RAYTHEON CO/
Form 10-Q
July 26, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended July 1, 2012

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

For the transition period from to

Commission File Number 1-13699

RAYTHEON COMPANY
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-1778500 (I.R.S. Employer Identification No.)

870 Winter Street, Waltham, Massachusetts 02451
(Address of principal executive offices) (Zip Code)
(781) 522-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes S No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes S No ¨

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

Large accelerated filer	S	Accelerated filer	£
Non-accelerated filer	£ (Do not check if a smaller reporting company)	Smaller reporting company	£

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No S

Number of shares of common stock outstanding as of July 23, 2012 was 332,019,000.

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Cautionary Note Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of federal securities laws, including information regarding our financial outlook, future plans, objectives, business prospects, trends and anticipated financial performance including with respect to our liquidity and capital resources, our cash tax payments, our pension expense and funding, the impact of new accounting pronouncements, our unrecognized tax benefits and the outcome of legal and administrative proceedings, claims, investigations, and commitments and contingencies. You can identify these statements by the fact that they include words such as “will,” “believe,” “anticipate,” “expect,” “estimate,” “intend,” “pla variations of these words or similar expressions. These forward-looking statements are not statements of historical facts and represent only our current expectations regarding such matters. These statements inherently involve a wide range of known and unknown uncertainties. Our actual actions and results could differ materially from what is expressed or implied by these statements. Specific factors that could cause such a difference include, but are not limited to, those set forth under Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011 and other important factors disclosed previously and from time to time in our other filings with the Securities and Exchange Commission (SEC). Given these factors, as well as other variables that may affect our operating results, you should not rely on forward-looking statements, assume that past financial performance will be a reliable indicator of future performance nor use historical trends to anticipate results or trends in future periods. We expressly disclaim any obligation or intention to provide updates to the forward-looking statements and the estimates and assumptions associated with them.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
RAYTHEON COMPANY
CONSOLIDATED BALANCE SHEETS

(In millions, except per share amounts)	(Unaudited) Jul 1, 2012	Dec 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$2,350	$4,000
Short-term investments	556	—
Contracts in process, net	5,054	4,526
Inventories	448	336
Deferred taxes	177	221
Prepaid expenses and other current assets	194	226
Total current assets	8,779	9,309
Property, plant and equipment, net	1,943	2,006
Deferred taxes	476	657
Goodwill	12,542	12,544
Other assets, net	1,338	1,338
Total assets	$25,078	$25,854
LIABILITIES AND EQUITY		
Current liabilities		
Advance payments and billings in excess of costs incurred	$2,274	$2,542
Accounts payable	1,179	1,507
Accrued employee compensation	888	941
Other accrued expenses	1,092	1,140
Total current liabilities	5,433	6,130
Accrued retiree benefits and other long-term liabilities	6,233	6,774
Deferred taxes	6	5
Long-term debt	4,607	4,605
Commitments and contingencies (Note 9)		
Equity		
Raytheon Company stockholders’ equity		
Common stock, par value, $0.01 per share, 1,450 shares authorized, 332 and 339 shares outstanding at July 1, 2012 and December 31, 2011, respectively, after deducting 175 and 163 treasury shares at July 1, 2012 and December 31, 2011, respectively.	3	3
Additional paid-in capital	11,863	11,676
Accumulated other comprehensive loss	(6,688)	(7,001)
Treasury stock, at cost	(8,779)	(8,153)
Retained earnings	12,242	11,656
Total Raytheon Company stockholders’ equity	8,641	8,181
Noncontrolling interests in subsidiaries	158	159
Total equity	8,799	8,340
Total liabilities and equity	$25,078	$25,854

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended		Six Months Ended	
(In millions, except per share amounts)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Net sales				
Products	$4,973	$5,243	$9,872	$10,284
Services	1,019	958	2,058	1,969
Total net sales	5,992	6,201	11,930	12,253
Operating expenses				
Cost of sales—products	3,805	4,131	7,590	8,192
Cost of sales—services	847	802	1,721	1,639
Administrative and selling expenses	404	436	809	862
Research and development expenses	194	162	362	301
Total operating expenses	5,250	5,531	10,482	10,994
Operating income	742	670	1,448	1,259
Non-operating (income) expense				
Interest expense	50	43	100	86
Interest income	(1)	(3)	(3)	(7)
Other (income) expense	3	1	(5)	1
Total non-operating (income) expense, net	52	41	92	80
Income from continuing operations before taxes	690	629	1,356	1,179
Federal and foreign income taxes	219	192	431	356
Income from continuing operations	471	437	925	823
Income (loss) from discontinued operations, net of tax	(1)	8	(3)	11
Net income	470	445	922	834
Less: Net income (loss) attributable to noncontrolling interests in subsidiaries	(1)	7	3	12
Net income attributable to Raytheon Company	$471	$438	$919	$822
Basic earnings (loss) per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$1.41	$1.21	$2.75	$2.28
Income (loss) from discontinued operations, net of tax	—	0.02	(0.01)	0.03
Net income	1.41	1.23	2.74	2.31
Diluted earnings (loss) per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$1.41	$1.20	$2.74	$2.26
Income (loss) from discontinued operations, net of tax	—	0.02	(0.01)	0.03
Net income	1.41	1.23	2.73	2.29
Amounts attributable to Raytheon Company common stockholders:				
Income from continuing operations	$472	$430	$922	$811
Income (loss) from discontinued operations, net of tax	(1)	8	(3)	11

Net income	$471	$438	$919	$822

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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RAYTHEON COMPANY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Net income	$470	$445	$922	$834
Other comprehensive income (loss), before tax:				
Foreign exchange translation	(24)	5	(1)	46
Cash flow hedges and interest rate locks	(6)	2	—	10
Pension and other employee benefit plans:				
Net change in initial net obligation	—	1	—	2
Prior service cost arising during period	—	45	—	45
Net loss arising during period	—	(7)	—	(7)
Amortization of prior service cost included in net periodic expense	3	—	4	2
Amortization of net actuarial loss included in net income	239	199	479	399
Effect of exchange rates	—	1	—	—
Defined benefit pension and other employee benefit plans, net	242	239	483	441
Other comprehensive income (loss), before tax	212	246	482	497
Income tax (expense) benefit related to items of other comprehensive income	(83)	(84)	(169)	(154)
Other comprehensive income (loss), net of tax	129	162	313	343
Total comprehensive income (loss)	599	607	1,235	1,177
Less: Comprehensive income (loss) attributable to noncontrolling interests in subsidiaries	(1)	7	3	12
Comprehensive income (loss) attributable to Raytheon Company	$600	$600	$1,232	$1,165

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)

Six months ended July 1, 2012 and July 3, 2011 (In millions)	Common stock	Additional paid-in capital	Accumulated other comprehensive (loss)	Treasury stock	Retained earnings	Total Raytheon Company stockholders' equity	Noncontrolling interests in subsidiaries	Total equity
Balance at December 31, 2010	$4	$ 11,406	$ (5,146)	$ (6,900)	$ 10,390	$ 9,754	$ 136	$ 9,890
Net income					822	822	12	834
Other comprehensive income (loss)			343			343		343
Dividends declared					(306)	(306)		(306)
Distributions and other activity related to noncontrolling interests							(4)	(4)
Common stock plans activity		90				90		90
Warrants exercised		123				123		123
Treasury stock activity				(631)		(631)		(631)
Balance at July 3, 2011	$4	$ 11,619	$ (4,803)	$ (7,531)	$ 10,906	$ 10,195	$ 144	$ 10,339
Balance at December 31, 2011	$3	$ 11,676	$ (7,001)	$ (8,153)	$ 11,656	$ 8,181	$ 159	$ 8,340
Net income					919	919	3	922
Other comprehensive income (loss)			313			313		313
Dividends declared					(333)	(333)		(333)
Distributions and other activity related to noncontrolling interests							(4)	(4)
Common stock plans activity		187				187		187
Treasury stock activity				(626)		(626)		(626)
Balance at July 1, 2012	$3	$ 11,863	$ (6,688)	$ (8,779)	$ 12,242	$ 8,641	$ 158	$ 8,799

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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RAYTHEON COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011
Cash flows from operating activities		
Net income	$922	$834
(Income) loss from discontinued operations, net of tax	3	(11)
Income from continuing operations	925	823
Adjustments to reconcile to net cash provided by (used in) operating activities from continuing operations, net of the effect of acquisitions and divestitures		
Depreciation and amortization	228	215
Stock-based compensation	56	54
Deferred income taxes	66	(20)
Tax benefit from stock-based awards	(10)	(9)
Changes in assets and liabilities		
Contracts in process, net and advance payments and billings in excess of costs incurred	(797)	(690)
Inventories	(112)	(56)
Prepaid expenses and other current assets	32	(24)
Accounts payable	(328)	(212)
Income taxes receivable/payable	9	(29)
Accrued employee compensation	(53)	(40)
Other accrued expenses	(46)	(100)
Other long-term liabilities	(26)	19
Pension and other postretirement benefit plans	(59)	8
Other, net	(33)	32
Net cash provided by (used in) operating activities from continuing operations	(148)	(29)
Net cash provided by (used in) operating activities from discontinued operations	6	(43)
Net cash provided by (used in) operating activities	(142)	(72)
Cash flows from investing activities		
Additions to property, plant and equipment	(137)	(107)
Proceeds from sales of property, plant and equipment	44	1
Additions to capitalized internal-use software	(46)	(50)
Purchases of short-term investments	(706)	—
Sales of short-term investments	150	—
Change in other assets	(1)	—
Payments for purchases of acquired companies, net of cash received	—	(550)
Net cash provided by (used in) investing activities from continuing operations	(696)	(706)
Net cash provided by (used in) investing activities from discontinued operations	—	17
Net cash provided by (used in) investing activities	(696)	(689)
Cash flows from financing activities		
Dividends paid	(313)	(288)
Repurchases of common stock	(600)	(625)
Proceeds from warrants exercised	—	123
Activity under common stock plans	94	24
Tax benefit from stock-based awards	10	9
Other	(3)	(4)
Net cash provided by (used in) financing activities	(812)	(761)
Net increase (decrease) in cash and cash equivalents	(1,650)	(1,522)

Cash and cash equivalents at beginning of the year	4,000	3,638
Cash and cash equivalents at end of period	$2,350	$2,116

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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RAYTHEON COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of Presentation

We prepared the accompanying unaudited consolidated financial statements of Raytheon Company and all wholly-owned and majority-owned domestic and otherwise controlled foreign subsidiaries on the same basis as our annual audited financial statements.
In the opinion of management, our financial statements reflect all adjustments, which are of a normal recurring nature, necessary for presentation of financial statements for interim periods in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and with the instructions to Form 10-Q in Article 10 of Securities and Exchange Commission (SEC) Regulation S-X. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates, and any such differences may be material to our financial statements. As discussed in more detail below in Note 6: "Discontinued Operations" and elsewhere in this Quarterly Report on Form 10-Q, during the six months ended July 1, 2012, we completed the disposal or abandonment of the remaining individual assets of our former turbo-prop commuter aircraft portfolio, Raytheon Airline Aviation Services LLC (RAAS), and all operations have ceased. As a result, we reclassified RAAS results as a discontinued operation for all periods presented. As used in this report, the terms “we,” “us,” “our,” “Raytheon” and the “Company” mean Raytheon Company and its subsidiaries, unless the context indicates another meaning.

