

ITT Corp
Form 10-K
February 24, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

**Form 10-K
ANNUAL REPORT**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010
OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the Transition period from to**

Commission File No. 1-5672

ITT CORPORATION

Incorporated in the State of Indiana

**13-5158950
(I.R.S. Employer Identification No.)**

**1133 Westchester Avenue, White Plains, NY 10604
(Principal Executive Office)
Telephone Number: (914) 641-2000**

**Securities registered pursuant to Section 12(b) of the Act, all of which are registered on The New York Stock
Exchange, Inc.:**

COMMON STOCK, \$1 PAR VALUE

**Securities registered pursuant to Section 12(g) of the Act:
None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

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

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

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

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

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant on June 30, 2010 was approximately \$8.3 billion.

As of February 11, 2011, there were outstanding 183.7 million shares of common stock, \$1 par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A for its 2011 Annual Meeting of Shareholders are incorporated by reference in Part II and Part III of this Form 10-K.

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* Included pursuant to Instruction 3 to Item 401(b) of Regulation S-K.

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

(In millions, except per share amounts, unless otherwise stated)

COMPANY OVERVIEW

ITT Corporation, with 2010 revenue of \$11.0 billion, is a global multi-industry high-technology engineering and manufacturing organization, with approximately 40 thousand employees, operations in more than 60 countries, and sales presence in more than 125 countries. Unless the context otherwise indicates, references herein to ITT, the Company, and such words as we, us, and our include ITT Corporation and its subsidiaries. ITT Corporation was incorporated as ITT Industries, Inc. on September 5, 1995 in the State of Indiana. On July 1, 2006, ITT Industries, Inc. changed its name to ITT Corporation.

We generate revenue through the design, manufacture, and sale of a wide range of products that are engineered to deliver extraordinary solutions to meet life's most essential needs—more livable environments, better protection and safety, and breakthrough communications that connect our world. Our products and services provide solutions in three vital markets: global defense and security, water and fluids management, and motion and flow control. Our portfolio includes three core businesses focused on making a difference in our communities and the world. From climate change and water scarcity to population growth, infrastructure modernization, critical communications and security concerns, ITT Corporation is prepared to play a continuing role in developing sustainable solutions to pressing global problems.

Our business comprises three principal business segments that are aligned with the markets they serve: Defense & Information Solutions (Defense segment), Fluid Technology (Fluid segment), and Motion & Flow Control (Motion & Flow segment). Our Defense segment is a major United States aerospace and defense contractor delivering advanced systems and providing technical and operational services. Our Fluid segment is a leading supplier of pumps and systems to transport and control water and other fluids. Our Motion and Flow segment is a manufacturer of highly engineered critical components for multiple growth markets. The following chart depicts the 2010 revenue on a percentage basis generated by business segment.

See Note 21, Business Segment Information in the Notes to Consolidated Financial Statements for financial information about segments and geographic areas.

Recent Acquisitions and Divestitures

Over the past five years, we have spent in excess of \$3.4 billion acquiring businesses that provide a strategic fit with businesses we presently conduct. During this period we have acquired 25 businesses that have provided approximately \$2 billion in annual revenue at the time of acquisition. Our most significant acquisition during the past five years was that of EDO Corporation (EDO) in December 2007 for approximately \$1.8 billion. The acquisition of EDO provided additional product offerings in the defense and security market and approximately \$1.1 billion in annual revenue. In 2010, we completed the acquisitions of Nova Analytics Corporation (Nova) and Godwin Pumps of America, Inc. and Godwin Holdings Limited (collectively referred to as Godwin). Nova, a manufacturer of premium quality laboratory, field, portable and on-line analytical instruments used in water and wastewater, environmental, medical, and food and beverage applications, provides us with brands, technologies, distribution and after-market content in the analytical instrumentation market. Godwin is a supplier and servicer of automatic self-priming and on-demand pumping solutions serving the global industrial, construction, mining, municipal, oil and gas dewatering markets. The addition of Godwin's specialized products and skills complements our Fluid segment's broad submersible pump portfolio and global sales and distribution network.

