



ANNUAL REPORT 2003  
LOCKHEED MARTIN CORPORATION

*Lockheed Martin Corporation*  
**2003 FINANCIAL HIGHLIGHTS**

<i>(In millions, except per share data and number of employees)</i>	<b>2003</b>	2002	2001
Net sales	<b>\$31,824</b>	\$26,578	\$23,990
Operating profit from business segments	<b>2,468</b>	2,020	1,709
Consolidated operating profit	<b>2,019</b>	1,158	833
Earnings from continuing operations	<b>1,053</b>	533	43
Net earnings (loss)	<b>1,053</b>	500	(1,046)
Earnings (loss) per diluted share	<b>2.34</b>	1.11	(2.42)
Average diluted common shares outstanding	<b>450.0</b>	452.0	432.5
Net cash provided by operating activities	<b>1,809</b>	2,288	1,825
Cash dividends per common share	<b>0.58</b>	0.44	0.44
Cash, cash equivalents and short-term investments	<b>1,250</b>	2,738	912
Total assets	<b>26,175</b>	26,979	27,714
Total debt	<b>6,208</b>	7,582	7,511
Stockholders' equity	<b>\$ 6,756</b>	\$ 5,865	\$ 6,443
Debt-to-total-capital ratio	<b>48%</b>	56%	54%
Negotiated backlog	<b>\$76,899</b>	\$70,385	\$71,269
Employees	<b>130,000</b>	125,000	125,000

*NOTE: For a discussion of matters affecting the comparability of the information presented above, refer to Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 17 through 39 of this Annual Report.*

## CONTENTS

Letter to Shareholders — PAGE 3
Narrative Section — PAGE 6
Financial Section of the 2003 Annual Report — PAGE 16
Corporate Directory — PAGE 71
General Information — PAGE 73

On the Cover: The Horizontal Integration Lab in Colorado Springs, Colorado, will enhance Lockheed Martin's collaboration with customers and partners to develop advanced architectures for Net-Centric Operations.

**WE NEVER FORGET**  
THE IMPORTANCE OF WHAT WE'RE DOING OR  
**WHO WE'RE DOING IT FOR™**





Vance D. Coffman  
Chairman and Chief Executive Officer

Robert J. Stevens  
President and Chief Operating Officer

## DEAR FELLOW SHAREHOLDERS,

With our management team united behind a straightforward and keenly focused strategy of disciplined growth, Lockheed Martin was, and continues to be, distinguished by robust operational and financial performance in 2003. As a result, we enter 2004 well positioned to fulfill the potential and promise of this innovative corporation of 130,000 dedicated men and women.

This strategy of disciplined growth is to increase shareholder value by:

- Putting operational performance and customer satisfaction at the top of our priorities.
- Maintaining consistent financial performance including strong cash flow and increasing financial strength and flexibility.
- Focusing on profitable growth in our core markets of Defense, Homeland Security and Government Information Technology (IT). We also look forward to working with NASA to support America's reinvigorated commitment to space exploration.

Successful execution of this strategy was demonstrated in the numbers with a third straight year of positive momentum. Net sales in 2003 grew 20 percent to \$31.8 billion. We have grown segment operating profit faster than sales, reflecting steadily improving margins. For the third consecutive year, orders remain strong with a backlog of \$76.9 billion at the end of 2003. Our Aeronautics business enjoyed a record year for sales and our Electronic Systems business completed a seventh consecutive year of organic growth.

We continued our record of consistent cash flow generation that reached \$1.8 billion in 2003, and deployed cash to enhance shareholder value through:

- *Debt reduction.* We reduced debt by \$1.4 billion in 2003 and \$3.7 billion since 2000. Our ratio of debt to total capital, at 48 percent, is now within our goal of 40 to 50 percent. We also restructured about \$1 billion of debt to achieve lower interest expense.
- *Share repurchase.* We have been buying back our shares periodically. Since we started our share repurchase activity about a year ago, we have retired approximately 11 million shares.
- *Dividends.* Financial flexibility and vitality are also reflected in our doubling the annual dividend rate from 44 cents to 88 cents per common share.
- *Acquisitions.* Growing business in our core markets is key to competing successfully, and we have made selective acquisitions to continue strengthening our position in defense and civil government IT.

Lockheed Martin last year completed strategic transactions with ACS and Orincon, and announced the proposed acquisition of The Titan Corporation. We expect these transactions will bring additional capabilities, a talented workforce and customers. These transactions will help us be more competitive in the defense and civil government IT markets.

About 25 percent of our sales are from IT solutions and services to defense, intelligence and civil government agencies.

The Titan acquisition, when completed and integrated with Orincon, will bolster our core capabilities in critical intelligence, knowledge management and data fusion that are applicable to national defense. In the ACS transaction, we acquired the defense and most of the civil government IT business of ACS, while ACS acquired Lockheed Martin's commercial IT business.

Financial performance and portfolio shaping are only part of the picture; Lockheed Martin consistently works to be a trusted and valued partner with our customers in the United States and worldwide. Consequently, last year we registered some impressive operational achievements:

- In 2003, the F/A-22 team continued to address avionics stability challenges, operational testing began on schedule, high quality aircraft are being delivered, and the team continues to make solid progress in the transition from development to production.
- In 2003, Lockheed Martin saw a resurgence in its space business with 11 new launches awarded and orders placed for five new commercial satellites.
- The Patriot Advanced Capability (PAC-3) missile, the world's first operational weapon system to employ hit-to-kill technology, made its operational debut during Operation Iraqi Freedom, defending troops and installations against ballistic missile threats.
- We recorded two successful launches of our Atlas V in 2003. In all, there have been 68 consecutive successful Atlas launches. NASA also selected the Atlas V to launch the first space probe to Pluto in 2006.
- The F-35 Joint Strike Fighter successfully completed its Preliminary Design Review and is proceeding toward the Design Integration Maturity Review this spring and the Critical Design Review in 2005.
- The Spitzer Space Telescope we built for NASA was launched and began providing extraordinary infrared images of the universe.
- The U.S. Air Force gave operational certification to the stealthy Joint Air to Surface Standoff Missile.
- We received a vote of confidence from the U.S. Air Force and Marine Corps for the C-130J airlifter, which was reflected in a multi-year acquisition of 60 aircraft.

We reorganized our business areas last year to better address the changing and increasingly complex needs of our defense customers, especially in the critical area of Information Superiority.

By creating a new business area, Integrated Systems & Solutions, we are leveraging technical expertise across the breadth of Lockheed Martin to address our customers' requirements for highly integrated, networked solutions. Integrated Systems & Solutions provides customers with the benefit of focused collaboration for solutions that are technically sound, cost effective, and that enhance operational performance.

As part of this effort, we are creating the Global Vision Network to enable collaboration among customers and Lockheed Martin. The central node of this high-bandwidth engineering network is the Global Vision Integration Center in Suffolk, Virginia, which will lead our development, simulation and analysis of network-centric solutions for the Department of Defense and other national security customers.

Without the people of Lockheed Martin, the achievements of the past year would not have been possible. We are proud of the men and women who bring a passion for invention to their work each and every day.

Our efforts to recruit and retain the best people continue apace. A diverse and talented workforce is fundamentally important to our future competitiveness. Also fundamental to this corporation are the values that inspire our management team. Ethics is not simply an add-on to our management strategy; it is inherent in the Lockheed Martin culture through regular training at all levels of the organization. We also apply these principles to meeting the highest standards of corporate governance and transparency in our financial disclosure practices.

LM21 represents the commitment of all our employees to Operating Excellence and is based on the two pillars of superior development processes (and process improvement), and lean manufacturing techniques.

Lockheed Martin's values are translated into action through our community and educational activities that help ensure that we as a corporate citizen give back to the communities where we work and live. The people of Lockheed Martin stood as one company in our response to the shootings in Meridian, Mississippi, and assisted those families affected by the tragedy. A year after the loss of the Space Shuttle Columbia, we honor the memory of the heroes who flew aboard that mission and stand with NASA in their commitment to manned and unmanned space exploration to the moon and beyond.

As a corporation with a long history of serving the armed forces of the United States, we are acutely aware of the sacrifices our servicemen and women make every day in the defense of freedom. Our management team and the entire corporation salute those who are serving abroad and in the United States, including the nearly 300 Lockheed Martin employees now on active military duty, as well as the Lockheed Martin employees working in Iraq and worldwide.

In summary, we are confident your company is well positioned for the future with:

- Leadership in Defense, Homeland Security, Government Information Technology and Services growth markets, as well as space systems and exploration.
- A broad portfolio of capabilities and programs that provide total systems solutions for customer challenges.
- A strong backlog plus substantial new business opportunities.
- Consistent financial performance and strong cash flow.
- Cash deployment to enhance shareholder value.

Lockheed Martin's reputation as a dynamic enterprise serving our customers', our nation's and our allies' most important priorities will be enhanced by adhering closely to a strategy that focuses on financial and operational performance, as well as the highest standards of business ethics. At the same time, we remain keenly aware of opportunities to grow our core businesses.

On a closing note, I recently announced my retirement as CEO, effective in August 2004. My 37 years with Lockheed Martin have been filled with challenge, wonder and tremendous gratification. The personal pride I feel for this company is exceeded only by the deep appreciation I have for its amazing 130,000 employees. The consolidation of the defense industry has led us through a challenging period in our history. All of you — our shareholders, customers and employees — have seen our corporation meet those demands and become stronger as a result.

Having served seven years at the helm, it is now time for new leadership to take us to the next level of performance. Bob Stevens will assume leadership of Lockheed Martin upon my retirement and his energy, skill and business acumen will continue to serve you well. I am sure Bob will be a great leader, bringing fresh thinking and perspective to our company and our industry. I leave confident that the future of Lockheed Martin is indeed bright and the best years are ahead.

March 1, 2004



Vance D. Coffman  
Chairman and Chief Executive Officer

PARTNERING TO HELP CUSTOMERS MEET THEIR  
**DEFINING MOMENTS™**



U.S. ARMED SERVICES and allied forces apply cutting-edge technologies from Lockheed Martin that enable them to turn data into knowledge, and knowledge into action. These systems link assets in space, in the air, at sea and on land with the goal of giving commanders the full picture of the battlespace in real-time. Information Superiority is the essence of the Department of Defense's drive to Net-Centric Operations.



**LOCKHEED MARTIN'S CAPABILITIES** are aligned strongly with the highest priorities of our customers, which are mainly large U.S. and allied government agencies responsible for their nations' most important challenges.

Whether the mission is defense, homeland security or managing complex civil government Information Technology (IT) systems, our customers face a continuing series of defining moments. These range from equipping military forces with transformational capabilities that will help them meet a new spectrum of threats, to strengthening defenses against terrorism while preserving civil liberties, to providing numerous civil government services that are vital to the functioning of society.

We recognize the importance of creating value for our customers. That means partnering with our customers and with companies in the United States and from around the world to deliver the advanced technology solutions our customers require to fulfill their most critical missions. We strive to earn a reputation as the partner of choice, supplier of choice and employer of choice in the global marketplace.



WE NEVER FORGET who we're working for, and that includes the pilots of the F/A-22 Raptor. Built with unprecedented stealth, supercruise and avionics brainpower, the F/A-22 will protect aircrews in the heat of battle while destroying an adversary's will to fight.



AS A TRUSTED and valued partner with government and industry, we take seriously the challenge of securing the homeland. Maritime and port traffic management and security are vital national priorities in the United States and worldwide.

# DISTINGUISHED BY WHOLE-SYSTEM THINKING AND ACTION™



THE EFFECTIVENESS OF MISSILE DEFENSE SYSTEMS depends on robust and extraordinarily reliable command and control systems. Lockheed Martin is working on significant missile defense programs including: Space-Based Infrared System-High (SBIRS-H), Battle Management Command and Control, Terminal High Altitude Area Defense (THAAD), Patriot Advanced Capability (PAC-3) Missile, Medium Extended Air Defense System (MEADS), Multiple Kill Vehicle, Airborne Laser, Targets and Countermeasures, Aegis sea-based missile defense, and the Boost Vehicle Plus.

**RECOGNIZING THAT THE COMPLEX** issues facing our Defense, Homeland Security and Government IT customers require integrated solutions, Lockheed Martin embraces the challenge by taking a whole-system approach.

As a lead systems integrator, Lockheed Martin is adept at combining the best of technologies and teams of dedicated people — supporting Net-Centric military and Citizen-Centered civil government agencies. That includes defense electronics that raise the capabilities of platforms such as surface ships, submarines, helicopters and fixed-wing aircraft.

We are combining industry teams, information systems and advanced technologies on the Deepwater Project for the U.S. Coast Guard as it fulfills its mission of protecting America's coastlines. Deepwater will recapitalize the Coast Guard by upgrading ships, aircraft, logistics, and command and control systems.

As a leader in E-Government solutions, we at Lockheed Martin apply our extensive Information Technology capability across the breadth of more than a dozen federal agencies that serve the American people, such as the Social Security Administration, which processes and delivers 50 million checks a month.



BY UTILIZING HIGH-SPEED and highly accurate IT solutions, government agencies can better assist the public with benefits, information and services. Lockheed Martin provides the Department of Veterans Affairs with IT infrastructure support so those who have served their country can be better served.



LOCKHEED MARTIN TECHNOLOGIES help the U.S. Coast Guard and U.S. Customs & Border Protection keep America secure. Our technologies are being applied to chemical and biological agent detection as well as biometrics that can help our government customers ensure the security and safety of their operations.

# TAKING ON CHALLENGES WITH A PASSION FOR INVENTION™



OUR COMBAT AIRCRAFT are designed and built with the same passion that has inspired inventors and innovators through a century of powered flight. Lockheed Martin's Paul Bevilaqua (*above*) designed the unique and advanced convertible lift fan propulsion system that powers the F-35 Joint Strike Fighter. The first truly global combat aircraft, the F-35 has become an innovative model for U.S. and international partnering.

**AT LOCKHEED MARTIN,** we are driven by a passion for invention — the ability to provide a new perspective, to look at any problem, any possible solution, from all sides.

We partner with the U.S. Department of Defense and allied nations to provide the advanced technology they need to deter aggression, or to project power, achieve air dominance and engage targets precisely in the event of combat. Defining moments for our customers can come when law enforcement officers, securing the homeland from the threats of terrorism and crime, can match a fingerprint out of a database of 400 million in a matter of minutes.

The work we do touches the lives of millions of citizens, such as when the governments of the United States, United Kingdom and Canada conduct and analyze their censuses. Crucial government decisions on schools, roads and other services depend on a reliable count, and Lockheed Martin delivers the advanced optical character recognition and computing technologies to address that vital requirement.

With inventive solutions, Lockheed Martin is helping the Environmental Protection Agency to develop an automated and integrated approach to managing the federal government's rule-making function in support of the President's Management Agenda.



THE PASSION TO TAKE ON complex challenges for our customers' most important priorities is one reason Lockheed Martin air traffic management products and services are a global standard for the industry, managing 60 percent of the world's air traffic.



MOVING MORE THAN 200 BILLION pieces of mail a year accurately, quickly and securely is a nationally consequential mission for the U.S. Postal Service. To that end, Lockheed Martin has developed integrated automation and character recognition technologies that work together to improve the sorting, processing and delivery of the mail.

# DELIVERING DISCIPLINED PERFORMANCE™



REDEFINING WHAT IS POSSIBLE is a term that well describes America's exploration of space for the sake of scientific discovery, defense, telecommunications and a better understanding of our own planet Earth, including its weather and natural resources. We will launch aboard our Atlas V vehicle (*interior shown above*) the first-ever probe to Pluto in 2006.

**LOCKHEED MARTIN IS EQUALLY** committed to operational and financial performance with a balanced business base and a focus on keeping programs on budget, on schedule and on target. As we make our customers' mission our own, we are dedicated to delivering products and services that perform with extraordinary reliability.

We must have the best talent available to meet the complex requirements of our customers in the United States and worldwide. Lockheed Martin is dedicated to hiring and retaining a diverse workforce with the creativity and innovation that will continue our long-standing commitment to excellent performance.

Disciplined performance also means adherence to a high standard of corporate governance and a rigorous program of ethics training among all our employees. We are motivated by a continually reinforced set of values:

- Ethics and Integrity
- People and Teamwork
- Excellence and a "Can-Do" Spirit



THE SERIOUSNESS AND URGENCY of the work the people of Lockheed Martin perform for the nation and our allies around the world are keenly felt by each and every one of us, such as when our C-130J airlifter is called to duty delivering aid after a natural disaster or when it is necessary to deploy military forces.



WE ALSO SUPPORT our NASA customer's mission to return the U.S. Space Shuttle to flight, as well as support the President's goal to establish a manned presence on the moon and to eventually send astronauts to Mars.

# LOCKHEED MARTIN: A TRUSTED AND VALUED PARTNER™



A NEW GENERATION OF INVENTORS, inspired by the pioneers who took to the skies a century ago, is experiencing the excitement of learning through Space Day. Lockheed Martin is a proud sponsor of Space Day, dedicated to encouraging those who yearn to push the boundaries of what is possible. Aspiring astronauts, these students (*shown above*) put learning into action in Space Day activities.



**AS A CORPORATE CITIZEN,** we are a trusted and valued partner with the communities in which we work. That includes joining with our schools and communities in promoting math and science education. Lockheed Martin supports science, math, computer sciences and engineering excellence, from elementary education through the university level, with grants and locally based initiatives.

The men and women of Lockheed Martin recognize that the foundation of a strong and free people starts at the local level — where we live and work. We are more than a collection of offices and facilities; we are neighbors, students, mentors, coaches and parents.

Building the advanced technology products and services that meet the needs of governments worldwide is part of the picture of Lockheed Martin. We are also a company of people working to build a better world by volunteering in our communities.



LOCKHEED MARTIN VOLUNTEERS across America are bringing their skills and knowledge back to the communities through mentoring and tutoring programs. As a company we are dedicated to educational achievement and the promise of our young people.



VOLUNTEERISM, THROUGH PROGRAMS to aid our neighbors in distress, clean up the environment or help combat disease, is vital to building a stronger America. In 2003, Lockheed Martin employees contributed more than 350,000 hours of volunteer time.

# FINANCIAL SECTION OF THE 2003 ANNUAL REPORT

2003 Financial Highlights — INSIDE FRONT COVER

Management's Discussion and Analysis of  
Financial Condition and Results of Operations — PAGE 17

Management's Responsibility for Financial Reporting — PAGE 40

Report of Ernst & Young LLP, Independent Auditors — PAGE 41

Consolidated Statement of Operations — PAGE 42

Consolidated Balance Sheet — PAGE 43

Consolidated Statement of Cash Flows — PAGE 44

Consolidated Statement of Stockholders' Equity — PAGE 45

Notes to Consolidated Financial Statements — PAGE 46

Consolidated Financial Data — Five Year Summary — PAGE 69

Forward-Looking Statements — Safe Harbor Provisions — PAGE 74

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

### FINANCIAL SECTION ROADMAP

The financial section of our Annual Report includes management's discussion and analysis, our consolidated financial statements, notes to those financial statements and a 5 year summary of financial information. We have prepared the following summary, or "roadmap," to assist in your review of the financial section. It is designed to give you an overview of our company and focus your review by directing you to some of the more important activities and events that occurred this year.

#### Lockheed Martin's Business

Lockheed Martin Corporation is mainly involved in the research, design, development, manufacture, integration, operation and support of advanced technology systems, products and services. We have customers in domestic and international defense, civil government, and commercial markets, and over 75% of our sales over the past three years have been to agencies of the U.S. Government. Our main areas of focus are in the defense, space, homeland security, and government information technology markets.

We operate in five principal business segments: Aeronautics, Electronic Systems, Space Systems, Integrated Systems & Solutions and Information & Technology Services. As a lead systems integrator, our products and services range from aircraft, spacecraft and launch vehicles to missiles, electronics and information systems, including integrated net-centric solutions.

#### Financial Section Overview

The financial section includes the following:

**Management's discussion and analysis, or MD&A (pages 17 through 39)** — provides management's view about industry trends, risks and uncertainties relating to Lockheed Martin, accounting policies that we view as critical in light of our business, our results of operations, including discussions about the key performance drivers of each of our business segments, our financial position and cash flows, commitments and contingencies, important events or transactions that have occurred over the last three years, and forward-looking information, as appropriate.

#### Financial statements, notes to the financial statements and related reports —

##### *Reports related to the financial statements*

(pages 40 through 41) — include the following:

- A report from our management, indicating our responsibility for financial reporting and maintaining an internal control environment, and
- A report from our independent auditors, Ernst & Young LLP, which includes their opinion about the fair presentation of our financial statements based on their audits. The report includes their opinion about the conformity of our financial statements, which includes the notes to the financial statements, with accounting principles that are generally accepted in the United States (GAAP).

*Financial statements (pages 42 through 45)* — include our consolidated statements of operations, cash flows and stockholders' equity for each of the last three years, and our balance sheet as of the end of the last two years. Our financial statements are prepared in accordance with GAAP.

*Notes to the financial statements (pages 46 through 68)* — provide insight into and are an integral part of our financial statements. There are explanations of our significant accounting policies, details about certain of the captions on the financial statements, information about significant events or transactions that have occurred, discussions about commitments and contingencies, and selected financial information relating to our business segments. The notes to the financial statements also are prepared in accordance with GAAP.

#### Highlights

The financial section of our Annual Report describes our ongoing operations, including discussions about particular lines of business or programs, our ability to finance our operating activities, and trends and uncertainties in our industry and how they might affect our future operations. We also discuss those items affecting our results that were not considered in senior management's assessment of the operating performance of our business segments. We separately disclose these items to assist in your evaluation of our overall operating performance and financial condition of the consolidated company.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

We would like to draw your attention to the following items disclosed in this financial section and where you will find them:

Topic	Location(s)
Critical accounting policies	Page 21
Post-retirement benefit plans	Page 23 and page 59
Environmental matters	Page 24, page 48 and page 63
Acquisition and divestiture activities	Page 25 and page 50
Changes in our business segment presentation, and discussions of each segment's operations	Page 28 and page 65
Unallocated Corporate (expense) income, net	Page 32 and page 66
Liquidity and cash flows	Page 33 and page 44
Capital structure and resources	Page 34, page 43 and page 45
Commitments and contingencies	Page 35 and page 63
Goodwill (FAS 142)	Page 47 and page 50
Stock-based compensation	Page 49 and page 57

**INDUSTRY CONSIDERATIONS**

**Defense Business Considerations**

Domestic and worldwide political and economic developments continue to have a significant impact on the markets for defense and advanced technology systems, products and services. Markets for defense and advanced technology systems during 2004 and beyond will continue to be affected by the worldwide war against terrorism, and the continued need for military missions in Iraq and Afghanistan and related reconstruction efforts. These realities have increased the need for greater attention to the security of our homeland and for better communication and interplay between law enforcement, civil government agencies, intelligence agencies and our military services. Our nation's overall defense posture continues to move toward a more capabilities-based structure, which creates the ability for a more flexible response with greater force mobility, stronger space capabilities, enhanced missile defense and improved information systems capabilities and security.

We anticipate that the next Congressionally mandated "Quadrennial Defense Review" (QDR) undertaken by the U.S. Department of Defense (DoD) will reinforce and advance efforts at the DoD to refocus activities towards joint operations, net-centric command and control, and integrated capabilities for the armed forces. Recognizing this emerging priority at the DoD, we formed Integrated Systems & Solutions, a new business segment, in 2003 from existing components of our Electronic Systems and Space

Systems segments. We believe this new segment will help us better focus our integrated solutions capabilities across the Corporation and enhance our ability to serve as a lead partner with the DoD to respond to this customer priority.

The President's budget for the DoD for fiscal year 2004 and beyond responds to increased needs for homeland security and combating terrorism. This is evidenced by budget increases for operational readiness and personnel needs, as well as for both procurement and research and development. This trend was reiterated in the Future Year Defense Plan (FYDP) submitted with the President's budget for fiscal year 2005. It projects sustained growth in both the procurement and research and development budgets for the DoD through fiscal year 2006 and, in the case of the procurement budgetary authority, through fiscal year 2009. While there is no assurance that the increased DoD budget levels will be approved by Congress, the current defense budget outlook appears to be one of modest growth. However, the level of growth and the amount of the budget that will ultimately be allocated to the investment accounts most closely aligned with our business (i.e., procurement, research and development) is unknown.

During 2003, Congress appropriated additional amounts to pay for operational costs for military missions in Iraq and Afghanistan, as well as for reconstruction activities. These supplemental appropriations enabled the DoD to proceed on critical modernization and acquisition programs, versus using amounts available for those programs to pay for the Iraq and Afghanistan missions. The DoD expects a further supplemental appropriation to continue these missions as needed through 2005. As a result, we do not anticipate that sustained operations in Iraq and Afghanistan will materially impact the procurement and research and development budget levels projected in the 2005 to 2009 FYDP.

Our broad mix of programs and capabilities gives us the ability to support the needs of the various agencies of the U.S. Government that require our products and services. Our major programs and capabilities include: missile defense; space intelligence; command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR); air mobility aircraft; and air-power projection/precision-strike capability. In terms of size and long-term potential impact, two of our more significant programs are the F/A-22 Raptor and the F-35 Joint Strike Fighter. We are also represented in almost every aspect of land, sea, air and space-based missile defense, including the Medium Extended Air Defense System (MEADS), the Patriot Advanced Capability (PAC-3) missile program, the Terminal High Altitude Area Defense (THAAD) system, the Multiple Kill Vehicle program, and the High

Altitude Airship program. In the areas of space intelligence and information superiority, we have leadership positions on programs such as Transformational Communications, Advanced Extremely High Frequency (AEHF), and Space-Based Infrared System-High (SBIRS-H), and in classified programs and battle management command and control capabilities. In airlift, we have the C-130J program and are under contract to upgrade the C-5 strategic airlift aircraft. Many of these programs are large and require funding over several budget cycles. There are risks associated with these and other large, highly visible programs subject to appropriation by Congress that, because of their size, could be expected to become potential targets for reduction or extension of funding to pay for other programs.

The Office of Management and Budget recently announced its intention to conduct a comprehensive review of the F/A-22 Raptor program. This independent assessment will evaluate the performance, requirements and cost aspects of the program. We believe sustained improved performance in production and testing of the F/A-22 will re-validate the transformational qualities of this weapons system, and the suitability of the F/A-22 for continued production by the U.S. Air Force.

We continue to expand our capabilities in critical intelligence, knowledge management and E-Government solutions. Consistent with the President's agenda, the expected growth in business process outsourcing has been enabled by recent rule changes for public/private competitions. In addition, recent trends have indicated an increase in demand by federal and civil government agencies for upgrading and investing in new information technology systems and solutions. As a result, we continue to focus our resources in support of infrastructure modernization that allows for interoperability and communication across agencies.

In addition, the increase in emphasis on homeland security may increase demand for our capabilities in areas such as air traffic management, ports and waterways security, biohazard detection systems for postal equipment, information systems security and other technical systems solutions.