In the three months ended July 1, 2012, we began investing in marketable securities in accordance with our short-term investment policy and cash management strategy. These marketable securities are classified as available-for-sale and are recorded at fair value as short-term investments in our consolidated balance sheets. Unrealized gains and losses on our available-for-sale securities are recorded in accumulated other comprehensive loss, net of tax. Realized gains and losses on sales of our available-for-sale securities are recorded in other (income) expense on the statement of operations. When determined, other than temporary declines in the value of available-for-sale securities are recorded as a loss in earnings. We make such determinations by considering, among other factors, the length of time the fair value of the investment has been less than the carrying value, future business prospects for the investee, and information regarding market and industry trends for the investee's business, if available. For purposes of computing realized gains and losses on available-for-sale securities, we determine cost on a specific identification basis. There were no securities deemed to have other than temporary declines in value for the three months ended July 1, 2012. In the three months ended July 1, 2012, we recorded an unrealized gain on short-term investments of less than $1 million, net of tax, in accumulated other comprehensive loss. In the three months ended July 1, 2012, we recorded gains on sales of short-term investments of less than $1 million in other (income) expense. The amortized cost of these securities closely approximated their fair value as of July 1, 2012.
We condensed or omitted certain information and footnote disclosures normally included in our annual audited financial statements, which we prepared in accordance with GAAP. Our quarterly financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011.
We have evaluated subsequent events through the time of filing our Quarterly Report on Form 10-Q with the SEC.

Note 2: Changes in Estimates under Percentage of Completion Contract Accounting

Raytheon has a Company-wide standard and disciplined quarterly Estimate at Completion (EAC) process in which management reviews the progress and performance of our contracts. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities, and the related changes in estimates of revenues and

costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (for example, the number and type of milestone events), technical requirements (for example, a newly-developed product versus a mature product), and other contract requirements. Management must make assumptions regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (to estimate increases in wages and prices for materials and related support cost allocations), performance by our subcontractors, the availability and timing of funding from our customer, and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations required under certain contracts. Based on this analysis, any adjustments to net sales, costs of sales, and the related impact to operating income are recorded as necessary in the period they become known. These adjustments may result from positive program performance, and in an

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increase in operating profit during the performance of individual contracts if we determine we will be successful in mitigating risks surrounding the technical, schedule, and cost aspects of those contracts or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating profit if we determine we will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, costs of sales, and the related impact to operating income are recognized on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a contract's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our contracts. When estimates of total costs to be incurred on a contract exceed total estimates of revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

Our operating income included net EAC adjustments resulting from changes in estimates of approximately $175 million and $117 million for the three months ended July 1, 2012 and July 3, 2011, respectively and approximately $315 million and $162 million for the six months ended July 1, 2012 and July 3, 2011, respectively. These adjustments increased our earnings from continuing operations attributable to Raytheon Company common stockholders by approximately $114 million ($0.34 per diluted share) and $76 million ($0.21 per diluted share) for the three months ended July 1, 2012 and July 3, 2011, respectively, and approximately $205 million ($0.61 per diluted share) and $101 million ($0.28 per diluted share) for the six months ended July 1, 2012 and July 3, 2011, respectively.

Note 3: Inventories

Inventories consisted of the following at:

(In millions)	Jul 1, 2012	Dec 31, 2011
Materials and purchased parts	$88	$60
Work in process	348	264
Finished goods	12	12
Total	$448	$336

We capitalize costs incurred in advance of contract award or funding in inventories if we determine that contract award or funding is probable. To the extent these are precontract costs, start-up costs have been excluded. We included capitalized precontract costs and other deferred costs of $149 million and $121 million in inventories as work in process at July 1, 2012 and December 31, 2011, respectively.

Note 4: Accounting Standards

New pronouncements issued but not effective until after July 1, 2012 are not expected to have a material impact on our financial position, results of operations or liquidity.

Note 5: Acquisitions

In pursuing our business strategies, we acquire and invest in certain businesses that meet strategic and financial criteria.
In the six months ended July 3, 2011, we acquired Applied Signal Technology, Inc., subsequently renamed Raytheon Applied Signal Technology, Inc. (RAST), and substantially all the assets of Ktech Corporation (Ktech) for a combined $550 million in cash, net of $25 million of cash and cash equivalents acquired, and exclusive of retention and management incentive payments. The acquisition of RAST is part of our strategy to extend and enhance our Space and Airborne Systems (SAS) offerings related to certain classified and Department of Defense markets, while the acquisition of Ktech is part of our strategy to extend and enhance our Missile Systems (MS) offerings. In connection with these acquisitions, in the six months ended July 3, 2011, we recorded a combined $421 million of goodwill related to expected synergies from combining operations and the value of the existing workforce, and a combined $97

million of intangible assets, primarily related to contractual relationships, license agreements and trade names, with a weighted average life of seven years.

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A rollforward of our goodwill by segment is as follows:

(In millions)	Integrated Defense Systems	Intelligence and Information Systems	Missile Systems	Network Centric Systems	Space and Airborne Systems	Technical Services	Total
Balance at December 31, 2011	$765	$1,775	$3,467	$2,616	$3,050	$871	$12,544
Acquisitions	—	(1)	—	—	—	—	(1)
Effect of foreign exchange rates and other	(1)	—	—	—	—	—	(1)
Balance at July 1, 2012	$764	$1,774	$3,467	$2,616	$3,050	$871	$12,542

Note 6: Discontinued Operations

In pursuing our business strategies, we have divested certain non-core businesses, investments, and assets when appropriate. All residual activity relating to our previously disposed businesses appears in discontinued operations. During the six months ended July 1, 2012, we completed the disposal or abandonment of the remaining individual assets of our former turbo-prop commuter aircraft portfolio, RAAS, and all operations have ceased. As a result, we have reported the results of RAAS as a discontinued operation for all periods presented. The sale of the remaining operating assets in the six months ended July 1, 2012, resulted in a gain of less than $1 million.
Income from discontinued operations included the following results of RAAS:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Pretax	$—	$12	$—	$15
After-tax	—	8	—	10

No interest expense relating to RAAS was allocated to discontinued operations for the three or six months ended July 1, 2012 and July 3, 2011 because there was no debt specifically attributable to discontinued operations.
We retain certain assets and liabilities of our previously disposed businesses. At July 1, 2012 and December 31, 2011, we had $9 million and $19 million, respectively, of assets primarily related to our retained interest in general aviation finance receivables from the previously sold Raytheon Aircraft Company (Raytheon Aircraft). At July 1, 2012 and December 31, 2011, we had $42 million and $44 million, respectively, of liabilities primarily related to non-income tax obligations, certain environmental and product liabilities, various contract obligations and aircraft lease obligations. We also retained certain pension assets and obligations, which we include in our pension disclosures.

Note 7: Fair Value Measurements

The estimated fair value of certain financial instruments, including cash and cash equivalents, approximates the carrying value due to their short maturities. The estimated fair value of notes receivable approximates the carrying value based principally on their underlying interest rates and terms, maturities, collateral and credit status of the receivables. The carrying value of long-term debt of $4,607 million and $4,605 million at July 1, 2012 and December 31, 2011, respectively, was recorded at amortized cost. The estimated fair value of long-term debt of $5,343 million and $5,121 million at July 1, 2012 and December 31, 2011, respectively, was based on quoted market prices in active markets, which falls within Level 1 of the fair value measurement hierarchy.

At July 1, 2012, we had short-term investments of $556 million consisting of highly rated bank certificates of deposit with a minimum long-term debt rating of A or A2 and a minimum short-term debt rating of A-1 and P-1.

We did not have any significant nonfinancial assets or nonfinancial liabilities that would be recognized or disclosed at fair value on a recurring basis as of July 1, 2012 and December 31, 2011. We did not have any transfers of assets or liabilities between levels of the fair value hierarchy during the six months ended July 1, 2012 or the year ended

December 31, 2011.

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Assets and liabilities measured at fair value on a recurring basis consisted of the following:

(In millions)	Level 1	Level 2 [(A)]	Level 3	Balances at Jul 1, 2012
Assets				
Marketable securities held in trust	$376	$—	$—	$376
Short-term investments	—	556	—	556
Foreign currency forward contracts	9	—	—	9
Liabilities				
Deferred compensation	229	—	—	229
Foreign currency forward contracts	18	—	—	18

(In millions)	Level 1	Level 2	Level 3	Balances at Dec 31, 2011
Assets				
Marketable securities held in trust	$363	$—	$—	$363
Foreign currency forward contracts	12	—	—	12
Liabilities				
Deferred compensation	223	—	—	223
Foreign currency forward contracts	22	—	—	22

(A) Fair value of Level 2 assets are determined by pricing vendors under a market approach using valuation models that utilize observable inputs, including maturity date, issue date, settlement date, current commercial paper rate, current certificate of deposit rate and coupon rates.

Note 8: Derivative Financial Instruments

Our primary market exposures are to interest rates and foreign exchange rates and we use certain derivative financial instruments to help manage these exposures. We execute these instruments with financial institutions that we judge to be credit-worthy, and the majority of our foreign currency forward contracts are denominated in currencies of major industrial countries. We do not hold or issue derivative financial instruments for trading or speculative purposes.
The fair value amounts of asset derivatives included in other assets, net and liability derivatives included in other accrued expenses in our consolidated balance sheets related to foreign currency forward contracts were as follows:

	Asset Derivatives		Liability Derivatives	
(In millions)	Jul 1, 2012	Dec 31, 2011	Jul 1, 2012	Dec 31, 2011
Derivatives designated as hedging instruments	$7	$11	$15	$17
Derivatives not designated as hedging instruments	2	1	3	5
Total	$9	$12	$18	$22

We recognized the following pretax gains (losses) related to foreign currency forward contracts designated as cash flow hedges:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Effective portion				
Gain (loss) recognized in accumulated other comprehensive loss (AOCL)	$(7)	$(1)	$(2)	$11
Gain (loss) reclassified from AOCL to net sales	1	1	1	1
Gain (loss) reclassified from AOCL to cost of sales	—	3	(1)	6

Amount excluded from effectiveness assessment and ineffective portion				
Gain (loss) recognized in cost of sales	—	—	—	—

We recognized the following pre-tax gains (losses) related to foreign currency forward contracts not designated as cash flow hedges:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Gain (loss) recognized in net sales	$(3)	$—	$(5)	$—
Gain (loss) recognized in cost of sales	5	—	4	7

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There were no interest rate swaps outstanding at July 1, 2012 or December 31, 2011.