Over the past five years we have received proceeds of approximately \$800 from the divestiture of ten businesses with combined annual revenue of approximately \$1.2 billion at the time of divestiture. The most significant divestitures that occurred during the five-year period were our CAS Inc. (CAS), Switches and Automotive Fluid Handling Systems (FHS) businesses. On September 8, 2010 we completed the sale of CAS for \$237. CAS was a component of our Defense segment engaging in systems engineering and technical

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assistance (SETA) for the U.S. Government. On July 26, 2007, we completed the sale of substantially all of our Switches business, with the remaining portion of the business sold during 2008. The two-part sale generated aggregate proceeds of \$228. On February 26, 2006, we completed the sale of FHS, for \$188. The financial position and results of operations from these businesses have been presented as discontinued operations.

2011 Announcement of Company Transformation

On January 12, 2011, the Company announced that its Board of Directors had unanimously approved a plan to separate the Company's businesses into three distinct, publicly traded companies. Following completion of the transaction, ITT will continue to trade on the New York Stock Exchange as an industrial company that supplies highly engineered solutions in the aerospace, transportation, energy and industrial markets. Under the plan, ITT shareholders will own shares in all three corporations following the completion of the transaction. The transaction is anticipated to be completed by the end of 2011.

Under the plan, ITT would execute tax-free spinoffs to shareholders of its water-related businesses and its Defense & Information Solutions segment. The water-related business will include the Water & Wastewater division and the Residential & Commercial Water division as well as the Flow Control division that is currently reported within the Motion & Flow Control segment. The Industrial Process division which is currently reported within the Fluid segment will continue to operate as a division of ITT Corporation. The following chart provides an overview of the planned company transformation and estimated 2011 pro forma revenue, without other adjustment.

The balance of the disclosures in this Annual Report on Form 10-K relate to the current operations of ITT, except as may be specifically described otherwise.

Sales and Distribution

We manage our business and report our financial results based on our current principal business segments mentioned above. Our customers are organized by defense and commercial customer groups, and distribution of our products occurs by direct

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sales to end customers and indirectly through our channel partners. Our channel partners include:

Resellers that sell our products, frequently with their own value-added products or services, to targeted customer groups

Distribution partners that supply our solutions to smaller resellers with which we do not have direct relationships

Independent distributors that sell our products into specific geographies or customer segments in which we have little or no presence

Our distribution mix differs substantially by business and region. We believe that customer buying patterns and different regional market conditions necessitate sales, marketing and distribution efforts to be tailored accordingly. We are focused on driving the depth and breadth of our sales footprint in addition to efficiencies and productivity gains in both the direct and indirect business.

Materials

Our business relies on third-party suppliers, contract manufacturing and commodity markets to secure raw materials, parts and components used in our products. In some instances we depend on a single source of supply, manufacturing or assembly or participate in commodity markets that may be subject to a limited number of suppliers.

All of our businesses require various raw materials, the availability and prices of which may fluctuate. Although some cost increases may be recovered through increased prices to customers, our operating results are exposed to such fluctuations. We attempt to control such costs through fixed-priced contracts with suppliers and various other programs, such as our global strategic sourcing initiative. There have been no raw materials shortages that have had a material adverse impact on our business as a whole.

For most of our products, we have existing alternate sources of supply, or such sources are readily available. We typically acquire materials and components through a combination of blanket and scheduled purchase orders to support our materials requirements for an average of four to eight weeks, with the exception of some specialty material. From time to time, we may experience price volatility or supply constraints for materials that are not available from multiple sources. Frequently, we are able to obtain scarce components for somewhat higher prices on the open market, which may have an impact on gross margin but does not disrupt production. We also acquire certain inventory in anticipation of supply constraints or enter into longer-term pricing commitments with vendors to improve the priority, price and availability of supply.

Manufacturing Methods

We utilize two primary methods of fulfilling demand for products: build-to-order and engineer-to-order. We employ build-to-order capabilities to maximize manufacturing and logistics efficiencies by producing high volumes of basic product configurations. Engineering products to order permits the configuration of units to meet the customization requirements of our customers. Our inventory management and distribution practices in both build-to-order and engineer-to-order seek to minimize inventory holding periods by taking delivery of the inventory and manufacturing immediately prior to the sale or distribution of products to our customers.