In prior years, companies in our industry had reacted to historically shrinking defense budgets for procurement and research and development by combining to maintain critical mass. More recently, we have focused our efforts on select core acquisitions, cost savings and improving efficiency, as well as generating cash to repay debt incurred during the period of consolidation. Through our consolidation activities, we have been able to pass along savings to our customers, mainly the DoD.

Non-U.S. defense budgets have generally been declining over the past decade. As a result, consolidation has also been occurring in the European aerospace industry, resulting in fewer but larger and more capable competitors, potentially resulting in an environment where there could be less demand abroad for products from U.S. companies. This type of environment could reduce opportunities for European partnerships and sales potential for U.S. exports.

### **Space Business**

The commercial launch vehicle marketplace remains very competitive due mainly to low demand for new satellites as a result of excess capacity in the telecommunications industry. The reduction in demand has resulted in pricing pressures in both the launch vehicle and satellite markets. We received new orders for both commercial satellites and launch vehicles in 2003; however, the majority of those orders relate to replacement satellites versus an expansion of telecommunications capacity.

The above factors have impacted orders for all of our commercial launch vehicles, including the Evolved Expendable Launch Vehicle (EELV or Atlas V), our next generation launch vehicle program in which we have made significant investments over the past few years. The Atlas V is available for both commercial and government use. This program has required investment of funds for research and development, start-up and other nonrecurring costs, and launch facilities. Some of these expenditures have been funded under an agreement with the U.S. Government. Commercial orders to-date for the Atlas V launch vehicle have been lower than originally expected and at lower prices. However, we have received a total of 18 EELV launch assignments from the U.S. Government (including those described in the following paragraph), 3 of which are under contract. We had our third Atlas V launch in 2003.

In July 2003, the U.S. Air Force announced that our competitor in the EELV competition had violated the Procurement Integrity Act. As a result of that determination, the Air Force reassigned 7 launch vehicles from the initial competition (referred to as "Buy 1") to us and removed our exclusion from west coast launches. At the same time, the Air Force assigned us 3 new west coast launches. To prepare for providing the west coast launches, we are upgrading west coast launch facilities, which will require further investment in the EELV program. However, we expect to recover that investment through pricing of the west coast launches. The 7 reassigned launches are expected to occur over the 2005 through 2009 time period. Contractual terms and conditions related to the west coast launches have not yet been finalized with the Air Force.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

December 31, 2003

Lockheed-Khrunichev-Energia International, Inc. (LKEI), a joint venture we have with two Russian government-owned space firms, has exclusive rights to market launches of commercial, non-Russian-origin space payloads on the Proton family of rockets from a launch site in Kazakhstan. Commercial Atlas and Proton launch services are marketed around the world through International Launch Services (ILS), a joint venture between Lockheed Martin and LKEI. We consolidate the results of operations of LKEI and ILS into our financial statements based on controlling financial interest. We received 7 new awards for launches on Proton vehicles in 2003. Contracts for launch services usually require substantial advances from the customer prior to launch. At the end of 2003, \$250 million of advances received from customers for Proton launch services not yet provided was included as a liability on our balance sheet in the caption "Customer advances and amounts in excess of costs incurred."

A sizeable percentage of the advances we receive from customers for Proton launch services are sent to Khrunichev State Research and Production Space Center (Khrunichev), the manufacturer of the launch vehicle and provider of the related launch services in Russia. If a contracted launch service is not provided, a sizeable percentage of the related advance would have to be refunded to the customer. In addition, we have sent advances to Khrunichev for launches we purchased which have not yet been assigned to customers. The advances sent to Khrunichev are included on our balance sheet in inventories. Advances for launches not under contract are subject to an agreement entered into in 2002 which provides for reduced future launch payments from us to Khrunichev, contingent on the receipt of new orders as well as a minimum number of actual launches each year. As a result of this agreement, as well as our assessment in 2002 of the likelihood of customer terminations for convenience for launches under contract, we reduced the carrying value of our advances to Khrunichev and recognized a charge, net of state income tax benefits, of \$173 million. The charge reduced 2002 net earnings by \$112 million (\$0.25 per diluted share). At year-end 2003, payments to Khrunichev included in inventories, net of the amount of the reserve recorded in 2002, totaled \$327 million. Our ability to realize the remaining amounts may be affected by Khrunichev's ability to provide the launch services and the political environment in Russia. Through the end of 2003, launch services through LKEI and ILS have been provided according to contract terms.

The Corporation has entered into an agreement with RD AMROSS, a joint venture of the Pratt & Whitney division of United

Technologies Corporation and the Russian firm NPO Energomash, for the purchase, subject to certain conditions, of RD-180 booster engines for use in the Corporation's Atlas launch vehicles. Terms of the agreement call for payments to be made to RD AMROSS upon the achievement of certain milestones in the manufacturing process. Payments of \$57 million made under this agreement for engines not yet delivered were included in the Corporation's inventories at December 31, 2003.

As discussed above, the commercial satellite market has continued to experience pricing pressures due to excess capacity and lower demand. Satellite demand also has been impacted by the business difficulties encountered by some companies in the commercial satellite services industry which have resulted in reduced access to capital and a reduction in the total market size in the near term. However, in the past year, we received 5 new commercial satellite orders, generally for replacement satellites versus capacity expansion. We expect to continue to control costs in our commercial satellite manufacturing business while keeping our focus on providing a reliable product. We also received new orders for government satellites in 2003 related to classified activities.

#### **Other Business Considerations**

As a government contractor, we are subject to U.S. Government oversight. The government may ask about and investigate our business practices and audit our compliance with applicable rules and regulations. Depending on the results of those audits and investigations, the government could make claims against us. Under government procurement regulations and practices, an indictment of a government contractor could result in that contractor being fined and/or suspended from being able to bid on, or be awarded, new government contracts for a period of time. A conviction could result in debarment for a specific period of time. Similar government oversight exists in most other countries where we conduct business. Although we cannot predict the outcome of these types of investigations and inquiries with certainty, based on current facts, we do not believe that any of the claims, audits or investigations pending against us are likely to have a material adverse effect on our business or our results of operations, cash flows or financial position.

Changes in government procurement policies and practices over the past several years, such as increases in the progress payment rate and the use of performance-based payments, have had a positive effect on our financial position and cash flows. But we are still exposed to risks associated with U.S. Government contracting,

including technological uncertainties and obsolescence, and having to depend on Congressional appropriation and allotment of funds each year. Many of our programs involve the development and application of state-of-the-art technologies aimed at achieving challenging goals. As a result, setbacks, delays, cost growth and product failures can occur.

In addition to our defense businesses, we also provide products and services to most civil government customers, as well as to commercial customers. We provide products and services to government agencies such as the Department of Homeland Security, the U.S. Postal Service, the Patent and Trademark Office, the Federal Aviation Administration, NASA, the U.S. Coast Guard and the Transportation Security Administration. Although our lines of business in civil government and commercial markets are not dependent on defense budgets, they share many of the same risks as our defense businesses, as well as other risks unique to their particular marketplaces. Although indemnification by the U.S. Government may be available in some instances for our defense businesses, U.S. Government indemnification may not be available to cover potential claims or liabilities resulting from a failure of technologies developed and deployed for homeland security purposes. While we maintain insurance for some business risks, it is not possible to obtain coverage to protect against all operational risks and liabilities. We do plan to seek limitation of such potential liabilities related to the sale and use of our homeland security products and services through qualification by the Department of Homeland Security under the "SAFETY Act" provisions of the Homeland Security Act of 2002. In the event we were to provide homeland security-related products and services to a customer without such qualification, we would not be afforded the benefit of the SAFETY Act's cap on tort liability or U.S. Government indemnification. Other risks unique to the civil government and commercial markets may include development of competing products, technological feasibility and product obsolescence.

We provide products and services to NASA, including the Space Shuttle program, mainly through our Space Systems and Information & Technology Services business segments. Work for NASA accounted for approximately 5% of our consolidated net sales in 2003. We also have a 50% equity interest in United Space Alliance, LLC which provides ground processing and other operational services to the Space Shuttle program. We worked with NASA and others in the independent investigation of the tragic accident in February 2003 involving the Space Shuttle Columbia. The investigation is now completed. We do not expect that the effects of

this accident will have a material impact on our results of operations, financial position or cash flows. We expect to compete for NASA programs related to the new Space Exploration Initiative announced by the President, which includes development of human-rated space launch and transportation systems over the next 15 years, replacing the current space shuttle architecture.

We have entered into various joint venture, teaming and other business arrangements to help support our portfolio of products and services in many of our lines of business, including commercial space. Some of these business arrangements include foreign partners. The conduct of international business introduces other risks into our operations, including changing economic conditions, fluctuations in relative currency values, regulation by foreign countries and the potential for unanticipated cost increases resulting from the possible deterioration of political relations.

The nature of our international business also makes us subject to the export control regulations of the U.S. Department of State and the Department of Commerce. If these regulations are violated, it could result in monetary penalties and denial of export privileges. We are currently unaware of any violations of export control regulations which are reasonably likely to have a material adverse effect on our business or our results of operations, cash flows or financial position.

## **CRITICAL ACCOUNTING POLICIES**

### **Contract Accounting/Revenue Recognition**

A large part of our business is derived from long-term contracts for development, production and service activities which we account for consistent with the American Institute of Certified Public Accountants' (AICPA) audit and accounting guide, "Audits of Federal Government Contractors," the AICPA's Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," and other relevant revenue recognition accounting literature. We consider the nature of these contracts and the types of products and services provided when we determine the proper accounting for a particular contract.

Generally, we record long-term fixed-price contracts on a percentage of completion basis using units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenue. For example, we use this method of revenue recognition on our C-130J tactical transport aircraft program, Atlas and Proton launch vehicle programs and Multiple Launch Rocket System program. For certain other long-term fixed-price contracts that, along with other factors, require us to deliver minimal quantities

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

over a longer period of time or to perform a substantial level of development effort in comparison to the total value of the contract, revenues are recorded when we achieve performance milestones or using the cost-to-cost method to measure percentage of completion. Under the cost-to-cost method of accounting, we recognize revenue based on the ratio of costs incurred to our estimate of total costs at completion. As examples, we use this methodology for our F/A-22 Raptor program and the AEGIS Weapons System program. In some instances, long-term production programs may require a significant level of development and/or a low level of initial production units in their initial phases, but will ultimately require delivery of increased quantities in full rate production stages. In those cases, the revenue recognition methodology may change from the cost-to-cost method to the units-of-delivery method after considering, among other factors, production stabilization. We record sales under cost-reimbursement-type contracts as we incur the costs. Examples of this type of revenue recognition include the F-35 Joint Strike Fighter system development and demonstration (SDD) program and the THAAD missile defense program. The majority of our long-term contracts are denominated in U.S. dollars, including contracts for sales of military products and services to foreign governments conducted through the U.S. Government (i.e., foreign military sales).

As a general rule, we recognize sales and profits earlier in a production cycle when we use the cost-to-cost and milestone methods of percentage of completion accounting than when we use the units-of-delivery method. In addition, our profits and margins may vary materially depending on the types of long-term government contracts undertaken, the costs incurred in their performance, the achievement of other performance objectives, and the stage of performance at which the right to receive fees, particularly under incentive and award fee contracts, is finally determined. We have accounting policies in place to address these as well as other contractual and business arrangements in accounting for long-term contracts. For other information on accounting policies we have in place for recognizing sales and profits, see our discussion under "Sales and earnings" in Note 1 to the financial statements.

Contract accounting requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions for schedule and technical issues. Due to the size and nature of many of our contracts, the estimation of total revenue and cost at completion is complicated and subject to many variables. Contract costs include material, labor and subcontracting costs, as well as an allocation of indirect costs. Assumptions have to be made regarding the length of time to complete the contract because costs also

include expected increases in wages and prices for materials. For contract change orders, claims or similar items, we apply judgment in estimating the amounts and assessing the potential for realization. These amounts are only included in contract value when they can be reliably estimated and realization is considered probable. Incentives and award fees related to performance on contracts, which are generally awarded at the discretion of the customer, as well as penalties related to contract performance, are considered in estimating sales and profit rates. Incentives and penalties are recorded when there is sufficient information for us to assess anticipated performance. Award fees are estimated based on actual and anticipated awards.

The majority of our sales are driven by pricing based on costs incurred to produce products or perform services under contracts with the U.S. Government, and therefore not necessarily on market-based factors. Cost-based pricing is determined under the Federal Acquisition Regulations (FAR). The FAR provides guidance on the types of costs that are allowable in establishing prices for goods and services under U.S. Government contracts. For example, costs such as those related to charitable contributions, advertising, public relations, and stock-based compensation programs are unallowable, and therefore not recoverable through sales. In addition, we may enter into agreements with the U.S. Government that address the subjects of allowability and allocability of costs to contracts for specific matters. For example, some of the amounts we spend for groundwater treatment and soil remediation related to discontinued operations and sites operated in prior years are allocated to our current operations as general and administrative costs under agreements reached with the U.S. Government.

Products and services provided under long-term development and production contracts make up a large portion of our business, and therefore the amounts we record in our financial statements using contract accounting methods and cost accounting standards are material. Because of the significance of the judgments and estimation processes, it is likely that materially different amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. When adjustments in estimated contract revenues or costs are required, any changes from prior estimates are generally included in earnings in the current period. We closely monitor compliance with and the consistent application of our critical accounting policies related to contract accounting. Business segment personnel assess the status of contracts through periodic contract status and performance reviews. Also, regular and recurring evaluations of contract cost, scheduling and technical matters are performed by



management personnel who are independent from the business segment performing work under the contract. Costs incurred and allocated to contracts with the U.S. Government are reviewed for compliance with regulatory standards by our personnel, and are subject to audit by the Defense Contract Audit Agency.

### **Post-Retirement Benefit Plans**

Most employees are covered by defined benefit pension plans, and we provide health care and life insurance benefits to eligible retirees. Our earnings may be positively or negatively impacted by the amount of income or expense we record for our employee benefit plans. This is particularly true with income or expense for qualified defined benefit plans (pension plans) because those calculations are sensitive to changes in several key economic assumptions and workforce demographics.

We account for our pension plans using Statement of Financial Accounting Standards (FAS) No. 87, "Employers' Accounting for Pensions" (FAS 87). Those rules require that the amounts we record, including the income or expense for the plans, be computed using actuarial valuations. These valuations include many assumptions, including assumptions we make relating to financial market and other economic conditions. Changes in key economic indicators can result in changes in the assumptions we use. The key year-end assumptions used to estimate pension income or expense for the following fiscal year are the discount rate, the expected long-term rate of return on plan assets and the rate of increase in future compensation levels.

We use judgment in reassessing these assumptions each year because we have to consider current market conditions and, in the case of the expected long-term rate of return on plan assets, past investment experience, judgments about future market trends, changes in interest rates and equity market performance. We also have to consider factors like the timing and amounts of expected contributions to the plans and benefit payments to plan participants.

An example of how changes in these assumptions can affect our financial statements occurred in 2003. As required by FAS 87, we reassessed the discount rate assumption at the end of 2003. Based on our review of interest rates at the end of the year, we lowered our discount rate assumption to 6.25% at year-end 2003, versus 6.75% used for 2002 and 7.25% used for 2001. This change, together with other factors such as the effects of the actual return on plan assets over the past few years, resulted in our projecting that the amount of pension expense for 2004 will approximately double as compared to \$484 million of expense recorded in 2003.

Also, at the end of 2002, we recorded a noncash after-tax adjustment of \$1.5 billion in the stockholders' equity section of our balance sheet to reflect a minimum pension liability for most of our pension plans. The adjustment did not impact earnings, but reduced our stockholders' equity. This adjustment is calculated on a plan-by-plan basis, and is determined by comparing the accumulated benefit obligation (ABO) for each plan to the fair value of that plan's assets. The amount by which the ABO exceeds the fair value of the plan assets, after adjusting for previously recorded accrued or prepaid pension cost for the plan, must be recorded as a minimum pension liability, with a corresponding increase in an intangible asset, if appropriate, and a reduction to stockholders' equity, consistent with FAS 87. In 2003, we reduced the adjustment recorded in stockholders' equity in 2002 by about \$300 million, mainly due to favorable asset returns for the year. Again, this minimum pension liability adjustment did not impact 2003 earnings. The amount of the minimum pension liability is computed at each year-end and could potentially continue to reduce the amount recorded in 2002 in future periods if financial markets improve and interest rates increase, or could potentially increase if financial market performance and interest rates decline.

U.S. Government Cost Accounting Standards (CAS) is a major factor in determining our funding requirements and governs the extent to which our pension costs are allocable to and recoverable under contracts with the U.S. Government. Funded amounts are recovered over time through the pricing of our products and services on U.S. Government contracts, and therefore are recognized in our net sales. The total funding requirement for our pension plans under CAS in 2003 was \$184 million. For 2004, we expect our funding requirements under CAS to increase. Also in 2004, funding in addition to the amount calculated under CAS will likely be required under Internal Revenue Code rules. Any additional amounts computed under those rules are considered to be prepayments under the CAS rules, and therefore will be recorded on our balance sheet and recovered in future periods. In December 2003, we made a discretionary prepayment of \$450 million to the pension trust, the majority of which will reduce our cash funding requirements for 2004. There is currently proposed legislation that would change the measurement of the liabilities that are included in the funding calculations for 2004. Our funding projections assume that this proposed legislation will be passed and become effective for 2004. We would expect our projected funding requirements for 2004 to increase if the proposed legislation does not become law.

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated in accordance with FAS 87 and pension costs calculated and funded in accordance with CAS. Since the CAS expense is recovered through the pricing of our products and services on U.S. Government contracts, and therefore recognized in a particular segment's net sales, the results of operations of our segments only include pension expense as determined and funded in accordance with CAS rules. Accordingly, the FAS/CAS adjustment is an amount included in the reconciliation of total segment operating profit to consolidated operating profit under GAAP. See the discussion of "Unallocated Corporate (Expense) Income, Net" under "Discussion of Business Segments."

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law by the President in December 2003. Historically, Medicare has not provided prescription drug benefits. Under the new law, Medicare will provide a prescription drug benefit beginning in 2006. The Act also provides for a federal subsidy to eligible sponsors of retiree health care benefits. At this point, there is a lack of clarity regarding how some of the key provisions of the Act will be applied and administered, and how it will impact the prescription drug benefits that we provide our retirees. In addition, specific authoritative guidance on the accounting for the federal subsidy is still pending and that guidance, when issued, could require a change to previously reported information. In recognition of these uncertainties, the Financial Accounting Standards Board decided to allow companies to defer recognition of the impact of the new law on the benefit obligations they provide their retirees, which we have elected to do. Accordingly, the accumulated post-retirement benefit obligation (APBO) for our retiree health care benefits, as well as the net periodic post-retirement benefit cost, included in our financial statements and the accompanying notes do not reflect the effects of the Act. It is expected that any such change would result in some reduction to the APBO and the net periodic post-retirement benefits cost.

### Environmental Matters

We are a party to various agreements, proceedings and potential proceedings for environmental clean-up issues, including matters at various sites where we have been designated a potentially responsible party (PRP) by the Environmental Protection Agency or by a state agency. We record financial statement accruals for environmental matters in the period that it becomes probable that a liability has been incurred and the amounts can be reasonably estimated (see the discussion under "Environmental matters" in Note 1

to the financial statements). Judgment is required when we develop assumptions and estimate costs expected to be incurred for environmental remediation activities due to, along with other factors, difficulties in assessing the extent of environmental remediation to be performed, complex environmental regulations and remediation technologies, and agreements between PRPs to share in the cost of remediation as discussed below.

We enter into agreements (e.g., administrative orders, consent decrees) which document the extent and timing of our obligation. We are also involved in remediation activities at environmental sites where formal agreements exist but do not quantify the extent and timing of our obligation. Environmental clean-up activities usually cover several years, which makes estimating the costs more judgmental due to, for example, changing remediation technologies. To determine the costs related to clean-up sites, we have to assess the extent of contamination, the appropriate technology to be used to accomplish the remediation and continually evolving regulatory environmental standards. We consider these factors in our estimates of the timing and amount of any future costs that may be required for remediation actions. In cases where a date to complete activities at a particular environmental site cannot be estimated by reference to agreements or otherwise, we project costs over a reasonable time frame not to exceed 20 years. Given the level of judgment and estimation which has to occur, it is likely that materially different amounts could be recorded if different assumptions were used or if circumstances were to change (e.g., a change in environmental standards).

If we are ultimately found to have liability at those sites where we have been designated a PRP, we expect that the actual costs of remediation will be shared with other liable PRPs. Generally, PRPs that are ultimately determined to be responsible parties are strictly liable for site clean-up and usually agree among themselves to share, on an allocated basis, the costs and expenses for investigation and remediation of hazardous materials. Under existing environmental laws, however, responsible parties are jointly and severally liable and, therefore, we are potentially liable for the full cost of funding such remediation. In the unlikely event that we were required to fund the entire cost of such remediation, the statutory framework provides that we may pursue rights of contribution from the other PRPs. The amounts we record do not reflect the fact that we may recover some of the environmental costs we have incurred through insurance or from other PRPs, which we are required to pursue by agreement and U.S. Government regulation.

Under agreements reached with the U.S. Government, some of the amounts we spend for groundwater treatment and soil

remediation are allocated to our operations as general and administrative costs. Under existing government regulations, these and other environmental expenditures relating to our U.S. Government business, after deducting any recoveries received from insurance or other PRPs, are allowable in establishing prices of our products and services. As a result, a substantial amount of the expenditures we incur are being included in our sales and cost of sales according to U.S. Government agreement or regulation.

At the end of 2003 and 2002, the total amount of liabilities recorded on our balance sheet for environmental matters was approximately \$425 million and \$445 million, respectively. About two-thirds of the liability recorded at the end of 2003 related to sites in Redlands, Burbank and Glendale, California, and in Great Neck, New York, mainly for remediation of soil and groundwater contamination. The remainder of the liability related to other properties (including current operating facilities and certain facilities operated in prior years) for which the financial exposure can be estimated. We have recorded an asset for the portion of environmental costs that are probable of future recovery in pricing of our products and services for U.S. Government businesses. The amount that is expected to be allocated to our commercial businesses has been expensed through cost of sales. Any recoveries we receive would reduce the allocated amounts included in our future U.S. Government sales and cost of sales.

#### **ACQUISITION AND DIVESTITURE ACTIVITIES**

In November 2003, we completed transactions resulting in our acquisition of the majority of the federal government information technology (IT) business of Affiliated Computer Services, Inc. (ACS), and ACS' concurrent acquisition of our commercial IT business. The total purchase price related to our acquisition of ACS' federal government IT business, including transaction-related costs, was approximately \$585 million. As part of our accounting for the acquisition of the federal IT business, we recorded intangible assets totaling about \$112 million related to contracts acquired and a covenant not to compete which will be amortized over 5 to 7 year periods, and goodwill of about \$460 million. This acquisition expands our capabilities in business process outsourcing and managed services, thereby enhancing our ability to support civil and defense government agencies. The divestiture of our commercial IT business to ACS resulted in a cash payment to us from ACS of approximately \$110 million and a gain, net of state income taxes, of \$15 million. The gain increased net earnings by approximately \$8 million (\$0.02 per diluted share). The operations of the business

acquired are included in the Information & Technology Services (I&TS) business segment. The majority of the operations divested had been included in the I&TS segment, with the remainder from the Information Systems & Solutions business segment.

In September 2003, we announced that Lockheed Martin and The Titan Corporation had entered into a merger agreement for Lockheed Martin to acquire Titan. The announced value of the transaction, including the assumption of Titan's long-term debt, is approximately \$2.4 billion before accumulated tax benefits. Under the merger agreement, stockholders of Titan may elect to receive \$22 per share in cash, an equivalent amount of Lockheed Martin common stock based on an exchange rate or a combination of cash and stock, subject to the allocation procedures set forth in the merger agreement. The merger agreement provides that 50% of Titan's outstanding common stock must be exchanged for Lockheed Martin common stock, and 50% of the Titan common stock must be exchanged for cash. The exchange rate will be determined by dividing \$22 by the average trading price of Lockheed Martin common stock over a 10 day trading period, subject to upper and lower limits, or "collars," of \$58 and \$46 per share. Under certain circumstances, the exchange rate for the stock portion of the merger consideration will be fixed based on the upper collar of \$58 per share or the lower collar of \$46 per share. Upon consummation of the merger, we would expect to issue between 16 and 22 million shares of our common stock, depending on the exchange rate. We plan to finance the cash portion of the transaction principally using existing cash and short-term investment holdings.

On February 13, 2004, Lockheed Martin and Titan announced that representatives of both companies had initiated meetings with the Department of Justice and the SEC to advise of an internal review relating to certain agreements between Titan and international consultants and related payments in foreign countries. The SEC informed Lockheed Martin and Titan that it has commenced an investigation into whether payments by Titan were made in violation of applicable law. Lockheed Martin is independently reviewing Titan's payments to international consultants to assess whether all conditions to the closing of the proposed merger will be satisfied. Lockheed Martin has requested that Titan afford it access to all relevant information related to its relationships with international consultants so that the review may be completed in advance of the Titan stockholders' meeting. Titan is cooperating with this request, as well as conducting its own review.

During the course of our review, we learned of allegations that improper payments were made, or items of value were provided, by

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

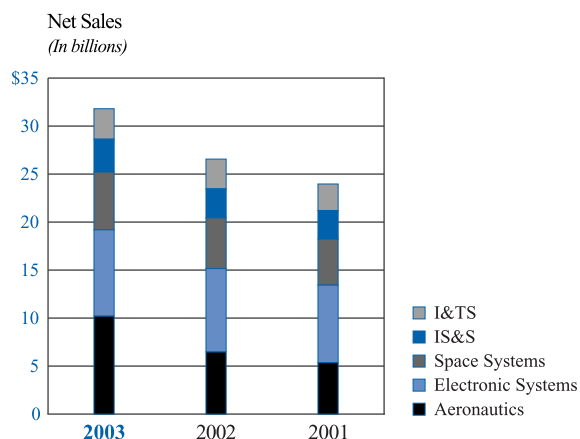
consultants for Titan or its subsidiaries directly or indirectly to foreign officials. The alleged payments and provision of items of value, if true, raise questions concerning whether there has been a violation of the Foreign Corrupt Practices Act. We also are reviewing with Titan whether payments made by Titan to consultants were accurately reflected on Titan's books and records. Our review is ongoing. Together with Titan, we disclosed the allegations to the SEC and the Department of Justice. During that meeting, Lockheed Martin and Titan were informed that the Department of Justice has initiated a criminal inquiry into this matter.