We use foreign currency forward contracts to fix the functional currency value of specific commitments, payments and receipts. The aggregate notional amount of the outstanding foreign currency forward contracts was $821 million and $941 million at July 1, 2012 and December 31, 2011, respectively.
Our foreign currency forward contracts contain off-set, or netting, provisions to mitigate credit risk in the event of counterparty default, including payment default and cross default. At July 1, 2012, and December 31, 2011, these netting provisions effectively reduced our exposure to less than $1 million, which is spread across numerous highly rated counterparties.

Note 9: Commitments and Contingencies

Environmental Matters—We are involved in various stages of investigation and cleanup related to remediation of various environmental sites. Our estimate of the liability of total environmental remediation costs includes the use of a discount rate and takes into account that a portion of these costs is eligible for future recovery through the pricing of our products and services to the U.S. Government. We consider such recovery probable based on government contracting regulations and our long history of receiving reimbursement for such costs and accordingly have recorded the estimated future recovery of these costs from the U.S. Government within contracts in process. Our estimates regarding remediation costs to be incurred were as follows:

(In millions, except percentages)	Jul 1, 2012	Dec 31, 2011
Total remediation costs—undiscounted	$219	$227
Weighted average risk-free rate	5.6 %	5.6 %
Total remediation costs—discounted	$150	$152
Recoverable portion	104	105

We also lease certain government-owned properties and are generally not liable for remediation of preexisting environmental contamination at these sites; as a result, we generally do not reflect the provision for these costs in our consolidated financial statements.
Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage, and the unresolved extent of our responsibility, it is difficult to determine the ultimate outcome of environmental matters; however, we do not expect any additional liability to have a material adverse effect on our financial position, results of operations or liquidity.
Financing Arrangements and Other—We issue guarantees and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. These instruments expire on various dates through 2022. Additional guarantees of project performance for which there are no stated values also remain outstanding. The stated values outstanding at July 1, 2012 and December 31, 2011 were as follows:

(In millions)	Jul 1, 2012	Dec 31, 2011
Guarantees	$255	$256
Letters of credit	1,242	1,275
Surety bonds	241	233

Included in guarantees and letters of credit were $108 million and $222 million, respectively, at July 1, 2012, and $109 million and $240 million, respectively, at December 31, 2011, related to our joint venture in Thales-Raytheon Systems Co. Ltd. (TRS). We provide these guarantees and letters of credit to TRS and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. While we expect these entities to satisfy their loans, and meet their project performance and other contractual obligations, their failure to do so may result in a future obligation to us. We periodically evaluate the risk of TRS and other affiliates failing to satisfy their loans, or meet project performance or other contractual obligations described above. At July 1, 2012, we believe the risk that TRS and other affiliates will not be able to perform or meet

their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at July 1, 2012. At July 1, 2012 and December 31, 2011, we had an estimated liability of $4 million and $6 million, respectively, related to guarantees and letters of credit.

In 1997, we provided a first loss guarantee of $133 million on $1.3 billion of U.S. Export-Import Bank loans (maturing in 2015) to the Brazilian Government related to Network Centric Systems’ System for the Vigilance of the Amazon program. Loan repayments by the Brazilian Government were current at July 1, 2012.

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We have entered into industrial cooperation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. At July 1, 2012, the aggregate amount of our offset agreements had an outstanding notional value of approximately $5 billion. These agreements are designed to return economic value to the foreign country by requiring the contractor to engage in activities supporting local defense or commercial industries, promoting a balance of trade, developing in-country technology capabilities, or addressing other local development priorities. Offset agreements may be satisfied through activities that do not require a direct cash payment, including transferring technology, providing manufacturing, training and other consulting support to in-country projects, and the purchase by third parties (e.g., our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for activities such as subcontracting with local partners, purchasing supplies from in-country vendors, providing financial support for in-country projects, and making investments in local ventures. Such activities may also vary country-by-country depending upon requirements as dictated by their governments. We typically do not commit to offset agreements until orders for our products or services are definitive. The amounts ultimately applied against our offset agreements are based on negotiations with the customers and typically require cash outlays that represent only a fraction of the notional value in the offset agreements. Offset programs usually extend over several or more years and may provide for penalties in the event we fail to perform in accordance with offset requirements. We have historically not been required to pay any such penalties.

As a government contractor, we are subject to many levels of audit and investigation by the U.S. Government relating to our contract performance and compliance with applicable rules and regulations. Agencies that oversee contract performance include: the Defense Contract Audit Agency, the Defense Contract Management Agency, the Inspector General of the Department of Defense and other departments and agencies, the Government Accountability Office, the Department of Justice and Congressional Committees. From time to time, these and other agencies investigate or conduct audits to determine whether our operations are being conducted in accordance with applicable requirements. Such investigations and audits could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, the suspension of government export licenses or the suspension or debarment from future U.S. Government contracting. U.S. Government investigations often take years to complete and many result in no adverse action against us. Our final allowable incurred costs for each year are also subject to audit and have from time to time resulted in disputes between us and the U.S. Government with litigation resulting at the Court of Federal Claims (COFC) or the Armed Services Board of Contract Appeals (ASBCA) or their related courts of appeals. In addition, the Department of Justice has, from time to time, convened grand juries to investigate possible irregularities by us. We also provide products and services to customers outside of the U.S. and those sales are subject to local government laws, regulations, and procurement policies and practices. Our compliance with such local government regulations or any applicable U.S. Government regulations (e.g., the Foreign Corrupt Practices Act and the International Traffic in Arms Regulations) may also be investigated or audited. Other than as specifically disclosed herein, we do not expect these audits, investigations or disputes to have a material effect on our financial position, results of operations or liquidity, either individually or in the aggregate.

We have completed a self-initiated internal review of certain of our international operations, focusing on compliance with the Foreign Corrupt Practices Act. In the course of the review, we identified possible areas of concern involving certain practices related to operations in a foreign jurisdiction where we do business. We voluntarily disclosed and shared the results of our review with the SEC and the Department of Justice. Based on the information available to date, we do not believe that the results of this review will have a material adverse effect on our financial condition, results of operations or liquidity.

On July 22, 2010, Raytheon Systems Limited (RSL) was notified by the UK Border Agency (UKBA) that it had been terminated for cause on a program. The termination notice included allegations that RSL had failed to perform on certain key milestones and other matters in addition to claiming entitlement to recovery of certain losses incurred and previous payments made to RSL. We believe that RSL performed well and delivered substantial capabilities to the UKBA under the program, which began live operations in May 2009 and had been operating successfully and providing actionable information through at least April 2011 when RSL's exit obligations ended. On July 29, 2010,

RSL filed a dispute notice on the grounds that the termination by the UKBA was not valid. On August 18, 2010, the UKBA initiated arbitration proceedings on this issue. On March 22, 2011, the UKBA gave notice that it had presented a demand to draw on the approximately $80 million of letters of credit provided by RSL upon the signing of the contract with the UKBA in 2007. On March 23, 2011, the UKBA submitted a detailed claim in the arbitration of approximately £350 million (approximately $546 million based on foreign exchange rates as of July 1, 2012) for damages and clawback of previous payments, plus interest and arbitration costs, excluding any credit for capability delivered or draw on the letters of credit. The UKBA also asserted that additional amounts may be detailed in the claim in the future if estimates of its damages change, and for continuing post-termination losses and any re-procurement costs, which have not been quantified. At RSL's request, on March 29, 2011, the Arbitration Tribunal issued an interim order restraining the UKBA from drawing down on the letters of credit pending a hearing on the issue. Following the hearing, the Tribunal lifted the restraint on the basis that, at this early stage of the proceedings, the Tribunal had not heard the evidence needed to decide the merits of whether the contractual conditions for a drawdown had been established. The Tribunal also

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concluded that any decision on the UKBA's right to call on the letters of credit is inextricably intertwined with the ultimate decision on the merits in the arbitration. The Tribunal also preserved RSL's right to claim damages should RSL later establish that the drawdown was not valid. As a result, on April 6, 2011, the UKBA drew the $80 million on the letters of credit.

As a result of the Tribunal’s decision that the letters of credit are inextricably intertwined with the ultimate decision on the merits in the arbitration, we were no longer able to evaluate, independently from the overall claim, the probability of recovery of any amounts drawn on the letters of credit. We therefore recorded $80 million of costs related to the UKBA drawdown (UKBA LOC Adjustment), which was included in the operating expenses of our Intelligence and Information Systems segment in the six months ended July 3, 2011.

In June 2011, RSL submitted in the arbitration its defenses to the UKBA claim as well as substantial counterclaims in the amount of approximately £500 million (approximately $779 million based on foreign exchange rates as of July 1, 2012) against the UKBA for the collection of receivables and damages. On October 3, 2011, the UKBA filed its reply to RSL's counterclaims, and increased its claim amount by approximately £32 million, to include additional civil service and post termination costs, and approximately £33 million for interest, raising the total gross amount of the UKBA claim for damages and clawback of previous payments to approximately £415 million (approximately $647 million based on foreign exchange rates as of July 1, 2012). On January 6, 2012, RSL filed its response to the UKBA's reply. RSL is pursuing vigorously the collection of all receivables for the program and damages in connection with the wrongful termination and is mounting a strong defense to the UKBA's alleged claims for losses and previous payments. RSL has also settled all subcontractor claims, novated all key subcontracts to the UKBA and agreed with the UKBA that RSL's exit obligations to operate the previously delivered capability ended in April 2011. Effective April 15, 2011, the UKBA took over responsibility for operating the previously delivered capability.

The receivables and other assets remaining under the program for technology and services delivered were approximately $40 million at July 1, 2012 and December 31, 2011. We believe the remaining receivables and other assets are probable of recovery in litigation or arbitration. We currently believe it is not probable that RSL is liable for losses, previous payments (which includes the $80 million related to the drawdown on the letters of credit), clawback or other claims asserted by the UKBA either in its March 2011 arbitration filing or its October 2011 reply. Due to the inherent uncertainties in litigation and arbitration and the complexity and technical nature of actual and potential claims and counterclaims, it is reasonably possible that the ultimate amount of any resolution of the termination could be less or greater than the amounts we have recorded. For the same reasons, at this time, we are unable to estimate a range of the possible loss or recovery, if any, beyond the claim and counterclaim amounts. If we are required to make payments against claims or other losses asserted by the UKBA in excess of the amounts we have recorded, it could have a material adverse effect on our financial position, results of operations or liquidity. Arbitration hearings are scheduled to commence in late 2012 and we expect to have a decision in 2013.