Significant Customers

The U.S. Government is our only customer that accounts for greater than 10% of consolidated revenue. The operations of our Defense segment represent the substantial majority of our sales to the U.S. Government. In total, the U.S. Government represented 46%, 52% and 51% of our consolidated revenue results during 2010, 2009 and 2008, respectively.

Research and Development

Research and development is a key element of ITT's engineering culture and is generally focused on the design and development of products and solutions that anticipate customer needs and emerging trends. Our businesses invest substantial resources for research and development (R&D) activities. We anticipate our investments in future R&D activities will be consistent with recent spending levels to ensure a continuing flow of innovative, high-quality products and maintain our competitive position in the markets we serve. Such activities are conducted in laboratory and engineering facilities at several of our major manufacturing locations. During 2010, 2009 and 2008, we recognized Company-funded R&D expenses of \$253, \$258, and \$236, respectively, within operating expenses. We also conduct R&D activities pursuant to contracts with the U.S. Government, generally related to the design of systems and equipment, as well as studies and experimentation to accomplish specific technical objectives. The knowledge gained from such R&D activities may be used in future production activities, including follow-on contracts for full-scale production of products based on the prototypes or models developed during the R&D phase. Costs incurred in connection with these activities are not included in the Company-funded R&D amounts noted above. R&D costs attributable to contracts with customers are recognized within costs of revenue when the expense is incurred.

Intellectual Property

We generally seek patent protection for those inventions and improvements likely to be incorporated into our products or where proprietary rights will improve our competitive position. We believe

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that our patents and applications are important for maintaining the competitive differentiation of our products and improving our return on research and development investments. While we own and control a significant number of patents, trade secrets, confidential information, trademarks, trade names, copyrights, and other intellectual property rights which, in the aggregate, are of material importance to our business, management believes that our business, as a whole, as well as each of our core business segments, is not materially dependent on any one intellectual property right or related group of such rights.

Patents, patent applications, and license agreements will expire or terminate over time by operation of law, in accordance with their terms or otherwise. As the portfolio of our patents, patent applications, and license agreements has evolved over time, we do not expect the expiration of any specific patent to have a material adverse effect on our financial position, results of operations or cash flows.

In addition to the development of our patents, we are licensed to use certain patents, technology, and other intellectual property rights owned and controlled by others, and, similarly, the U.S. Government and/or other entities may be licensed to use certain patents, technology, and other intellectual property rights owned and controlled by us, under U.S. Government contracts or otherwise when we consider such licenses to be in our best interests.

Environmental Matters

We are subject to stringent environmental laws and regulations concerning air emissions, water discharges and waste disposal. In the United States, such environmental laws and regulations include the Federal Clean Air Act, the Clean Water Act, the Resource, Conservation and Recovery Act, and the Comprehensive Environmental Response, Compensation and Liability Act. Environmental requirements are significant factors affecting all operations. We have established an internal program to assess compliance with applicable environmental requirements for all of our facilities. The program is designed to identify problems in a timely manner, correct deficiencies and prevent future noncompliance. Over the past several years, we have conducted regular, thorough audits of our major operating facilities. As a result, management believes that our companies are in substantial compliance with current environmental regulations.

Management does not believe, based on current circumstances, that we will incur compliance costs pursuant to such regulations that will have a material adverse effect on our financial position, results of operations or cash flows. We closely monitor our environmental responsibilities, together with trends in the environmental laws. While environmental laws and regulations are subject to change, the nature of such is inherently unpredictable and the timing of potential changes is uncertain. However, the effect of legislative or regulatory changes could be material to the Company's financial condition or results of operations. In addition, we have purchased insurance protection against certain unknown environmental risks.

Accruals for environmental matters are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Our estimated liability is reduced to reflect the anticipated participation of other potentially responsible parties in those instances where it is probable that such parties are legally responsible and financially capable of paying their respective share of the relevant costs. At December 31, 2010, we had accrued \$139 related to environmental matters.