Closing of the Titan transaction is subject to approval of Titan's stockholders, the absence of any material adverse change in Titan and other conditions set forth in the merger agreement. Either Lockheed Martin or Titan may terminate the merger agreement if the merger is not completed by March 31, 2004, provided that the party seeking to terminate the agreement is not then in material breach of its obligations under the merger agreement in a manner that has contributed to the failure to consummate the merger. The full text of the merger agreement is publicly available as an attachment to the proxy statement/prospectus mailed to Titan stockholders and as an exhibit to Lockheed Martin's 2003 Form 10-K.

On an ongoing basis, we plan to continue to explore the sale of various non-core businesses, passive equity investments and surplus real estate. If we were to decide to sell any such holdings or real estate, the resulting gains, if any, would be recorded when the transactions are consummated and losses, if any, would be recorded when they are probable and estimable. We also continue to review our businesses on an ongoing basis to identify ways to improve organizational effectiveness and performance, and to focus on our core business strategy.

**RESULTS OF OPERATIONS**

Since our operating cycle is long-term and involves many types of development and production contracts with varying production delivery schedules, the results of operations of a particular year, or year-to-year comparisons of recorded sales and profits, may not be indicative of future operating results. The following discussions of comparative results among periods should be viewed in this context.



**Continuing Operations**

The following discussion of net sales and operating results will provide an overview of our operations by focusing on key elements set forth in our "Consolidated Statement of Operations." The "Discussion of Business Segments" which follows, will review the contributions of each of our business segments to our consolidated results for 2003, 2002 and 2001.

For 2003, net sales were \$31.8 billion, a 20% increase over 2002 sales. Sales for 2002 were \$26.6 billion, an increase of 11% compared to 2001. Sales increased in all segments as compared to the prior year for the second straight year. The U.S. Government is our largest customer, accounting for about 78% of our sales for 2003, compared to 80% in 2002 and 78% in 2001.

For 2003, 2002 and 2001 the items in the table below, among other things, were included in "Unallocated Corporate (expense) income, net" (see the related "Discussion of Business Segments" below).

	Operating (Loss) Profit	Net (Loss) Earnings	(Loss) Earnings per Diluted Share
<i>(In millions, except per share data)</i>			
<b>YEAR ENDED DECEMBER 31, 2003</b>			
Loss on early retirement of debt	\$ (146)	\$ (96)	\$(0.21)
Charge related to exit from the commercial mail sorting business	(41)	(27)	(0.06)
Gain on partial reversal of Space Imaging guarantee	19	13	0.03
Gain on sale of the commercial IT business	15	8	0.02
	<b>\$ (153)</b>	<b>\$(102)</b>	<b>\$(0.22)</b>

<i>(In millions, except per share data)</i>	Operating (Loss) Profit	Net (Loss) Earnings	(Loss) Earnings per Diluted Share
<b>YEAR ENDED DECEMBER 31, 2002</b>			
Write-down of telecommunications investments	\$ (776)	\$(504)	\$(1.12)
Charge related to a Russian launch services provider	(173)	(112)	(0.25)
Write-down of investment in Space Imaging and charge related to recording of guarantee	(163)	(106)	(0.23)
Benefit from R&D tax credit settlement	—	90	0.20
	<u>\$ (1,112)</u>	<u>\$(632)</u>	<u>\$(1.40)</u>
<b>YEAR ENDED DECEMBER 31, 2001</b>			
Write-off of investment in Astrolink and related costs	\$ (387)	\$(267)	\$(0.62)
Write-down of investment in Loral Space	(361)	(235)	(0.54)
Other charges related to global telecommunications	(176)	(117)	(0.27)
Impairment charge related to Americom Asia-Pacific	(100)	(65)	(0.15)
Loss on early repayment of debt	(55)	(36)	(0.08)
Gain on sale of surplus real estate	111	72	0.17
Other activities, net	(5)	(3)	(0.01)
	<u>\$ (973)</u>	<u>\$(651)</u>	<u>\$(1.50)</u>

Our operating profit for 2003 was \$2.0 billion, an increase of 74% compared to 2002. Our operating profit for 2002 was \$1.2 billion, an increase of 39% compared to 2001. The results for 2001 included amortization expense of \$274 million for goodwill and certain other intangibles that was not included in 2002 or 2003 due to the adoption of FAS 142. See Note 1 to the financial statements for information regarding our adoption of FAS 142.

Interest expense for 2003 was \$487 million, \$94 million lower than the amount for 2002. This was primarily the result of reductions in our debt portfolio and the favorable impact of having issued \$1.0 billion of convertible notes in August 2003 to replace higher cost debt. Interest expense for 2002 was \$581 million, \$119 million lower than in 2001 mainly due to reductions in our debt portfolio and the benefit from interest rate swap agreements.

Our effective tax rates were 31.3% for 2003, 7.7% for 2002 and 67.7% for 2001. The tax rate for 2002 was reduced by a \$90 million tax benefit related to a research and development tax credit

settlement, and the rate for 2001 was increased by non-deductible goodwill that was being amortized for financial reporting purposes. The effective tax rates for all periods were reduced by tax benefits related to export sales, changes to prior year liabilities arising from tax refund initiatives and adjustments to true-up actual tax return liabilities. The 2002 tax rate was also reduced by a favorable IRS audit settlement.

Congress is considering new tax legislation that would repeal the extraterritorial income exclusion relating to export sales and enact new rules providing for a tax reduction on profits from the sale of products manufactured in the United States. If such legislation were passed, we do not expect that it would adversely impact the Corporation's effective tax rate. In the event that this or other tax legislation is enacted, its impact on our deferred tax balances and effective tax rate will be recognized as of the date the new tax rules are enacted.

For 2003, we reported net earnings from continuing operations of \$1.1 billion (\$2.34 per diluted share) compared to \$533 million (\$1.18 per diluted share) for 2002. In 2001, we reported earnings from continuing operations of \$43 million (\$0.10 per diluted share).

### Discontinued Operations

During 2003, the activities of the remaining telecommunications service business held for sale were immaterial and had no impact on earnings. We reported total losses from discontinued operations of \$33 million (\$0.07 per diluted share) in 2002 and \$1.1 billion (\$2.52 per diluted share) in 2001. Operating losses of the businesses included in discontinued operations totaled \$33 million (\$0.07 per diluted share) in 2002 and \$62 million (\$0.14 per diluted share) in 2001.

Discontinued operations for 2002 included losses incurred for wind-down activities related to the global telecommunications services businesses, offset by the reversal of a reserve associated with the sale of Lockheed Martin IMS Corporation (IMS). When recording the sale of IMS in 2001, we established transaction-related reserves to address various indemnity provisions in the sale agreement. The risks associated with certain of these indemnity provisions were resolved and \$39 million, net of taxes, was recognized through discontinued operations in 2002.

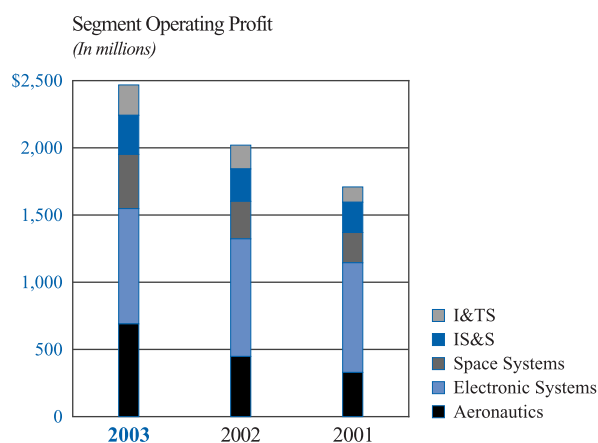
Included in the 2001 loss from discontinued operations was an after-tax charge of \$1.3 billion (\$3.09 per diluted share) related to our decision to exit the global telecommunications services business. The 2001 results also included an after-tax gain of \$309 million (\$0.71 per diluted share) from the sale of IMS.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

**Net Earnings (Loss)**

We reported net earnings of \$1.1 billion, or \$2.34 per diluted share, in 2003, compared to net earnings of \$500 million, or \$1.11 per diluted share, in 2002 and a net loss of \$1.0 billion (\$2.42 per diluted share) in 2001.

**DISCUSSION OF BUSINESS SEGMENTS**

As described more fully in Note 16 to the financial statements, we announced the formation of Integrated Systems & Solutions (IS&S), a new business segment, in 2003. With the formation of IS&S, the former Systems Integration business segment is now named Electronic Systems. Also in 2003, we changed the name of our Technology Services business segment to Information & Technology Services (I&TS) to better reflect the scope of its activities. We operate in five business segments: Aeronautics, Electronic Systems, Space Systems, IS&S, and I&TS. The following segment information has been reclassified from amounts previously reported to reflect the current business segments.

Net sales have increased in each of our business segments over the last 3 years. Our demonstrated performance and broad portfolio of capabilities have contributed to this growth.

In the Aeronautics business segment, sales have increased as we ramped up activities on the F-35 program, delivered more F-16 aircraft and entered low-rate production on the F/A-22 program. During 2003, we increased deliveries of F-16s to 62 aircraft, from the 21 aircraft delivered in 2002, reflecting the backlog associated with several of our international F-16 customers. We anticipate the F-16 deliveries to be in the range of 70 – 75 aircraft over the next 2 years. The C-130J program was awarded a multi-year award for 60 aircraft during 2003. This award solidifies our production planning and long-term supplier pricing as we complete the initial 119

aircraft program and produce aircraft under the new award. We expect the program will return to profitability in 2004.

The Electronic Systems business segment has a broad portfolio of products and services. Many of its activities involve a combination of both development and production contracts with varying delivery schedules. We expect this mix of contract types to continue in the short term, and it may affect the year-to-year comparisons of segment margins and the operating results of the lines of business within Electronic Systems.

The Space Systems business segment is a key supplier of space solutions, primarily to our U.S. Government customers. Satellites and Strategic & Defensive Missile System activities, primarily for our U.S. Government customers, are expected to experience steady growth as we work on our existing backlog and any new awards that we may receive. However, the commercial satellite and launch vehicle industries continue to be very competitive. We did receive new orders for both commercial satellites and launch vehicles in 2003; however, the majority of those orders relate to replacement satellites versus an expansion of telecommunications capacity. The Satellites line of business received 5 new commercial satellite orders during 2003. The Launch Services line of business received 11 new awards for launch missions, including 7 Proton, 1 Atlas V and 3 EELV missions. To date, the segment has received 18 EELV mission assignments from the U.S. Government, including the 3 under contract. The activities in the Titan program will continue, though at a lower level than prior years, as we work to complete the remaining 3 missions.

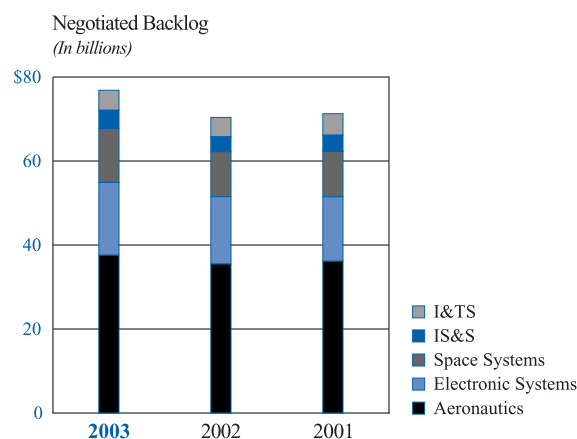
The IS&S and the I&TS business segments have strengthened their capabilities in providing information technology services to defense, intelligence and other government customers. We expect continued strong growth in providing information technology services to government agencies.

In the following tables of financial data, the total of the operating results of the business segments is reconciled to the corresponding consolidated amount. With respect to the caption "Operating profit," the reconciling item "Unallocated Corporate (expense) income, net" includes the FAS/CAS pension adjustment (see discussion below), earnings and losses from equity investments (mainly telecommunications), interest income, costs for stock-based compensation programs, the effects of items not considered part of management's evaluation of segment operating performance, and Corporate costs not allocated to the operating segments, as well as other miscellaneous Corporate activities.

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated for financial reporting purposes in accordance with FAS 87, and pension costs calculated and funded in accordance with U.S. Government CAS, which are reflected in the business segment results. CAS is a major factor in determining our pension funding requirements, and governs the extent of allocability and recoverability of pension costs on government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts, and therefore recognized in segment net sales. The results of operations of the segments only include pension expense as determined and funded in accordance with CAS rules.

This table shows net sales and operating profit of the business segments and reconciles to the consolidated total.

<i>(In millions)</i>	2003	2002	2001
<b>NET SALES</b>			
Aeronautics	<b>\$10,202</b>	\$ 6,471	\$ 5,355
Electronic Systems	<b>8,991</b>	8,685	8,079
Space Systems	<b>6,021</b>	5,287	4,801
Integrated Systems & Solutions	<b>3,420</b>	3,015	2,970
Information & Technology Services	<b>3,174</b>	3,104	2,763
Total business segments	<b>31,808</b>	26,562	23,968
Other	<b>16</b>	16	22
	<b>\$31,824</b>	\$26,578	\$23,990
<b>OPERATING PROFIT</b>			
Aeronautics	<b>\$ 690</b>	\$ 448	\$ 329
Electronic Systems	<b>858</b>	875	816
Space Systems	<b>403</b>	279	225
Integrated Systems & Solutions	<b>291</b>	241	225
Information & Technology Services	<b>226</b>	177	114
Total business segments	<b>2,468</b>	2,020	1,709
Unallocated Corporate (expense) income, net	<b>(449)</b>	(862)	(602)
Impact of FAS 142 adoption	<b>—</b>	—	(274)
	<b>\$ 2,019</b>	\$ 1,158	\$ 833



The following segment discussions also include information relating to negotiated backlog for each segment. Total negotiated backlog was \$76.9 billion at December 31, 2003. This amount included both funded backlog (unfilled firm orders for our products and services for which funding has been both authorized and appropriated by the customer — Congress in the case of U.S. Government agencies) and unfunded backlog (firm orders for which funding has not yet been appropriated). Negotiated backlog does not include unexercised options or task orders to be issued under indefinite-delivery/indefinite-quantity (IDIQ) type contracts. Funded backlog was \$39.1 billion at December 31, 2003.

The Aeronautics segment generally includes fewer programs that have much larger sales and operating results than programs included in the other segments. Therefore, due to the large number of comparatively smaller programs in the remaining segments, the discussions of the results of operations of these business segments generally focus on lines of business within the segments. The following tables of financial information and related discussions of the results of operations of our business segments are consistent with the presentation of segment information in Note 16 to the financial statements.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

**Aeronautics**

Aeronautics' operating results included the following:

<i>(In millions)</i>	<b>2003</b>	2002	2001
Net sales	<b>\$10,202</b>	\$ 6,471	\$ 5,355
Operating profit	<b>690</b>	448	329
Backlog at year-end	<b>37,580</b>	35,477	36,149

Net sales for Aeronautics increased by 58% in 2003 compared to 2002 due to growth in the Combat Aircraft and Air Mobility lines of business. Approximately half the growth in Combat Aircraft was due to higher volume on the F-35 Joint Strike Fighter program with a majority of the remaining growth attributable to F-16 programs as a result of increased deliveries. In 2003, 62 F-16s were delivered, 41 more than in 2002. Increased C-130J deliveries contributed \$470 million to the year-over-year growth in sales. There were 15 C-130J deliveries in 2003 compared to 8 deliveries in 2002.

Net sales for Aeronautics increased by 21% in 2002 compared to 2001 due to growth in the Combat Aircraft line of business. Approximately 60% of the growth was due to higher volume on the F-35 program with the majority of the remaining increase attributable to the F/A-22 program. Sales in Air Mobility declined \$180 million year-over-year, as 7 fewer C-130J deliveries more than offset sales growth in other Air Mobility programs.

Operating profit for the segment increased by 54% in 2003 compared to the 2002 periods. This increase was primarily due to the impact of the volume increases in Combat Aircraft and performance on other programs.

Operating profit for the segment increased by 36% in 2002 compared to 2001. This increase primarily resulted from the higher volume in Combat Aircraft. Operating profit for 2002 was negatively affected by \$30 million in charges recorded for performance issues on an aircraft modification contract and a change in estimate adjustment related to cost growth on F/A-22 activities.

In all periods, the C-130J deliveries do not impact operating profit due to the previously disclosed suspension of earnings recognition on the program.

Backlog increased in 2003 as compared to 2002 primarily as a result of booking the C-130J U.S. Government multi-year and international F-16 contracts.

**Electronic Systems**

Electronic Systems' operating results included the following:

<i>(In millions)</i>	<b>2003</b>	2002	2001
Net sales	<b>\$ 8,991</b>	\$ 8,685	\$ 8,079
Operating profit	<b>858</b>	875	816
Backlog at year-end	<b>17,339</b>	16,034	15,333

Net sales for Electronic Systems increased 4% in 2003 as compared to 2002. Sales increases in Missiles & Fire Control (M&FC) and Maritime Systems & Sensors (MS2) more than offset a decline at Platform, Training & Transportation Systems (PT&TS). Increased volume in air defense and tactical missile programs accounted for the majority of M&FC's \$250 million sales growth over 2002. In MS2, the \$155 million increase in sales was primarily due to higher volume on radar and surface systems programs. The PT&TS decline of \$100 million was the result of lower volume on transportation and security system activities. The majority of this decline is attributable to the 2002 rapid deployment of Transportation Security Administration (TSA) programs.

Net sales for Electronic Systems increased 8% in 2002 as compared to 2001. Sales increased as a result of higher volume in all three of the segment's lines of business. Increased sales at M&FC of \$285 million were mainly due to higher volumes in air defense and on certain tactical missile programs. PT&TS' sales increased by \$175 million mainly as a result of volume on transportation and security system activities (primarily the TSA programs), which offset declines on platform integration programs. MS2 sales increased by \$145 million primarily due to higher volumes on surface systems and radar systems programs.

Operating profit for the segment decreased by 2% in 2003 compared to 2002. PT&TS' operating profit declined by \$40 million due to a mix of program maturity and initial development activities on platform integration programs, as well as the impact of the decline in volume in transportation and security system activities. These decreases more than offset a \$25 million increase in operating profit primarily attributable to higher volume on air defense programs at M&FC.

Operating profit for the segment increased by 7% in 2002 compared to 2001. The increase in operating profit was primarily



driven by higher volumes at M&FC and PT&TS as noted in the preceding discussion of sales.

The increase in backlog during 2003 over 2002 resulted from increased orders on development programs which more than offset declines in orders on mature production programs.

### Space Systems

Space Systems' operating results included the following:

<i>(In millions)</i>	<b>2003</b>	2002	2001
Net sales	<b>\$ 6,021</b>	\$ 5,287	\$ 4,801
Operating profit	<b>403</b>	279	225
Backlog at year-end	<b>12,813</b>	10,701	10,797

Net sales for Space Systems increased by 14% in 2003 compared to 2002. Sales increased by \$570 million in Satellites and \$140 million in Strategic & Defensive Missile Systems (S&DMS) compared to 2002. The growth in Satellites is due to higher volume on government satellite programs. The growth in S&DMS is attributable to increases in both fleet ballistic missile and missile defense activities. In Launch Services, increased Titan activities offset lower sales resulting from a decline in Proton deliveries (2 in 2003 and 4 in 2002). There were 5 Atlas launches in both 2003 and 2002.

Net sales for Space Systems increased by 10% in 2002 compared to 2001. The increase in sales for 2002 resulted from higher volume in Satellites of \$520 million, due to government satellite activities. This growth was partially offset by sales declines in both S&DMS and Launch Services.

Operating profit for the segment increased 44% in 2003 as compared to 2002. Satellites' operating profit increased by \$70 million over the 2002 period mainly due to improved performance

on commercial satellite activities and volume increases on government satellite programs, including the impact of a \$30 million charge recorded in 2003 related to a handling incident on a NASA satellite program. In Launch Services, operating profit increased by \$35 million. The increase was primarily due to improved performance and risk retirement activities on the maturing Titan program, which were partially offset by the impact of a decline in Proton launches in 2003. S&DMS' operating profit increased by \$20 million due to the impact of the volume increases discussed above.

Operating profit for the segment increased 24% in 2002 as compared to 2001. Satellites' operating profit increased \$150 million due to reduced commercial satellite losses and the impact of volume increases in government satellite programs when compared to 2001. The commercial satellite manufacturing losses declined \$100 million in 2002 as operating performance improved (including the benefit of closing out certain manufacturing contracts) and satellite deliveries increased. Also, in the first quarter of 2001, a \$40 million loss provision was recorded on certain commercial satellite manufacturing contracts. The Satellites increase was partially offset by an \$85 million decline in profitability in Launch Services. Reduced volume on government launch vehicle programs, primarily driven by a decrease in Titan activities, accounted for almost all of the decrease in year-over-year operating profit. In 2002, operating profit on Atlas and Proton launch vehicles declined \$10 million when compared to 2001. This decrease was primarily due to lower profitability of \$55 million on the 3 additional launches in 2002, additional charges of \$60 million (net of a favorable contract adjustment of \$20 million) for market and pricing pressures and included the adverse effect of a \$35 million adjustment for commercial launch vehicle contract

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

settlement costs. The 2001 results included charges for market and pricing pressures, which reduced that year's operating profit by \$145 million.

The increase in backlog during 2003 as compared to 2002 was mainly due to an increase in orders for launch services, commercial satellites, and missile defense and classified activities.

### Integrated Systems & Solutions

Integrated Systems & Solutions' operating results included the following:

<i>(In millions)</i>	2003	2002	2001
Net sales	\$3,420	\$3,015	\$2,970
Operating profit	291	241	225
Backlog at year-end	4,350	3,556	3,874

Net sales for IS&S increased by 13% in 2003 as compared to 2002 and by 2% for 2002 over 2001. For both comparative periods, the sales increases were primarily attributable to a higher volume of intelligence, defense and information assurance activities.

Operating profit for the segment increased 21% in 2003 as compared to 2002 and by 7% for 2002 over 2001. The increases in operating profit for both comparative periods were primarily attributable to higher volume and performance improvements on the activities described above.

### Information & Technology Services

Information & Technology Services' operating results included the following:

<i>(In millions)</i>	2003	2002	2001
Net sales	\$3,174	\$3,104	\$2,763
Operating profit	226	177	114
Backlog at year-end	4,817	4,617	5,116

Net sales for I&TS increased by 2% in 2003 as compared to 2002. The sales increase for the year was mainly the result of volume increases of \$110 million in Information Technology, which more than offset lower sales volume totaling \$40 million on Defense Services and NASA programs. Information Technology's

results included the net impact of our purchase of the ACS federal government IT business and the concurrent sale of our commercial IT business in November 2003.

Net sales for I&TS increased by 12% in 2002 compared to 2001. For the year, the increase in sales was primarily attributable to growth of \$240 million in Information Technology, due to increased volume on existing programs and the acquisition of OAO Corporation in December 2001, and \$160 million in Defense Services. This growth was partially offset by a decline in sales related to volume on NASA programs.

Operating profit for the segment increased by 28% in 2003 as compared to 2002. The operating profit increase was mainly due to the higher volume in Information Technology and improved performance across all lines of business.

Operating profit for the segment increased by 55% in 2002 compared to 2001. The increase is mainly due to higher volumes and improved performance (primarily on commercial programs) in Information Technology. These increases were partially offset by a combined decrease in operating profit of \$30 million on NASA and Defense Services programs.

Backlog increased mainly due to the fourth quarter 2003 ACS acquisition and as a result of a higher volume of Information Technology orders.

The I&TS segment has a business unit that provides services to the government of Argentina. At December 31, 2003, we had net investments in and advances totaling about \$20 million. While we expect that these amounts will be recoverable, there is always the potential that further devaluation of the Argentine peso, deterioration in the Argentine economy or other factors could adversely affect our ability to recover those amounts.

### Unallocated Corporate (Expense) Income, Net

The following table shows the components of Unallocated Corporate (expense) income, net. For a discussion of the FAS/CAS pension adjustment and other types of items included in Unallocated Corporate (expense) income, net, see Note 16 to the financial statements. For information about items not considered in segment operating performance, see the table under the previous discussion of continuing operations.

<i>(In millions)</i>	<b>2003</b>	2002	2001
FAS/CAS pension adjustment	<b>\$(300)</b>	\$ 243	\$ 360
Items not considered in segment operating performance	<b>(153)</b>	(1,112)	(973)
Other, net	<b>4</b>	7	11
	<b>\$(449)</b>	\$ (862)	\$(602)

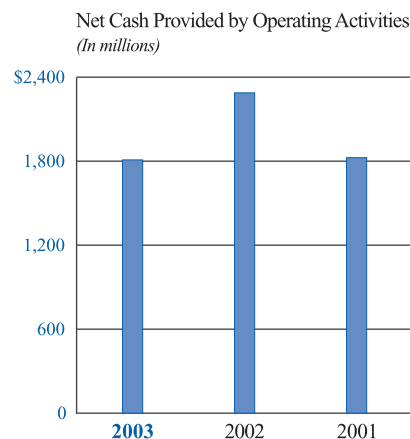
The difference between pension costs calculated and funded in accordance with CAS and pension expense or income determined in accordance with FAS 87 is not included in segment operating results and therefore is a reconciling item between operating profit from the business segments and consolidated operating profit (FAS/CAS adjustment). The CAS funding amount is allocated among the business segments and is included as an expense item in the segments' cost of goods sold. A majority of the cost is also passed along to our customers through contract pricing, and is consequently included in the segments' sales.

The change in the FAS/CAS pension adjustment in 2003 was mainly due to the Corporation reporting FAS pension expense versus FAS pension income in 2002. The following table shows the CAS funding that is included as expense in the segments' operating results, the related FAS (expense) income, and the resulting FAS/CAS adjustment:

<i>(In millions)</i>	<b>2003</b>	2002	2001
FAS 87 (expense) income	<b>\$(484)</b>	\$156	\$354
Less: CAS expense and funding	<b>(184)</b>	(87)	(6)
FAS/CAS pension adjustment — (expense) income	<b>\$(300)</b>	\$243	\$360

## LIQUIDITY AND CASH FLOWS

Our management has set forth strategic cash deployment objectives to help ensure that we keep a focus toward growing our core business and increasing shareholder value, and that we are in a position to take advantage of opportunities to do so when they arise. Those objectives include internal investment in our business (e.g., capital expenditures, independent research and development), share repurchases, increases in dividends, debt reduction and management, and acquisitions of businesses that will complement our core operations. The following discussion highlights our cash deployment activities over the past three years as well as our future plans.