On June 29, 2012 and July 13, 2012 we received a contracting officer’s final decision (COFD) for 2005 and 2004 incurred costs at our Space and Airborne Systems (SAS) business. The COFDs demand a total payment of $241 million for costs, interest and penalties associated with several issues, the largest of which relates to specific research and development and capital projects undertaken by SAS between 2000 and 2005. To date, no COFDs have been provided for 2000 to 2003 periods at SAS on these issues. The Government alleges that the costs incurred on the projects should have been charged directly to U.S. Government contracts rather than through indirect rates and that these costs should not be recoverable. We strongly disagree with the Government's position and are in the process of seeking a deferment of the payment and intend to litigate the issues. Due to the inherent uncertainties of litigation, we cannot estimate a range of potential loss. We believe that we appropriately charged the disputed costs based on government accounting standards and applicable precedent and properly disclosed our approach to the Government. We also believe that in many cases, the statute of limitations has run on the issues. Based upon the foregoing, we do not expect the results of the COFDs to have a material impact on our financial position, results of operations or liquidity.

In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against us. We do not expect any additional liability from these proceedings to have a material

adverse effect on our financial position, results of operations or liquidity.

Product Warranty—We provide product warranties in conjunction with certain product sales for which we recognize revenue upon delivery.

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Activity related to our product warranty accruals was as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Balance at beginning of period	$36	$42	$38	$43
Provisions for warranties	3	3	4	5
Warranty services provided	(3)	(2)	(6)	(5)
Balance at end of period	$36	$43	$36	$43

We account for warranty provision costs incurred under our long-term contracts using the cost-to-cost measure of progress as contracts costs, as the estimation of these costs is integral in determining the price of the related long-term contracts. The table above excludes these costs.

Note 10: Stockholders' Equity

Repurchases of our common stock under our share repurchase programs were as follows:

	Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011
Amount of stock repurchased	$600	$625
Shares of stock repurchased	11.9	12.5

In September 2011, our Board of Directors authorized the repurchase of up to $2.0 billion of our outstanding common stock. At July 1, 2012, we had approximately $1.6 billion available under this repurchase program. All previous programs have been completed as of July 1, 2012. Share repurchases will take place from time to time at management's discretion depending on market conditions.

In March 2012, our Board of Directors authorized a 16% increase to our annual dividend payout rate from $1.72 to $2.00 per share. Our Board of Directors also declared dividends of $1.00 per share during the six months ended July 1, 2012, compared to dividends of $0.86 per share during the six months ended July 3, 2011. Dividends are subject to quarterly approval by our Board of Directors.

The changes in shares of our common stock outstanding for the six months ended July 1, 2012 were as follows:

(In millions)	Number of Shares
Balance at December 31, 2011	338.9
Stock plan activity	5.1
Treasury stock repurchases	(11.9)
Balance at July 1, 2012	332.1

Earnings Per Share (EPS)

We compute basic and diluted EPS using actual income from continuing operations attributable to Raytheon Company common stockholders, income (loss) from discontinued operations attributable to Raytheon Company common stockholders, net income attributable to Raytheon Company, and our actual weighted-average shares and participating securities outstanding rather than the numbers presented within our consolidated financial statements, which are rounded to the nearest million. As a result, it may not be possible to recalculate EPS as presented in our unaudited consolidated financial statements. Furthermore, it may not be possible to recalculate EPS attributable to Raytheon Company common stockholders by adjusting EPS from continuing operations by EPS from discontinued operations.

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EPS from continuing operations attributable to Raytheon Company common stockholders and unvested share-based payment awards was as follows:

	Three Months Ended		Six Months Ended	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.50	$0.43	$0.99	$0.86
Undistributed earnings	0.91	0.78	1.76	1.42
Total	$1.41	$1.21	$2.75	$2.28
Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.50	$0.43	$0.99	$0.85
Undistributed earnings	0.91	0.77	1.75	1.41
Total	$1.41	$1.20	$2.74	$2.26

Basic EPS from discontinued operations attributable to Raytheon Company common stockholders and unvested share-based payment awards was a loss of less than $0.01 and income of $0.02 for the three months ended July 1, 2012 and July 3, 2011, respectively and a loss of $0.01 and income of $0.03 for the six months ended July 1, 2012 and July 3, 2011, respectively. Diluted EPS from discontinued operations attributable to Raytheon Company common stockholders and unvested share-based payment awards was a loss of less than $0.01 and income of $0.02 for the three months ended July 1, 2012 and July 3, 2011, respectively and a loss of $0.01 and income of $0.03 for the six months ended July 1, 2012 and July 3, 2011, respectively.

The amount of income from continuing operations attributable to participating securities was $9 million and $7 million for the three months ended July 1, 2012 and July 3, 2011, respectively and $17 million and $13 million for the six months ended July 1, 2012 and July 3, 2011, respectively. The amount of income (loss) from discontinued operations attributable to participating securities was a loss of less than $1 million and income of less than $1 million for the three months ended July 1, 2012 and July 3, 2011, respectively. The amount of income (loss) from discontinued operations attributable to participating securities was a loss of less than $1 million and income of less than $1 million for the six months ended July 1, 2012 and July 3, 2011, respectively. The amount of net income attributable to participating securities was $9 million and $7 million for the three months ended July 1, 2012 and July 3, 2011, respectively and was $17 million and $13 million for the six months ended July 1, 2012 and July 3, 2011, respectively.

The weighted-average shares outstanding for basic and diluted EPS were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Shares for basic EPS (including 6.6 and 5.9 participating securities for the three months ended July 1, 2012 and July 3, 2011, respectively, and 6.1 and 5.7 for the six months ended July 1, 2012 and July 3, 2011, respectively.)	333.4	355.0	335.4	356.2
Dilutive effect of stock options and Long-Term Performance Plan	1.0	1.5	1.1	1.7
Dilutive effect of warrants	—	0.6	—	1.0
Shares for diluted EPS	334.4	357.1	336.5	358.9

There were no stock options with exercise prices greater than the average market price that were excluded from our calculations of EPS for the three and six months ended July 1, 2012 and July 3, 2011. The following stock options with exercise prices less than the average market price included in our calculations of EPS were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Stock options included in calculations of EPS	1.2	4.6	1.2	4.6

Warrants to purchase shares of our common stock with an exercise price of $37.50 per share were included in our calculations of diluted EPS for the three and six months ended July 3, 2011. These warrants expired in June 2011.

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Stock-based compensation plans

Restricted stock activity for the six months ended July 1, 2012 was as follows:

(In millions)	Number of Shares
Outstanding unvested at December 31, 2011	5.5
Granted	2.3
Vested	(1.6)
Forfeited	(0.1)
Outstanding unvested at July 1, 2012	6.1

During each of the six months ended July 1, 2012 and July 3, 2011, we issued 0.5 million shares of our common stock in connection with the vesting of our 2009–2011 and 2008–2010 Long-Term Performance Plan (LTPP) awards. During the same periods, we also granted our 2012–2014 and 2011–2013 LTPP awards with an aggregate target award of 0.5 million shares for each period.

The performance goals for the 2012–2014 LTPP award are independent of each other and based on three metrics, as defined in the award agreements: return on invested capital, weighted at 50%; total shareholder return relative to a peer group, weighted at 25%; and cumulative free cash flow, weighted at 25%. The ultimate award, which is determined at the end of the three-year cycle, can range from zero to 200% of the target award and includes dividend equivalents, which are not included in the aggregate target award numbers.

Other Comprehensive Income

Other comprehensive income (loss) includes foreign currency translation adjustments, gains and losses on derivative instruments qualified as cash flow hedges, unrealized gains (losses) on equity investments, unrealized gains (losses) on short-term investments and gains and losses associated with pension and other postretirement benefits. The computation of other comprehensive income (loss) and its components are presented in the consolidated statements of comprehensive income. The related gross, tax and net amounts for each component were as follows:

Six Months Ending July 1, 2012 (In millions)	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Foreign exchange translation	$(1)	$—	$(1)
Pension and other employee benefit plans:			
Amortization of prior service cost included in net periodic expense	4	(1)	3
Amortization of net actuarial loss included in net income	479	(168)	311
Defined benefit pension and other employee benefit plans, net	483	(169)	314
Other comprehensive income (loss)	$482	$(169)	$313

Six Months Ending July 3, 2011 (In millions)	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Foreign exchange translation	$46	$—	$46
Cash flow hedges and interest rate locks	10	(4)	6
Unrealized gains on investments and other	—	4	4
Pension and other employee benefit plans:			
Net change in initial net obligation	2	(1)	1
Prior service cost arising during period	45	(16)	29
Net loss arising during period	(7)	3	(4)
Amortization of prior service cost included in net periodic expense	2	(1)	1
Amortization of net actuarial loss included in net income	399	(139)	260

Defined benefit pension and other employee benefit plans, net	441	(154)	287
Other comprehensive income (loss)	$ 497	$ (154)	$ 343

Note 11: Pension and Other Employee Benefits

We have pension plans covering the majority of our employees, including certain employees in foreign countries. We also

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provide various health care and life insurance benefits to certain retired employees through other postretirement benefit plans.

The components of net periodic pension expense were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Service cost	$135	$123	$270	$246
Interest cost	262	265	524	531
Expected return on plan assets	(357)	(319)	(714)	(638)
Amortization of prior service cost included in net periodic pension expense	3	3	5	7
Amortization of net actuarial loss included in net income	238	199	477	398
Net periodic pension expense	$281	$271	$562	$544

Our net periodic pension expense included expense from foreign benefit plans of $1 million and $3 million in the three months ended July 1, 2012 and July 3, 2011, respectively and $2 million and $7 million in the six months ended July 1, 2012 and July 3, 2011, respectively.

The components of net periodic expense (income) related to our other postretirement benefit plans were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Service cost	$2	$2	$4	$4
Interest cost	10	11	20	21
Expected return on plan assets	(7)	(9)	(15)	(17)
Net change in initial net obligation	—	1	—	2
Amortization of prior service cost included in net periodic pension expense	—	(3)	(1)	(5)
Amortization of net actuarial loss included in net income	1	—	2	1
Net periodic postretirement expense	$6	$2	$10	$6

Long-term pension and other postretirement benefit plan liabilities were $5,467 million and $401 million, respectively, at July 1, 2012, and $6,012 million and $400 million, respectively, at December 31, 2011.

We may make both required and discretionary contributions to our pension plans. Required contributions are primarily determined in accordance with the Pension Protection Act (PPA), which amended the Employee Retirement Income Security Act of 1974 (ERISA) rules and are affected by the actual return on plan assets and plan funded status. Under the PPA, we are required to fully fund our pension plans over a rolling seven-year period as determined annually based upon the funded status at the beginning of the year. In July 2012, the Surface Transportation Extension Act, which is also referred to as the Moving Ahead for Progress in the 21st Century Act (STE Act), was passed by Congress and signed by the president. The STE Act includes a provision for temporary pension funding relief due to the low interest rate environment. The provision is expected to reduce our cash funding requirements in 2012. We now expect to make total required contributions of approximately $0.7 billion–$0.8 billion to our pension and other postretirement benefit plans in 2012. The actual amount of required contributions in 2012 will be determined when the Internal Revenue Service (IRS) publishes the 25-year average interest rate prescribed under the STE Act. We made required contributions of $631 million and $542 million during the six months ended July 1, 2012 and July 3, 2011, respectively, to our pension and other postretirement benefit plans. We did not make any discretionary contributions to our pension plans during the six months ended July 1, 2012 and July 3, 2011, however, we periodically evaluate whether to make discretionary contributions.