Available Information, Internet Address and Internet Access to Current and Periodic Reports

ITT's website address is www.itt.com. ITT makes available free of charge on or through www.itt.com/ir our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). Information contained on our website is not incorporated by reference unless specifically stated herein. As noted, we file the above reports electronically with the SEC, and they are available on the SEC's web site (www.sec.gov). In addition, all reports filed by ITT with the SEC may be read and copied at the

SEC's Public Reference Room located at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

OVERVIEW OF BUSINESS SEGMENTS

Defense and Information Solutions

Our Defense segment is a major defense contractor and trusted provider of mission-critical products and services that support the Armed Services of the U.S. Government and its allies, as well as manufacturer of highly-engineered innovative technologies to meet the emerging requirements of U.S. government agencies and commercial customers. Our products are designed to serve needs around safety, security, intelligence and communication.

During 2010, we executed a strategic realignment of the Defense segment to better align with the emerging needs of its expanding global customer base, which is increasingly integrated and network-centric. The Defense segment was renamed ITT Defense and Information Solutions and the previous organizational structure, consisting of seven divisions, was consolidated into three larger divisions. The realignment

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provided for better product portfolio integration, encouraging a more coordinated market approach while providing reductions in overhead costs. The realigned Defense segment divisions are: Electronic Systems (ES), Information Systems (IS), and Geospatial Systems (GS). The following table illustrates the annual revenue for the Defense segment and the percentage of revenue by segment division.

	2010	2009	2008
Defense segment revenue	\$ 5,897	\$ 6,067	\$ 6,064
Percentage of revenue by division:			
Electronic Systems	41%	43%	46%
Information Systems	39	38	36
Geospatial Systems	20	19	18

Customers

The principal customer for our Defense segment is the U.S. Government, specifically the U.S. Department of Defense (DoD). A substantial portion of U.S. Government work is performed in the United States under prime contracts and subcontracts, some of which by statute are subject to profit limitations and all of which are subject to termination by the U.S. Government, although such terminations generally are rare. A portion of our business is classified by the U.S. Government and cannot be specifically described. The operating results of these classified programs are included in our Consolidated Financial Statements. The business risks associated with classified programs, as a general matter, do not differ materially from those of our other government programs and products.

We also serve as a contractor and supplier for other U.S. government agencies, including the intelligence community, National Aeronautics and Space Administration (NASA), Federal Aviation Administration (FAA), Department of Homeland Security, and several first-responder agencies. In addition, we provide certain products to international governments through direct channels and the U.S. foreign military sales program. A smaller, but growing portion of our business is with commercial customers. The following table illustrates annual revenue for the Defense segment, as well as the approximate percentage of revenue by customer class.

	2010	2009
Percentage of revenue by customer class:		
U.S. Government DoD	73%	77%
U.S. Government Other Agencies	13%	11%
International governments ^(a)	10%	9%
Commercial	4%	3%

(a) Includes revenue derived through the U.S. Government's foreign military sales program (FMS). The FMS program is the government-to-government method for selling U.S. defense equipment, services, and training.

Defense Segment Divisions

Electronic Systems Division (ES) This division develops tactical communications equipment, electronic warfare and force protection equipment, radar systems and integrated structures equipment, providing the U.S. Armed Forces and its allies the ability to sense and deny threats to manned and unmanned platforms, ships, submarines and ground

vehicles, and provides soldiers with secure and reliable networked communications. The realigned ES division, based in Clifton, New Jersey, consists of the businesses that previously were included within the prior Electronic Systems and Communication Systems divisions, as well as a portion of the Intelligence & Information Warfare division.