## Operating Activities

Our operating cash flow continues to be the primary source of funds for financing our activities. Cash from operations amounted to \$1.8 billion in 2003, \$2.3 billion in 2002 and \$1.8 billion in 2001. Our earnings, adjusted for non-cash items such as depreciation, amortization and impairment charges, were the driving force behind these cash flows. Our working capital has remained relatively stable the last 2 years, even though our sales have increased by 20 percent in 2003 and 11 percent in 2002 when compared to the prior year. We attribute this to our continued discipline in managing our cash conversion cycle, including the negotiation of performance-based progress payment or advance payment terms in our contracts, inventory management, and billing and collection activities. Cash from operations is net of internal investments we have made in our business relative to independent research and development and bid and proposal activities aggregating \$903 million in 2003, \$830 million in 2002 and \$679 million in 2001. In December 2003, we made a discretionary prepayment of \$450 million to our defined benefit pension plan trust that reduced cash from operations, the majority of which will reduce our cash funding requirements for 2004. Our 2002 cash from operations included \$117 million from the settlement of a research and development tax credit claim, while in 2001 we paid \$655 million of income taxes related to divested businesses. We expect cash from operations to continue to be strong over the next 2 years.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

**Investing Activities**

*Capital expenditures* — Capital expenditures for property, plant and equipment amounted to \$687 million in 2003, \$662 million in 2002 and \$619 million in 2001. We expect our capital expenditures to increase over the next 2 years consistent with the expected growth in our business.

*Acquisitions and divestitures* — In addition to our internal investment in capital expenditures and independent research and development activities, we also selectively identify businesses for potential acquisition. During 2003, we paid approximately \$645 million for two businesses that will strengthen our capabilities in providing IT services to defense, intelligence and other government customers. Relative to our pending acquisition of Titan, we plan to finance the cash portion of the transaction principally using existing cash and short-term investment holdings.

During the past 3 years, we have divested non-core businesses, primarily those serving commercial markets. We received cash of approximately \$110 million in 2003 from the sale of our commercial IT business, \$134 million in 2002 from the sale of certain discontinued telecommunications businesses and \$825 million in 2001 from the sale of IMS.

In December 2003, Inmarsat Ventures, Ltd., a venture in which we held a 14% interest, was acquired by a consortium of private equity firms in a leveraged buyout transaction. In exchange for our interest, we received cash of \$114 million and a 14% ownership interest in the new Inmarsat holding company, Inmarsat Holdings, Ltd., valued at \$96 million. We recorded a deferred gain of \$42 million from the transaction, which we would expect to recognize at such time as we sell all or a portion of our interest in the new company.

**Financing Activities**

*Issuance and repayment of long-term debt* — Cash provided from operations has been our principal source of funds to reduce our long-term debt. In 2003, we issued \$1.0 billion of floating rate convertible senior debentures that bear interest at three-month LIBOR less 25 basis points, reset quarterly (the interest rate on this debt at December 31, 2003 was 0.93%). We used the proceeds from that issuance, along with cash provided by operations, to repay \$2.2 billion of debt in advance of its maturity and retire other high cost debt. We used \$175 million of cash for debt issuance and repayment costs to complete those transactions.

Interest rates on the debt we retired early ranged from 7.25% to 8.375%. We also used \$110 million in 2002 and \$2.6 billion in 2001, to repay our long-term debt. The result has been a decrease in our total debt balance from \$9.9 billion at December 31, 2000 to \$6.2 billion at December 31, 2003, and a decrease in interest paid from \$707 million in 2001 to \$519 million in 2003. We expect interest payments to decline further in 2004 when the full impact of the debt repayment and refinancing activities in 2003 will be reflected in our operating results. Scheduled debt maturities are \$136 million in 2004 and \$15 million in 2005. We currently do not expect any material early repayments of long-term debt over the next 2 years.

*Share repurchases and dividends* — We also used cash to opportunistically repurchase 10.7 million of our common shares for \$482 million in 2003 and 1.0 million of our common shares for \$50 million in 2002. These transactions were pursuant to our share repurchase program initiated in 2002. In February 2004, an additional 20 million shares were authorized for repurchase under the program. As a result of the increase, a total of 31.3 million shares may be repurchased in the future under the program.

Shareholders were paid dividends of \$261 million in 2003, \$199 million in 2002 and \$192 million in 2001. We paid a quarterly dividend of \$0.12 per share during each of the first three quarters of 2003 and \$0.22 per share for the last quarter of 2003. Quarterly dividends of \$0.11 per share were paid during 2002 and 2001.

We are currently expecting to deploy a majority of the cash we generate from operations over the next 2 years (after capital expenditures) to repurchase shares and pay dividends.

**CAPITAL STRUCTURE AND RESOURCES**

At December 31, 2003, our total long-term debt amounted to \$6.2 billion. Our long-term debt is mainly in the form of publicly issued notes and debentures. The newly issued \$1.0 billion of convertible debentures discussed in more detail below has a floating interest rate based on LIBOR. The balance of our long-term debt bears interest at fixed rates. Through our repayment activities, our long-term debt balance has declined from a balance of \$9.9 billion at December 31, 2000. During the last 3 years, we improved our debt-to-total capital ratio from 58% at December 31, 2000 to 48% at December 31, 2003.

Our stockholders' equity amounted to \$6.8 billion at December 31, 2003, an increase of about \$900 million from December 31, 2002. Net earnings, stock plan activities and a reduction of our minimum pension liability, more than offset our payment of dividends and share repurchase activities.

The \$1.0 billion in floating rate convertible debentures we issued in 2003 are due in 2033. They bear interest at a rate equal to three-month LIBOR less 25 basis points, reset quarterly. Accordingly, to the extent three-month LIBOR increases or decreases by 1%, our interest expense would increase or decrease by \$10 million on a pretax basis. Interest on the debentures is payable quarterly through August 15, 2008, after which the interest will accrue as part of the value of the debenture and will be payable, along with the principal amount, at maturity. The debentures are convertible by their holders into our common stock in certain limited circumstances as outlined in the indenture agreement. Upon conversion, we have the right to deliver, in lieu of common stock, cash or a combination of cash and common stock. We have the right to redeem any or all of the debentures at any time after August 15, 2008.

In 2003, we repaid a total of \$2.2 billion of long-term debt, including scheduled and early debt repayments, and the repayment of \$130 million related to our guarantee of Space Imaging, LLC's borrowings under its credit facility. We repaid several issuances of our long-term debt early through the completion of tender offers, redemption of certain callable debt securities and open market purchases of other outstanding debt issuances. Through these activities, we repaid debt totaling \$1.4 billion with interest rates ranging from 7.25% to 8.375% and maturities ranging from 2006 to 2026. In connection with the early repayments, we recorded losses in 2003, net of state income tax benefits, totaling \$146 million. The losses reduced net earnings by \$96 million (\$0.21 per diluted share).

At the end of 2003, we had in place a \$1.5 billion revolving credit facility under which no borrowings were outstanding. This credit facility will expire in November 2006. Borrowings under the credit facility would be unsecured and bear interest at rates based, at our option, on the Eurodollar rate or a bank Base Rate (as defined). Each bank's obligation to make loans under the credit facility is subject to, among other things, our compliance with various representations, warranties and covenants, including covenants limiting our ability and the ability of certain of our subsidiaries to encumber our assets, and a covenant not to exceed a maximum leverage ratio.

We have agreements in place with banking institutions to provide for the issuance of commercial paper. There were no commercial paper borrowings outstanding at December 31, 2003. If we were to issue commercial paper, the borrowings would be supported by the \$1.5 billion credit facility.

We have an effective shelf registration statement on file with the Securities and Exchange Commission to provide for the issuance of up to \$1 billion in debt securities. If we were to issue debt under this shelf registration, we would expect to use the net proceeds for general corporate purposes. These purposes may include repayment of debt, working capital needs, capital expenditures, acquisitions and any other general corporate purpose.

We actively seek to finance our business in a manner that preserves financial flexibility while minimizing borrowing costs to the extent practicable. Our management continually reviews changes in financial, market and economic conditions to manage the types, amounts and maturities of our indebtedness. We may at times refinance existing indebtedness, vary our mix of variable-rate and fixed-rate debt, or seek alternative financing sources for our cash and operational needs.

At December 31, 2003, we had contractual commitments to repay debt (including capital lease obligations), make payments under operating leases, settle obligations related to agreements to purchase goods and services, and settle other long-term liabilities. Payments due under these long-term obligations and commitments are as follows:

<i>(In millions)</i>	Total	Payments Due by Period			
		Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt and capital lease obligations	\$ 6,208	\$ 136	\$ 253	\$ 725	\$5,094
Operating lease commitments	1,135	254	349	219	313
Purchase obligations	1,660	827	553	207	73
Other long-term liabilities	1,051	120	202	145	584
Total contractual cash obligations	\$10,054	\$1,337	\$1,357	\$1,296	\$6,064

Generally, our long-term debt obligations are subject to, along with other things, compliance with certain covenants,

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

including covenants limiting our ability and the ability of certain of our subsidiaries to encumber our assets.

Purchase obligations include agreements and requirements contracts that give the supplier recourse to us for cancellation or nonperformance under the contract or contain terms that would subject us to liquidated damages. Such agreements and contracts may, for example, be related to direct materials, obligations to sub-contractors, outsourcing arrangements, and non-cancelable commitments for property, plant and equipment. Generally, amounts for purchase obligations in the preceding table exclude contractual commitments entered into as a result of contracts we have with our U.S. Government customers. These commitments are excluded because the U.S. Government would be required to pay us for any costs we incur if they terminate our contracts with them "for convenience" pursuant to the FAR. For example, if we had commitments to purchase goods and services that were entered into as a result of a specific contract we received from a U.S. Government customer and the customer terminated the contract for convenience, any amounts we would be required to pay to settle the related commitments, as well as amounts previously incurred, would generally be reimbursed by the customer. This would also be true in cases where we perform sub-contract work for a prime contractor under a U.S. Government contract. The termination for convenience language may also be included in contracts with foreign, state and local governments. If so, amounts related to purchase obligations entered into in support of those contracts were excluded from the preceding table. To the extent contracts with customers do not include termination for convenience provisions, including contracts with commercial customers, related purchase obligation amounts are included in the table.

Amounts related to "Other long-term liabilities" in the preceding table represent the contractual obligations for certain long-term liabilities recorded as of December 31, 2003. Such amounts mainly include expected payments under deferred compensation plans, non-qualified pension plans and environmental liabilities. Obligations related to environmental liabilities represent our estimate of remediation payment obligations under government consent decrees and agreements, excluding amounts reimbursed by the U.S. Government in its capacity as a PRP under an agreement entered into in 2000.

We have entered into standby letter of credit agreements and other arrangements with financial institutions and customers mainly relating to the guarantee of future performance on some of our contracts to provide products and services to customers. At December 31, 2003, we had contingent liabilities on outstanding letters of credit, guarantees and other arrangements, as follows:

(In millions)	Total Commit- ment	Commitment Expiration per Period			
		Less than 1 year	1-3 years	4-5 years	After 5 years
Surety bonds <sup>(a)</sup>	\$253	\$ 61	\$ 68	\$124	\$ —
Standby letters of credit <sup>(a)</sup>	261	180	57	13	11
Guarantees	4	3	1	—	—
<b>Total commitments</b>	<b>\$518</b>	<b>\$244</b>	<b>\$126</b>	<b>\$137</b>	<b>\$ 11</b>

(a) Approximately \$43 million of surety bonds in the "less than 1 year" period, and approximately \$117 million and \$15 million of standby letters of credit in the "less than 1 year" and "1-3 year" periods, respectively, are expected to automatically renew for additional 1-2 year periods until completion of the contractual obligation.

We have issued standby letters of credit and surety bonds totaling \$3.9 billion related to advances received from customers and/or to secure our performance under long-term contracts. Amounts included in the table above totaling \$514 million are those amounts over and above advances received from customers which are recorded in the balance sheet as either offsets against inventories or in customer advances and amounts in excess of costs incurred. Of the \$3.4 billion recorded in the balance sheet, approximately \$2 billion relates to a standby letter of credit to secure advance payments received under an F-16 contract from an international customer. This letter of credit is available for draw down only in the event of our nonperformance. Similar to the letter of credit for the F-16 contract, letters of credit and surety bonds for other contracts are available for draw down only in the event of our nonperformance.

Cash and cash equivalents, short-term investments, cash flow from operations and other available financing resources, are expected to be sufficient to meet anticipated operating, capital expenditure and debt service requirements, as well as acquisition and other discretionary investment needs,

projected over the next 3 years. Consistent with our desire to generate cash to reduce debt and invest in our core businesses, we expect that, depending on prevailing financial, market and economic conditions, we will continue to explore the sale of non-core businesses, passive equity investments and surplus real estate.

## **EQUITY INVESTMENTS**

In 2002, we recorded impairment charges, net of state income tax benefits, totaling \$776 million related to our investments in Intelsat, Ltd. (Intelsat), Inmarsat and New Skies Satellites, N.V. (New Skies). The charges reduced net earnings by \$504 million (\$1.12 per diluted share). The charges were recorded primarily due to unfavorable trends in the satellite services and telecommunications industries that were not expected to be resolved in the near term.

Intelsat, Inmarsat and New Skies are subject to regulation by the Federal Communications Commission (FCC). FCC decisions and policies have had, and may continue to have, a significant impact on these companies. The Open-Market Reorganization for the Betterment of International Telecommunications Act (the ORBIT Act), passed by Congress in 2000, established deadlines for Intelsat and Inmarsat to complete initial public offerings. Based on congressional and regulatory extensions received to date, and unless otherwise extended by Congress, each is required to complete their initial public offerings by June 30, 2004. Their ability to do so may be impacted by changes in trends and market conditions in the telecommunications industry, as well as in the capital markets. If those deadlines are not met or extended by further amendments to the legislation, the FCC may limit access by U.S. users to the satellite capacity of the privatized entities for some services. If this were to occur, the value of our investments could be adversely affected. In December 2003, Inmarsat was acquired in a leveraged buyout transaction and, in doing so, believes it has complied with the ORBIT Act requirements. There is no assurance that the FCC will accept Inmarsat's position that it has satisfied the ORBIT Act requirement by completing a leveraged buyout transaction. In January 2004, Intelsat announced its intention to conduct an initial public offering of its shares in an amount up to \$500 million, and expects the offering to occur on or before June 30, 2004.

In December 2002, we recorded a charge, net of state income tax benefits, of \$163 million related to our investment in Space Imaging, LLC and our guarantee of up to \$150 million of

Space Imaging's borrowings under a credit facility that matured on March 30, 2003. At December 31, 2002, we increased current maturities of long-term debt by \$150 million representing our estimated obligation under the guarantee. On March 31, 2003, we paid \$130 million to acquire Space Imaging's outstanding borrowings under Space Imaging's credit facility, and the guarantee was eliminated. We therefore reversed, net of state income taxes, approximately \$19 million of the charge recorded in December 2002, representing the unutilized portion of the credit facility covered by our guarantee. This gain increased 2003 net earnings by \$13 million (\$0.03 per diluted share).

In 2001, we recorded a charge, net of state income tax benefits, of \$361 million related to the impairment of our investment in Loral Space & Communications Ltd. (see Note 8 to the financial statements). The charge reduced net earnings by \$235 million (\$0.54 per diluted share). In July 2003, Loral Space and certain of its subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In the third quarter of 2003, we sold our ownership interest in Loral Space. The sale did not have a material impact on our results of operations, financial position or cash flows. We are an unsecured creditor of Loral Space in the bankruptcy proceeding. Loral Space has made a claim that they are entitled to a refund of payments made to us under various terminated launch service contracts. We believe that the claim is without merit and that we are entitled to retain the amounts under the terms of the contracts. We do not expect these events to have a material impact on our results of operations, financial position or cash flow.

In 2001, we recorded a charge, net of state income tax benefits, of \$367 million related to impairment in the value of our investment in Astrolink International LLC. We also recorded charges of approximately \$20 million, net of state income tax benefits, in cost of sales for certain other costs related to Astrolink. On a combined basis, these charges reduced net earnings for 2001 by approximately \$267 million (\$0.62 per diluted share). In January 2003, we entered into an agreement with Astrolink's other members to restructure Astrolink. As part of the transaction, Liberty Satellite & Technology, a subsidiary of Liberty Media Corporation, had an option to acquire Astrolink's assets and pursue a business plan to build a one- or two-satellite system. On October 24, 2003, Liberty Satellite & Technology notified us that they would not exercise the option to acquire Astrolink's assets and build the satellite system. As a result, as part of the restructuring agreement, Astrolink's procurement contracts were

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2003

terminated, and we acquired the remaining ownership interests in Astrolink. The restructuring also entailed the settlement of existing claims related to termination of Astrolink's procurement contracts with its members, certain of their affiliates and other vendors. Under these settlements, we retained our work in process. Completion of the restructuring did not have a material impact on our financial position, results of operations or cash flows.

In 2001 we recorded charges, net of state income tax benefits, of approximately \$232 million related to commitments to and impairment in the values of investments in satellite joint ventures, primarily Asia Cellular Satellite System and Americom Asia-Pacific, LLC. The charges reduced net earnings for 2001 by \$153 million (\$0.35 per diluted share).

Realization and valuation of our investments in equity securities may be affected by an investee's ability to obtain adequate funding, including through public and private sales of its debt and equity securities, and execute its business plans, as well as by general market conditions, industry considerations specific to the investee's business, and/or other factors. The inability of an investee to obtain future funding or successfully execute its business plan could adversely affect our earnings in the periods affected by those events.

### DISCONTINUED OPERATIONS

In the fourth quarter of 2001, we announced that we would exit our global telecommunications services business and recorded related charges, net of state income tax benefits, of approximately \$1.4 billion. The charges reduced net earnings by about \$1.3 billion (\$3.09 per diluted share).

The charges related to global telecommunications services businesses held for sale and exit costs for the elimination of the administrative function supporting the global telecommunications businesses and investments. Amounts recorded included about \$1.2 billion related to impairment of goodwill, with the remainder related to impairment of some of the long-lived assets employed by foreign businesses held for sale and costs associated with elimination of administrative functions. We completed sales of all of the businesses classified as held for sale in 2002 with the exception of Lockheed Martin Intersputnik (LMI). Those transactions did not have a material impact on our consolidated results of operations or financial position.

We reached an agreement to sell LMI in the third quarter of 2002; however, in April 2003, the agreement was terminated. We are continuing to treat LMI as a discontinued operation, as we are

still holding and actively marketing the business for sale, and there are interested potential buyers. The operating results of LMI had no impact on the statement of earnings in 2003, and its assets and liabilities, which represented less than 1% of our consolidated assets and liabilities at the end of 2003, were included in our balance sheet in other current assets and other current liabilities. We do not expect that the operating results of LMI (until such time as we sell the business), or its ultimate sale, will have a material effect on our consolidated results of operations, financial position or cash flows.

We completed the sale of IMS, a wholly-owned subsidiary, for \$825 million in cash in August 2001. This transaction resulted in a gain, net of state income taxes, of \$476 million and increased net earnings by \$309 million (\$0.71 per diluted share). The results of IMS' operations, as well as the gain on the sale, were classified as discontinued operations.

### QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK

Our main exposure to market risk relates to interest rates and, to a lesser extent, foreign currency exchange rates. Our financial instruments that are subject to interest rate risk principally include short-term investments and long-term debt. Our long-term debt obligations, other than the \$1.0 billion in convertible debentures issued in 2003, are generally not callable until maturity. We sometimes use interest rate swaps to manage our exposure to fixed and variable interest rates. At year-end 2003, we had agreements in place to swap fixed interest rates on approximately \$70 million of our long-term debt for variable interest rates based on LIBOR. The interest rate swap agreements are designated as effective hedges of the fair value of the underlying fixed-rate debt instruments. At December 31, 2003, the fair values of interest rate swap agreements outstanding were not material. The amounts of gains and losses from changes in the fair values of the swap agreements were entirely offset by those from changes in the fair value of the associated debt obligations. Changes in swap rates would affect the market value of the agreements, but those changes in value would be offset by changes in the value of the underlying debt obligations.

We use forward foreign exchange contracts to manage our exposure to fluctuations in foreign exchange rates. These contracts are designated as qualifying hedges of the cash flows associated with firm commitments or specific anticipated transactions, and related gains and losses on the contracts, to the



extent they are effective hedges, are recognized in income when the hedged transaction occurs. To the extent the hedges are ineffective, gains and losses on the contracts are recognized currently. At December 31, 2003, the fair value of forward exchange contracts outstanding, as well as the amounts of gains and losses recorded during the year then ended, were not material. We do not hold or issue derivative financial instruments for trading purposes.

### **CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic filings with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in certain unconsolidated entities. As we do not control or manage those entities, our disclosure controls and procedures with respect to those entities are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

At December 31, 2003, we performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. The evaluation was performed with the participation of senior management of each business segment and key Corporate functions, and under the supervision of the CEO and CFO. Based on the evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective.

There have been no significant changes in our internal controls over financial reporting during the most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

*Lockheed Martin Corporation*  
**MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING**

The management of Lockheed Martin prepared and is responsible for the consolidated financial statements and all related financial information contained in this Annual Report. The consolidated financial statements, which include amounts based on estimates and judgments, have been prepared in accordance with accounting principles generally accepted in the United States.

In recognition of its responsibility for the integrity and objectivity of data in the financial statements, the Corporation maintains a system of internal controls over financial reporting designed and intended to provide reasonable assurance, based on an appropriate cost-benefit relationship, that assets are safeguarded and transactions are properly executed and recorded. The Corporation also maintains a system of disclosure controls and procedures which includes controls and procedures designed to ensure that information required to be disclosed in its filings with the Securities and Exchange Commission (SEC) is gathered and communicated to management for timely consideration of disclosure. An environment that provides for an appropriate level of control consciousness is maintained and monitored and includes examinations by an internal audit staff, examinations by the independent auditors in connection with their reviews of interim financial information and their annual audit, and audits by the Defense Contract Audit Agency of our compliance with federal government rules and regulations applicable to contracts with the U.S. Government. In addition, a Disclosure Controls Committee assists in monitoring and evaluating disclosure controls and procedures, and to review interim and annual reports of financial information filed with the SEC for accuracy and completeness.

Essential to the Corporation's internal control system is management's dedication to the highest standards of integrity, ethics and social responsibility. To support these standards, management has issued the Code of Ethics and Business Conduct (the Code) and developed policy statements that cover, among other topics, maintaining accurate and complete accounting records, proper business practices, regulatory compliance, potentially conflicting outside interests of employees, and adherence to high standards of conduct and practices in dealings with customers, including the U.S. Government. The Code provides for a help line that employees can use to confidentially or anonymously communicate to the Corporation's ethics office complaints or concerns about accounting, internal control or auditing matters. These matters, if requested by the employee, must be forwarded directly to the Corporation's Audit and Ethics Committee. The importance of ethical behavior is regularly communicated to all employees through the distribution of the Code, and through ongoing education and review programs designed to create a strong compliance environment.

The Audit and Ethics Committee of the Board of Directors is composed of seven independent directors. This Committee meets periodically with the independent auditors, internal auditors and management to review their activities. Both the independent auditors and the internal auditors have unrestricted access to meet with members of the Audit and Ethics Committee, with or without management representatives present.

The Audit and Ethics Committee is responsible for the selection, retention and compensation of the independent auditors. The consolidated financial statements included in this Annual Report have been audited by Ernst & Young LLP, whose report follows.



Vance D. Coffman  
Chairman and Chief Executive Officer



Christopher E. Kubasik  
Senior Vice President and Chief Financial Officer



Robert J. Stevens  
President and Chief Operating Officer



Rajeev Bhalla  
Vice President and Controller

*Lockheed Martin Corporation*  
**REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS**

Board of Directors and Stockholders  
Lockheed Martin Corporation

We have audited the accompanying consolidated balance sheet of Lockheed Martin Corporation as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lockheed Martin Corporation at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 of the Notes to Consolidated Financial Statements, in 2002 the Corporation adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

*Ernst & Young LLP*

McLean, Virginia  
January 27, 2004

*Lockheed Martin Corporation*  
**CONSOLIDATED STATEMENT OF OPERATIONS**

<i>(In millions, except per share data)</i>	<i>Year ended December 31,</i>		
	<b>2003</b>	2002	2001
<b>NET SALES</b>	<b>\$ 31,824</b>	\$ 26,578	\$ 23,990
Cost of sales	<b>29,848</b>	24,629	22,447
Earnings from operations	<b>1,976</b>	1,949	1,543
Other income and expenses, net	<b>43</b>	(791)	(710)
	<b>2,019</b>	1,158	833
Interest expense	<b>487</b>	581	700
Earnings from continuing operations before taxes	<b>1,532</b>	577	133
Income tax expense	<b>479</b>	44	90
Earnings from continuing operations	<b>1,053</b>	533	43
Discontinued operations	—	(33)	(1,089)
<b>NET EARNINGS (LOSS)</b>	<b>\$ 1,053</b>	\$ 500	\$ (1,046)
<b>EARNINGS (LOSS) PER COMMON SHARE:</b>			
Basic:			
Continuing operations	<b>\$ 2.36</b>	\$ 1.20	\$ 0.10
Discontinued operations	—	(0.07)	(2.55)
	<b>\$ 2.36</b>	\$ 1.13	\$ (2.45)
Diluted:			
Continuing operations	<b>\$ 2.34</b>	\$ 1.18	\$ 0.10
Discontinued operations	—	(0.07)	(2.52)
	<b>\$ 2.34</b>	\$ 1.11	\$ (2.42)

*See accompanying Notes to Consolidated Financial Statements.*

*Lockheed Martin Corporation*  
**CONSOLIDATED BALANCE SHEET**

<i>(In millions)</i>	<i>December 31,</i>	
	<b>2003</b>	2002
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	<b>\$ 1,010</b>	\$ 2,738
Short-term investments	<b>240</b>	—
Receivables	<b>4,039</b>	3,655
Inventories	<b>2,348</b>	2,250
Deferred income taxes	<b>921</b>	1,277
Other current assets	<b>843</b>	706
Total current assets	<b>9,401</b>	10,626
Property, plant and equipment, net	<b>3,489</b>	3,258
Investments in equity securities	<b>1,060</b>	1,009
Goodwill	<b>7,879</b>	7,380
Purchased intangibles, net	<b>807</b>	814
Prepaid pension asset	<b>1,213</b>	1,221
Other assets	<b>2,326</b>	2,671
	<b>\$26,175</b>	\$26,979
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	<b>\$ 1,434</b>	\$ 1,102
Customer advances and amounts in excess of costs incurred	<b>4,256</b>	4,542
Salaries, benefits and payroll taxes	<b>1,418</b>	1,272
Income taxes	<b>91</b>	107
Current maturities of long-term debt	<b>136</b>	1,365
Other current liabilities	<b>1,558</b>	1,433
Total current liabilities	<b>8,893</b>	9,821
Long-term debt	<b>6,072</b>	6,217
Post-retirement benefit liabilities	<b>1,440</b>	1,480
Accrued pension liabilities	<b>1,100</b>	1,872
Other liabilities	<b>1,914</b>	1,724
Stockholders' equity:		
Common stock, \$1 par value per share	<b>446</b>	455
Additional paid-in capital	<b>2,477</b>	2,796
Retained earnings	<b>5,054</b>	4,262
Unearned ESOP shares	<b>(17)</b>	(50)
Accumulated other comprehensive loss	<b>(1,204)</b>	(1,598)
Total stockholders' equity	<b>6,756</b>	5,865
	<b>\$26,175</b>	\$26,979

