type contracts.

The majority of our contracts (revenue arrangements) require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services according to the buyer’s specifications. These sales are transacted using written revenue arrangements, or contracts, which are generally either fixed-price, cost-reimbursable or time-and-material. For a description of our revenue recognition policies, see ‘‘Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies.’’ For the year ended December 31, 2005, approximately 53.2% of our sales were generated from fixed-price type contracts, approximately 30.4% of our sales were generated from cost-reimbursable type contracts and approximately 16.4% of our sales were generated from time-and-material type contracts. Substantially all of our cost-reimbursable and time-and-material type contracts are with the U.S. Government, primarily with the DoD. Substantially all of our sales to commercial customers are transacted under fixed-price sales arrangements, and are included in our fixed-price type contract sales.

On a fixed-price type contract (revenue arrangement), we agree to perform the contractual statement of work for a predetermined contract price. Although a fixed-price type contract generally permits us to retain profits if the total actual contract costs are less than the estimated contract costs, we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on the contract. Accounting for the sales on a fixed-price type contract requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work, and (3) the measurement of progress towards completion. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated total profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur.

On a cost-reimbursable type contract (revenue arrangement), we are paid our allowable incurred costs plus a profit which can be fixed or variable depending on the contract's fee arrangement up to predetermined funding levels determined by our customers. On a time-and-material type contract (revenue arrangement), we are paid on the basis of direct labor hours expended at specified fixed-price hourly rates (that include wages, overhead, general and administrative expenses and profit) and materials

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at cost. Therefore, on cost-reimbursable type and time-and-material type contracts we do not bear the risks of unexpected cost overruns, provided that we do not incur costs that exceed the predetermined funded amounts.

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

Our government contracts entail certain risks.

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

Our government contracts are dependent upon the U.S. defense budget. The DoD budget has increased for each fiscal year from fiscal year 1997 to fiscal year 2006 and, based on the Bush Administration's current Future Year Defense Plan (FYDP), the DoD budget would continue to increase through fiscal year 2009. However, the future DoD budgets after fiscal year 2006 could be negatively impacted by several factors, including, but not limited to, the U.S. Government's budget deficits, a change in spending priorities and the costs of sustaining the U.S. military operations in Iraq and Afghanistan, which could cause the DoD budget to remain unchanged or to decline. A significant decline in or redirection of U.S. military expenditures in the future could result in a material decrease to our sales, earnings and cash flow. The loss or significant reduction in government funding of a large program in which we participate could also result in a material decrease to our future sales, earnings and cash flows. U.S. Government contracts are also conditioned upon the continuing approval by Congress of the amount of necessary spending. Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress for future fiscal years.

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

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

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

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

The U.S. Government may review our costs and performance on their contracts, as well as our accounting and general business practices. Based on the results of such audits, the U.S. Government may

adjust our contract-related costs and fees, including allocated indirect costs. In addition, under U.S. Government purchasing regulations, some of our costs, including most financing costs, portions of research and development costs, and certain marketing expenses may not be reimbursable under U.S. Government contracts. Further, as a U.S. Government contractor, we are subject to investigation, legal action and/or liability that would not apply to a commercial company.

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

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

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

In addition to these U.S. Government contract risks, we are required to obtain licenses from U.S. Government agencies to export many of our products and systems. Additionally, we are not permitted to export some of our products. Failure to receive required licenses would eliminate our ability to sell our products outside the United States. Furthermore, in connection with a plea agreement with the DoJ regarding Titan's alleged violations of the Foreign Corrupt Practices Act (FCPA), Titan is currently unable to obtain new export licenses for items regulated by the U.S. Department of State and Titan may not be able to obtain new export licenses or amendments to existing ones or to utilize licensing exemptions until after March 2008.

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

We are from time to time subject to governmental investigations relating to our operations. We are currently cooperating with the U.S. Government on several investigations, including but not limited to, an investigation regarding the Combat Survivor/Evader Locator (CSEL) program (which is discussed below). Under U.S. Government procurement regulations, an indictment by a federal grand jury could result in us being suspended for a period of time from eligibility for awards of new government contracts. A conviction could result in debarment from contracting with the federal government for a specified term.