Note 12: Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. The IRS has completed their examination of our tax returns through 2008 and we have protested to the IRS Appeals Division certain proposed adjustments related to the federal research tax credit and transfer pricing matters. In addition, we are currently under

IRS examination for the 2009 through 2012 tax years, with tax years 2011 and 2012 being examined under the Compliance Assurance Process (CAP) program. CAP is a method of identifying and resolving tax issues through open, cooperative, and transparent interaction with the IRS prior to the filing of a return. Through the CAP program, we expect to achieve tax certainty sooner and with less administrative burden than conventional post-filing examinations. It is expected that this program will shorten and narrow the scope of the post-filing

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examinations. We are also under audit by multiple state and foreign tax authorities.

We believe that our income tax reserves are adequate; however, amounts asserted by taxing authorities could be greater or less than amounts accrued and reflected in our consolidated balance sheets. Accordingly, we could record adjustments to the amounts for federal, foreign and state tax-related liabilities in the future as we revise estimates or as we settle or otherwise resolve the underlying matters.

There were no significant changes in the balance of our unrecognized tax benefits during the three and six months ended July 1, 2012 and July 3, 2011. The balance of our unrecognized tax benefits, exclusive of interest, was $168 million and $167 million at July 1, 2012 and December 31, 2011, respectively, and $196 million and $188 million at July 3, 2011 and December 31, 2010, respectively. If recognized, the majority of our unrecognized tax benefits would affect our earnings.

We accrue interest and penalties related to unrecognized tax benefits in tax expense. At July 1, 2012 and December 31, 2011, we had $20 million and $17 million, respectively, of interest and penalties accrued related to unrecognized tax benefits, which, net of the federal tax benefit, was approximately $13 million and $11 million, respectively.

In the ordinary course of business, we may take new positions that could increase or decrease our unrecognized tax benefits in future periods. It is reasonably possible that within the next 12 months our unrecognized tax benefits, exclusive of interest, may decrease by up to $60 million as a result of resolving issues protested to the IRS Appeals Division for the 2006–2008 tax years. We expect that the majority of the decrease would not impact earnings because the resolution of the issues is anticipated to be consistent with the benefit previously recognized.

Note 13: Business Segment Reporting

Our reportable segments, organized based on capabilities and technologies, are: Integrated Defense Systems, Intelligence and Information Systems, Missile Systems, Network Centric Systems, Space and Airborne Systems and Technical Services. Segment net sales and operating income generally include intersegment sales and profit recorded at cost plus a specified fee, which may differ from what the selling entity would be able to obtain on sales to external customers. Corporate and Eliminations includes corporate expenses and intersegment sales and profit eliminations. Corporate expenses represent unallocated costs and certain other corporate costs not considered part of management's evaluation of reportable segment operating performance.

During the six months ended July 1, 2012 we completed the disposal or abandonment of the remaining individual assets of our former turbo-prop commuter aircraft portfolio, RAAS, and all operations have ceased. As a result, we have reported the results of RAAS, which were formerly included in Corporate and Eliminations, as a discontinued operation for all periods presented. The sale of the remaining operating assets in the six months ended July 1, 2012 resulted in a gain of less than $1 million.

Revised segment sales for the fiscal quarters and year ended 2011 were as follows:

	Three Months Ended				Year Ended
(In millions)	Apr 3, 2011	Jul 3, 2011	Oct 2, 2011	Dec 31, 2011	Dec 31, 2011
Integrated Defense Systems	$1,219	$1,272	$1,176	$1,291	$4,958
Intelligence and Information Systems	750	752	760	753	3,015
Missile Systems	1,329	1,366	1,413	1,482	5,590
Network Centric Systems	1,121	1,135	1,104	1,137	4,497
Space and Airborne Systems	1,265	1,344	1,305	1,341	5,255
Technical Services	799	851	817	886	3,353

Corporate and Eliminations	(431)	(519)	(459)	(468)	(1,877)
Total	$6,052	$6,201	$6,116	$6,422	$24,791

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Revised segment operating income for the fiscal quarters and year ended 2011 were as follows:

	Three Months Ended				Year Ended
(In millions)	Apr 3, 2011	Jul 3, 2011	Oct 2, 2011	Dec 31, 2011	Dec 31, 2011
Integrated Defense Systems	$193	$203	$204	$236	$836
Intelligence and Information Systems	(28)	55	58	74	159
Missile Systems	155	151	178	209	693
Network Centric Systems	160	170	162	175	667
Space and Airborne Systems	156	176	171	214	717
Technical Services	81	72	75	84	312
FAS/CAS Adjustment	(89)	(90)	(75)	(83)	(337)
Corporate and Eliminations	(39)	(67)	(51)	(60)	(217)
Total	$589	$670	$722	$849	$2,830

Revised components of operating income related to Corporate and Eliminations for the fiscal quarters and year ended 2011 were as follows:

	Three Months Ended				Year Ended
(In millions)	Apr 3, 2011	Jul 3, 2011	Oct 2, 2011	Dec 31, 2011	Dec 31, 2011
Intersegment profit eliminations	$(38)	$(53)	$(45)	$(41)	$(177)
Corporate	(1)	(14)	(6)	(19)	(40)
Total	$(39)	$(67)	$(51)	$(60)	$(217)

Segment financial results were as follows:

	Three Months Ended		Six Months Ended	
Total Net Sales (In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$1,221	$1,272	$2,441	$2,491
Intelligence and Information Systems	751	752	1,515	1,502
Missile Systems	1,355	1,366	2,706	2,695
Network Centric Systems	962	1,135	1,962	2,256
Space and Airborne Systems	1,377	1,344	2,634	2,609
Technical Services	821	851	1,623	1,650
Corporate and Eliminations	(495)	(519)	(951)	(950)
Total	$5,992	$6,201	$11,930	$12,253

	Three Months Ended		Six Months Ended	
Intersegment Sales (In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$19	$18	$42	$35
Intelligence and Information Systems	3	3	6	6
Missile Systems	5	23	12	38
Network Centric Systems	109	123	212	247
Space and Airborne Systems	161	131	293	252
Technical Services	198	221	386	372
Total	$495	$519	$951	$950

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	Three Months Ended		Six Months Ended	
Operating Income (In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$236	$203	$452	$396
Intelligence and Information Systems	61	55	123	27
Missile Systems	169	151	349	306
Network Centric Systems	123	170	239	330
Space and Airborne Systems	204	176	377	332
Technical Services	75	72	146	153
FAS/CAS Adjustment	(71)	(90)	(141)	(179)
Corporate and Eliminations	(55)	(67)	(97)	(106)
Total	$742	$670	$1,448	$1,259

We must calculate our pension and other postretirement benefit costs under both Financial Accounting Standards (FAS) requirements under GAAP and U.S. Government cost accounting standards (CAS). GAAP outlines the methodology used to determine pension expense or income for financial reporting purposes, which is not indicative of the funding requirements for pension and postretirement plans that we determine by other factors. CAS prescribes the allocation to and recovery of pension and other postretirement costs on U.S. Government contracts. The results of each segment only include pension and postretirement expense as determined under CAS. The CAS requirements for pension costs and its calculation methodology differ from the FAS requirements and calculation methodology. As a result, while both FAS and CAS use long-term assumptions in their calculation methodologies, each method results in different calculated amounts of pension and postretirement cost. The FAS/CAS Adjustment, which is reported as a separate line in our segment results above, represents the difference between our pension and postretirement benefit (PRB) expense or income under FAS in accordance with GAAP and our pension and PRB expense under CAS.
The components of our FAS/CAS Adjustment were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
FAS/CAS Pension Adjustment	$(70)	$(89)	$(140)	$(179)
FAS/CAS PRB Adjustment	(1)	(1)	(1)	—
FAS/CAS Adjustment	$(71)	$(90)	$(141)	$(179)

The components of operating income related to Corporate and Eliminations were as follows:

	Three Months Ended		Six Months Ended	
(In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Intersegment profit eliminations	$(49)	$(53)	$(91)	$(91)
Corporate	(6)	(14)	(6)	(15)
Total	$(55)	$(67)	$(97)	$(106)

	Three Months Ended		Six Months Ended	
Intersegment Operating Income (In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$2	$1	$4	$2
Intelligence and Information Systems	—	—	—	—
Missile Systems	1	2	3	4
Network Centric Systems	11	14	20	26
Space and Airborne Systems	16	11	28	23
Technical Services	19	25	36	36
Total	$49	$53	$91	$91

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Identifiable Assets (In millions)	Jul 1, 2012	Dec 31, 2011
Integrated Defense Systems	$1,945	$1,909
Intelligence and Information Systems	2,485	2,442
Missile Systems	5,467	5,214
Network Centric Systems	4,340	4,242
Space and Airborne Systems	4,818	4,700
Technical Services	1,433	1,399
Corporate	4,590	5,948
Total	$25,078	$25,854

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With respect to the unaudited consolidated financial information of Raytheon Company for the three and six months ended July 1, 2012 and July 3, 2011, PricewaterhouseCoopers LLP (PricewaterhouseCoopers) reported that it has applied limited procedures in accordance with professional standards for a review of such information. Its report dated July 26, 2012, appearing below, states that the firm did not audit and does not express an opinion on that unaudited consolidated financial information. Accordingly, the degree of reliance on its report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (Securities Act) for its report on the unaudited consolidated financial information because that report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers within the meaning of Sections 7 and 11 of the Securities Act.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Raytheon Company:

We have reviewed the accompanying consolidated balance sheet of Raytheon Company and its subsidiaries as of July 1, 2012, and the related consolidated statements of operations and comprehensive income for the three-month and six-month periods ended July 1, 2012 and July 3, 2011, and the consolidated statements of equity and cash flows for the six-month periods ended July 1, 2012 and July 3, 2011. This interim financial information is the responsibility of the Company’s management.

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

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2011, and the related consolidated statements of operations, comprehensive income, equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 22, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2011, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Boston, Massachusetts

July 26, 2012

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We develop technologically advanced, integrated products, services and solutions in four core defense markets: sensing, effects, command, control, communications and intelligence (C3I), and mission support, as well as in the cybersecurity and homeland security markets. We serve both domestic and international customers, as both a prime and subcontractor on a broad portfolio of defense and related programs for primarily government customers.

We operate in six segments: Integrated Defense Systems (IDS), Intelligence and Information Systems (IIS), Missile Systems (MS), Network Centric Systems (NCS), Space and Airborne Systems (SAS), and Technical Services (TS). For a more detailed description of our segments, see “Business Segments” within Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2011.

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011 and our unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q.