*See accompanying Notes to Consolidated Financial Statements.*

*Lockheed Martin Corporation*  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

<i>(In millions)</i>	<i>Year ended December 31,</i>		
	<b>2003</b>	2002	2001
<b>OPERATING ACTIVITIES</b>			
Earnings from continuing operations	<b>\$ 1,053</b>	\$ 533	\$ 43
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	<b>480</b>	433	425
Amortization of purchased intangibles	<b>129</b>	125	154
Amortization of goodwill	<b>—</b>	—	244
Deferred federal income taxes	<b>467</b>	(463)	(118)
Loss from discontinued operations	<b>—</b>	(33)	(1,089)
Write-down of investments and other charges	<b>42</b>	1,127	1,051
Net charges related to discontinued operations	<b>—</b>	—	936
Changes in operating assets and liabilities:			
Receivables	<b>(258)</b>	394	(34)
Inventories	<b>(94)</b>	585	651
Accounts payable	<b>330</b>	(317)	192
Customer advances and amounts in excess of costs incurred	<b>(285)</b>	(460)	318
Income taxes	<b>(16)</b>	44	(456)
Other	<b>(39)</b>	320	(492)
Net cash provided by operating activities	<b>1,809</b>	2,288	1,825
<b>INVESTING ACTIVITIES</b>			
Expenditures for property, plant and equipment	<b>(687)</b>	(662)	(619)
Acquisition of businesses / investments in affiliated companies	<b>(821)</b>	(104)	(192)
Purchase of short-term investments, net	<b>(240)</b>	—	—
Proceeds from divestiture of affiliated companies	<b>234</b>	134	825
Other	<b>53</b>	93	125
Net cash (used for) provided by investing activities	<b>(1,461)</b>	(539)	139
<b>FINANCING ACTIVITIES</b>			
Issuances of long-term debt	<b>1,000</b>	—	—
Repayments of long-term debt	<b>(2,202)</b>	(110)	(2,508)
Long-term debt issuance and repayment costs	<b>(175)</b>	—	(58)
Issuances of common stock	<b>44</b>	436	213
Repurchases of common stock	<b>(482)</b>	(50)	—
Common stock dividends	<b>(261)</b>	(199)	(192)
Other	<b>—</b>	—	(12)
Net cash (used for) provided by financing activities	<b>(2,076)</b>	77	(2,557)
Net (decrease) increase in cash and cash equivalents	<b>(1,728)</b>	1,826	(593)
Cash and cash equivalents at beginning of year	<b>2,738</b>	912	1,505
Cash and cash equivalents at end of year	<b>\$ 1,010</b>	\$ 2,738	\$ 912

*See accompanying Notes to Consolidated Financial Statements.*

*Lockheed Martin Corporation*  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

<i>(In millions, except per share data)</i>	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity	Comprehensive (Loss) Income
Balance at December 31, 2000	\$ 431	\$ 1,789	\$ 5,199	\$ (115)	\$ (144)	\$ 7,160	
Net loss	—	—	(1,046)	—	—	(1,046)	\$(1,046)
Common stock dividends declared (\$0.44 per share)	—	—	(192)	—	—	(192)	—
Stock awards and options, and ESOP activity	10	353	—	31	—	394	—
Other comprehensive income (loss):							
Minimum pension liability	—	—	—	—	(33)	(33)	(33)
Net unrealized gain from available-for-sale investments	—	—	—	—	23	23	23
Reclassification adjustment related to available-for-sale investments	—	—	—	—	151	151	151
Other	—	—	—	—	(14)	(14)	(14)
Balance at December 31, 2001	441	2,142	3,961	(84)	(17)	6,443	\$ (919)
Net earnings	—	—	500	—	—	500	\$ 500
Common stock dividends declared (\$0.44 per share)	—	—	(199)	—	—	(199)	—
Stock awards and options, and ESOP activity	15	703	—	34	—	752	—
Repurchases of common stock	(1)	(49)	—	—	—	(50)	—
Other comprehensive income (loss):							
Minimum pension liability	—	—	—	—	(1,537)	(1,537)	(1,537)
Net unrealized loss from available-for-sale investments	—	—	—	—	(100)	(100)	(100)
Reclassification adjustments related to available-for-sale investments	—	—	—	—	53	53	53
Other	—	—	—	—	3	3	3
Balance at December 31, 2002	455	2,796	4,262	(50)	(1,598)	5,865	\$(1,081)
Net earnings	—	—	<b>1,053</b>	—	—	<b>1,053</b>	<b>\$ 1,053</b>
Common stock dividends declared (\$0.58 per share)	—	—	<b>(261)</b>	—	—	<b>(261)</b>	—
Repurchases of common stock	<b>(11)</b>	<b>(471)</b>	—	—	—	<b>(482)</b>	—
Stock awards and options, and ESOP activity	<b>2</b>	<b>152</b>	—	<b>33</b>	—	<b>187</b>	—
Other comprehensive income (loss):							
Minimum pension liability	—	—	—	—	<b>331</b>	<b>331</b>	<b>331</b>
Net unrealized gain from available-for-sale investments	—	—	—	—	<b>46</b>	<b>46</b>	<b>46</b>
Other	—	—	—	—	<b>17</b>	<b>17</b>	<b>17</b>
<b>Balance at December 31, 2003</b>	<b>\$ 446</b>	<b>\$ 2,477</b>	<b>\$ 5,054</b>	<b>\$ (17)</b>	<b>\$ (1,204)</b>	<b>\$ 6,756</b>	<b>\$ 1,447</b>

See accompanying Notes to Consolidated Financial Statements.

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

**NOTE 1 — SIGNIFICANT ACCOUNTING POLICIES**

*Organization* — Lockheed Martin Corporation (Lockheed Martin or the Corporation) is engaged in the conception, research, design, development, manufacture, integration and operation of advanced technology systems, products and services. As a leading systems integrator, its products and services range from aircraft, spacecraft and launch vehicles to missiles, electronics and information systems. The Corporation serves customers in both domestic and international defense and commercial markets, with its principal customers being agencies of the U.S. Government.

*Basis of consolidation and classifications* — The consolidated financial statements include the accounts of wholly-owned subsidiaries and majority-owned entities which the Corporation controls. Intercompany balances and transactions have been eliminated in consolidation. Receivables and inventories are primarily attributable to long-term contracts or programs in progress for which the related operating cycles are longer than 1 year. In accordance with industry practice, these items are included in current assets.

Certain amounts for prior years have been reclassified to conform with the 2003 presentation.

*Use of estimates* — The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions, including estimates of anticipated contract costs and revenues utilized in the earnings recognition process, that affect the reported amounts in the financial statements and accompanying notes. Due to the size and nature of many of the Corporation's programs, the estimation of total revenues and cost at completion is subject to a wide range of variables, including assumptions for schedule and technical issues. Actual results may differ from those estimates.

*Cash and cash equivalents* — Cash equivalents are generally composed of highly liquid instruments with maturities of 3 months or less. Due to the short maturity of these instruments, carrying value on the Corporation's consolidated balance sheet approximates fair value.

*Short-term investments* — The Corporation's short-term investments consist of marketable securities that are categorized as

available-for-sale securities as defined by Statement of Financial Accounting Standards (FAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Unrealized gains and losses on those securities are reflected as a net amount under the caption of accumulated other comprehensive income (loss) in the statement of stockholders' equity. Realized gains and losses are recorded in the statement of operations under the caption other income or expenses. For purposes of computing realized gains and losses, cost is determined on a specific identification basis. The fair values of marketable securities are estimated based on quoted market price for the respective securities.

At December 31, 2003, the Corporation recorded short-term investments with an aggregate amortized cost of \$239 million and fair value of \$240 million. There were no short-term investments at December 31, 2002. The investment portfolio was composed of the following:

<i>(In millions)</i>	Amortized Cost	Fair Value
U.S. treasury and government agency securities	\$125	\$126
Corporate debt securities	94	94
Mortgage-backed and other securities	20	20
	<u>\$239</u>	<u>\$240</u>

Over 80% of the securities had contractual maturities of 1 to 5 years. Proceeds from sales of marketable securities totaled \$116 million in 2003. Gross gains and losses related to sales of marketable securities for the year, as well as net unrealized gains and losses at year-end, were not material.

*Receivables* — Receivables consist of amounts billed and currently due from customers, and include unbilled costs and accrued profits primarily related to revenues on long-term contracts that have been recognized for accounting purposes but not yet billed to customers. As such revenues are recognized, appropriate amounts of customer advances, performance-based payments and progress payments are reflected as an offset to the related accounts receivable balance.

*Inventories* — Inventories are stated at the lower of cost or estimated net realizable value. Costs on long-term contracts and programs in progress represent recoverable costs incurred for production, allocable operating overhead, advances to suppliers and, where appropriate, research and development and general



and administrative expenses. Pursuant to contract provisions, agencies of the U.S. Government and certain other customers have title to, or a security interest in, inventories related to such contracts as a result of advances, performance-based payments and progress payments. Such advances and payments are reflected as an offset against the related inventory balances. General and administrative expenses related to commercial products and services provided essentially under commercial terms and conditions are expensed as incurred. Costs of other product and supply inventories are principally determined by the first-in first-out or average cost methods.

*Property, plant and equipment* — Property, plant and equipment are carried principally at cost. Depreciation is provided on plant and equipment generally using accelerated methods during the first half of the estimated useful lives of the assets; thereafter, straight-line depreciation is used. Estimated useful lives generally range from 10 to 40 years for buildings and 5 to 15 years for machinery and equipment.

*Investments in equity securities* — Investments in equity securities include the Corporation's ownership interests in affiliated companies accounted for under the equity method of accounting. Under this method of accounting, which generally applies to investments that represent a 20% to 50% ownership of the equity securities of the investees, the Corporation's share of the earnings or losses of the affiliated companies is included in other income and expenses. The Corporation recognizes currently gains or losses arising from issuances of stock by wholly-owned or majority-owned subsidiaries, or by equity method investees. These gains or losses are also included in other income and expenses. Investments in equity securities also include the Corporation's ownership interests in companies in which its investment represents less than 20%. If classified as available-for-sale, these investments are accounted for at fair value, with unrealized gains and losses recorded in other comprehensive income, in accordance with FAS 115. If declines in the value of investments accounted for under either the equity method or FAS 115 are determined to be other than temporary, a loss is recorded in earnings currently. The Corporation makes 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,

information regarding market and industry trends for the investee's business, and investment analyst reports, if available. Investments not accounted for under one of these methods are generally accounted for under the cost method of accounting.

*Goodwill* — Beginning January 1, 2002, goodwill is no longer amortized. Goodwill is displayed on the consolidated balance sheet net of accumulated amortization of \$1,382 million at December 31, 2003 and 2002. Under FAS 142 (see discussion under the caption "Recent accounting pronouncements" in this Note), goodwill is evaluated for potential impairment annually by comparing the fair value of a reporting unit to its carrying value, including goodwill recorded by the reporting unit. If the carrying value exceeds the fair value, impairment is measured by comparing the derived fair value of goodwill to its carrying value, and any impairment determined is recorded in the current period.

*Purchased intangibles, net* — Intangible assets acquired as part of business combinations are amortized over their estimated useful lives unless their useful lives are determined to be indefinite. For material business combinations, amounts recorded related to purchased intangibles are determined from independent valuations. The Corporation's purchased intangibles primarily relate to contracts and programs acquired which are amortized over periods of 15 years or less. Purchased intangibles are displayed in the consolidated balance sheet net of accumulated amortization of \$1,491 million and \$1,364 million at December 31, 2003 and 2002, respectively. Amortization expense related to these intangible assets was \$129 million, \$125 million, and \$154 million for the years ended December 31, 2003, 2002 and 2001, respectively, and is estimated to be approximately \$145 million per year in 2004 through 2006, \$125 million in 2007 and \$75 million in 2008, excluding the effects of any future acquisitions or divestitures.

*Customer advances and amounts in excess of costs incurred* — The Corporation receives advances, performance-based payments and progress payments from customers which may exceed costs incurred on certain contracts, including contracts with agencies of the U.S. Government. Such advances, other than those reflected as an offset to accounts receivable or inventories as discussed above, are classified as current liabilities.

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2003

*Environmental matters* — The Corporation records a liability for environmental matters when it is probable that a liability has been incurred and the amount can be reasonably estimated. A substantial portion of these costs are expected to be reflected in sales and cost of sales pursuant to U.S. Government agreement or regulation. At the time a liability is recorded for future environmental costs, an asset is recorded for estimated future recovery considered probable through the pricing of products and services to agencies of the U.S. Government. The portion of those costs expected to be allocated to commercial business or that is determined to be unallowable for pricing under U.S. Government contracts is reflected in cost of sales at the time the liability is established.

*Sales and earnings* — Sales and anticipated profits under long-term fixed-price production contracts are recorded on a percentage of completion basis, generally using units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenue. Estimated contract profits are taken into earnings in proportion to recorded sales. Sales under certain long-term fixed-price contracts which, among other factors, provide for the delivery of minimal quantities or require a substantial level of development effort in relation to total contract value, are recorded upon achievement of performance milestones or using the cost-to-cost method of accounting where sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion.

Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs. Sales of products and services provided essentially under commercial terms and conditions are recorded upon delivery and passage of title.

Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Incentives or penalties related to performance on contracts are considered in estimating sales and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance. Estimates of award fees are also considered in estimating sales and profit rates based on actual and anticipated awards. Incentive provisions which increase or decrease earnings based solely on a single significant event are generally not recognized until the event occurs.

When adjustments in contract value or estimated costs are determined, any changes from prior estimates are generally reflected in earnings in the current period. Anticipated losses on contracts are charged to earnings when identified and determined to be probable.

*Research and development and similar costs* — Corporation-sponsored research and development costs primarily include independent research and development and bid and proposal efforts related to government products and services. Except for certain arrangements described below, these costs are generally included as part of the general and administrative costs that are allocated among all contracts and programs in progress under U.S. Government contractual arrangements. Corporation-sponsored product development costs not otherwise allocable are charged to expense when incurred. Under certain arrangements in which a customer shares in product development costs, the Corporation's portion of unreimbursed costs is generally expensed as incurred. Total independent research and development costs charged to cost of sales in 2003, 2002 and 2001, including costs related to bid and proposal efforts, were \$903 million, \$830 million and \$679 million, respectively. Costs incurred under customer-sponsored research and development programs pursuant to contracts are accounted for as sales and cost of sales under the contract.

*Restructuring activities* — Under existing U.S. Government regulations, certain costs incurred for consolidation or restructuring activities that can be demonstrated to result in savings in excess of the cost to implement those actions can be deferred and amortized for government contracting purposes and included as allowable costs in future pricing of the Corporation's products and services. Included in other assets in the consolidated balance sheet at December 31, 2003 and 2002 is approximately \$155 million and \$215 million, respectively, of deferred costs related to various consolidation actions.

*Impairment of certain long-lived assets* — Generally, the carrying values of long-lived assets other than goodwill are reviewed for impairment if events or changes in the facts and circumstances indicate that their carrying values may not be recoverable. Any impairment determined is recorded in the current period and is measured by comparing the fair value of the related asset to its carrying value.

*Derivative financial instruments* — The Corporation sometimes uses derivative financial instruments to manage its exposure to fluctuations in interest rates and foreign exchange rates. The Corporation accounts for derivative financial instruments in accordance with FAS 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended. Under FAS 133, all derivatives are recorded as either assets or liabilities in the consolidated balance sheet, and periodically adjusted to fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives that are not considered highly effective hedges are reflected in earnings. Adjustments to reflect changes in fair values of derivatives that are considered highly effective hedges are either reflected in earnings and largely offset by corresponding adjustments related to the fair values of the hedged items, or reflected in other comprehensive income until the hedged transaction matures and the entire transaction is recognized in earnings. The change in fair value of the ineffective portion of a hedge is immediately recognized in earnings.

Interest rate swap agreements are designated as effective hedges of the fair value of certain existing fixed-rate debt instruments. Forward currency exchange contracts are designated as qualifying hedges of cash flows associated with firm commitments or specific anticipated transactions. At December 31, 2003, the fair values of interest rate swap agreements and forward currency exchange contracts outstanding, as well as the amounts of gains and losses recorded during the year, were not material. The Corporation does not hold or issue derivative financial instruments for trading purposes.

*Stock-based compensation* — The Corporation measures compensation cost for stock-based compensation plans using the intrinsic value method of accounting as prescribed in Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. The Corporation has adopted those provisions of FAS 123, “Accounting for Stock-Based Compensation,” as amended, which require disclosure of the pro forma effects on net earnings and earnings per share as if compensation cost had been recognized based upon the fair value-based method at the date of grant for options awarded.

For purposes of pro forma disclosures, the options’ estimated fair values are amortized to expense over the options’

vesting periods (see Note 12). The Corporation’s pro forma information follows:

<i>(In millions, except per share data)</i>	<b>2003</b>	2002	2001
<b>NET EARNINGS (LOSS):</b>			
As reported	<b>\$ 1,053</b>	\$ 500	\$(1,046)
Fair value-based compensation cost, net of taxes	<b>(61)</b>	(67)	(49)
Pro forma net earnings (loss)	<b>\$ 992</b>	\$ 433	\$(1,095)
<b>EARNINGS (LOSS) PER BASIC SHARE:</b>			
As reported	<b>\$ 2.36</b>	\$ 1.13	\$ (2.45)
Pro forma	<b>\$ 2.22</b>	\$ 0.97	\$ (2.56)
<b>EARNINGS (LOSS) PER DILUTED SHARE:</b>			
As reported	<b>\$ 2.34</b>	\$ 1.11	\$ (2.42)
Pro forma	<b>\$ 2.20</b>	\$ 0.96	\$ (2.53)

*Comprehensive income* — Comprehensive income (loss) for the Corporation consists primarily of net earnings (loss) and the after-tax impact of: the additional minimum pension liability, unrealized gains and losses related to available-for-sale investments, reclassification adjustments related to available-for-sale investments, and other activities related to hedging activities and foreign currency translation. Income taxes related to components of other comprehensive income are generally recorded based on an effective tax rate, including the effects of federal and state taxes, of 37%.

The accumulated balances of the components of other comprehensive income (loss) at December 31, 2003 are as follows: minimum pension liability — \$(1,239) million; net unrealized gains from available-for-sale investments — \$44 million; and other activities — \$(9) million.

*Recent accounting pronouncements* — In December 2003, the Financial Accounting Standards Board issued a Staff Position that allows companies to defer recognition of the impact that the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) might have on the benefit obligations they provide their retirees, pending the issuance of specific guidance on the accounting for the federal subsidy introduced by the Act which, when issued, could require a change to previously reported information. The Corporation elected to defer recognition of the impact of the Act; accordingly, the accumulated post-retirement benefit obligation (APBO) for its retiree health care benefits, as well as the net periodic

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

post-retirement benefit cost, included in the Corporation's financial statements and the accompanying notes do not currently reflect the effects of the Act. It is expected that any such change would result in some reduction to the APBO and the net periodic post-retirement benefit cost.

As required, the Corporation adopted FAS 142, "Goodwill and Other Intangible Assets," as of January 1, 2002. Among other things, the Statement prohibits the amortization of goodwill and sets forth a new methodology for periodically assessing and, if warranted, recording impairment of goodwill. The Corporation completed the initial step of the goodwill impairment test required by the new rules and concluded that no adjustment to the balance of goodwill at the date of adoption was required. In addition, the Corporation reassessed the estimated remaining useful lives of other intangible assets as part of its adoption of the Statement. As a result of that review, the estimated remaining useful life of the intangible asset related to the F-16 fighter aircraft program was extended from 6 to 10 years, effective January 1, 2002. This change resulted in a decrease in annual amortization expense associated with that intangible asset of approximately \$30 million on a pretax basis.

The following table provides a reconciliation of reported earnings from continuing operations and related per share amounts for the year ended December 31, 2001 to adjusted amounts which exclude the effects of goodwill amortization and reflect the change in amortization related to the F-16 program for those periods.

<i>(In millions, except per share data)</i>	<b>2003</b>	2002	2001
<b>EARNINGS FROM CONTINUING OPERATIONS:</b>			
As reported	<b>\$ 1,053</b>	\$ 533	\$ 43
Impact of:			
Goodwill amortization	—	—	215
Purchased intangibles amortization change	—	—	21
Adjusted	<b>\$ 1,053</b>	\$ 533	\$ 279
<b>EARNINGS PER DILUTED SHARE FROM CONTINUING OPERATIONS:</b>			
As reported	<b>\$ 2.34</b>	\$1.18	\$0.10
Impact of:			
Goodwill amortization	—	—	0.50
Purchased intangibles amortization change	—	—	0.05
Adjusted	<b>\$ 2.34</b>	\$1.18	\$0.65

**NOTE 2 — ACQUISITIONS AND DIVESTITURES**

In November 2003, the Corporation and Affiliated Computer Services, Inc. (ACS) completed transactions whereby the Corporation acquired ACS' federal government information technology (IT) business, and ACS concurrently acquired the Corporation's commercial IT business. The total purchase price related to the Corporation's acquisition of ACS' federal government IT business, including transaction-related costs, was approximately \$585 million. The acquisition was accounted for by allocating the purchase price to the assets acquired and liabilities assumed based on their fair values, and included recording an intangible asset of \$57 million related to a covenant not to compete that will be amortized over 5 years, an intangible asset of approximately \$55 million related to contracts acquired that will be amortized over 7 years, and goodwill of approximately \$460 million which is not tax deductible. The acquisition expands the Corporation's capabilities in business process outsourcing and managed services, thereby enhancing its ability to support civil and defense government agencies. The divestiture of the Corporation's commercial IT business resulted in a gain, net of state income taxes, of \$15 million which was recorded in other income and expenses. The gain increased net earnings by approximately \$8 million (\$0.02 per diluted share).

In September 2003, the Corporation announced that a definitive agreement had been reached to acquire The Titan Corporation (Titan). Under the terms of the merger agreement, stockholders of Titan may elect to receive \$22 in cash for each share of Titan common stock, an amount of Lockheed Martin common stock based on an exchange rate, or a combination of cash and stock. Titan stockholders who elect to receive all cash or all stock will be subject to allocation procedures set forth in the merger agreement which require that, in the aggregate, 50% of the shares of outstanding Titan common stock must be exchanged for the Corporation's common stock and 50% of the Titan common stock must be exchanged for cash. The announced value of the transaction, including the assumption of Titan's long-term debt, is approximately \$2.4 billion before accumulated tax benefits. Nearly all of Titan's sales are to the U.S. Government. The acquisition remains subject to approval by Titan stockholders and satisfaction of other closing conditions.

**NOTE 3 — DISCONTINUED OPERATIONS**

In December 2001, the Corporation announced that it would exit its global telecommunications services business as a result of continuing overcapacity in the telecommunications industry and deteriorating business and economic conditions in Latin America. The Corporation recorded charges, net of state income tax benefits, totaling approximately \$1.4 billion in 2001 related to this action. The charges decreased net earnings by approximately \$1.3 billion (\$3.09 per diluted share).

The charges related to certain global telecommunications services businesses held for sale included, net of state income tax benefits, approximately \$1.2 billion for the impairment of goodwill, and \$170 million for the impairment of other long-lived assets and exit costs associated with elimination of the administrative infrastructure supporting the global telecommunications businesses and investments. The charges were included in discontinued operations in the statement of operations, and the results of operations and cash flows of the businesses identified as held for sale were classified as discontinued operations in the Corporation’s consolidated financial statements for all periods presented and were excluded from business segment information. The Corporation completed sales of all of the businesses classified as held for sale in 2002 with the exception of Lockheed Martin Intersputnik (LMI). Those transactions did not have a material impact on the Corporation’s consolidated results of operations or financial position.

The Corporation is continuing to treat LMI as a discontinued operation, as the Corporation is still holding and actively marketing the business for sale, and there are interested potential buyers. The operating results of LMI had no impact on the statement of earnings for the year ended December 31, 2003, and were not material for the years ended December 31, 2002 and 2001. LMI’s assets and liabilities represented less than 1% of the Corporation’s consolidated assets and liabilities at December 31, 2003 and 2002, and were included in the consolidated balance sheet in other current assets and other current liabilities.

In addition, the Corporation completed the sale of Lockheed Martin IMS Corporation (IMS), a wholly-owned subsidiary, for \$825 million in cash in August 2001. The transaction resulted in a gain, net of state income taxes, of \$476 mil-

lion and increased net earnings by \$309 million (\$0.71 per diluted share). The results of IMS’ operations, as well as the gain on the sale, are classified as discontinued operations.

Net sales and loss before income taxes included in discontinued operations were as follows:

<i>(In millions)</i>	<b>2003</b>	2002	2001
Net sales	<b>\$ 20</b>	\$ 228	\$ 803
Loss before income taxes:			
Results of operations of discontinued businesses	<b>\$ —</b>	\$ (19)	\$ (52)
Charges related to discontinued businesses, net of IMS gain	<b>—</b>	—	(970)
	<b>\$ —</b>	\$ (19)	\$(1,022)

The Corporation reported a net loss from discontinued operations of \$33 million (\$0.07 per diluted share) in 2002. This amount included losses incurred to complete wind-down activities related to the global telecommunications services businesses, offset by the reversal of a reserve associated with the sale of IMS. When recording the sale of IMS in 2001, the Corporation established transaction reserves to address various indemnity provisions in the sale agreement. The risks associated with certain of these indemnity provisions were resolved and \$39 million, net of taxes, was reversed through discontinued operations in 2002.

**NOTE 4 — EARNINGS PER SHARE**

Basic and diluted per share results for all periods presented were computed based on the net earnings or loss for the respective periods. The weighted average number of common shares outstanding during the period was used in the calculation of basic earnings (loss) per share. In accordance with FAS 128, “Earnings Per Share,” the weighted average number of common shares used in the calculation of diluted per share amounts is adjusted for the dilutive effects of stock options based on the treasury stock method. The dilutive effect of the convertible debentures issued in 2003 (see Note 9) will not be included in earnings per share calculations until such time as certain contingency provisions that would permit conversion as outlined in the underlying indenture agreement are satisfied.