Our Interstate Electronics Corporation subsidiary (IEC) is under criminal investigation by the United States Army Criminal Investigation Command. The investigation relates to IEC's role on the CSEL program, on which IEC is a subcontractor to The Boeing Company (Boeing). IEC provides the GPS modules to Boeing for the CSEL program. The GPS module includes a complex printed wiring board (PWB) that IEC purchased from two suppliers. The investigation appears to be focused on alleged manufacturing deficiencies in the PWBs and IEC's actions when it became aware of the potential manufacturing problems of the suppliers. We have conducted an internal investigation of this matter using outside counsel and currently believe that no criminal activity occurred. We are cooperating fully with the investigation and have voluntarily recalled all the PWBs and are repairing them as they are received. The outcome of our current (or future) governmental investigations cannot, however, be predicted, and any indictment, conviction or material fine or settlement arising out of these investigations could have a material adverse effect on our business, financial condition, results of operations and future prospects.

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

At any given time, we are a defendant in various material legal proceedings and litigations arising in the ordinary course of business, including litigation, claims and assessments that have been asserted against acquired businesses, which we have assumed. Although we maintain insurance policies, we can make no assurance that this insurance will be adequate to protect us from all material judgments and expenses related to potential future claims or that these levels of insurance will be available in the future at economical prices or at all. A significant judgment against us, arising out of any of our current or future legal proceedings and litigation, could have a material adverse effect on our business, financial condition and future prospects. At present, the litigation with OSI Systems, Inc., is scheduled to go to trial in April 2006. In addition, The Titan Corporation was subject to a number of litigation matters and government investigations that we assumed as part of our acquisition of Titan. For a discussion of the material litigation to which we are currently a party, see Note 14 to our audited consolidated financial statements.

Our inability to keep pace with rapidly evolving products and technological change could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

We are the incumbent supplier or have been the sole provider for many years for certain programs. We refer to such contracts as ‘‘sole-source’’ contracts. In such cases, there may be other suppliers who have the capability to compete for the programs involved, but they can only enter or reenter the market if the customer chooses to reopen or recompete the particular program to competition. The majority of our sales are derived from contracts with the U.S. Government and its prime contractors, which are principally awarded on the basis of negotiations or competitive bids. Additionally, some of our competitors are larger than us and have substantially greater financial and other resources than we have.

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

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

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

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

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

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

Our future success depends to a significant degree upon the continued contributions of our management, including Mr. Lanza, our Chairman and Chief Executive Officer, and our ability to attract and retain other highly qualified management and technical personnel, including employees who have U.S. Government security clearances, particularly clearances of top-secret and above. We do not maintain any key person life insurance policies for members of our management. We have an employment agreement with Mr. Lanza. We face competition for management and technical personnel from other companies and organizations. Failure to attract and retain such personnel would damage our prospects.

Environmental laws and regulation may subject us to significant liability.

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

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

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

We currently have a backlog of orders, primarily under contracts with the U.S. Government. Our total funded backlog was $7,000.9 million at December 31, 2005. The U.S. Government may unilaterally

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modify or terminate its contracts. Accordingly, most of our backlog could be modified or terminated by the U.S. Government, which would negatively impact our results of operations and cash flows.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

At December 31, 2005, we operated in 513 locations consisting of manufacturing facilities and properties throughout the United States and internationally. Of these, we owned 35 locations consisting approximately 4.3 million square feet and leased space at 478 locations consisting approximately 20.3 million square feet.

Our reportable segments had major operations at the following locations:

- C^3ISR – Annapolis, Maryland; Camden, New Jersey; Greenville and Waco, Texas; Salt Lake City, Utah; and Reston, Virginia.
- Government Services – Huntsville, Alabama; Orlando, Florida; and Alexandria, Arlington, Chantilly and Vienna, Virginia.
- AM&M – Selma, Alabama; South Madison, Mississippi; Greenville and Waco, Texas; Edmonton, Quebec and Toronto, Canada.
- Specialized Products – Anaheim, San Carlos, San Diego, San Leandro, Simi Valley, Sylmar and Torrance, California; Muskegon, Michigan; Binghamton, New York; Cincinnati and Mason, Ohio; Philadelphia, Pittsburgh and Williamsport, Pennsylvania; and Arlington, Texas.

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

A summary of square footage by reportable segment as of December 31, 2005 is presented below.

	Leased	Owned	Total
	(Square feet in millions)		
C^3ISR	6.4	0.6	7.0
Government Services	2.0	0.1	2.1
AM&M	5.2	1.0	6.2
Specialized Products	6.6	2.6	9.2
Corporate	0.1	—	0.1
Total	20.3	4.3	24.6

Item 3. Legal Proceedings

The information required with respect to this item can be found in Note 14 to our audited consolidated financial statements.