CONSOLIDATED RESULTS OF OPERATIONS

As described in our Cautionary Note Regarding Forward-Looking Statements on page 3 of this Form 10-Q, our interim period results of operations and period-to-period comparisons of such results, particularly at a segment level, may not be indicative of our future operating results. Additionally, we use a fiscal calendar, which may cause the number of work days in the current and comparable prior interim period to differ and could affect period-to-period comparisons. The following discussions of comparative results among periods, including the discussion of segment results, should be viewed in this context.

As described in Note 1: “Basis of Presentation” within Item 1 of this Form 10-Q, we prepared the accompanying unaudited consolidated financial statements of Raytheon Company on the same basis as our annual audited consolidated financial statements. As discussed in more detail in Note 6: "Discontinued Operations" and elsewhere in this Quarterly Report on Form 10-Q, during the first quarter of 2012, we completed the disposal or abandonment of the remaining individual assets of our former turbo-prop commuter aircraft portfolio, and all operations have ceased. As a result, we have reported the results of Raytheon Airline Aviation Services LLC (RAAS) as a discontinued operation for all periods presented.

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Selected consolidated results were as follows:

	Three Months Ended		% of Total Net Sales Three Months Ended	
(In millions, except percentages and per share data)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Net sales				
Products	$4,973	$5,243	83.0 %	84.6 %
Services	1,019	958	17.0 %	15.4 %
Total net sales	5,992	6,201	100.0 %	100.0 %
Operating expenses				
Cost of sales				
Products	3,805	4,131	63.5 %	66.6 %
Services	847	802	14.1 %	12.9 %
Total cost of sales	4,652	4,933	77.6 %	79.6 %
Administrative and selling expenses	404	436	6.7 %	7.0 %
Research and development expenses	194	162	3.2 %	2.6 %
Total operating expenses	5,250	5,531	87.6 %	89.2 %
Operating income	742	670	12.4 %	10.8 %
Non-operating (income) expense				
Interest expense	50	43	0.8 %	0.7 %
Interest income	(1)	(3)	— %	— %
Other (income) expense	3	1	0.1 %	— %
Non-operating (income) expense, net	52	41	0.9 %	0.7 %
Federal and foreign income taxes	219	192	3.7 %	3.1 %
Income from continuing operations	471	437	7.9 %	7.0 %
Income (loss) from discontinued operations, net of tax	(1)	8	— %	0.1 %
Net income	470	445	7.8 %	7.2 %
Less: Net income (loss) attributable to noncontrolling interests in subsidiaries	(1)	7	— %	0.1 %
Net income attributable to Raytheon Company	$471	$438	7.9 %	7.1 %
Diluted earnings per share from continuing operations attributable to Raytheon Company common stockholders	$1.41	$1.20		
Diluted earnings per share attributable to Raytheon Company common stockholders	1.41	1.23		

	Six Months Ended		% of Total Net Sales Six Months Ended	
(In millions, except percentages and per share data)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Net sales				
Products	$9,872	$10,284	82.7 %	83.9 %
Services	2,058	1,969	17.3 %	16.1 %
Total net sales	11,930	12,253	100.0 %	100.0 %
Operating expenses				
Cost of sales				
Products	7,590	8,192	63.6 %	66.9 %
Services	1,721	1,639	14.4 %	13.4 %

Total cost of sales	9,311	9,831	78.0	%	80.2	%

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Administrative and selling expenses	809	862	6.8 %	7.0 %
Research and development expenses	362	301	3.0 %	2.5 %
Total operating expenses	10,482	10,994	87.9 %	89.7 %
Operating income	1,448	1,259	12.1 %	10.3 %
Non-operating (income) expense				
Interest expense	100	86	0.8 %	0.7 %
Interest income	(3)	(7)	— %	(0.1)%
Other (income) expense	(5)	1	— %	— %
Non-operating (income) expense, net	92	80	0.8 %	0.7 %
Federal and foreign income taxes	431	356	3.6 %	2.9 %
Income from continuing operations	925	823	7.8 %	6.7 %
Income (loss) from discontinued operations, net of tax	(3)	11	— %	0.1 %
Net income	922	834	7.7 %	6.8 %
Less: Net income (loss) attributable to noncontrolling interests in subsidiaries	3	12	— %	0.1 %
Net income attributable to Raytheon Company	$919	$822	7.7 %	6.7 %
Diluted earnings per share from continuing operations attributable to Raytheon Company common stockholders	$2.74	$2.26		
Diluted earnings per share attributable to Raytheon Company common stockholders	2.73	2.29		

Total Net Sales

The composition of external net sales by products and services for each segment for the second quarter and first six months of 2012 remained relatively consistent with the year ended December 31, 2011 which was approximately the following:

External Net Sales by Products and Services (% of segment total net external sales)

	IDS	IIS	MS	NCS	SAS	TS
Products	95 %	80 %	100 %	90 %	90 %	15 %
Services	5 %	20 %	— %	10 %	10 %	85 %

Total Net Sales - Second Quarter of 2012 vs. Second Quarter of 2011—The decrease in total net sales of $209 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to lower external net sales of $159 million at NCS. The decrease in external net sales at NCS was primarily due to lower net sales on U.S. Army sensor programs due to a planned decline in production, lower net sales of acoustic sensor systems due to higher 2011 deliveries based on customer demands and lower net sales on certain radio and communication programs as a result of customer program requirements.

Products and Services Net Sales - Second Quarter of 2012 vs. Second Quarter of 2011—The decrease in product net sales of $270 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to lower external product net sales of $146 million at NCS, $49 million at IDS and $38 million at IIS. The decrease in external product net sales at NCS was primarily due to the activity in the programs described above. The decrease in external product net sales at IDS was primarily due to the scheduled completion of certain design and production phases on a U.S. Navy combat systems program and the scheduled completion of certain design and production phases of various global integrated sensors programs, partially offset by higher net sales in various integrated air and missile defense programs principally driven by higher net sales on an international Patriot program awarded in the second quarter of

2011 partially offset by lower net sales from the completion of certain design and production phases on an international Patriot program awarded in the first quarter of 2008. The decrease in external product net sales at IIS was primarily due to lower net sales on the UKBA Program. The increase in service net sales of $61 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to higher external service net sales of $37 million at IIS, principally due to higher service net sales on classified programs and additional sales from businesses acquired in the fourth quarter of 2011.

Total Net Sales - First Six Months of 2012 vs. First Six Months of 2011—The decrease in total net sales of $323 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to lower external net sales of $259 million

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at NCS. The decrease in external net sales at NCS was primarily due to lower net sales on U.S. Army sensor programs due to a planned decline in production and decreases in net EAC adjustments, lower net sales on certain radio and communication programs as a result of customer program requirements, and lower net sales of acoustic sensor systems due to higher 2011 deliveries based on customer demands.

Products and Services Net Sales - First Six Months of 2012 vs. First Six Months of 2011—The decrease in product net sales of $412 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to lower external product net sales of $239 million at NCS and $69 million at IIS. The decrease in external product net sales at NCS was primarily due to the activity on the programs described above. The decrease in external product net sales at IIS was primarily due to lower net sales on the UKBA Program. The increase in service net sales of $89 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to higher external service net sales of $82 million at IIS, principally due to higher service net sales on classified programs and additional sales from businesses acquired in the fourth quarter of 2011.

Sales to Major Customers - Second Quarter of 2012 vs. Second Quarter of 2011—Sales to the U.S. Department of Defense (DoD) were 82% and 83% of total net sales in the second quarters of 2012 and 2011, respectively. Sales to the U.S. Government were 87% and 86% of total net sales in the second quarters of 2012 and 2011, respectively. Included in both DoD and U.S. Government sales were foreign military sales through the U.S. Government of $779 million and $823 million in the second quarters of 2012 and 2011, respectively. Total international sales, including foreign military sales, were $1.5 billion or 25.3% of total net sales in the second quarter of 2012 compared to $1.6 billion or 25.9% in the second quarter of 2011.

Sales to Major Customers - First Six Months of 2012 vs. First Six Months of 2011—Sales to the DoD were 82% and 83% of total net sales in the first six months of 2012 and 2011, respectively. Sales to the U.S. Government were 87% of total net sales in the first six months of 2012 and 2011. Included in both DoD and U.S. Government sales were foreign military sales through the U.S. Government of $1,615 million and $1,579 million in the first six months of 2012 and 2011, respectively. Total international sales, including foreign military sales, were $3.0 billion or 25.4% of total net sales in the first six months of 2012 compared to $3.1 billion or 25.2% in the first six months of 2011.

Total Cost of Sales

Cost of sales, for both products and services, consists of material, labor, and subcontract costs, as well as related allocated costs. For each of our contracts, we manage the nature and amount of direct costs at the contract level, and manage indirect costs through cost pools as required by government accounting regulations. The estimate of the actual amount of direct costs and indirect costs forms the basis for estimating our total costs at completion of the contract.

Total Cost of Sales - Second Quarter of 2012 vs. Second Quarter of 2011—The decrease in total cost of sales of $281 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to decreased external costs of $104 million at NCS and $94 million at IDS, as well as $19 million of lower expense in the second quarter of 2012 compared to the second quarter of 2011 related to the FAS/CAS Adjustment described below in Segment Results. The decrease in external costs at NCS was primarily due to the activity on the programs described above in Total Net Sales. The decrease in external costs at IDS was primarily due to the scheduled completion of certain design and production phases on a U.S. Navy combat systems program and the scheduled completion of certain design and production phases of various global integrated sensors programs, partially offset by higher net sales in various integrated air and missile defense programs principally driven by higher net sales on an international Patriot program awarded in the second quarter of 2011, partially offset by lower net sales from the completion of certain design and production phases on an international Patriot program awarded in the first quarter of 2008.

Products and Services Cost of Sales - Second Quarter of 2012 vs. Second Quarter of 2011—The decrease in product cost of sales of $326 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to

lower external product cost of sales of $93 million at IDS, $93 million at NCS, $40 million at IIS and $40 million at SAS. The decreases in external product costs of sales at IDS, NCS and IIS were primarily due to the activity described above in Total Net Sales. The decrease in external product costs of sales at SAS was spread across numerous programs. The increase in service cost of sales of $45 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to higher external service cost of sales of $32 million at IIS, driven primarily by the activity described above in Total Net Sales.

Total Cost of Sales - First Six Months of 2012 vs. First Six Months of 2011—The decrease in total cost of sales of $520 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to decreased external costs of $152 million at NCS, $118 million at IDS, $91 million at IIS and $74 million at SAS as well as $38 million of lower expense in the first six months of 2012 compared to the first six months of 2011 related to the FAS/CAS Adjustment described below in Segment Results. The decrease in external costs at NCS was primarily due to the activity on the programs described above in

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Total Net Sales. The decrease in external costs as IDS was primarily due to the scheduled completion of certain design and production phases on a U.S. Navy combat systems program and the scheduled completion of certain design and production phases of various global integrated sensors programs, partially offset by higher costs in various integrated air and missile defense programs principally driven by higher costs on an international Patriot program awarded in the second quarter of 2011 partially offset by lower costs from the scheduled completion of certain design and production phases on an international Patriot program awarded in the first quarter of 2008. The decrease in external costs at IIS was primarily due to the UKBA LOC Adjustment in the first quarter of 2011, as described in Commitments and Contingencies on page 50, which had an impact of $80 million. The decrease in external costs at SAS was spread across numerous programs.