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2003

The following table sets forth the computations of basic and diluted earnings (loss) per share:

<i>(In millions, except per share data)</i>	<b>2003</b>	2002	2001
<b>NET EARNINGS (LOSS):</b>			
Continuing operations	<b>\$ 1,053</b>	\$ 533	\$ 43
Discontinued operations:			
Results of operations from discontinued businesses	—	(33)	(62)
Charges related to discontinued businesses, net of IMS gain	—	—	(1,027)
Net earnings (loss) for basic and diluted computations	<b>\$ 1,053</b>	\$ 500	\$(1,046)
<b>AVERAGE COMMON SHARES OUTSTANDING:</b>			
Average number of common shares outstanding for basic computations	<b>446.5</b>	445.1	427.4
Dilutive stock options — based on the treasury stock method	<b>3.5</b>	6.9	5.1
Average number of common shares outstanding for diluted computations	<b>450.0</b>	452.0	432.5
<b>EARNINGS (LOSS) PER COMMON SHARE:</b>			
Basic:			
Continuing operations	<b>\$ 2.36</b>	\$ 1.20	\$ 0.10
Discontinued operations:			
Results of operations from discontinued businesses	—	(0.07)	(0.15)
Charges related to discontinued businesses, net of IMS gain	—	—	(2.40)
	<b>\$ 2.36</b>	\$ 1.13	\$ (2.45)
Diluted:			
Continuing operations	<b>\$ 2.34</b>	\$ 1.18	\$ 0.10
Discontinued operations:			
Results of operations from discontinued businesses	—	(0.07)	(0.14)
Charges related to discontinued businesses, net of IMS gain	—	—	(2.38)
	<b>\$ 2.34</b>	\$ 1.11	\$ (2.42)

**NOTE 5 — RECEIVABLES**

<i>(In millions)</i>	<b>2003</b>	2002
U.S. Government:		
Amounts billed	<b>\$ 1,421</b>	\$ 1,048
Unbilled costs and accrued profits	<b>2,351</b>	2,116
Less customer advances and progress payments	<b>(470)</b>	(422)
Commercial and foreign governments:		
Amounts billed	<b>335</b>	483
Unbilled costs and accrued profits	<b>448</b>	474
Less customer advances	<b>(46)</b>	(44)
	<b>\$ 4,039</b>	\$ 3,655

Less than 10% of the December 31, 2003 unbilled costs and accrued profits are expected to be recovered after 1 year.

**NOTE 6 — INVENTORIES**

<i>(In millions)</i>	<b>2003</b>	2002
Work in process, primarily related to long-term contracts and programs in progress		
	<b>\$ 5,434</b>	\$ 6,221
Less customer advances and progress payments	<b>(3,396)</b>	(4,272)
	<b>2,038</b>	1,949
Other inventories	<b>310</b>	301
	<b>\$ 2,348</b>	\$ 2,250

Inventories included amounts advanced to Khrunichev State Research and Production Space Center (Khrunichev), the Russian manufacturer of Proton launch vehicles and provider of related launch services, of \$327 million and \$391 million at December 31, 2003 and 2002, respectively, to provide launch services. These amounts are net of a reserve recorded in 2002 related to the Corporation's assessment of the probability of termination of certain launches under contract, as well as amounts related to advances for launches not under contract. Advances for launches not under contract are subject to an agreement which provides for reduced future payments from Lockheed Martin to Khrunichev on launches contingent on the receipt of new orders as well as a minimum number of actual launches each year, in lieu of the requirement to provide launch services. The charge related to the reserve, net of state income tax benefits, was \$173 million, and reduced 2002 net earnings by \$112 million (\$0.25 per diluted share). In addition, commercial

launch vehicle inventories included amounts advanced to RD AMROSS, a joint venture between Pratt & Whitney and NPO Energomash, of \$57 million and \$61 million at December 31, 2003 and 2002, respectively, for the development and purchase, subject to certain conditions, of RD-180 booster engines used for Atlas launch vehicles.

In 2003, the Corporation recorded a charge, net of state income tax benefits, of \$41 million in cost of sales related to its decision to exit the commercial mail sorting business. The charge, which related primarily to the impairment of inventories of the business, reduced net earnings by \$27 million (\$0.06 per diluted share).

Work in process inventories at December 31, 2003 and 2002 included general and administrative costs, including independent research and development costs and bid and proposal costs, of \$381 million and \$502 million, respectively. General and administrative costs charged to cost of sales from inventories for the years ended December 31, 2003, 2002 and 2001, including independent research and development costs and bid and proposal costs, totaled \$2.0 billion, \$1.7 billion and \$1.8 billion, respectively.

Approximately \$534 million of costs included in 2003 inventories, including \$166 million advanced to Khrunichev, are not expected to be recovered within 1 year.

#### NOTE 7 — PROPERTY, PLANT AND EQUIPMENT

<i>(In millions)</i>	2003	2002
Land	\$ 106	\$ 102
Buildings	3,365	3,197
Machinery and equipment	5,198	5,017
	<b>8,669</b>	8,316
Less accumulated depreciation and amortization	(5,180)	(5,058)
	<b>\$ 3,489</b>	\$ 3,258

During the year ended December 31, 2003, the Corporation recorded write-offs of fully depreciated property, plant and equipment totaling approximately \$330 million.

#### NOTE 8 — INVESTMENTS IN EQUITY SECURITIES

<i>(In millions)</i>	2003	2002
Equity method investments (ownership interest):		
Intelsat, Ltd. (25%)	\$ 729	\$ 682
Other	94	84
	<b>823</b>	766
Cost method investments (ownership interest):		
New Skies Satellites, N.V. (16%)	133	56
Inmarsat Holdings, Ltd. (14%)	96	—
Inmarsat Ventures, Ltd. (14%)	—	168
Other	8	19
	<b>237</b>	243
	<b>\$ 1,060</b>	\$ 1,009

Other equity method investments include United Space Alliance, LLC (50% ownership interest) and other smaller joint ventures in which the Corporation participates. The carrying value of the Corporation's investment in New Skies is marked to market.

In 2002, the Corporation recorded charges relating to its telecommunications investments, including Intelsat, Ltd. (Intelsat), Inmarsat Ventures, Ltd. (Inmarsat Ventures) and New Skies Satellites, N.V. (New Skies). The charges were recorded as a result of the decline in the values of the investments which the Corporation assessed as being other than temporary, primarily due to unfavorable trends in the satellite services and telecommunications industries that were not expected to be resolved in the near term. The charges reduced operating profit (earnings from continuing operations before interest and taxes), net earnings and earnings per diluted share for the year ended December 31, 2002 as follows:

<i>(In millions, except per share data)</i>	Operating Profit	Net Earnings	Earnings per Diluted Share
Intelsat	\$ (572)	\$ (371)	\$ (0.82)
Inmarsat Ventures	(101)	(66)	(0.15)
New Skies	(103)	(67)	(0.15)
	<b>\$ (776)</b>	<b>\$ (504)</b>	<b>\$ (1.12)</b>

In December 2003, Inmarsat Ventures was acquired by a consortium of private equity firms in a leveraged buyout transaction. In exchange for its interest, the Corporation received cash of \$114 million and a 14% ownership interest in the new Inmarsat holding company valued at \$96 million. The Corporation recorded a deferred gain of \$42 million from the transaction, representing the difference between the considera-

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

tion received and the carrying value of its investment in Inmarsat Ventures of \$168 million. The Corporation would expect to recognize the deferred gain at such time as it sells all or a portion of its interest in the new company, Inmarsat Holdings, Ltd.

In 2001, the Corporation decided not to make any further investment in Astrolink International LLC (Astrolink), and wrote off its 31% equity interest. As a result, the Corporation recorded a charge, net of state income tax benefits, of \$367 million in other income and expenses to reflect the other than temporary decline in the value of its investment in Astrolink. The Corporation also recorded, net of state income tax benefits, approximately \$20 million of charges through cost of sales for certain other costs related to Astrolink. On a combined basis, these charges reduced net earnings for 2001 by approximately \$267 million (\$0.62 per diluted share).

In January 2003, the Corporation entered into an agreement with Astrolink's other members to restructure Astrolink. As part of the transaction, Liberty Satellite & Technology, a subsidiary of Liberty Media Corporation, had an option to acquire Astrolink's assets and pursue a business plan to build a one- or two-satellite system. On October 24, 2003, Liberty Satellite & Technology notified the Corporation that they would not exercise the option to acquire Astrolink's assets and build the satellite system. As a result, as part of the previously disclosed restructuring agreement, Astrolink's procurement contracts were terminated, and the Corporation acquired the remaining ownership interests in Astrolink. The restructuring also entailed the settlement of existing claims related to termination of Astrolink's procurement contracts with its members, certain of their affiliates and other vendors. Under these settlements, the Corporation retained its work in process. Completion of the restructuring did not have a material impact on the Corporation's financial position, results of operations or cash flows.

In 2001, the Corporation recorded a charge, net of state income tax benefits, of \$361 million in other income and expenses related to its investment in Loral Space & Communications, Ltd. (Loral Space). The charge reduced net earnings by \$235 million (\$0.54 per diluted share). The decline in the value of the investment was assessed to be other than temporary due to the downward trend in the market price of Loral Space's stock and the potential impact of market and industry conditions on its ability to execute its business plans. In July 2003, Loral Space

and certain of its subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In the third quarter of 2003, the Corporation sold its ownership interest in Loral Space. The sale did not have a material impact on the Corporation's results of operations, financial position or cash flows.

In 2001, the Corporation recorded charges, net of state income tax benefits, of approximately \$232 million in other income and expenses related to commitments to and impairment in the values of investments in certain satellite joint ventures, primarily Asia Cellular Satellite System (ACeS) and Americom Asia-Pacific, LLC (AAP). These charges reduced net earnings by \$153 million (\$0.35 per diluted share).

**NOTE 9 — DEBT**

The Corporation's long-term debt is primarily in the form of publicly issued, fixed-rate and variable-rate notes and debentures, summarized as follows:

Type (Maturity Dates) <i>(In millions, except interest rate data)</i>	Range of Interest Rates	2003	2002 <sup>(a)</sup>
Floating rate convertible			
debentures (2033)	0.93%	\$ 1,000	\$ —
Other debentures (2013-2036)	7.0–9.1%	3,388	4,198
Notes (2004-2022)	6.5–9.0%	1,778	3,099
Other obligations (2004-2017)	1.0–10.5%	42	260
		<b>6,208</b>	7,557
Less current maturities		(136)	(1,365)
		<b>\$ 6,072</b>	\$ 6,192

*(a) Amounts exclude a \$25 million adjustment to the fair value of long-term debt relating to the Corporation's interest rate swap agreements which will not be settled in cash.*

In August 2003, the Corporation completed a tender offer to purchase for cash any and all of its outstanding 7.25% notes due May 15, 2006 and 8.375% debentures due June 15, 2024. A total principal amount of \$720 million of the notes and debentures were retired. The Corporation also repurchased \$251 million of long-term debt securities from other of its outstanding debt issuances in the open market. The Corporation recorded a loss, net of state income tax benefits, totaling \$127 million in other income and expenses related to the early retirement of the long-term debt repurchased under the tender offer and in the open market. The loss reduced 2003 net earnings by \$83 million (\$0.18 per diluted share).



Also in August 2003, the Corporation issued \$1.0 billion in floating rate convertible debentures due in 2033. The debentures bear interest at a rate equal to three-month LIBOR less 25 basis points, reset quarterly. The interest rate in effect at December 31, 2003 was 0.93%. Interest on the debentures is payable quarterly through August 15, 2008, after which the interest will accrue as part of the value of the debenture and will be payable, along with the principal amount of the debenture, at maturity. The debentures are convertible by their holders into the Corporation's common stock in certain limited circumstances as outlined in the indenture agreement. Absent certain events not currently anticipated, the debentures are not convertible unless the price of the Corporation's common stock is greater than or equal to 130% of the applicable conversion price for a specified period during a quarter. The conversion price was \$75.79 per share at December 31, 2003, and is expected to change over time as provided for in the indenture agreement. Upon conversion, the Corporation has the right to deliver, in lieu of common stock, cash or a combination of cash and common stock, and also has the right to redeem any or all of the debentures at any time after August 15, 2008.

In the first quarter of 2003, the Corporation issued irrevocable redemption notices to the trustees for two issuances of callable debentures totaling \$450 million. This amount was included in current maturities of long-term debt on the balance sheet at December 31, 2002. One notice was for \$300 million of 7.875% debentures due on March 15, 2023, which were repaid on March 15, 2003. The second notice was for \$150 million of 7.75% debentures due on April 15, 2023, which were repaid on April 15, 2003. The Corporation recorded a loss, net of state income tax benefits, of \$19 million in other income and expenses related to the early repayment of the \$450 million of debt. The loss reduced 2003 net earnings by \$13 million (\$0.03 per diluted share).

In December 2002, the Corporation recorded a charge, net of state income tax benefits, of \$163 million related to its investment in Space Imaging, LLC and its guarantee of up to \$150 million of Space Imaging's borrowings under a credit facility that matured on March 30, 2003. The charge was recorded in light of the Corporation's decision, and the decision of its other major partner in the joint venture, not to provide further funding, its assessment that Space Imaging will likely not be able to repay their obligation under the credit facility when due, and the uncertainties as to whether Space Imaging would be successful

in obtaining the additional investment necessary to fund replacement satellites consistent with their business plans. On March 31, 2003, the Corporation paid \$130 million to acquire Space Imaging's outstanding borrowings under Space Imaging's credit facility, and the guarantee was eliminated. The Corporation therefore reversed, net of state income taxes, approximately \$19 million of the charge recorded in December 2002, representing the unutilized portion of the credit facility covered by its guarantee. This gain increased first quarter 2003 net earnings by \$13 million (\$0.03 per diluted share).

In September 2001, the Corporation redeemed approximately \$117 million of 7% debentures (\$175 million at face value) due in 2011 which were originally sold at approximately 54% of their principal amount. The debentures were redeemed at face value, resulting in a loss, net of state income tax benefits, of \$55 million which was included in other income and expenses. The loss reduced net earnings by \$36 million (\$0.08 per diluted share).

The registered holders of \$300 million of 40-year debentures issued in 1996 may elect, between March 1 and April 1, 2008, to have their debentures repaid by the Corporation on May 1, 2008.

A leveraged employee stock ownership plan (ESOP) incorporated into the Corporation's salaried savings plan borrowed \$500 million through a private placement of notes in 1989. These notes are being repaid in quarterly installments over terms ending in 2004. The ESOP note agreement stipulates that, in the event that the ratings assigned to the Corporation's long-term senior unsecured debt are below investment grade, holders of the notes may require the Corporation to purchase the notes and pay accrued interest. These notes are obligations of the ESOP but are guaranteed by the Corporation and included as debt in the Corporation's consolidated balance sheet.

At December 31, 2003, the Corporation had in place a \$1.5 billion revolving credit facility; no borrowings were outstanding. This credit facility will expire in November 2006. Borrowings under the credit facility would be unsecured and bear interest at rates based, at the Corporation's option, on the Eurodollar rate or a bank Base Rate (as defined). Each bank's obligation to make loans under the credit facility is subject to, among other things, the Corporation's compliance with various representations, warranties and covenants, including covenants limiting the ability of the Corporation and certain of its subsidiaries to encumber assets and a covenant not to exceed a maximum leverage ratio.

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2003

The Corporation's scheduled long-term debt maturities for the 5 years following December 31, 2003 are: \$136 million in 2004; \$15 million in 2005; \$238 million in 2006; \$33 million in 2007; \$692 million in 2008; and \$5,094 million thereafter.

Certain of the Corporation's other financing agreements contain restrictive covenants relating to debt, limitations on encumbrances and sale and lease-back transactions, and provisions which relate to certain changes in control.

The estimated fair values of the Corporation's long-term debt instruments at December 31, 2003, aggregated approximately \$7.4 billion, compared with a carrying amount of approximately \$6.2 billion. The fair values were estimated based on quoted market prices for those instruments that are publicly traded. For privately placed debt, the fair values were estimated based on the quoted market prices for similar issues, or on current rates offered to the Corporation for debt with similar remaining maturities. Unless otherwise indicated elsewhere in the notes to the financial statements, the carrying values of the Corporation's other financial instruments approximate their fair values.

Interest payments were \$519 million in 2003, \$586 million in 2002 and \$707 million in 2001.

#### NOTE 10 — INCOME TAXES

The provision for federal and foreign income taxes attributable to continuing operations consisted of the following components:

<i>(In millions)</i>	2003	2002	2001
Federal income taxes:			
Current	\$ (14)	\$ 469	\$ 170
Deferred	467	(463)	(118)
Total federal income taxes	453	6	52
Foreign income taxes	26	38	38
Total income taxes provided	\$ 479	\$ 44	\$ 90

Net provisions for state income taxes are included in general and administrative expenses, which are primarily allocable to government contracts. The net state income tax expense was \$38 million for 2003, and net state income tax benefits were \$7 million for 2002 and \$8 million for 2001.

A reconciliation of income tax expense computed using the U.S. federal statutory income tax rate to actual income tax expense is as follows:

<i>(In millions)</i>	2003	2002	2001
Income tax expense at the statutory federal tax rate	\$ 536	\$ 202	\$ 47
Increase (reduction) in tax expense from:			
Extraterritorial income exclusion benefit	(46)	(42)	(38)
Revisions to prior years' estimated liabilities	(28)	(62)	(20)
R&D tax credit settlement	—	(90)	—
Nondeductible amortization	—	—	62
Other, net	17	36	39
Actual income tax expense	\$ 479	\$ 44	\$ 90

The primary components of the Corporation's federal deferred income tax assets and liabilities at December 31 were as follows:

<i>(In millions)</i>	2003	2002
Deferred tax assets related to:		
Accumulated post-retirement benefit obligations	\$ 502	\$ 535
Contract accounting methods	459	493
Accrued compensation and benefits	476	344
Basis differences of impaired investments	74	407
Pensions <sup>(a)</sup>	—	110
Other	242	470
	1,753	2,359
Deferred tax liabilities related to:		
Purchased intangibles	269	345
Property, plant and equipment	225	178
Pensions <sup>(a)</sup>	96	—
	590	523
Net deferred tax assets	\$ 1,163 <sup>(b)</sup>	\$ 1,836 <sup>(b)</sup>

(a) The change in deferred tax balances related to pensions was primarily due to the recording of an adjustment to reduce the minimum pension liability in 2003.

(b) These amounts included \$242 million and \$559 million, respectively, of net noncurrent deferred tax assets which are included in "Other assets" on the consolidated balance sheet.

Federal and foreign income tax payments, net of refunds received, were \$170 million in 2003, \$55 million in 2002 and \$837 million in 2001. Included in these amounts are tax payments and refunds related to the Corporation's divestiture activities. In addition, these amounts include net tax payments (refunds) related to discontinued operations of \$(123) million in 2003, \$(22) million in 2002 and \$179 million in 2001.

The Corporation realized an income tax cash benefit of \$140 million in 2002 as a result of exercises of employee stock options. This benefit is recorded in stockholders' equity under the caption, "Stock awards and options, and ESOP activity." The benefit for 2003 was not material.

**NOTE 11 — OTHER INCOME AND EXPENSES, NET**

<i>(In millions)</i>	<b>2003</b>	2002	2001
Equity in earnings of equity			
investees, net	<b>\$ 107</b>	\$ 93	\$ 68
Interest income	<b>75</b>	47	91
Loss on early repayment of debt	<b>(146)</b>	—	(55)
Gain on sale of commercial IT business	<b>15</b>	—	—
Space Imaging and related guarantee	<b>19</b>	(163)	—
Write-down of telecommunications investments	—	(776)	—
Write-off of investments in Astrolink and Loral Space	—	—	(728)
Gain on sales of surplus real estate	—	—	111
Impairment loss related to AAP	—	—	(100)
Other charges related to the exit from global telecommunications	—	—	(73)
Other activities, net	<b>(27)</b>	8	(24)
	<b>\$ 43</b>	\$(791)	\$(710)

**NOTE 12 — STOCKHOLDERS' EQUITY AND RELATED ITEMS**

*Capital stock* — At December 31, 2003, the authorized capital of the Corporation was composed of 1.5 billion shares of common stock (approximately 446 million shares issued), 50 million shares of series preferred stock (no shares issued), and 20 million shares of Series A preferred stock (no shares outstanding).

In October 2002, the Corporation announced a share repurchase program for the repurchase of up to 23 million

shares of its common stock from time-to-time. Under the program, management has discretion to determine the number and price of the shares to be repurchased, and the timing of any repurchases in compliance with applicable law and regulation. The Corporation repurchased approximately 10.7 million shares under the program in 2003 for \$482 million, and 1 million shares in 2002 for \$50 million. In February 2004, an additional 20 million shares were authorized for repurchase under the program. As a result of the increase, a total of 31.3 million shares may be repurchased in the future under the program.

*Stock option and award plans* — In April 2003, the stockholders approved the Lockheed Martin 2003 Incentive Performance Award Plan (the Award Plan). Under the Award Plan, employees of the Corporation may be granted stock-based incentive awards, including options to purchase common stock, stock appreciation rights, restricted stock or stock units. The maximum number of shares that may be subject to such stock-based incentive awards in any calendar year is limited to 1.9% of the Corporation's common stock outstanding on the December 31 preceding the grant. The maximum number of shares that may be issued as restricted stock is limited to 18% of the total number of shares authorized to be issued under the Award Plan, or 18% of 22.5 million shares at December 31, 2003. Employees may also be granted cash-based incentive awards. These awards may be granted either individually or in combination with other awards. The Award Plan requires that options to purchase common stock have an exercise price of not less than 100% of the market value of the underlying stock on the date of grant. Under the Award Plan, no award of options may become fully vested prior to the second anniversary of the grant and no portion of an option grant may become vested in less than one year, except for 1.5 million options specifically exempted from vesting restrictions. The minimum vesting period for restricted stock or stock units payable in stock is three years. Award agreements may provide for shorter vesting periods or vesting following termination of employment in the case of death, disability, divestiture, retirement or layoff. The Award Plan does not impose any minimum vesting periods on other types of awards. The maximum term of an option or any other award is 10 years.

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

The Award Plan allows the Corporation to provide for financing by award recipients other than executive officers of the exercise or purchase price of common stock underlying an award, subject to certain conditions, by interest-bearing notes payable to the Corporation.

Prior to April 2003, the Corporation granted stock-based and cash-based incentive awards pursuant to the Lockheed Martin Corporation 1995 Omnibus Performance Award Plan (the "Omnibus Plan"), which was approved by the stockholders in March 1995. Awards under the Omnibus Plan were similar to those authorized by the Award Plan except that the Omnibus Plan did not include any minimum vesting requirements.

In 2003, 25,000 shares of restricted common stock were issued under the Award Plan. In 2001, 25,000 restricted shares were awarded under the Omnibus Plan. No restricted common stock was awarded in 2002. The shares were recorded based on the market value of the Corporation's common stock on the date of the award. Recipients are entitled to receive cash dividends and to vote their respective shares, but are prohibited from selling or transferring shares prior to vesting. The restricted shares generally vest over 4 to 5 year periods from the grant date. The impact of restricted stock awards was not material to stockholders' equity or compensation expense in 2003, 2002 or 2001.

In April 1999, the stockholders approved the Lockheed Martin Directors Equity Plan (the Directors Plan). Approximately 50% of each director's annual compensation is awarded under the Directors Plan. Directors of the Corporation may elect to receive such compensation in the form of stock units which track investment returns to changes in value of the Corporation's common stock with dividends reinvested, options to purchase common stock of the Corporation, or a combination of the two. The Directors Plan requires that options to purchase common stock have an exercise price of not less than 100% of the market value of the underlying stock on the date of grant. Except in certain circumstances, options and stock units issued under the Directors Plan vest on the first anniversary of the grant. The maximum term of an option is 10 years.

The Award Plan, the Omnibus Plan and the Directors Plan, as well as the number of shares of Lockheed Martin common stock authorized for issuance under these plans, have been approved by the stockholders of the Corporation. At December 31, 2003, the number of shares of Lockheed Martin common stock reserved for issuance under the Corporation's stock option and award plans totaled 58.9 million.

The following table summarizes stock option and restricted stock activity related to the Corporation's plans during 2001, 2002 and 2003:

	Number of Shares (In thousands)		Weighted Average Exercise Price
	Available for Grant	Options Outstanding	
December 31, 2000	9,734	38,582	\$ 31.91
Additional shares reserved	16,000	—	—
Options granted	(7,016)	7,016	35.06
Options exercised	—	(7,024)	22.61
Options terminated	177	(177)	43.27
Restricted stock awards	(25)	—	—
December 31, 2001	18,870	38,397	34.12
Options granted	(7,049)	7,049	50.45
Options exercised	—	(14,231)	30.76
Options terminated	554	(581)	35.55
December 31, 2002	12,375	30,634	39.42
Additional shares reserved	<b>22,500</b>	—	—
Retired Omnibus Plan shares	<b>(4,814)</b>	—	—
Options granted	<b>(6,664)</b>	<b>6,664</b>	<b>51.08</b>
Options exercised	—	<b>(1,637)</b>	<b>26.96</b>
Options terminated	<b>29</b>	<b>(181)</b>	<b>49.12</b>
Restricted stock awards	<b>(25)</b>	—	—
<b>December 31, 2003</b>	<b>23,401</b>	<b>35,480</b>	<b>42.14</b>

Approximately 25.5 million, 19.6 million, and 27.1 million outstanding options were exercisable by employees at December 31, 2003, 2002 and 2001, respectively.

Information regarding options outstanding at December 31, 2003 follows (number of options in thousands):

Range of Exercise Prices	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Options outstanding:			
Less than \$20.00	2,578	\$ 18.35	5.0
\$20.00–\$29.99	2,514	26.54	3.1
\$30.00–\$39.99	10,074	36.05	5.5
\$40.00–\$50.00	3,468	45.58	3.1
Greater than \$50.00	16,846	51.04	7.6
<b>Total</b>	<b>35,480</b>	<b>42.14</b>	<b>6.1</b>
Options exercisable:			
Less than \$20.00	2,578	\$ 18.35	5.0
\$20.00–\$29.99	2,514	26.54	3.1
\$30.00–\$39.99	10,074	36.05	5.5
\$40.00–\$50.00	3,443	45.58	3.1
Greater than \$50.00	6,924	51.26	6.1
<b>Total</b>	<b>25,533</b>	<b>38.74</b>	<b>5.0</b>

Stock options granted in 2003 under the Omnibus Plan have 10-year terms and generally vest over a 3-year service period. Options granted in 2002 and 2001 under the Omnibus Plan also have 10-year terms, but generally vest over a 2-year service period. Exercise prices of options awarded for all years were equal to the market price of the stock on the date of grant. Pro forma information regarding net earnings and earnings per share as if the Corporation had accounted for its employee stock options under the fair value method is included in Note 1. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2003	2002	2001
Risk-free interest rate	<b>2.91%</b>	4.24%	4.95%
Dividend yield	<b>1.00%</b>	1.00%	0.60%
Volatility factors related to expected price of Lockheed Martin stock	<b>0.387</b>	0.376	0.366
Expected option life	<b>5 years</b>	5 years	5 years

The weighted average fair value of each option granted during 2003, 2002 and 2001 was \$17.78, \$18.23 and \$13.32, respectively.

#### NOTE 13 — POST-RETIREMENT BENEFIT PLANS

*Defined contribution plans* — The Corporation maintains a number of defined contribution plans with 401(k) features that cover substantially all employees, the most significant of which are the 401(k) plans for salaried employees and hourly employees. Under the provisions of these 401(k) plans, employees' eligible contributions are matched by the Corporation at established rates. The Corporation's matching obligations were \$238 million in 2003, \$232 million in 2002 and \$226 million in 2001, the majority of which were funded in Lockheed Martin common stock.