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

None.

PART II

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

Price Range of Common Stock

The common stock of L-3 Holdings is traded on the NYSE under the symbol ‘‘LLL’’. The table below sets forth, for each of the quarterly periods indicated, the high and low closing price of the common stock as reported on the NYSE and the amount of dividends paid per share.

	Dividends Paid	Price Range of Common Stock High	Price Range of Common Stock Low
Fiscal Year Ended December 31, 2004:			
Quarter Ended:			
March 31, 2004	$ 0.10	$ 59.48	$ 49.80
June 30, 2004	0.10	66.80	59.73
September 30, 2004	0.10	67.00	56.50
December 31, 2004	0.10	76.87	62.51
Fiscal Year Ended December 31, 2005:			
Quarter Ended:			
March 31, 2005	$ 0.125	$ 76.61	$ 68.06
June 30, 2005	0.125	76.82	65.23
September 30, 2005	0.125	84.52	74.50
December 31, 2005	0.125	82.05	70.74

On February 7, 2006, L-3 Holdings announced that its Board of Directors had increased L-3 Holdings’ regular quarterly cash dividend by 50% to $0.1875 per share, payable on March 15, 2006, to shareholders of record at the close of business on February 22, 2006.

On March 3, 2006, the closing price of L-3 Holdings common stock, as reported by the NYSE, was $84.14 per share and the number of holders of L-3 Holdings’ common stock was approximately 95,000.

L-3 Holdings relies on dividends paid by L-3 Communications to generate the funds necessary to pay dividends on its common stock. See ‘‘Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources’’ for the financial and other restrictive covenants that limit the payment of dividends by L-3 Communications to L-3 Holdings.

Item 6. Selected Financial Data

We derived the selected financial data presented below at December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005 from our audited consolidated financial statements included elsewhere in this Form 10-K. We derived the selected financial data presented below at December 31, 2003, 2002 and 2001 and for the years ended December 31, 2002 and 2001 from our audited consolidated financial statements not included in this Form 10-K. You should read the selected financial data together with our ''Management's Discussion and Analysis of Financial Condition and Results of Operations'' and our audited consolidated financial statements. Our results of operations, cash flows and financial position are impacted significantly by our business acquisitions, some of which are described elsewhere herein.

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	Year Ended December 31,				
	2005	2004	2003	2002(1)	2001
Statement of Operations Data:	(in millions, except per share data)				
Sales	$ 9,444.7	$ 6,897.0	$ 5,061.6	$ 4,011.2	$ 2,347.4
Operating income	996.7	748.6	581.0	454.0	275.3
Other expense (income), net	(5.5)	(7.3)	(0.2)	(5.0)	(1.8)
Interest expense	204.2	145.3	132.7	122.5	86.4
Minority interests in net income of consolidated subsidiaries	9.7	8.9	3.5	6.2	4.4
Loss on retirement of debt	—	5.0	11.2	16.2	—
Provision for income taxes	279.8	214.8	156.2	111.6	70.8
Income before cumulative effect of a change in accounting principle	508.5	381.9	277.6	202.5	115.5
Cumulative effect of a change in accounting principle	—	—	—	(24.4)	—
Net income	$ 508.5	$ 381.9	$ 277.6	$ 178.1	$ 115.5
Basic earnings per common share:					
Income before cumulative effect of a change in accounting principle	$ 4.28	$ 3.54	$ 2.89	$ 2.33	$ 1.54
Cumulative effect of a change in accounting principle	—	—	—	(0.28)	—
Net income	$ 4.28	$ 3.54	$ 2.89	$ 2.05	$ 1.54
Diluted earnings per common share;					
Income before cumulative effect of a change in accounting principle	$ 4.20	$ 3.33	$ 2.62	$ 2.13	$ 1.47
Cumulative effect of a change in accounting principle	—	—	—	(0.23)	—
Net income	$ 4.20	$ 3.33	$ 2.62	$ 1.90	$ 1.47
Weighted average common shares outstanding:					
Basic	118.8	107.8	96.0	86.9	74.9

Diluted	121.2	117.4	113.9	105.2	85.4
Cash dividends declared per share on L-3 Holdings' common stock	$ 0.50	$ 0.40	$ —	$ —	$ —
Balance Sheet Data (at year end):					
Working capital	$ 1,789.2	$ 1,632.5	$ 1,013.5	$ 929.4	$ 717.8
Total assets	11,909.1	7,780.8	6,505.3	5,242.3	3,339.2
Long-term debt	4,633.5	2,189.8	2,457.3	1,847.8	1,315.3
Minority interests	81.2	77.5	76.2	73.2	69.9
Shareholders' equity	4,490.7	3,799.8	2,574.5	2,202.2	1,213.9

(1) In accordance with SFAS 142, effective January 1, 2002, we ceased amortizing goodwill and in connection with the adoption of SFAS 142, we recorded a goodwill impairment charge.