Products and Services Cost of Sales - First Six Months of 2012 vs. First Six Months of 2011—The decrease in product cost of sales of $602 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to lower external product cost of sales of $168 million at IIS, at $130 million NCS, at $109 million SAS and $104 million at IDS. The decrease in external product cost of sales at IIS was primarily driven by activity on the UKBA Program, including $80 million related to the UKBA LOC Adjustment in the first six months of 2011 described above. The decreases in external product cost of sales at NCS, SAS and IDS were primarily due to the activity on the programs described above. The increase in service cost of sales of $82 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to higher external service cost of sales of $77 million at IIS, driven primarily by the activity described above in Total Net Sales.

Administrative and Selling Expenses
The decrease in administrative and selling expenses of $32 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to various cost reduction efforts and due to lower acquisition-related costs for Raytheon Applied Signal Technology, Inc. (RAST). Administrative and selling expenses in the second quarter of 2012 remained relatively consistent as a percentage of total net sales compared to the second quarter of 2011.

The decrease in administrative and selling expenses of $53 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to various cost reduction efforts and due to lower acquisition-related costs for RAST. Administrative and selling expenses in the first six months of 2012 remained relatively consistent as a percentage of total net sales compared to the first six months of 2011.

Research and Development Expenses
The increase in research and development expenses of $32 million in the second quarter of 2012 compared to the second quarter of 2011 was related to increased bid and proposal expenses due to the timing of various pursuits.

The increase in research and development expenses of $61 million in the first six months of 2012 compared to the first six months of 2011 was related to increased bid and proposal expenses due to the timing of various pursuits.

Total Operating Expenses
The decrease in total operating expenses of $281 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to the decrease in cost of sales of $281 million, the primary drivers of which are described above in Total Cost of Sales.

The decrease in total operating expenses of $512 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to the decrease in cost of sales of $520 million, the primary drivers of which are described above in Total Cost of Sales.

Operating Income

The increase in operating income of $72 million in the second quarter of 2012 compared to the second quarter of 2011 was due to the decrease in operating expenses of $281 million, the primary drivers of which are described above in Total Operating Expenses, partially offset by the decrease in total net sales of $209 million, the primary drivers of which are described above in Total Net Sales.

The increase in operating income of $189 million in the first six months of 2012 compared to the first six months of 2011 was due to the decrease in operating expenses of $512 million, the primary drivers of which are described above in Total Operating Expenses, partially offset by the decrease in total net sales of $323 million, the primary drivers of which are described above in Total Net Sales.

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Non-operating (Income) Expense, Net
The increase in non-operating (income) expense, net of $11 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to $7 million of higher interest expense, principally due to the issuance of $1.0 billion of fixed rate long-term debt in the fourth quarter of 2011.

The increase in non-operating (income) expense, net of $12 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to $14 million of higher interest expense, principally due to the issuance of $1.0 billion of fixed rate long-term debt in the fourth quarter of 2011.

Federal and Foreign Income Taxes
Our effective tax rate in the second quarter of 2012 was 31.7% compared to 30.5% in the second quarter of 2011. The increase of 1.2% was primarily due to the expiration of the U.S. research and development tax credit as of December 31, 2011, which increased the rate by approximately 1%, partially offset by the foreign income tax rate differential, which decreased the rate by approximately 0.7%. The remaining increase of 0.9% is comprised of various unrelated items which individually or collectively are not significant. Our effective tax rate in the second quarter of 2012 was lower than the statutory federal tax rate primarily due to the domestic manufacturing deduction, which decreased the rate by approximately 2%, and the foreign income tax rate differential, which decreased the rate by approximately 0.8%. The remaining decrease of 0.5% is comprised of various unrelated items which individually or collectively are not significant. Our effective tax rate in the second quarter of 2011 differed from the statutory federal rate primarily due to the domestic manufacturing deduction, which decreased the rate by approximately 2.4%, and the U.S. research and development tax credit, which decreased the rate by approximately 1%. The remaining decrease of 1.1% is comprised of various unrelated items which individually or collectively are not significant.

Our effective tax rate in the first six months of 2012 was 31.8% compared to 30.2% in the first six months of 2011. The increase of 1.6% was primarily due to the expiration of the U.S. research and development tax credit as of December 31, 2011, which increased the rate by approximately 1%, an interest recalculation refund claim filed in the first quarter of 2011, which decreased the 2011 effective tax rate by approximately 0.5%, partially offset by the foreign income tax rate differential, which decreased the rate by approximately 0.5%. The remaining increase of 0.6% is comprised of various unrelated items which individually or collectively are not significant. Our effective tax rate in the first six months of 2012 was lower than the statutory federal tax rate primarily due to the domestic manufacturing deduction, which decreased the rate by approximately 2% and the foreign income tax rate differential, which decreased the rate by approximately 0.6%. The remaining decrease of 0.6% is comprised of various unrelated items which individually or collectively are not significant. Our effective tax rate in the first six months of 2011 differed from the statutory federal rate primarily due to the domestic manufacturing deduction, which decreased the rate by approximately 2.4%, the U.S. research and development tax credit, which decreased the rate by approximately 1% and an interest recalculation refund claim filed in the first quarter of 2011, which decreased the rate by approximately 0.5%. The remaining decrease of 0.9% is comprised of various unrelated items which individually or collectively are not significant.

Income from Continuing Operations
The increase in income from continuing operations of $34 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to the $72 million increase in operating income, the primary drivers of which are described above in Operating Income, partially offset by a $27 million increase in federal and foreign income taxes, related primarily to the higher levels of income and the change in effective tax rate described above in Federal and Foreign Income Taxes.

The increase in income from continuing operations of $102 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to the $189 million increase in operating income, the primary drivers of which are described above in Operating Income, partially offset by a $75 million increase in federal and foreign

income taxes, related primarily to the higher levels of income and the change in the effective tax rate described above in Federal and Foreign Income Taxes.

Net Income

The increase in net income of $25 million in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to the increase of $34 million in income from continuing operations, the primary drivers of which are described above in Income from Continuing Operations.

The increase in net income of $88 million in the first six months of 2012 compared to the first six months of 2011 was primarily due to the increase of $102 million in income from continuing operations, the primary drivers of which are described above in Income from Continuing Operations.

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Diluted Earnings per Share (EPS) from Continuing Operations Attributable to Raytheon Company Common Stockholders

Diluted EPS from continuing operations attributable to Raytheon Company common stockholders for the second quarter of 2012 and 2011 was as follows:

	Three Months Ended	
(In millions, except per share amounts)	Jul 1, 2012	Jul 3, 2011
Income from continuing operations attributable to Raytheon Company	$472	$430
Diluted weighted average shares outstanding	334.4	357.1
Diluted EPS from continuing operations attributable to Raytheon Company	$1.41	$1.20

The increase in diluted EPS from continuing operations attributable to Raytheon Company common stockholders of $0.21 in the second quarter of 2012 compared to the second quarter of 2011 was primarily due to the increase in income from continuing operations attributable to Raytheon Company common stockholders described above. In addition, diluted EPS from continuing operations attributable to Raytheon Company common stockholders was also affected by common stock share activity, including the activity for the periods shown in the table below.

	Three Months Ended	
Shares of Common Stock Outstanding (Shares in millions)	Jul 1, 2012	Jul 3, 2011
Beginning balance	332.8	354.6
Warrants exercised	—	2.9
Stock plan activity	3.3	2.3
Treasury stock repurchases	(4.0)	(6.4)
Ending balance	332.1	353.4

Diluted EPS from continuing operations attributable to Raytheon Company common stockholders for the first six months of 2012 and 2011 was as follows:

	Six Months Ended	
(In millions, except per share amounts)	Jul 1, 2012	Jul 3, 2011
Income from continuing operations attributable to Raytheon Company	$922	$811
Diluted weighted average shares outstanding	336.5	358.9
Diluted EPS from continuing operations attributable to Raytheon Company	$2.74	$2.26

The increase in diluted EPS from continuing operations attributable to Raytheon Company common stockholders of $0.48 in the first six months of 2012 compared to the first six months of 2011 was primarily due to the increase in income from continuing operations attributable to Raytheon Company common stockholders described above. In addition, diluted EPS from continuing operations attributable to Raytheon Company common stockholders was also affected by common stock share activity, including the activity for the periods shown in the table below.

	Six Months Ended	
Shares of Common Stock Outstanding (Shares in millions)	Jul 1, 2012	Jul 3, 2011
Beginning balance	338.9	359.4
Warrants exercised	—	3.3
Stock plan activity	5.1	3.2
Treasury stock repurchases	(11.9)	(12.5)
Ending balance	332.1	353.4

Warrants to purchase shares of our common stock with an exercise price of $37.50 per share were included in our calculations of diluted EPS for the second quarter and first six months of 2011. These warrants expired in June 2011.

Diluted EPS Attributable to Raytheon Company Common Stockholders

The increase in diluted EPS attributable to Raytheon Company common stockholders of $0.18 in the second quarter of 2012

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compared to the second quarter of 2011 was primarily due to the $0.21 increase in diluted EPS from continuing operations attributable to Raytheon Company common stockholders described above.

The increase in diluted EPS attributable to Raytheon Company common stockholders of $0.44 in the first six months of 2012 compared to the first six months of 2011 was primarily due to the $0.48 increase in diluted EPS from continuing operations attributable to Raytheon Company common stockholders described above.

Adjusted EPS

Adjusted EPS is diluted EPS from continuing operations attributable to Raytheon Company common stockholders excluding the earnings per share impact of the FAS/CAS Adjustment tax effected at the federal statutory rate of 35% and, from time to time, certain other items. In addition to the FAS/CAS Adjustment, first six months of 2011 Adjusted EPS excludes the earnings per share impact of the UKBA LOC Adjustment, as described in Commitments and Contingencies on page 50, tax effected at the blended global tax rate of approximately 29%. We are providing Adjusted EPS because management uses it for the purpose of evaluating and forecasting the Company's financial performance and believes that it provides additional insight into the Company's underlying business performance. We believe it allows investors to benefit from being able to assess our operating performance in the context of how our principal customer, the U.S. Government, allows us to recover pension and other postretirement costs and to better compare our operating performance to others in the industry on that same basis. Adjusted EPS is not a measure of financial performance under GAAP and should be considered supplemental to and not a substitute for financial performance in accordance with GAAP. Adjusted EPS may not be defined and calculated by other companies in the same manner and the amounts presented may not recalculate directly due to rounding. Adjusted EPS was as follows:

	Three Months Ended		Six Months Ended	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Diluted EPS from continuing operations attributable to Raytheon Company common stockholders	$1.41	$1.20	$2.74	$2.26
Earnings per share impact of FAS/CAS Adjustment	0.14	0.16	0.27	0.32
Earnings per share impact of UKBA LOC Adjustment	—	—	—	0.16
Adjusted EPS	$1.55	$1.37	$3.01	$2.74

SEGMENT RESULTS

We report our results in the following segments: Integrated Defense Systems (IDS), Intelligence and Information Systems (IIS), Missile Systems (MS), Network Centric Systems (NCS), Space and Airborne Systems (SAS) and Technical Services (TS). The following provides some context for viewing our segment performance through the eyes of management.