Further details on the types of programs supported by the division include:

- n Communication systems equipment including Single Channel Ground and Airborne Radio (SINCGARS) equipment and Advanced Tactical Communications Systems (ATCS) as well as the development of Soldier Radio Waveform (SRW), the U.S. next generation capability to support network-centric operations. Other programs include SpearNet systems for the individual soldier, and fully programmable radio systems, including Soldier and Sensor Radios.
- n Force protection equipment including electronic countermeasures, interference mitigation technology, secure voice, data link and command and control systems and products. Countermeasure technology include CREW 2.1 which is equipment designed to neutralize certain improvised explosive devices from detonating.
- n Integrated electronic warfare systems, including Advanced Integrated Defensive Electronic Warfare Suite (AIDEWS) and Integrated Defensive Electronic Countermeasures (IDECM), allowing pilots and unmanned aerial vehicles to detect, deny, and evade battlefield threats.
- n Integrated structures equipment related to the carriage and release of weapons from an aircraft and lightweight advanced fiber-reinforced composite products.
- n Radar systems providing area surveillance and precision-approach control capabilities in fixed-site, transportable and mobile configurations including the integrated tactical Air Traffic Control System and the GCA-2000.

Information Systems Division (IS) This division provides world-class integrated networked solutions across a broad spectrum of customers including military, intelligence, civil and commercial organizations. IS provides advanced systems and technologies in the areas of air traffic management, information and cyber solutions, large-scale systems engineering and integration and defense technologies. We provide the U.S. Government with both the advanced technologies that will manage their data flow and the personnel they need to run their sophisticated

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communications centers and systems. The realigned IS division, based in Herndon, Virginia, consists of the businesses that previously were included within the prior Advanced Engineering & Sciences and Systems divisions, as well as a portion of the Intelligence & Information Warfare division. Further details on the types of programs and services provided by the division include:

- n Providing systems integration, communications, engineering and technical support solutions ranging from strategic command and control and tactical warning and attack assessment, to testing, training and range evaluation.
- n Providing total systems support solutions for combat equipment, tactical information systems and facilities management.
- n Developing and deploying the Automatic Dependent Surveillance Broadcast (ADS-B) system, a key component of the FAA's program to modernize the nation's air transportation system;
- n Providing NASA's Goddard Space Flight Center with telemetry, tracking and command services for near-Earth missions by supporting NASA's Space and Near Earth Networks, which provide most of the communications and tracking services for a wide range of Earth-orbiting spacecraft, including the International Space Station, the space shuttle, the Hubble Space Telescope and the Earth Observing System satellites.
- n Providing information sharing, protection and integration solutions for intelligence and military customers for enhanced situational clarity by building intelligent core environments that transform data into actionable knowledge in real-time.

Geospatial Systems Division (GS) This division develops sophisticated digital imaging and sensor equipment systems that provide sight and situational awareness at the space, airborne, ground and soldier levels. Imaging and sensor equipment includes night vision goggles, as well as weather, location, surveillance and other related technologies. GS's systems process and distribute information through defined networks, such that battlefield command posts and planning headquarters have the capabilities of viewing images provided by on-the-ground troops. The realigned GS division, based in Rochester, New York, consists of the businesses that previously were included within the prior Space Systems and Night Vision divisions.

The GS division serves a broad range of customers that include NASA, National Oceanic and Atmospheric Administration (NOAA), U.S. Air Force, U.S. Allied Military Forces and the U.S. Army. The products and services provided encompass: night vision goggles, sensor fused night vision goggles, monocular and weapon sights for ground forces, and image intensifier tubes required for all of these systems; satellite-based imaging payloads for intelligence, surveillance and reconnaissance solutions; high-resolution commercial imaging systems with earth and space science applications, climate and environmental monitoring sensors and systems, GPS navigation and software applications designed for image and data processing and dissemination.

Order Backlog

Funded order backlog, which represents unfilled firm orders for which funding has been authorized and appropriated by the customer, was \$4.1 billion at December 31, 2010 compared to \$5.1 billion at December 31, 2009. Certain defense programs have contract periods in excess of one year, as such we do not expect to fulfill all funded order backlog obligations during 2011; however, we do expect to satisfy a substantial portion. Unfunded order backlog, which represents unfunded firm orders and potential options on multi-year contracts, excluding protested awards and potential orders under indefinite delivery/indefinite quantity (ID/IQ) contracts, was approximately \$7.4 billion at

December 31, 2010 as compared to approximately \$4.9 billion at December 31, 2009. The level of order activity and related backlog associated with programs within the Defense segment can be affected by project evaluation cycles, the timing of government funding authorizations, the general timing of the budget approval process and non-linear sales fluctuations associated with certain long-term production contracts. Year-over-year comparisons could, at times, be impacted by these factors, among others.