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

Overview

We are a leading supplier of a broad range of products used in a substantial number of aerospace and defense platforms. We also are a major supplier of systems, subsystems and products on many platforms, including those for secure networked communications and communication products, mobile satellite communications, information security systems, shipboard communications, naval power systems, missiles and munitions, telemetry and instrumentation, and airport security systems. We also are a prime system contractor for aircraft modernization and O&M, C^3ISR collection systems and services, training and simulation, intelligence services and government support services. The substantial majority of our sales are generated using written revenue arrangements, or contracts. Most of these contracts require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services according to the buyer's specifications. Our primary customer is the DoD. For the year ended December 31, 2005, direct sales to the DoD and indirect sales to the DoD through its prime contractors and subcontractors provided in the aggregate $6,962.5 million, or 73.7%, of our consolidated sales. Our other customers include the 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.

Our objective is to grow our sales organically and through business acquisitions and to improve our profitability. To achieve these objectives we intend to expand our share of existing programs and to participate in new programs by leveraging our existing customer relationships. We expect to continue to benefit from the outsourcing of subsystems, components and products by prime contractors. We plan to continue to align our research and development, manufacturing and new business efforts to complement our customers' requirements and to provide state-of-the-art products. We plan to maintain a diversified and broad business mix with limited reliance on any single program, a favorable balance of cost-reimbursable and fixed-price type contracts, a significant follow-on business and an attractive customer profile. A significant portion of our growth strategy is to selectively acquire companies or assets that complement and enhance our existing businesses.

On July 29, 2005, we acquired all of the outstanding shares of Titan for $23.10 per share in cash, or approximately $2,742.1 million, including the assumption of $626.0 million of Titan's debt, plus $41.4 million of acquisition costs, primarily comprised of merger and acquisition fees, change in control payments and other advisory fees. Concurrent with the Titan acquisition, we repaid or redeemed all of Titan's outstanding debt. The Titan acquisition was financed with a combination of cash on hand, borrowings under our senior credit facility and net proceeds from the issuance of convertible contingent debt securities by L-3 Holdings and senior subordinated notes by L-3 Communications. See ‘‘— Liquidity and Capital Resources — Statement of Cash Flows — Financing Activities’’ below.

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^{3}ISR, enterprise information technology and homeland security programs. Titan’s business mix is complementary to L-3’s with its focus on C^{3}ISR, advanced and transformational products and enterprise information technology for a number of government agencies, including the DoD, Federal Aviation Administration (FAA) and NASA, in addition to its systems integration work.

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 a total of 12,504 employees at the date of acquisition.

Titan’s capabilities are expected to broaden and enhance L-3’s participation in national intelligence and DHS infrastructure protection and analysis of weapons of mass destruction, expand L-3’s operational analysis and simulation offering and enable L-3 to penetrate new customer areas.

We expect that the Titan business will reduce our consolidated operating margin because the Titan business is largely performed under lower margin (and lower risk) cost-reimbursable type and time-and-material type contracts. Total sales for Titan for the year ended December 31, 2004 were $2,046.5 million. The table below presents customer-type and contract-type sales mix as a percentage of total sales for the year ended December 31, 2005 for L-3 and pro forma for the combined company, excluding L-3's other 2005 acquired businesses. The pro forma combined sales by customer-type and contract-type percentages below are not necessarily indicative of the results that would have actually occurred had we completed the Titan acquisition on January 1, 2005.

	L-3	Pro Forma Combined
Customer-Type		
U.S. Government	79.9%	82.0%
Commercial and foreign governments	20.1%	18.0%
	100.0%	100.0%
Contract-Type:		
Fixed-price	53.2%	48.7%
Cost-reimbursable	30.4%	33.0%
Time-and-material	16.4%	18.3%
	100.0%	100.0%

See ‘‘Business Acquisitions’’ below for a summary of our other acquisitions made in 2005, 2004 and 2003.

We have four reportable segments: (1) Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C^3ISR); (2) Government Services; (3) Aircraft Modernization and Maintenance (AM&M); and (4) Specialized Products.