The Lockheed Martin Corporation Salaried Savings Plan is a defined contribution plan with a 401(k) feature that includes an ESOP. The ESOP purchased 34.8 million shares of the Corporation's common stock in 1989 with the proceeds from a \$500 million note issue which is guaranteed by the Corporation. The Corporation's match consisted of shares of its common stock, which was partially fulfilled with stock released from the ESOP at approximately 2.4 million shares per year based upon the debt repayment schedule through June 2004. Compensation costs recognized relative to the ESOP shares were \$108 million, \$134 million and \$90 million in 2003, 2002 and 2001, respectively. The remainder of the Corporation's match to the Salaried Savings Plan was fulfilled through purchases of common stock from terminating participants or in the open market, or through newly issued shares from the Corporation. Interest incurred on the ESOP debt totaled \$5 million, \$10 million and \$13 million in 2003, 2002 and 2001, respectively. Dividends received by the ESOP with respect to unallocated shares held are used for debt service. The ESOP held approximately 48.2 million issued shares of the Corporation's common stock at December 31, 2003, of which approximately 47.0 million were allocated and 1.2 million were unallocated. The fair value of the unallocated ESOP shares at December 31, 2003 was approximately \$60 million. Unallocated common shares held by the ESOP are considered outstanding for voting and other Corporate purposes, but excluded from weighted average outstanding shares in calculating earnings per share. For 2003, 2002 and 2001, the weighted average unallocated ESOP shares excluded in calculating earnings per share totaled approximately 2.0 million, 4.4 million and 6.7 million common shares, respectively.

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

Certain plans for hourly employees include a non-leveraged ESOP. In one such plan, the match is made, generally at the election of the participant, in either the Corporation's common stock or a different investment choice. The Corporation's contributions to these plans were made through cash contributed to the ESOP trust which was used, if so elected, to purchase common stock from terminating participants or in the open market for allocation to participant accounts. This ESOP trust held approximately 3.3 million issued and outstanding shares of common stock at December 31, 2003.

*Defined benefit pension plans, and retiree medical and life insurance plans* — Most employees are covered by defined benefit pension plans, and certain health care and life insurance benefits are provided to eligible retirees by the Corporation. The Corporation has made contributions to trusts (including Voluntary Employees' Beneficiary Association trusts and 401(h) accounts, the assets of which will be used to pay expenses of certain retiree medical plans) established to pay future benefits to eligible retirees and dependents. The Corporation uses December 31 as its measurement date. Benefit obligations as of the end of each year reflect assumptions in effect as of those dates. Net pension and net retiree medical costs for each of the years presented were based on assumptions in effect at the end of the respective preceding years.

The following provides a reconciliation of benefit obligations, plan assets and funded status of the plans:

<i>(In millions)</i>	Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
	2003	2002	2003	2002
<b>CHANGE IN BENEFIT OBLIGATIONS</b>				
Benefit obligations at beginning of year	<b>\$21,918</b>	\$19,713	<b>\$3,316</b>	\$3,125
Service cost	<b>640</b>	565	<b>40</b>	37
Interest cost	<b>1,453</b>	1,401	<b>211</b>	213
Benefits paid	<b>(1,296)</b>	(1,247)	<b>(344)</b>	(320)
Actuarial losses	<b>1,603</b>	1,417	<b>424</b>	190
Amendments	<b>46</b>	102	<b>80</b>	13
Divestitures	—	(33)	<b>3</b>	(6)
Participants' contributions	—	—	<b>80</b>	64
Benefit obligations at end of year	<b>\$24,364</b>	\$21,918	<b>\$3,810</b>	\$3,316

<i>(In millions)</i>	Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
	2003	2002	2003	2002
<b>CHANGE IN PLAN ASSETS</b>				
Fair value of plan assets at beginning of year	<b>\$17,661</b>	\$20,300	<b>\$ 906</b>	\$ 1,026
Actual return on plan assets	<b>3,876</b>	(1,397)	<b>216</b>	(125)
Benefits paid	<b>(1,296)</b>	(1,247)	<b>(343)</b>	(318)
Corporation's contributions	<b>669</b>	69	<b>276</b>	259
Participants' contributions	—	—	<b>80</b>	64
Divestitures	<b>3</b>	(64)	—	—
Fair value of plan assets at end of year	<b>\$20,913</b>	\$17,661	<b>\$ 1,135</b>	\$ 906
Unfunded status of the plans	<b>\$ (3,451)</b>	\$ (4,257)	<b>\$ (2,675)</b>	\$ (2,410)
Unrecognized net actuarial losses	<b>5,486</b>	6,075	<b>1,122</b>	891
Unrecognized prior service cost	<b>534</b>	568	<b>113</b>	39
Unrecognized transition asset	<b>(1)</b>	(3)	—	—
Net amount recognized	<b>\$ 2,568</b>	\$ 2,383	<b>\$ (1,440)</b>	\$ (1,480)
<b>AMOUNTS RECOGNIZED IN THE CONSOLIDATED BALANCE SHEET:</b>				
Prepaid assets	<b>\$ 1,213</b>	\$ 1,221	<b>\$ —</b>	\$ —
Accrued liabilities	<b>(1,100)</b>	(1,872)	<b>(1,440)</b>	(1,480)
Intangible asset	<b>517</b>	551	—	—
Accumulated other comprehensive loss related to minimum pension liability	<b>1,938</b>	2,483	—	—
Net amount recognized	<b>\$ 2,568</b>	\$ 2,383	<b>\$ (1,440)</b>	\$ (1,480)

The projected benefit obligations (PBO) for the Corporation's more significant defined benefit pension plans exceeded the fair value of the plans' assets at December 31, 2003 and 2002, as reflected in the table above.

At December 31, 2003 and 2002, the Corporation's consolidated balance sheet included pretax additional minimum pension liabilities of \$1.9 billion and \$2.5 billion, respectively, related to certain of its defined benefit pension plans. This liability is calculated on a plan-by-plan basis, and is required if the accumulated benefit obligation (ABO) of the plan exceeds the fair value of the plan assets and the plan's accrued pension lia-

bilities. The ABO for all defined benefit pension plans was approximately \$21 billion and \$19 billion at December 31, 2003 and 2002, respectively.

For defined benefit pension plans in which the ABO was in excess of the fair value of the plans' assets, the PBO, ABO and fair value of the plans' assets were as follows:

<i>(In millions)</i>	2003	2002
Projected benefit obligation	\$15,228	\$13,648
Accumulated benefit obligation	13,312	11,994
Fair value of plan assets	12,211	10,122

The net pension cost as determined by FAS 87, "Employers' Accounting for Pensions," and the net post-retirement benefit cost as determined by FAS 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions," related to the Corporation's plans include the following components:

<i>(In millions)</i>	2003	2002	2001
<b>DEFINED BENEFIT PENSION PLANS</b>			
Service cost	\$ 640	\$ 565	\$ 523
Interest cost	1,453	1,401	1,357
Expected return on plan assets	(1,748)	(2,162)	(2,177)
Amortization of prior service cost	79	72	64
Recognized net actuarial losses (gains)	62	(33)	(117)
Amortization of transition asset	(2)	(3)	(4)
Total net pension expense (income)	\$ 484	\$ (160)	\$ (354)

**RETIREE MEDICAL AND LIFE INSURANCE PLANS**

Service cost	\$ 40	\$ 37	\$ 41
Interest cost	211	213	211
Expected return on plan assets	(69)	(89)	(99)
Amortization of prior service cost	1	(4)	(5)
Recognized net actuarial losses	49	20	9
Total net post-retirement expense	\$ 232	\$ 177	\$ 157

The actuarial assumptions used to determine the benefit obligations at December 31, 2003 and 2002 related to the Corporation's defined benefit pension and post-retirement benefit plans, as appropriate, are as follows:

	Benefit Obligation Assumptions	
	2003	2002
Discount rates	6.25%	6.75%
Rates of increase in future compensation levels	5.50	5.50

The actuarial assumptions used to determine the net expense (income) related to the Corporation's defined benefit pension and post-retirement benefit plans for the years ended December 31, 2003, 2002 and 2001, as appropriate, are as follows:

	Pension Cost Assumptions		
	2003	2002	2001
Discount rates	6.75%	7.25%	7.50%
Expected long-term rates of return on assets	8.50	9.50	9.50
Rates of increase in future compensation levels	5.50	5.50	5.50

The long-term rate of return assumption represents the expected average rate of earnings on the funds invested or to be invested to provide for the benefits included in the benefit obligations. The long-term rate of return assumption is determined based on a number of factors, including historical market index returns, the anticipated long-term asset allocation of the plans, historical plan return data, plan expenses and the potential to outperform market index returns.

The decrease in the discount rate from 6.75% at December 31, 2002 to 6.25% at December 31, 2003 resulted in a \$1.5 billion increase in the benefit obligations of the Corporation's defined benefit pension plans at December 31, 2003.

The medical trend rates used in measuring the post-retirement benefit obligation were 10.0% in 2003 and 9.1% in 2002, and were assumed to ultimately decrease to 5.0% by the year 2011. An increase or decrease of one percentage point in the assumed

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

medical trend rates would result in a change in the benefit obligation of approximately 5% and (4)%, respectively, at December 31, 2003, and a change in the 2003 post-retirement service cost plus interest cost of approximately 5% and (4)%, respectively. The medical trend rate for 2004 is 11.0%.

The asset allocations of the Corporation's plans at December 31, 2003 and 2002, by asset category, were as follows:

	Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
	2003	2002	2003	2002
Asset category:				
Equity securities	<b>63%</b>	52%	<b>64%</b>	59%
Debt securities	<b>33</b>	44	<b>34</b>	39
Other	<b>4</b>	4	<b>2</b>	2
	<b>100%</b>	100%	<b>100%</b>	100%

Lockheed Martin Investment Management Company (LMIMCO), an investment adviser registered under the Investment Advisers Act of 1940 and a wholly-owned subsidiary of the Corporation, has the fiduciary responsibility for making investment decisions related to the assets of the Corporation's defined benefit pension plans and retiree medical and life insurance plans. LMIMCO's investment objectives for the assets of the defined benefit pension plans are to minimize the present value of expected funding contributions and to meet or exceed the rate of return assumed for plan funding purposes over the long term. The investment objective for the assets of the retiree medical and life insurance plans is to meet or exceed the rate of return assumed for the plans for funding purposes over the long term. The nature and duration of benefit obligations, along with assumptions concerning asset class returns and return correlations, are considered when determining an appropriate asset allocation to achieve the investment objectives.

Investment policies and strategies governing the assets of the plans are designed to achieve investment objectives within prudent risk parameters. Risk management practices include the use of external investment managers and the maintenance of a portfolio diversified by asset class, investment approach and security holdings, and the maintenance of sufficient liquidity to meet benefit obligations as they come due.

LMIMCO's investment policies require that asset allocations of defined benefit pension plans be maintained within the following ranges:

Investment Groups	Asset Allocation Ranges
Equity securities	35–70%
Non-U.S. equity securities	0–20%
Debt securities	10–60%
Cash	0–35%
Other	0–15%

Current policies for the plans target an asset mix of 65% in total equity securities and 35% in debt and other securities.

Investment policies for all plans limit the use of alternative investments and derivatives. Investments in alternative asset classes or structures (e.g., real estate, private equity, hedge funds and commodities) are limited to 15% of plan assets. Investments in derivatives are subject to additional limitations and constraints, including a maximum notional value of futures of no more than 5% of plan assets. Use of derivatives to create leverage is prohibited.

Equity securities purchased by external investment managers and included in the assets of the defined benefit pension plans included the Corporation's common stock in the amounts of \$13.7 million (less than 0.07% of total plan assets) and \$9.5 million (less than 0.06% of total plan assets) at December 31, 2003 and 2002, respectively. Equity securities included in the assets of the retiree medical and life insurance plans included the Corporation's common stock in the amounts of \$0.3 million (less than 0.03% of total plan assets) and \$1.4 million (less than 0.2% of total plan assets) at December 31, 2003, and 2002, respectively.

The Corporation generally refers to U.S. Government Cost Accounting Standards (CAS) and Internal Revenue Code rules in determining funding requirements for its pension plans. In December 2003, the Corporation made a discretionary prepayment of \$450 million to the defined benefit plan pension trust, the majority of which will reduce its cash funding requirements for 2004. In 2004, the Corporation expects to contribute approximately \$50 million–\$60 million to its defined benefit pension plans, after giving consideration to the 2003 prepayment, and \$310 million–\$320 million to its retiree medical and life insurance plans.



The Corporation sponsors nonqualified defined benefit plans to provide benefits in excess of qualified plan limits. The expense associated with these plans totaled \$60 million in 2003, \$54 million in 2002 and \$47 million in 2001.

#### **NOTE 14 — LEASES**

Total rental expense under operating leases was \$301 million, \$235 million and \$223 million for 2003, 2002 and 2001, respectively.

Future minimum lease commitments at December 31, 2003 for all operating leases that have a remaining term of more than 1 year were approximately \$1.1 billion (\$254 million in 2004, \$194 million in 2005, \$155 million in 2006, \$120 million in 2007, \$99 million in 2008 and \$313 million in later years). Certain major plant facilities and equipment are furnished by the U.S. Government under short-term or cancelable arrangements.

#### **NOTE 15 — COMMITMENTS AND CONTINGENCIES**

The Corporation or its subsidiaries are parties to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment. In the opinion of management and in-house counsel, the probability is remote that the outcome of these matters will have a material adverse effect on the Corporation's consolidated results of operations, financial position or cash flows. These matters include the following items:

*Environmental matters* — The Corporation is responding to three administrative orders issued in 1994 and 1997 by the California Regional Water Quality Control Board (the Regional Board) in connection with the Corporation's former Lockheed Propulsion Company facilities in Redlands, California. Under the orders, the Corporation is investigating the impact and potential remediation of regional groundwater contamination by perchlorates and chlorinated solvents. The Regional Board has approved the Corporation's plan to maintain public water supplies with respect to chlorinated solvents during this investigation, and the Corporation continues to negotiate with local water purveyors to implement this plan, as well as to address water supply concerns relative to perchlorate contamination. In January 2002, the State of California reduced its provisional standard for perchlorate concentration in water from 18 parts

per billion (ppb) to 4 ppb, a move that industry believes is not supported by the current studies.

Although this provisional standard does not create any legally enforceable requirements for the Corporation at this time, the Corporation developed and is in the process of implementing a preliminary remediation plan that would meet the provisional standard if it were to become final. The consolidated balance sheet at December 31, 2003 includes a liability of approximately \$180 million representing the Corporation's estimate of the remaining expenditures necessary to implement the remediation and other work at the site. As at other sites, the Corporation is pursuing claims for contribution to site clean-up costs against other potentially responsible parties (PRPs), including the U.S. Government.

The Corporation has been conducting remediation activities to address soil and groundwater contamination by chlorinated solvents at its former operations in Great Neck, New York which it acquired as part of its acquisition of Loral Corporation in 1996. This work is being done pursuant to a series of orders and agreements with the New York State Department of Environmental Conservation beginning with a 1991 administrative order entered by Unisys Tactical Defense Systems, a predecessor company at the site. The remediation work associated with this site includes work performed on the site itself, as well as implementation of an interim remedial measure intended to address an off-site plume of groundwater contamination. Future costs are estimated to be approximately \$50 million. This amount is included in the consolidated balance sheet at December 31, 2003. As at other sites, the Corporation is pursuing claims against other PRPs, including the U.S. Government, for contribution to site clean-up costs.

Since 1990, the Corporation has been responding to various consent decrees and orders relating to soil and regional groundwater contamination in the San Fernando Valley associated with the Corporation's former operations in Burbank and Glendale, California. Among other things, these consent decrees and orders obligate the Corporation to construct and fund the operations of soil and groundwater treatment facilities in Burbank and Glendale, California through 2018 and 2012, respectively; however, responsibility for the long-term operation of these facilities was assumed by the respective localities in 2001. The Corporation has been successful in limiting its financial responsibility for these activities to date to its pro rata

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2003

share as a result of litigation and settlements with other PRPs. In addition, under an agreement reached with the U.S. Government in 2000, the Corporation will continue to be reimbursed in an amount equal to approximately 50% of future expenditures for certain remediation activities by the U.S. Government in its capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act. The Corporation has recorded a liability of approximately \$55 million representing its estimate of the total expenditures required over the remaining terms of the consent decrees and orders described above, net of the effects of the agreement.

The Corporation is involved in proceedings and potential proceedings relating to environmental matters at other facilities, including disposal of hazardous wastes and soil and groundwater contamination. The extent of the Corporation's financial exposure cannot in all cases be reasonably determined at this time. In addition to the amounts with respect to the Redlands, Great Neck, Burbank and Glendale sites described above, a liability of approximately \$140 million for the other properties (including current operating facilities and certain facilities operated in prior years) in which an estimate of financial exposure can be determined has been recorded. In cases where a date to complete activities at a particular environmental site cannot be estimated by reference to agreements or otherwise, the Corporation projects costs over a reasonable time frame not to exceed 20 years.

Under agreements reached with the U.S. Government in 1990 and 2000, certain groundwater treatment and soil remediation expenditures referenced above are being allocated to the Corporation's operations as general and administrative costs and, under existing government regulations, these and other environmental expenditures related to U.S. Government business, after deducting any recoveries from insurance or other PRPs, are allowable in establishing the prices of the Corporation's products and services. As a result, a substantial portion of the expenditures are being reflected in the Corporation's sales and cost of sales pursuant to U.S. Government agreement or regulation.

At December 31, 2003 and 2002, the aggregate amount of liabilities recorded relative to environmental matters was approximately \$425 million and \$445 million, respectively. The Corporation has recorded an asset for the portion of environmental costs that are probable of future recovery in pricing of

the Corporation's products and services for U.S. Government business. The portion that is expected to be allocated to commercial business has been reflected in cost of sales. The recorded amounts do not reflect the possible future recoveries of portions of the environmental costs through insurance policy coverage or from other PRPs, which the Corporation is pursuing as required by agreement and U.S. Government regulation. Any such recoveries, when received, would reduce the allocated amounts to be included in the Corporation's U.S. Government sales and cost of sales.

*Waste remediation contract* — In 1994, the Corporation was awarded a \$180 million fixed-price contract by the U.S. Department of Energy (DoE) for the design, construction and limited test of remediation facilities, and the remediation of waste found in Pit 9, located on the Idaho National Engineering and Environmental Laboratory reservation. The DoE, through its management contractor, terminated the Pit 9 contract for default on June 1, 1998. The DoE's lawsuit, together with the Corporation's counterclaims, was tried in the U.S. District Court in Pocatello, Idaho from August through November 2003. At trial, the DoE sought damages and interest totaling approximately \$100 million. The Corporation sought to overturn the termination for default and damages of approximately \$270 million. The matter is expected to be submitted to the trial court for decision in March 2004. The Corporation has assumed that it will recover some portion of its costs, which are recorded in inventories, based on its estimate of the probable outcome of the case. It is not possible to predict the outcome of the lawsuit with certainty. The court may award damages to either party in the full amount it sought at trial or in some lesser amount. The Corporation expects the court to render a decision later in 2004, although final resolution of the lawsuit will likely depend upon the outcome of further proceedings and possible negotiations with the DoE.

*Letters of credit and other matters* — The Corporation has entered into standby letter of credit agreements and other arrangements with financial institutions primarily relating to the guarantee of future performance on certain of its contracts. At December 31, 2003, the Corporation had contingent liabilities on outstanding letters of credit and other arrangements aggregating approximately \$518 million.

## NOTE 16 — INFORMATION ON BUSINESS SEGMENTS AND MAJOR CUSTOMERS

In 2003, the Corporation announced the formation of Integrated Systems & Solutions (IS&S), a new business segment, from components of the Electronic Systems and Space Systems segments. IS&S is leveraging the Corporation's existing and emerging capabilities related to addressing customers' growing needs for integrated, net-centric solutions. With the formation of IS&S, the former Systems Integration business segment is now called Electronic Systems. Also in 2003, the Corporation changed the name of its Technology Services segment to Information & Technology Services (I&TS) to better reflect the scope of its activities. The Aeronautics business segment was unaffected by these changes.

The Corporation operates in five business segments: Aeronautics, Electronic Systems, Space Systems, IS&S, and I&TS. In the following tables of financial data, the total of the operating results of the principal business segments is reconciled to the corresponding consolidated amount. With respect to the caption "Operating profit," the reconciling item "Unallocated Corporate (expense) income, net" includes the FAS/CAS pension adjustment (see discussion below), earnings and losses from equity investments (mainly telecommunications), interest income, costs for stock-based compensation programs, the effects of items not considered part of management's evaluation of segment operating performance, Corporate costs not allocated to the operating segments and other miscellaneous Corporate activities. The remaining reconciling item relates to the effects of the Corporation's adoption of FAS 142 in 2002. For financial data other than "Operating profit," all activities other than those pertaining to the principal business segments are included in "Other."

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated for financial reporting purposes under GAAP in accordance with FAS 87, and pension costs calculated and funded in accordance with U.S. Government Cost Accounting Standards (CAS), which are reflected in the business segment results. CAS is a major factor in determining pension funding requirements for the Corporation, and governs the extent of allocability and recoverability of pension costs on government contracts. The CAS expense is recovered through the pricing of the Corporation's products and services on U.S. Government contracts, and therefore recognized in segment net sales. The results of operations

of the Corporation's segments only include pension expense as determined and funded in accordance with CAS rules.

Transactions between segments are generally negotiated and accounted for under terms and conditions that are similar to other government and commercial contracts; however, these intercompany transactions are eliminated in consolidation and for purposes of the presentation of "Net sales" in the related table that follows. Other accounting policies of the business segments are the same as those described in "Note 1 — Significant Accounting Policies."

Following is a brief description of the activities of the principal business segments:

- *Aeronautics* — Engaged in design, research and development, systems integration, production, support and upgrade of advanced military aircraft and related technologies. Its customers include the military services of the United States and allied countries throughout the world. Major products and programs include the F-16 multi-role fighter, F/A-22 air dominance and multi-mission combat aircraft, F-35 Joint Strike Fighter, Japanese F-2 combat aircraft, Korean T-50 advanced trainer, C-130 tactical airlift aircraft, C-5 strategic airlift aircraft, C-27J medium transport aircraft and support for the F-117 stealth fighter and special mission and reconnaissance aircraft (e.g., P-3 Orion, S-3 Viking, U-2 and Big Safari modifications).
- *Electronic Systems* — Engaged in the design, research, development, integration and production of high performance systems for undersea, shipboard, land and airborne applications. Major product lines include: missiles and fire control systems; air and theater missile defense systems; surface ship and submarine combat systems; anti-submarine and undersea warfare systems; avionics and ground combat vehicle integration; radars; platform integration systems; homeland security systems; surveillance and reconnaissance systems; advanced aviation management, security and information technology solutions; simulation and training systems; and postal automation systems.
- *Space Systems* — Engaged in the design, research, development, engineering, integration and production of satellites, strategic and defensive missile systems and launch services. The satellite product line includes both government and commercial satellites. Strategic and defensive

*Lockheed Martin Corporation*  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

missile systems include airborne and missile defense technologies and fleet ballistic missiles. Launch services include launches on Titan, Atlas and Proton launch vehicles, and also include the Space Shuttle's external tank. In addition, the segment has investments in joint ventures that are principally engaged in businesses that complement and enhance other activities of the segment.

- *Integrated Systems & Solutions* — Engaged in the design, research, development, integration and management of net-centric solutions supporting command, control, communications, computers, intelligence, reconnaissance and surveillance (C4ISR) activities of the U.S. Department of Defense (DoD), intelligence agencies, other federal agencies and allied countries; provides technology, full life cycle support and highly specialized talent in the areas of software and systems engineering, including expertise in space, air and ground systems; serves as the Corporation's focal point for customers with joint and net-centric operations requiring overarching architectures, horizontal systems integration and inter-connected capabilities for the gathering, processing, storage and delivery of on-demand information for mission management, modeling, simulation and large-scale systems integration.
- *Information & Technology Services* — Engaged in a wide array of information technology (IT), IT-related, and other technology services to federal agencies and other customers. Major product lines include: information technology integration and management; enterprise solutions, application development, maintenance and consulting for strategic programs for the DoD and civil government agencies; aircraft and engine maintenance and modification services; management, operation, maintenance, training, and logistics support for military, homeland security and civilian systems; launch, mission, and analysis services for military, classified and commercial satellites; engineering, science and information services for NASA; and research, development, engineering and science in support of nuclear weapons stewardship and naval reactor programs.

Consistent with the requirements of FAS 131, "Disclosures about Segments of an Enterprise and Related Information," the following tables of financial data have been adjusted to reflect the changes in the business segments as noted above. This did

not result in any changes to the historical operating results in total for the Corporation.

