

With regard to the Aegis Combat System, our Electronic Systems segment performs activities in the development, production, ship integration and test, and lifetime support for ships of international customers such as Japan, Spain, Korea, Norway, and Australia. The system also has been selected to be used as a ground-based missile defense system in Europe, referred to as “Aegis Ashore.” This segment has contracts with the Canadian Government for the upgrade and support of combat systems on Halifax class frigates. The new Littoral Combat Ship (LCS) is also generating interest from potential international customers. Electronic Systems also produces the PAC-3 missile, an advanced defensive missile designed to intercept incoming airborne threats, for international customers including Japan, Germany, the Netherlands, Taiwan, and the United Arab Emirates (UAE). The UAE entered into a FMS agreement with the U.S. Government for the first international sale of the THAAD missile defense system, with other countries having expressed interest. In 2011, the Commonwealth of Australia entered into a FMS agreement for the first international sale of the MH-60R helicopter, for which we are responsible for integrating the common cockpit avionics suite, which marks the first ever purchase of an MH-60R helicopter outside of the U.S., and we also received an order to upgrade the United Kingdom’s Warrior fighting vehicles.

To the extent our contracts and business arrangements with international partners include operations in foreign countries, other risks are introduced into our business, including changing economic conditions, fluctuations in relative currency values, regulation by foreign countries, and the potential for deterioration of political relations.

### ***Status of the F-35 Program***

The F-35 program consists of multiple contracts. Under our customer’s acquisition strategy, the System Development and Demonstration (SDD) contract will be performed concurrently with the Low Rate Initial Production (LRIP) contracts. Concurrent performance of development and production contracts is advantageous in complex programs to test airplanes, shorten the time to field systems, and achieve overall cost savings. Accordingly, we are performing the SDD contract concurrently with LRIP aircraft lots 2 through 6.

The SDD portion of the F-35 program is expected to continue into 2017 and has approximately \$530 million of fee remaining, only a minor portion of which has been tied to specific performance milestones to date. Any portion of the remaining fee that we or our partners receive will be dependent upon our customer’s evaluation of our progress on program milestones, most of which have yet to be determined by our customer. The current profit booking rate on the SDD contract contemplates that we will earn a portion of these outstanding award fees.

Given the size and complexity of the F-35 program, we anticipate that there will be continual reviews related to aircraft quantities, program schedule, cost, and requirements as part of the DoD, Congressional, and international partners’ oversight and budgeting processes. Current program challenges include, but are not limited to, executing flight tests, supplier and partner performance, software development, and receiving funding for the LRIP contracts on a timely basis. In 2011, both of the LRIP lot 1 aircraft and seven of the 12 LRIP lot 2 aircraft were delivered to the U.S. Government. We received additional funding for LRIP 5 and long lead funding for LRIP 6 in 2011. We now have 93 production aircraft on order.

Although not exclusively related to the F-35 program, on October 4, 2010, the Defense Contracting Management Agency (DCMA) withdrew its prior validation and determination of compliance of the earned value management system (EVMS) at our Fort Worth, Texas location. EVMS is a tool for managing cost and schedule performance on complex programs. We understand that the DCMA has chosen to re-audit our EVMS system in 2012. The withdrawal of the prior validation and determination of compliance of the EVMS system has no impact on our internal controls over financial reporting.

In January 2012, the Secretary of Defense removed the short takeoff and vertical landing (STOVL) fighter variant from “probation” as the STOVL variant completed highly successful initial sea trials aboard the USS Wasp and is demonstrating the kind of performance and maturity that is in line with the other two variants of the F-35.

International interest in the F-35 continues to grow with two U.S. Government FMS customers to go along with our eight partner countries. In 2011, the Israeli government signed a letter of offer and acceptance with the U.S. Government for the procurement of F-35 aircraft and the Japanese Ministry of Defense selected the F-35 to be its next generation fighter. Israel and Japan are expected to be the first two countries to receive the F-35 aircraft through the U.S. Government FMS process.