As described in our Current Report on Form 8-K filed on November 23, 2005, we revised the aggregation of our operating segments within our four reportable segments in connection with the Titan acquisition to provide a more clearly defined presentation of our businesses, focused on customers, markets, products and services and independent research and development. Prior period reportable segment data have been restated to conform to the current period presentation.

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

In recent years, domestic and geo-political developments have significantly affected the markets for defense systems, products and services. There has been a fundamental and philosophical shift in focus from a ‘‘threat-based’’ model to one that emphasizes the capabilities needed to defeat a full spectrum of adversaries, which has transformed the U.S. defense posture to a capabilities-based orientation. This

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approach involves creating the ability for (1) a more flexible response, with greater force agility and stronger space capabilities, and (2) improved missile defense systems, networked communications and information systems, and security systems. This transformation also includes an increased emphasis on homeland defense. The U.S. Quadrennial Defense Review completed in February 2006 incorporates lessons learned from the Afghanistan and Iraq wars, promotes more special operations, intelligence gathering, language and cultural capabilities, improved communications and enhanced security cooperation activities.

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

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

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

Business Acquisitions

A significant component of our growth strategy has been to enhance our existing product and service base through selective business acquisitions that will add new products and services in areas that complement our present technologies. We intend to continue acquiring select businesses that (1) exhibit significant market positions in their business areas, (2) offer products and services that complement and/or extend our product and service offerings and expand our customer base, and (3) display positive sales, earnings and cash flow prospects.

The table below summarizes the more significant acquisitions that we have completed during 2003, 2004 and 2005, referred to herein as business acquisitions. See Note 3 to our audited consolidated financial statements. During 2005, we used cash of $3,434.8 million for business acquisitions. See ''Statement of Cash Flows — Investing Activities.''

Business Acquisitions	Date Acquired	Purchase Price[1] (in millions)
2003		
Avionics Systems business of Goodrich Corporation[2]	March 28, 2003	$ 188.7
Military Aviation Services business of Bombardier, Inc. (MAS)	October 31, 2003	89.6
Vertex Aerospace LLC (Vertex)	December 1, 2003	664.8
Aeromet, Inc., Klein Associates, Inc. and certain defense and aerospace assets of IPICOM, Inc.	Various	75.3
2004		
Beamhit LLC	May 13, 2004	40.9[3]
Brashear, LP	June 14, 2004	36.3
Commercial Infrared business of Raytheon Company[4]	November 9, 2004	44.3
Cincinnati Electronics, Inc.	December 9, 2004	176.3
Canadian Navigation Systems and Space Sensors System business of Northrop Grumman[5]	December 30, 2004	69.9[6]
	Various	85.4[7]

AVISYS, Inc., General Electric Driver Development business, Bay Metals, D.P. Associates, certain video security product lines of Sarnoff Corporation and BAI Aerosystems		
2005		
Marine Controls division of CAE (MAPPS)(8)	February 3, 2005	196.8(9)
Propulsion Systems business unit of General Dynamics(10)	February 25, 2005	196.8
Electron Dynamics Devices business of the Boeing Company(11)	February 28, 2005	82.3(12)
The Titan Corporation	July 29, 2005	2,742.1(13)
EOTech Acquisition Corp.	October 31, 2005	49.6(9)(14)
InfraredVision Technology Corporation, Mobile-Vision, Inc., Sonoma Design Group, Inc., Advanced Laser Systems Technology, Inc., Joseph Sheairs Associates, Inc., Hitec O, and Applied Signal and Image Technologies, Inc. .	Various	139.7(15)

(1) The purchase price represents the contractual consideration for the acquired business, excluding adjustments for net cash acquired and acquisition costs.

(2) Following the acquisition, we changed the name of Avionics Systems to L-3 Communications Avionics Systems, Inc.

(3) Excludes additional purchase price, which is contingent upon the financial performance of Beamhit for the years ending December 31, 2006 and 2007.

(4) Following the acquisition, we changed the name of the Commercial Infrared business to L-3 Communications Infrared Products (LIP).

(5) Following the acquisition, we changed the name of the Canadian Navigation Systems and Space Sensors System business to L-3 Communications Electronics Systems (LES).

(6) Includes $4.9 million final purchase price adjustment paid in the third quarter of 2005, which was based on final closing date net working capital.