U.S. Government Regulatory Matters

We act as a prime contractor or major subcontractor for numerous U.S. Government programs. As a result, we are subject to extensive regulations and requirements of the U.S. Government agencies and entities which govern these programs, including with respect to the award, administration and performance of contracts under such programs. We are also subject to certain unique business risks associated with U.S. Government program funding and appropriations and U.S. Government contracts, and with supplying technologically advanced, cutting-edge defense-related products and services to the U.S. Government.

U.S. Government contracts generally are subject to the Federal Acquisition Regulation (FAR), which sets forth policies, procedures and requirements for the acquisition of goods and services by the U.S. Government, agency-specific regulations that implement or supplement FAR, such as the DoD's Defense Federal Acquisition Regulation Supplement (DFARS) and other applicable laws and regulations. These regulations impose a broad range of requirements, many of which are unique to government contracting, including various procurement,

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import and export, security, contract pricing and cost, contract termination and adjustment, and audit requirements. A contractor's failure to comply with these regulations and requirements could result in reductions to the value of contracts, contract modifications or termination, and the assessment of penalties and fines and lead to suspension or debarment, for cause, from government contracting or subcontracting for a period of time. In addition, government contractors are also subject to routine audits and investigations by U.S. Government agencies such as the Defense Contract Audit Agency (DCAA). These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The DCAA also reviews the adequacy of and a contractor's compliance with its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems.

U.S. Government contracts include both cost reimbursement and fixed-price contracts. Cost reimbursement contracts, subject to a contract-ceiling amount in certain cases, provide for the reimbursement of allowable costs plus the payment of a fee. These contracts fall into three basic types: (i) cost plus fixed fee contracts which provide for the payment of a fixed fee irrespective of the final cost of performance, (ii) cost plus incentive fee contracts which provide for increases or decreases in the fee, within specified limits, based upon actual results as compared to contractual targets relating to such factors as cost, performance and delivery schedule, and (iii) cost plus award fee contracts which provide for the payment of an award fee determined at the discretion of the customer based upon the performance of the contractor against pre-established criteria. Under cost reimbursement type contracts, the contractor is reimbursed periodically for allowable costs and is paid a portion of the fee based on contract progress. Some costs incident to performing contracts have been made partially or wholly unallowable for reimbursement by statute, FAR or other regulation. Examples of such costs include charitable contributions, certain merger and acquisition costs, lobbying costs, interest expense and certain litigation defense costs.

Fixed-price contracts are either firm fixed-price contracts or fixed-price incentive contracts. Under firm fixed-price contracts, the contractor agrees to perform a specific scope of work for a fixed price and as a result, benefits from cost savings and carries the burden of cost overruns. Under fixed-price incentive contracts, the contractor shares with the government savings accrued from contracts performed for less than target costs and costs incurred in excess of targets up to a negotiated ceiling price (which is higher than the target cost) and carries the entire burden of costs exceeding the negotiated ceiling price. Accordingly, under such incentive contracts, the contractor's profit may also be adjusted up or down depending upon whether specified performance objectives are met. Under firm fixed-price and fixed-price incentive type contracts, the contractor usually receives either milestone payments based on a percentage of the total contract price or monthly progress payments generally based on a percentage of costs incurred. The remaining amount, including profits or incentive fees, is billed upon delivery and acceptance of end items under the contract.

U.S. Government contracts generally also permit the government to terminate the contract, in whole or in part, without prior notice, at the government's convenience or for default based on performance. If a contract is terminated for convenience, the contractor is generally entitled to payments for its allowable costs and will receive some allowance for profit on the work performed. If a contract is terminated for default, the contractor is generally entitled to payments for its work that has been accepted by the government. The U.S. Government's right to terminate its contracts has not had a material adverse effect upon our results of operations or financial condition.