Given the nature of our business, bookings, net sales, and operating income (including operating margin percentage), which we disclose and discuss at the segment level, are most relevant to an understanding of management's view of our segment performance, and often these measures have significant interrelated effects, as described below. In addition, we disclose and discuss backlog, which represents future sales that we expect to recognize over the remaining contract period, which is generally several years. We also disclose cost of sales and the components of costs of sales within our segment disclosures.

Bookings—We disclose the amount of bookings and notable contract awards for each segment. Bookings generally represent the dollar value of new contracts awarded to us during the reporting period and include firm orders for which funding has not been appropriated. We believe bookings are an important measure of future performance and are an indicator of potential future changes in net sales, because we cannot record revenues under a new contract without first having a booking in the current or a preceding period (i.e., a contract award).

Total Net Sales—We generally express changes in net sales in terms of volume. Volume generally refers to increases or decreases in revenues related to varying amounts of total operating expenses, which are comprised of cost of sales, administrative and selling expenses, and research and development expenses, incurred on individual contracts (i.e., from performance against contractual commitments on our bookings related to engineering, production or service activity). Therefore, we discuss volume changes attributable principally to individual programs unless there is a discrete event (e.g., a major contract termination, natural disaster or major labor strike), or some other unusual item that has a material effect on changes in a segment's volume for a reported period. Due to the nature of our contracts, the amount of costs incurred and related revenues will naturally fluctuate over the lives of the contracts. As a result, in any reporting period, the changes in volume on numerous contracts are likely to be due to normal fluctuations in our engineering, production or service activities.

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Total Operating Expenses—We generally disclose operating expenses for each segment in terms of the following: 1) cost of sales—labor; 2) cost of sales—materials and subcontractors; and 3) other costs of sales and other operating expenses. Included in cost of sales—labor is the incurred direct labor associated with the performance of contracts in the current period and any applicable overhead and fringe costs. Included in cost of sales—materials and subcontractors is the incurred direct materials, subcontractor costs (which include effort performed by other Raytheon segments), and applicable overhead allocations in the current period. Included in other cost of sales and other operating expenses is other direct costs not captured in labor or material and subcontractor costs, such as precontract costs previously deferred, costs previously deferred into inventory on contracts using commercial or units of delivery accounting, applicable overhead allocations, general and administrative costs, research and development costs (including bid and proposal costs), and adjustments for loss contracts.

Operating Income (and the related operating margin percentage)—We generally express changes in segment operating income in terms of volume, net changes in Estimate at Completion (EAC) adjustments or changes in contract mix and other program performance.

The impact of changes in volume on operating income excludes the impact of net EAC adjustments and the impact of changes in contract mix and other program performance and is calculated based on changes in costs on individual programs at an overall margin for the segment.

Changes in net EAC adjustments typically relate to the current period impact of revisions to total estimated revenues and costs at completion. These changes reflect improved or deteriorated operating performance or award fee rates. Raytheon has a Company-wide standard and disciplined quarterly EAC process in which management reviews the progress and performance of our contracts. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities, and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (for example, the number and type of milestone events), technical requirements (for example, a newly developed product versus a mature product), and other contract requirements. Management must make assumptions regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (to estimate increases in wages and prices for materials and related support cost allocations), performance by our subcontractors, the availability and timing of funding from our customer, and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations required under certain contracts. Based on this analysis, any adjustments to net sales, costs of sales, and the related impact to operating income are recorded as necessary in the period they become known. These adjustments may result from positive program performance and an increase in operating profit during the performance of individual contracts if we determine we will be successful in mitigating risks surrounding the technical, schedule, and cost aspects of those contracts or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating profit if we determine we will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, costs of sales, and the related impact to operating income are recognized on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a contract's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our contracts. Given that we have over 15,000 individual contracts and the types and complexity of the assumptions and estimates we must make on an on-going basis, as discussed above, we have both favorable and unfavorable EAC adjustments. We had the following aggregate EAC adjustments for the periods presented:

	Three Months Ended		Six Months Ended	
EAC Adjustments (In millions)	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Gross favorable	$263	$230	$499	$452

Gross unfavorable	(88)	(113)	(184)	(290)
Total net EAC adjustments	$175	$117	$315	$162

There were no significant individual EAC adjustments in the second quarters of 2012 and 2011. There were no significant individual EAC adjustments in the first six months of 2012. In the first six months of 2011, we had the UKBA LOC Adjustment of $80 million, which is described in Commitments and Contingencies on page 50.

The $58 million increase in net EAC adjustments in the second quarter of 2012 compared to the second quarter of 2011 was primarily driven by $23 million at SAS and $21 million at MS, as more fully described below in the operating income discussions for each respective segment. The $153 million increase in net EAC adjustments in the first six months of 2012 compared to the first six months of 2011 was primarily due to $85 million at IIS, $57 million at SAS and $31 million at MS, as

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more fully described below in the operating income discussions for each respective segment.

Changes in contract mix and other program performance refer to changes in operating margin due to a change in the relative volume of contracts with higher or lower fee rates such that the overall average margin rate for the segment changes and other drivers of program performance, including margin rate increases or decreases due to EAC adjustments in prior periods. A higher or lower expected fee rate at the initial award of a contract typically correlates to the contract's risk profile, which is often specifically driven by the type of customer and related procurement regulations, the type of contract (for example, fixed price vs. cost plus), the maturity of the product or service, and the scope of work.

Because each segment has thousands of contracts in any reporting period, changes in operating income and margin are likely to be due to normal changes in volume, net EAC adjustments, and contract mix and other performance on many contracts with no single change, or series of related changes, materially driving a segment's change in operating income or operating margin percentage.

Backlog—We disclose period-ending backlog for each segment. Backlog represents the dollar value of contracts awarded for which work has not been performed. Backlog generally increases with bookings and generally converts into sales as we incur costs under the related contractual commitments. Therefore, we discuss changes in backlog, including any significant cancellations, for each of our segments, as we believe such discussion provides an understanding of the awarded but not executed portions of our contracts.

Segment financial results were as follows:

Total Net Sales (In millions)	Three Months Ended		Six Months Ended	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$1,221	$1,272	$2,441	$2,491
Intelligence and Information Systems	751	752	1,515	1,502
Missile Systems	1,355	1,366	2,706	2,695
Network Centric Systems	962	1,135	1,962	2,256
Space and Airborne Systems	1,377	1,344	2,634	2,609
Technical Services	821	851	1,623	1,650
Corporate and Eliminations	(495)	(519)	(951)	(950)
Total	$5,992	$6,201	$11,930	$12,253

Operating Income (In millions)	Three Months Ended		Six Months Ended	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$236	$203	$452	$396
Intelligence and Information Systems	61	55	123	27
Missile Systems	169	151	349	306
Network Centric Systems	123	170	239	330
Space and Airborne Systems	204	176	377	332
Technical Services	75	72	146	153
FAS/CAS Adjustment	(71)	(90)	(141)	(179)
Corporate and Eliminations	(55)	(67)	(97)	(106)
Total	$742	$670	$1,448	$1,259

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Bookings (In millions)	Three Months Ended		Six Months Ended	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Integrated Defense Systems	$676	$2,306	$1,412	$2,942
Intelligence and Information Systems	646	757	1,092	1,585
Missile Systems	1,757	1,315	3,082	2,209
Network Centric Systems	984	896	1,605	1,756
Space and Airborne Systems	1,240	1,039	2,893	2,389
Technical Services	854	1,108	1,235	1,643
Total	$6,157	$7,421	$11,319	$12,524

Included in bookings were international bookings of $576 million and $2,651 million in the second quarters of 2012 and 2011, respectively, and $1,944 million and $4,089 million in the first six months of 2012 and 2011, respectively which included foreign military bookings through the U.S. Government. International bookings amounted to 9% and 36% of total bookings in the second quarters of 2012 and 2011, respectively and 17% and 33% in the first six months of 2012 and 2011, respectively.

We record bookings for not-to-exceed contract awards based on reasonable estimates of expected contract definitization, which will generally not be less than 75% of the award. We subsequently adjust bookings to reflect the actual amounts definitized, or, when prior to definitization, when facts and circumstances indicate that our previously estimated amounts are no longer reasonable. The timing of awards that may cover multiple fiscal years influences the size of bookings in each year. Bookings exclude unexercised contract options and potential orders under ordering-type contracts (e.g., indefinite delivery/indefinite quantity (IDIQ) type contracts), and are reduced for contract cancellations and terminations of bookings recognized in the current year. We reflect contract cancellations and terminations from prior year bookings, as well as the impact of changes in foreign exchange rates, directly as an adjustment to backlog in the period in which the cancellation or termination occurs and the impact is determinable.

Backlog (In millions)	Funded Backlog		Total Backlog	
	Jul 1, 2012	Dec 31, 2011	Jul 1, 2012	Dec 31, 2011
Integrated Defense Systems	$7,199	$7,100	$8,725	$9,766
Intelligence and Information Systems	1,163	829	3,924	4,366
Missile Systems	6,350	6,205	8,899	8,570
Network Centric Systems	2,989	3,267	3,819	4,160
Space and Airborne Systems	3,613	3,104	6,137	5,864
Technical Services	1,771	1,957	2,419	2,586
Total	$23,085	$22,462	$33,923	$35,312

Total backlog includes both funded backlog (unfilled orders for which funding is authorized, appropriated and contractually obligated by the customer) and unfunded backlog (firm orders for which funding has not been appropriated and/or contractually obligated by the customer). Revenue is generally not recognized on backlog until funded. Backlog excludes unexercised contract options and potential orders under ordering-type contracts (e.g., IDIQ). Both funded and unfunded backlog are affected by changes in foreign exchange rates.

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Integrated Defense Systems

(In millions, except percentages)	Three Months Ended			Six Months Ended		
	Jul 1, 2012	Jul 3, 2011	% Change	Jul 1, 2012	Jul 3, 2011	% Change
Total Net Sales	$1,221	$1,272	(4.0)%	$2,441	$2,491	(2.0)%
Operating Expenses						
Cost of sales—labor	440	479	(8.1)%	904	977	(7.5)%
Cost of sales—materials and subcontractors						