(7) Excludes additional purchase price, expected not to exceed $15.8 million, which is contingent upon the financial performance of certain of these acquired businesses for the year ending December 31, 2006.

(8) Following the acquisition, we changed the name of the Marine Controls business to L-3 Communications MAPPS Inc.

(9) The purchase price is subject to adjustment based on final closing date net assets or net working capital of the acquired business.

(10) Following the acquisition, we changed the name of the Propulsion Systems business to L-3 Communications – Combat Propulsion Systems.

(11) Following the acquisition, we changed the name of the Electron Dynamics Devices business to L-3 Communications Electron Technologies, Inc.

(12) Includes a $7.7 million reduction to the contractual purchase price, which was based on final closing date net assets.

(13) Excludes additional purchase price, not to exceed $28.5 million relating to a previous business acquisition made by Titan (International Systems L.L.C.), prior to its acquisition by L-3. The additional purchase price is contingent primarily upon the financial performance of International Systems for the years ending December 31, 2006 though 2011.

(14) Excludes additional purchase price, not to exceed $8.4 million, which is contingent upon the financial performance of EOTech Acquisition Corp. for the year ending December 31, 2006.

(15) Excludes additional purchase price, not to exceed $60.6 million, which is contingent primarily upon the financial performance of InfraredVision Technology Corporation, Mobile-Vision, Inc., Sonoma Design

Group, Inc., Advanced Laser Systems Technology, Inc., Joseph Sheairs Associates, Inc. and Applied Signal and Image Technologies, Inc. for fiscal years ending on various dates in 2006 through 2008.

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Additionally, during the years ended December 31, 2003 and 2004, we purchased other businesses, which individually and in the aggregate were not material to our consolidated results of operations, financial position or cash flows during the year acquired.

All of our business acquisitions are included in our consolidated results of operations from their dates of acquisition. We regularly evaluate potential business acquisitions and joint venture transactions. Since January 1, 2006, in separate transactions, we acquired all of the outstanding stock of Advanced Systems Architectures Ltd on January 25, 2006, TCS Design and Management Services on January 26, 2006 and SAM Electronics GmbH on January 31, 2006 for an aggregate purchase price, paid in cash, of approximately $200.0 million. We financed these acquisitions using cash on hand. On February 14, 2006, we entered into an agreement to acquire a company for $120 million. The proposed business acquisition is currently subject to review under the Hart-Scott-Rodino Act and is expected to close in March 2006.

Critical Accounting Policies

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs and expenses during the reporting period. The most significant of these estimates and assumptions relate to (i) contract revenues and costs, (ii) recoverability and valuation of recorded amounts of goodwill and identifiable intangible assets, (iii) pension and postretirement benefit obligations, (iv) valuation of deferred tax assets and liabilities, (v) litigation reserves and (vi) valuation of long-lived assets. Actual amounts will differ from these estimates. We believe that our critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are uncertain and inherently risky at the time of the estimate; (2) use of reasonably different assumptions could have changed our estimates, particularly with respect to estimates of contract revenues and costs, and (3) changes in the estimate could have a material effect on our financial condition or results of operations. We believe the following critical accounting policies contain the more significant judgments and estimates used in the preparation of our financial statements.

Contract Revenue Recognition and Contract Estimates.   The majority of our revenue is generated using written contracts (revenue arrangements) that require us to design, develop, manufacture, modify, upgrade, test and integrate complex aerospace and electronic equipment, and to provide related engineering and technical services according to the buyer’s specifications. These revenue arrangements or contracts are generally fixed price, cost-reimbursable, or time-and-material. These contracts are covered by the American Institute of Certified Public Accountants Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts (SOP 81-1) and Accounting Research Bulletin No. 45, Long-term Construction-Type Contracts (ARB 45). Cost-reimbursable type contracts are also specifically covered by Accounting Research Bulletin No. 43, Chapter 11, Section A, Government Contracts, Cost-Plus-Fixed Fee Contracts (ARB 43). Substantially all of our cost-reimbursable type and time and material type contracts are with the U.S. Government, primarily with the DoD. Certain of our contracts with the U.S. Government are multi-year contracts that are funded annually by the customer, and sales on these multi-year contracts are based on amounts appropriated (funded) by the U.S. Government.