U.S. Government programs generally are implemented by the award of individual contracts and subcontracts. Congress generally appropriates funds on a fiscal year basis even though a program may extend across several fiscal years. Consequently, programs are often only partially funded initially and additional funds are committed only as Congress makes further appropriations. The contracts and subcontracts under a program generally are subject to termination for convenience or adjustment if appropriations for such programs are not available or change. The U.S. Government is required to equitably adjust a contract price for additions or reductions in scope or other changes ordered by it.

We are also involved in U.S. Government programs which are classified by the U.S. Government and cannot be specifically described in this Annual Report on Form 10-K. The operating results of these classified programs are included in our Consolidated Financial Statements. The business risks and considerations associated with these classified programs generally do not differ materially from those of our other U.S. Government programs and products, and are subject to the same oversight and internal controls as other U.S. Government programs.

We are subject to government regulations and contract requirements which may differ from U.S. Government regulation with respect to our sales to non-U.S. customers. Sales and income from international operations and investments are subject to U.S. Government laws, regulations and policies, including the International Traffic in Arms Regulations (ITAR) and the Foreign Corrupt Practices Act (FCPA) and export laws and

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regulations, as well as foreign government laws, regulations and procurement policies and practices, which may differ from U.S. Government regulation, including import-export control, investments, exchange controls, repatriation of earnings and requirements to expend a portion of program funds in-country. The export from the U.S. of many of our products may require the issuance of a license by either the U.S. Department of State under the Arms Export Control Act of 1976 (formerly the Foreign Military Sales Act) and its implementing regulations under the ITAR, the U.S. Department of Commerce under the Export Administration Act and its implementing regulations as kept in force by the International Emergency Economic Powers Act of 1977 (IEEPA), and/or the U.S. Department of the Treasury under IEEPA or the Trading with the Enemy Act of 1917. Such licenses may be denied for reasons of U.S. national security or foreign policy. In the case of certain exports of defense equipment and services, the Department of State must notify Congress at least 15-60 days (depending on the identity of the importing country that will utilize the equipment and services) prior to authorizing such exports. During that time, Congress may take action to block or delay a proposed export by joint resolution which is subject to Presidential veto.

Competitive Conditions

We compete with many companies in the U.S. defense industry for a number of programs, both large and small, but primarily with Lockheed Martin Corporation, The Boeing Company, Raytheon Company, General Dynamics Corporation, L-3 Communications Corporation, SAIC Inc., Northrop Grumman Corporation, Harris Corporation and BAE Systems, Inc. Intense competition and long operating cycles are both key characteristics of our business and the defense industry. We also compete internationally against these same companies, as well as Thales Group, EADS N.V., Finmeccanica S.p.A., SAAB and many others. It is common in this industry for work on major programs to be shared among a number of companies. A company competing to be a prime contractor may, upon ultimate award of the contract to another party, serve as a subcontractor for the ultimate prime contracting party. It is not uncommon to compete for a contract award with a peer company and, simultaneously, perform as a supplier to or a customer of such competitor on other contracts. The nature of major defense programs, conducted under binding contracts, allows companies that perform well to benefit from a level of program continuity not common in many industries.

Our success in the competitive defense industry depends upon our ability to develop and market our products and services, as well as our ability to provide the people, technologies, facilities, equipment, and financial capacity needed to deliver those products and services with maximum efficiency. We must continue to maintain sources for raw materials, fabricated parts, electronic components, and major subassemblies. In this manufacturing and systems integration environment, effective oversight of subcontractors and suppliers is as vital to success as managing internal operations.

Similarly, there is intense competition among many companies in the information and services markets. Programs within the information and services market as compared to product-based programs are generally shorter in duration, more labor intensive and have extremely competitive margin rates. Competitors in the information and services markets include the defense industry participants mentioned above, as well as many other large and small entities with expertise in various specialized areas. Our ability to compete successfully in the information and services markets depends on a number of factors; most important is the capability to deploy skilled professionals, many requiring security clearances, at competitive prices across the diverse spectrum of these markets. A