**Selected Financial Data by Business Segment**

<i>(In millions)</i>	2003	2002	2001
<b>NET SALES</b>			
Aeronautics	<b>\$ 10,202</b>	\$ 6,471	\$ 5,355
Electronic Systems	<b>8,991</b>	8,685	8,079
Space Systems	<b>6,021</b>	5,287	4,801
Integrated Systems & Solutions	<b>3,420</b>	3,015	2,970
Information & Technology Services	<b>3,174</b>	3,104	2,763
Total business segments	<b>31,808</b>	26,562	23,968
Other	<b>16</b>	16	22
	<b>\$ 31,824</b>	\$ 26,578	\$ 23,990

**OPERATING PROFIT<sup>(a)</sup>**

Aeronautics	<b>\$ 690</b>	\$ 448	\$ 329
Electronic Systems	<b>858</b>	875	816
Space Systems	<b>403</b>	279	225
Integrated Systems & Solutions	<b>291</b>	241	225
Information & Technology Services	<b>226</b>	177	114
Total business segments	<b>2,468</b>	2,020	1,709
Unallocated Corporate expense, net <sup>(b)</sup>	<b>(449)</b>	(862)	(602)
Impact of FAS 142 adoption	<b>—</b>	—	(274)
	<b>\$ 2,019</b>	\$ 1,158	\$ 833

**INTERSEGMENT REVENUE**

Aeronautics	<b>\$ 41</b>	\$ 28	\$ 52
Electronic Systems	<b>550</b>	338	221
Space Systems	<b>134</b>	147	67
Integrated Systems & Solutions	<b>471</b>	272	174
Information & Technology Services	<b>765</b>	707	814
Total business segments	<b>1,961</b>	1,492	1,328
Other	<b>83</b>	75	77
	<b>\$ 2,044</b>	\$ 1,567	\$ 1,405

**DEPRECIATION AND**

**AMORTIZATION OF PROPERTY,  
PLANT AND EQUIPMENT**

Aeronautics	<b>\$ 89</b>	\$ 74	\$ 84
Electronic Systems	<b>160</b>	153	142
Space Systems	<b>120</b>	108	123
Integrated Systems & Solutions	<b>29</b>	34	31
Information & Technology Services	<b>42</b>	36	22
Total business segments	<b>440</b>	405	402
Other	<b>40</b>	28	23
	<b>\$ 480</b>	\$ 433	\$ 425

**Selected Financial Data by Business Segment (continued)**

<i>(In millions)</i>	2003	2002	2001
<b>AMORTIZATION OF PURCHASED INTANGIBLES</b>			
Aeronautics	\$ 50	\$ 50	\$ 51
Electronic Systems	47	49	47
Space Systems	8	7	8
Integrated Systems & Solutions	14	12	13
Information & Technology Services	8	7	5
Total business segments	127	125	124
Other	2	—	30
	\$ 129	\$ 125	\$ 154

**EXPENDITURES FOR PROPERTY, PLANT AND EQUIPMENT<sup>(c)</sup>**

Aeronautics	\$ 210	\$ 205	\$ 142
Electronic Systems	204	200	184
Space Systems	143	147	112
Integrated Systems & Solutions	35	34	38
Information & Technology Services	41	44	30
Total business segments	633	630	506
Other	54	22	39
	\$ 687	\$ 652	\$ 545

**ASSETS<sup>(d)</sup>**

Aeronautics	\$ 3,061	\$ 2,835	\$ 3,017
Electronic Systems	8,740	8,697	8,685
Space Systems	2,986	3,147	3,916
Integrated Systems & Solutions	2,223	2,070	2,219
Information & Technology Services	2,342	1,634	1,911
Total business segments	19,352	18,383	19,748
Other <sup>(e)</sup>	6,823	8,596	7,966
	\$ 26,175	\$ 26,979	\$ 27,714

**GOODWILL**

Aeronautics	\$ —	\$ —	\$ —
Electronic Systems	5,075	5,075	5,075
Space Systems	453	453	453
Integrated Systems & Solutions	1,357	1,311	1,311
Information & Technology Services	994	541	532
	\$ 7,879	\$ 7,380	\$ 7,371

<i>(In millions)</i>	2003	2002	2001
<b>CUSTOMER ADVANCES AND AMOUNTS IN EXCESS OF COSTS INCURRED</b>			
Aeronautics	\$ 2,049	\$ 2,408	\$ 2,406
Electronic Systems	1,049	816	766
Space Systems	1,042	1,238	1,701
Integrated Systems & Solutions	98	57	114
Information & Technology Services	16	19	15
Total business segments	4,254	4,538	5,002
Other	2	4	—
	\$ 4,256	\$ 4,542	\$ 5,002

(a) Operating profit included equity in earnings of equity investees as follows:

<i>(In millions)</i>	2003	2002	2001
Space Systems	\$ 51	\$ 39	\$ 51
Information & Technology Services	15	10	10
Total business segments	66	49	61
Other	41	44	7
	\$ 107	\$ 93	\$ 68

(b) Unallocated Corporate (expense) income, net includes the following:

<i>(In millions)</i>	2003	2002	2001
FAS/CAS pension adjustment	\$ (300)	\$ 243	\$ 360
Items not considered in segment operating performance	(153)	(1,112)	(973)
Other	4	7	11
	\$ (449)	\$ (862)	\$ (602)

For information regarding the items not considered in management's evaluation of segment operating performance, see Notes 2, 3, 6, 8, 9 and 11 to the consolidated financial statements.

(c) Amounts exclude expenditures related to discontinued businesses totaling \$10 million in 2002 and \$74 million in 2001.

(d) The Corporation has no significant long-lived assets located in foreign countries.

(e) Assets primarily include cash, investments, assets held for sale, deferred income taxes and the prepaid pension asset.

Lockheed Martin Corporation  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2003

**Net Sales by Customer Category**

<i>(In millions)</i>	2003	2002	2001
<b>U.S. GOVERNMENT</b>			
Aeronautics	<b>\$ 6,613</b>	\$ 4,483	\$ 3,437
Electronic Systems	<b>7,363</b>	6,910	6,114
Space Systems	<b>4,928</b>	4,303	4,148
Integrated Systems & Solutions	<b>3,252</b>	2,804	2,646
Information & Technology Services	<b>2,799</b>	2,735	2,269
	<b>\$24,955</b>	\$21,235	\$18,614

**FOREIGN GOVERNMENTS<sup>(a)(b)</sup>**

Aeronautics	<b>\$ 3,580</b>	\$ 1,971	\$ 1,899
Electronic Systems	<b>1,467</b>	1,592	1,804
Space Systems	—	—	36
Integrated Systems & Solutions	<b>16</b>	51	44
Information & Technology Services	<b>79</b>	76	104
	<b>\$ 5,142</b>	\$ 3,690	\$ 3,887

**COMMERCIAL<sup>(b)</sup>**

Aeronautics	<b>\$ 9</b>	\$ 17	\$ 19
Electronic Systems	<b>161</b>	183	161
Space Systems	<b>1,093</b>	984	617
Integrated Systems & Solutions	<b>152</b>	160	280
Information & Technology Services	<b>296</b>	293	390
Total business segments	<b>1,711</b>	1,637	1,467
Other	<b>16</b>	16	22
	<b>\$ 1,727</b>	\$ 1,653	\$ 1,489

(a) Sales made to foreign governments through the U.S. Government are included in the foreign governments category above.

(b) International sales, including export sales included in the foreign governments and commercial categories above, were approximately \$5.6 billion, \$4.3 billion and \$4.1 billion in 2003, 2002 and 2001, respectively.

**NOTE 17 — SUMMARY OF QUARTERLY INFORMATION (UNAUDITED)**

<i>(In millions, except per share data)</i>	2003 Quarters			
	First <sup>(a)</sup>	Second <sup>(b)</sup>	Third <sup>(c)</sup>	Fourth <sup>(d)</sup>
Net sales	<b>\$ 7,059</b>	<b>\$ 7,709</b>	<b>\$ 8,078</b>	<b>\$ 8,978</b>
Earnings from operations	<b>472</b>	<b>410</b>	<b>538</b>	<b>556</b>
Net earnings	<b>250</b>	<b>242</b>	<b>217</b>	<b>344</b>
Earnings per diluted share	<b>0.55</b>	<b>0.54</b>	<b>0.48</b>	<b>0.77</b>

<i>(In millions, except per share data)</i>	2002 Quarters			
	First	Second <sup>(e)</sup>	Third	Fourth <sup>(f)</sup>
Net sales	\$ 5,966	\$ 6,290	\$ 6,542	\$ 7,780
Earnings from operations	438	483	553	475
Earnings (loss) from continuing operations	224	351	300	(342)
Net earnings (loss)	218	339	290	(347)
Earnings (loss) per diluted share from continuing operations	0.50	0.78	0.66	(0.76)
Earnings (loss) per diluted share	0.49	0.75	0.64	(0.77)

(a) Net earnings for the first quarter of 2003 included the following items: a charge related to the early repayment of debt which decreased net earnings by \$13 million (\$0.03 per diluted share); and partial reversal of a charge recorded in 2002 related to Space Imaging which increased net earnings by \$13 million (\$0.03 per diluted share).

(b) Net earnings for the second quarter of 2003 included a charge related to the Corporation's decision to exit the commercial mail sorting business which reduced net earnings by \$27 million (\$0.06 per diluted share).

(c) Net earnings for the third quarter of 2003 included a charge related to the early repayment of debt which decreased net earnings by \$83 million (\$0.18 per diluted share).

(d) Net earnings for the fourth quarter of 2003 included a gain from the sale of the Corporation's commercial IT business which increased net earnings by \$8 million (\$0.02 per diluted share).

(e) Net earnings for the second quarter of 2002 included the effects of a settlement of a research and development tax credit claim. The settlement increased net earnings by \$90 million (\$0.20 per diluted share) and was recorded as a reduction of income tax expense.

(f) The net loss for the fourth quarter of 2002 included the following: impairment charges related to certain of the Corporation's telecommunications equity investments which increased the net loss by \$504 million (\$1.12 per diluted share); a charge related to advances to a Russian launch vehicle manufacturer which increased the net loss by \$112 million (\$0.25 per diluted share); and a charge related to the Corporation's investment in and its guarantee of certain obligations of Space Imaging which increased the net loss by \$106 million (\$0.24 per diluted share).

*Lockheed Martin Corporation*  
**CONSOLIDATED FINANCIAL DATA — FIVE YEAR SUMMARY**

<i>(In millions, except per share data)</i>	2003 <sup>(a)</sup>	2002 <sup>(b)</sup>	2001 <sup>(c)</sup>	2000 <sup>(d)</sup>	1999 <sup>(e)</sup>
<b>OPERATING RESULTS</b>					
Net sales	\$ 31,824	\$ 26,578	\$ 23,990	\$ 24,541	\$ 24,999
Cost of sales	29,848	24,629	22,447	22,881	23,346
Earnings from operations	1,976	1,949	1,543	1,660	1,653
Other income and expenses, net	43	(791)	(710)	(555)	344
	<b>2,019</b>	<b>1,158</b>	<b>833</b>	<b>1,105</b>	<b>1,997</b>
Interest expense	487	581	700	919	809
Earnings from continuing operations before income taxes and cumulative effect of change in accounting	1,532	577	133	186	1,188
Income tax expense	479	44	90	663	459
Earnings (loss) from continuing operations before cumulative effect of change in accounting	1,053	533	43	(477)	729
Discontinued operations	—	(33)	(1,089)	(42)	8
Cumulative effect of change in accounting	—	—	—	—	(355)
Net earnings (loss)	<b>\$ 1,053</b>	<b>\$ 500</b>	<b>\$ (1,046)</b>	<b>\$ (519)</b>	<b>\$ 382</b>
<b>EARNINGS (LOSS) PER COMMON SHARE</b>					
Basic:					
Continuing operations before cumulative effect of change in accounting	\$ 2.36	\$ 1.20	\$ 0.10	\$ (1.19)	\$ 1.91
Discontinued operations	—	(0.07)	(2.55)	(0.10)	0.02
Cumulative effect of change in accounting	—	—	—	—	(0.93)
	<b>\$ 2.36</b>	<b>\$ 1.13</b>	<b>\$ (2.45)</b>	<b>\$ (1.29)</b>	<b>\$ 1.00</b>
Diluted:					
Continuing operations before cumulative effect of change in accounting	\$ 2.34	\$ 1.18	\$ 0.10	\$ (1.19)	\$ 1.90
Discontinued operations	—	(0.07)	(2.52)	(0.10)	0.02
Cumulative effect of change in accounting	—	—	—	—	(0.93)
	<b>\$ 2.34</b>	<b>\$ 1.11</b>	<b>\$ (2.42)</b>	<b>\$ (1.29)</b>	<b>\$ 0.99</b>
<b>CASH DIVIDENDS</b>	<b>\$ 0.58</b>	<b>\$ 0.44</b>	<b>\$ 0.44</b>	<b>\$ 0.44</b>	<b>\$ 0.88</b>
<b>CONDENSED BALANCE SHEET DATA</b>					
Current assets	\$ 9,401	\$ 10,626	\$ 10,778	\$ 13,339	\$ 11,080
Property, plant and equipment, net	3,489	3,258	2,991	2,941	3,361
Goodwill	7,879	7,380	7,371	7,479	9,152
Purchased intangibles, net	807	814	939	1,073	1,259
Other assets	4,599	4,901	5,635	5,594	5,409
Total	<b>\$ 26,175</b>	<b>\$ 26,979</b>	<b>\$ 27,714</b>	<b>\$ 30,426</b>	<b>\$ 30,261</b>
Short-term borrowings	\$ —	\$ —	\$ —	\$ 12	\$ 475
Current maturities of long-term debt	136	1,365	89	882	52
Other current liabilities	8,757	8,456	9,600	9,408	8,298
Long-term debt	6,072	6,217	7,422	9,065	11,427
Post-retirement benefit liabilities	1,440	1,480	1,565	1,647	1,805
Other liabilities	3,014	3,596	2,595	2,252	1,843
Stockholders' equity	6,756	5,865	6,443	7,160	6,361
Total	<b>\$ 26,175</b>	<b>\$ 26,979</b>	<b>\$ 27,714</b>	<b>\$ 30,426</b>	<b>\$ 30,261</b>
<b>COMMON SHARES OUTSTANDING AT YEAR-END</b>	<b>446.5</b>	<b>455.5</b>	<b>441.2</b>	<b>431.4</b>	<b>397.8</b>
<b>CASH FLOW DATA</b>					
Cash from operating activities	\$ 1,809	\$ 2,288	\$ 1,825	\$ 2,016	\$ 1,077
Cash (used by) from investing activities	(1,461)	(539)	139	1,762	(1,638)
Cash (used by) from financing activities	(2,076)	77	(2,557)	(2,728)	731
<b>NEGOTIATED BACKLOG</b>	<b>\$ 76,899</b>	<b>\$ 70,385</b>	<b>\$ 71,269</b>	<b>\$ 55,076</b>	<b>\$ 44,807</b>

*Lockheed Martin Corporation*  
**CONSOLIDATED FINANCIAL DATA — FIVE YEAR SUMMARY**

**NOTES TO FIVE YEAR SUMMARY**

- (a) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments (see the section "Results of Operations" in Management's Discussion and Analysis of Financial Condition and Results of Operations) which, on a combined basis, decreased earnings from continuing operations before income taxes by \$153 million, \$102 million after tax (\$0.22 per diluted share).*
- (b) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments (see the section "Results of Operations" in Management's Discussion and Analysis of Financial Condition and Results of Operations) which, on a combined basis, decreased earnings from continuing operations before income taxes by \$1,112 million, \$632 million after tax (\$1.40 per diluted share). In 2002, the Corporation adopted FAS 142 which prohibits the amortization of goodwill.*
- (c) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments (see the section "Results of Operations" in Management's Discussion and Analysis of Financial Condition and Results of Operations) which, on a combined basis, decreased earnings from continuing operations before income taxes by \$973 million, \$651 million after tax (\$1.50 per diluted share). Also includes a gain from the disposal of a business and charges for the Corporation's exit from its global telecommunications services business which is included in discontinued operations and which, on a combined basis, increased the net loss by \$1 billion (\$2.38 per diluted share).*
- (d) Reflects the business combination with COMSAT Corporation effective August 2000. Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments which, on a combined basis, decreased earnings from continuing operations before income taxes by \$685 million, \$951 million after tax (\$2.36 per diluted share).*
- (e) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments which, on a combined basis, increased earnings from continuing operations before income taxes by \$249 million, \$162 million after tax (\$0.42 per diluted share). Also includes a cumulative effect adjustment relating to the adoption of SOP No. 98-5 regarding costs for start-up activities which resulted in a charge that reduced net earnings by \$355 million (\$0.93 per diluted share).*



*Lockheed Martin Corporation*  
**CORPORATE DIRECTORY**

(As of March 1, 2004)

**BOARD OF DIRECTORS**

**E. C. Pete Aldridge, Jr.**  
*Former Under Secretary of Defense*

**Nolan D. Archibald**  
*Chairman, President &  
Chief Executive Officer  
The Black & Decker Corporation*

**Norman R. Augustine**  
*Chairman of the Executive Committee  
Lockheed Martin Corporation*

**Marcus C. Bennett**  
*Retired Executive Vice President and  
Chief Financial Officer  
Lockheed Martin Corporation*

**Vance D. Coffman**  
*Chairman and Chief Executive Officer  
Lockheed Martin Corporation*

**Gwendolyn S. King**  
*President  
Podium Prose  
(A Washington, D.C.-based  
Speaker's Bureau)*

**Douglas H. McCorkindale**  
*Chairman, President &  
Chief Executive Officer  
Gannett Co., Inc.*

**Eugene F. Murphy**  
*Retired Vice Chairman and  
Executive Officer  
General Electric Company*

**Joseph W. Ralston**  
*Vice Chairman  
The Cohen Group*

**Frank Savage**  
*Chief Executive Officer  
Savage Holdings, LLC*

**Anne Stevens**  
*Group Vice President  
Canada, Mexico and South America  
Ford Motor Company*

**Robert J. Stevens**  
*President and Chief Operating Officer  
Lockheed Martin Corporation*

**James R. Ukropina**  
*Chief Executive Officer  
Directions, LLC  
(A Management and Consulting Firm)*

**Douglas C. Yearley**  
*Chairman Emeritus  
Phelps Dodge Corporation*

**COMMITTEES**

**Audit and Ethics Committee**  
*Mr. Yearley, Chairman  
Mrs. King, Ms. Stevens and Messrs.  
Aldridge, Archibald, Murphy and  
Ukropina*

**Executive Committee**  
*Mr. Augustine, Chairman  
Mrs. King, and Messrs. Bennett, Coffman,  
McCorkindale, Ukropina and Yearley*

**Strategic Affairs and  
Finance Committee**  
*Mr. McCorkindale, Chairman  
Messrs. Archibald, Augustine, Bennett,  
Ralston, Savage and Yearley*

**Management Development and  
Compensation Committee and  
Stock Option Subcommittee**  
*Mrs. King, Chairman  
Ms. Stevens, and Messrs. Aldridge,  
McCorkindale, Murphy and Savage*

**Nominating and  
Corporate Governance Committee**  
*Mr. Ukropina, Chairman  
Messrs. Augustine, McCorkindale,  
Murphy and Ralston*

Lockheed Martin Corporation  
**CORPORATE DIRECTORY**  
(As of March 1, 2004)

**OFFICERS**

Kenneth Asbury  
*Vice President*

James F. Berry  
*Vice President*

Rajeev Bhalla  
*Vice President and Controller*

Dennis R. Boxx  
*Senior Vice President*

Charles T. Burbage  
*Vice President*

Michael F. Camardo  
*Executive Vice President*  
*Information & Technology Services*

Joseph R. Cleveland  
*Vice President*

Vance D. Coffman  
*Chairman and*  
*Chief Executive Officer*

Robert B. Coutts  
*Executive Vice President*  
*Electronic Systems*

Brian D. Dailey  
*Senior Vice President*

Robert T. Elrod  
*Vice President*

John J. Freeh  
*Vice President*

Kimberly P. Gavaletz  
*Vice President*

Theofanis G. Gavrilis  
*Vice President*

Linda R. Gooden  
*Vice President*

Dain M. Hancock  
*Executive Vice President*  
*Aeronautics*

Jeffrey K. Harris  
*Vice President*

Marillyn A. Hewson  
*Senior Vice President*

Jay F. Honeycutt  
*Vice President*

Arthur E. Johnson  
*Senior Vice President*

Michael J. Joyce  
*Vice President*

Christopher E. Kubasik  
*Senior Vice President and*  
*Chief Financial Officer*

Maryanne R. Lavan  
*Vice President*

G. Thomas Marsh  
*Executive Vice President*  
*Space Systems*

Janet L. McGregor  
*Vice President*

Frank H. Menaker  
*Senior Vice President and*  
*General Counsel*

Frank C. Meyer  
*Vice President*

Fred P. Moosally  
*Vice President*

Malcolm R. O'Neill  
*Vice President*

David J. Posek  
*Vice President*

James R. Ryan  
*Vice President*

Stanton D. Sloane  
*Vice President*

Albert E. Smith  
*Executive Vice President*  
*Integrated Systems & Solutions*

Robert J. Stevens  
*President and*  
*Chief Operating Officer*

Edward S. Taft  
*Senior Vice President*

Robert H. Trice  
*Senior Vice President*

Lillian M. Trippett  
*Vice President, Corporate Secretary*  
*and Associate General Counsel*

Anthony G. Van Schaick  
*Vice President and Treasurer*

*Lockheed Martin Corporation*  
**GENERAL INFORMATION**  
 December 31, 2003

As of December 31, 2003, there were approximately 44,682 holders of record of Lockheed Martin common stock and 446,737,018 shares outstanding.

**COMMON STOCK PRICES**

<i>(In dollars)</i>	High	Low	Close
<b>2003 Quarters</b>			
<b>1st</b>	<b>58.95</b>	<b>40.64</b>	<b>47.55</b>
<b>2nd</b>	<b>51.66</b>	<b>43.32</b>	<b>47.57</b>
<b>3rd</b>	<b>55.00</b>	<b>44.09</b>	<b>46.15</b>
<b>4th</b>	<b>51.47</b>	<b>44.78</b>	<b>51.40</b>
<b>2002 Quarters</b>			
1st	59.96	45.85	57.58
2nd	71.52	57.35	69.50
3rd	69.97	52.30	64.67
4th	65.55	48.64	57.75

**TRANSFER AGENT & REGISTRAR**

EquiServe Trust Company, N.A.  
 Shareholder Services  
 P.O. Box 43010  
 Providence, Rhode Island 02940-3010  
 Telephone: 1-800-519-3111  
 TDD for the hearing impaired: 1-800-490-1493 or  
 781-575-2692  
 Internet: <http://www.equiserve.com>

**DIVIDEND REINVESTMENT PLAN**

Lockheed Martin Direct Invest, our direct stock purchase and dividend reinvestment plan, provides new investors and current stockholders with a convenient, cost-effective way to purchase Lockheed Martin common stock, increase holdings and manage the investment. For more information about Lockheed Martin Direct Invest, contact our transfer agent, EquiServe Trust Company, N.A. at 1-800-446-2617, or to view plan materials online and enroll electronically, access Internet site <http://www.shareholder.com/lmt/shareholder.cfm#drip>.

**INDEPENDENT AUDITORS**

Ernst & Young LLP  
 8484 Westpark Drive  
 McLean, Virginia 22102

**COMMON STOCK**

Stock symbol: LMT  
 Listed: New York Stock Exchange

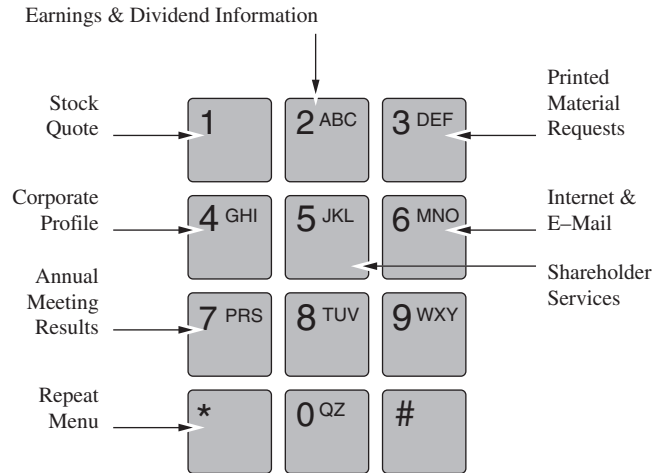
**ANNUAL REPORT ON FORM 10-K**

Stockholders may obtain, without charge, a copy of Lockheed Martin's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission for the year ended December 31, 2003 by writing to:

Lockheed Martin Investor Relations  
 6801 Rockledge Drive  
 Bethesda, MD 20817

For accessing the Lockheed Martin Investor Relations homepage on the Internet use the Uniform Resource Locator: <http://www.lockheedmartin.com/investor>

**Lockheed Martin Shareholder Direct**  
**1-800-568-9758**



Financial results, stock quotes, dividend news as well as other Lockheed Martin information are available by calling the above toll-free number. The information will be read to the caller and certain of the information can also be received by mail, fax or E-mail. You may also reach Shareholder Services for account information or Investor Relations for additional information on Lockheed Martin via the toll-free number.

**FORWARD-LOOKING STATEMENTS — SAFE HARBOR PROVISIONS**

This Annual Report contains statements which, to the extent that they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws. The words “believe,” “estimate,” “anticipate,” “project,” “intend,” “expect,” “plan,” “outlook,” “forecast” and similar expressions are intended to identify forward-looking statements. Numerous factors, including potentially the following factors, could affect the Corporation’s forward-looking statements and actual performance: the ability to obtain or the timing of obtaining future government awards; the availability of government funding and customer requirements both domestically and internationally; changes in government or customer priorities due to program reviews or revisions to strategic objectives (including changes in priorities to respond to terrorist threats or to improve homeland security); the level of returns on pension and retirement plan assets; the termination of programs or contracts for convenience by customers; difficulties in developing and producing operationally advanced technology systems; charges from any future FAS 142 review for impairment of goodwill; the potential future impact of proposed tax or employee benefit legislation; the competitive environment (including continued pricing pressures associated with commercial satellites and launch services); the ability to achieve or realize savings through global cost-cutting programs; economic business and political conditions both domestically and internationally; government import and export policies; program performance; the timing of product deliveries and customer acceptance; performance issues with key suppliers and subcontractors; the completion and integration of proposed acquisitions and divestitures; and the outcome of litigation and other contingencies (including environmental remediation efforts and costs).

The value of the Corporation’s investments in equity securities, or related equity earnings for a given period, may be affected by the investee’s ability to obtain adequate funding (including through private and public sales of its debt and equity securities) and execute its business plan, general market conditions, industry considerations specific to the investee’s business, and other factors.

For a discussion identifying additional important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see the Corporation’s filings with the SEC including, but not limited to, the discussion of “Government Contracts and Regulation” and “Risk Factors and Forward-Looking Statements” on pages 20 through 21 and on pages 23 through 30 of the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2003 (Form 10-K), “Management’s Discussion and Analysis of Financial Condition and Results of Operations” on pages 17 through 39 of this Annual Report, and “Note 1 — Significant Accounting Policies,” “Note 2 — Acquisitions and Divestitures,” and “Note 15 — Commitments and Contingencies” of the Notes to Consolidated Financial Statements of the Audited Consolidated Financial Statements on pages 46 through 50, page 50, and pages 63 through 64, respectively, included in this Annual Report and included in the Form 10-K.

The Corporation’s actual financial results likely will be different from those projected due to the inherent nature of projections. Given these uncertainties, you should not rely on forward-looking statements in making investment decisions. The forward-looking statements contained in this Annual Report speak only as of the date of the Report. The Corporation expressly disclaims a duty to provide updates to forward-looking statements after the date of this Annual Report to reflect the occurrence of subsequent events, changed circumstances, changes in its expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Annual Report are intended to be subject to the safe harbor protection provided by the federal securities laws.

# LOCKHEED MARTIN APPLIES ITS VISION, ITS PURPOSE AND ITS VALUES TO CUSTOMER PRIORITIES

## OUR VISION

To be the world's best advanced technology systems integrator.

## OUR PURPOSE

To achieve Mission Success by attaining total customer satisfaction  
and meeting all our commitments.

## OUR VALUES

Ethics

Excellence

“Can-Do”

Integrity

People

Teamwork

## ACHIEVING RESULTS THROUGH

Leadership and Teamwork

Commitment of Our People to Our Customers

Excellence as a Premier Systems Integrator

Innovation in Technology and Business

Alliances Worldwide



Lockheed Martin Corporation  
6801 Rockledge Drive • Bethesda, MD 20817  
[www.lockheedmartin.com](http://www.lockheedmartin.com)