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

Accounting for the sales on a fixed-price contract, other then those contracts subject to SAB 104, requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion,

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

Sales and profits on cost-reimbursable type contracts are recognized as allowable costs are incurred on the contract, at an amount equal to the allowable costs plus the estimated profit on those costs. The estimated profit on a cost-reimbursable contract is generally fixed or variable based on the contractual fee arrangement. Incentive and award fees on these contracts are recorded as sales when the conditions under which they are earned are reasonably assured of being met and can be reasonably estimated. Sales and profits on time-and-material type contracts are recognized on the basis of direct labor hours expended multiplied by the contractual fixed rate per hour, plus the actual costs of material and other direct non-labor costs. On a time-and-material type contract the fixed hourly rates include amounts for the cost of direct labor, indirect contract costs and profit. Cost-reimbursable type or time-and-material type contracts generally contain less estimation risks than fixed-price type contracts.

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

Sales on arrangements for fixed-price type contracts that require us to perform services that are not related to production of tangible assets (Fixed-Price Service Contracts) and certain commercial customers are recognized in accordance with U.S. Securities and Exchange Commission's (SEC) Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (SAB 104). Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectibility is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are recognized when the units of work are completed. Sales and profit on cost-reimbursable type contracts that require us to perform services that are not related to production of tangible assets are recognized in the same manner as those within the scope of ARB 43 and SOP 81-1, except that award fees on these contracts are recorded as sales when awarded by the customer.

Goodwill and Identifiable Intangible Assets. In accordance with SFAS No. 141, Business Combinations, we allocate the cost of acquired businesses 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 acquired businesses, identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or

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if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged, unless the intangible asset is comprised of the assembled workforce of the acquired business.

Generally, the substantial majority of the intangible assets from the businesses that we acquire are derived from the intellectual capital of the management, administrative, scientific, engineering and technical employees of the acquired businesses. The success of our businesses is primarily dependent on the management, contracting, engineering and technical skills and knowledge of our employees, rather than on productive capital (plant and equipment) and intellectual property. Additionally, for a significant portion for our businesses, our 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 patents in most domestic work performed by such other companies for the U.S. Government. Therefore, the substantial majority of the intangible assets for our acquired businesses are recognized as goodwill.

The values assigned to acquired identifiable intangible assets for customer relationships and technology are determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax cash flows from those assets over their lives, including the probability of expected future contract renewals and sales, less a cost-of-capital charge, all of which is discounted to present value. If actual future after-tax cash flows are significantly lower than our estimates, we may be required to record an impairment charge to write down the identifiable intangible assets to their realizable values. The value assigned to goodwill equals the amount of the purchase price of the business acquired in excess of the sum of the amounts assigned to identifiable acquired assets, both tangible and intangible, less liabilities assumed. At December 31, 2005, we had goodwill of $6,899.8 million and identifiable intangible assets of $412.8 million.

We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also review goodwill annually in accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 142 requires that goodwill be tested, at a minimum, annually for each reporting unit using a two-step process. A reporting unit is an operating segment, as defined in paragraph 10 of SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, or a component of an operating segment. A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and is reviewed. Two or more components of an operating segment may be aggregated and deemed a single reporting unit if the components have similar economic characteristics. The first step is to identify any potential impairment by comparing the carrying value of the reporting unit to its fair value. If a potential impairment is identified, the second step is to measure the impairment loss by comparing the implied fair value of goodwill with the carrying value of goodwill of the reporting unit. The fair value of a reporting unit is estimated using a discounted cash flow valuation approach, and is dependent on estimates for future sales, operating income, depreciation and amortization, income tax payments, working capital changes, and capital expenditures, as well as, expected growth rates for cash flows and long-term interest rates, all of which are impacted by economic conditions related to the industries in which we operate, as well as, conditions in the U.S. capital markets. A decline in estimated fair value of a reporting unit could result in an impairment charge to goodwill, which could have a material adverse effect on our business, financial condition and results of operations.

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

materially affect the amount of annual net periodic benefit costs recognized in our results of operations from one year to the next, the liabilities for the pension plans and postretirement benefit plans, and our annual cash requirements to fund these plans.

Discount rates are used to determine the present value of our pension obligation and also affect the amount of pension expense in any given period. The discount rate assumptions used to determine our postretirement obligations at November 30, 2005 were based on a hypothetical double A yield curve represented by a series of annualized individual discount rates. Each bond issue underlying the yield curve is required to have a rating of AA or better by Moody’s Investors Service, Inc. The resulting discount rate reflects the matching of plan liability cash flows to the yield curve. Prior to using the yield curve rates, the discount assumptions for the postretirement expenses in 2005, 2004 and 2003 and the obligations at November 30, 2004 were based on investment yields available on AA rated long-term corporate bonds. In 2005, we changed our discount rate assumption methodology to consider the plans' expected cash flows because we believe it results in a more refined estimate of the discount rate assumption. For a sensitivity analysis projecting the impact of a change in the discount rate on our projected benefit obligation and pension expense, see "Liquidity and Capital Resources – Pension Plans."

Valuation of Deferred Income Tax Assets and Liabilities. At December 31, 2005, we had net deferred tax assets of $111.5 million, including $88.8 million for loss carryforwards and $18.6 million for tax credit carryforwards which are subject to various limitations and will expire if unused within their respective carryforward periods. Deferred income taxes are determined separately for each of our tax-paying entities in each tax jurisdiction. The future realization of our deferred income tax assets ultimately depends on our ability to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law, and, to a lesser extent, our ability to execute successful tax planning strategies. Based on our estimates of the amounts and timing of future taxable income and tax planning strategies, we believe that L-3 will be able to realize its deferred tax assets. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement desired tax planning strategies, could affect our ability to realize the future tax deductions underlying our net deferred tax assets, and require us to provide a valuation allowance against our net deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

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

Valuation of Long-Lived Assets. In addition to goodwill and identifiable intangible assets recognized in connection with our business acquisitions, our long-lived assets also include property and equipment, capitalized software development costs for software to be sold, leased or otherwise marketed, and certain long-term investments. We review the valuation of our long-lived assets at least annually and whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value or net realizable value expected to result from the asset's use and eventual disposition. We use a variety of factors to assess valuation, depending upon the asset. Long-lived assets are evaluated based upon the expected period the asset will be utilized, and other factors depending on the asset, including estimated future sales, profits and related cash flows, estimated product acceptance and product life cycles, changes in technology and customer demand, and the performance of investee companies and joint

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ventures, as well as volatility in external markets for investments. Changes in estimates and judgments on any of these factors could have a material impact on our results of operations and financial position.

Results of Operations

The following information should be read in conjunction with our audited consolidated financial statements. Our results of operations for the periods presented are impacted significantly by our business acquisitions. See Note 3 to our audited consolidated financial statements for a discussion of L-3's business acquisitions.

Presentation of Sales and Costs and Expenses. On the statements of operations, L-3 presents its sales and costs and expenses in two categories, ''Contracts, primarily U.S. Government'' and ''Commercial, primarily products.'' For a detailed description of these two categories, refer to Note 2 to our audited consolidated financial statements.

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Years Ended December 31, 2005, 2004 and 2003

The tables below provide two presentations of sales, operating income and operating margin data for L-3 for the years ended December 31, 2005, 2004 and 2003. The first table presents the selected data segregated between L-3's U.S. Government contractor businesses and L-3's commercial businesses. The second table presents the selected data by reportable segment. See Note 17 to our audited consolidated financial statements.

	Year Ended December 31,		
	2005	2004	2003
Statement of Operations Presentation		(in millions)	
Sales:			
Contracts, primarily U.S. Government	$ 8,549.2	$ 6,155.6	$ 4,401.7
Commercial, primarily products	895.5	741.4	659.9
Consolidated	$ 9,444.7	$ 6,897.0	$ 5,061.6
Operating income:			
Contracts, primarily U.S. Government	$ 915.9	$ 678.8	$ 537.9
Commercial, primarily products	80.8	69.8	43.1
Consolidated	$ 996.7	$ 748.6	$ 581.0
Operating margin:(1)			
Contracts, primarily U.S. Government	10.7%	11.0%	12.2%
Commercial, primarily products	9.0%	9.4%	6.5%
Consolidated	10.6%	10.9%	11.5%
Reportable Segment Presentation			
Sales(2):			
C^3ISR	$ 2,170.1	$ 1,663.6	$ 1,439.4
Government Services	1,819.8	1,059.9	814.6
AM&M	2,289.1	1,912.9	732.4
Specialized Products	3,165.7	2,260.6	2,075.2
Consolidated	$ 9,444.7	$ 6,897.0	$ 5,061.6
Operating income:			
C^3ISR	$ 249.9	$ 218.0	$ 172.9
Government Services	168.6	124.1	100.7
AM&M	227.4	186.1	100.7
Specialized Products	350.8	220.4	206.7
Consolidated	$ 996.7	$ 748.6	$ 581.0
Operating margin:(1)			
C^3ISR	11.5%	13.1%	12.0%

Government Services	9.3%	11.7%