LOCKHEED MARTIN CORP
Form 10-Q
April 25, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the quarterly period ended March 25, 2018
Commission file number: 1-11437

LOCKHEED MARTIN CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	52-1893632
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6801 Rockledge Drive, Bethesda, Maryland	20817
(Address of principal executive offices)	(Zip Code)

(301) 897-6000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non–accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b–2 of the Exchange Act.
Large accelerated filer Accelerated filer Non–accelerated filer Smaller reporting company Emerging growth company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES NO
There were 285,529,483 shares of our common stock, $1 par value per share, outstanding as of March 25, 2018.

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PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
Lockheed Martin Corporation
Consolidated Statements of Earnings
(unaudited; in millions, except per share data)

	Quarters Ended	
	March 25, 2018	March 26, 2017
Net sales		
Products	$9,762	$9,613
Services	1,873	1,599
Total net sales	11,635	11,212
Cost of sales		
Products	(8,697)	(8,744)
Services	(1,689)	(1,434)
Other unallocated, net	409	372
Total cost of sales	(9,977)	(9,806)
Gross profit	1,658	1,406
Other income (expense), net	67	(4)
Operating profit	1,725	1,402
Interest expense	(155)	(155)
Other non-operating expense, net	(210)	(212)
Earnings before income taxes	1,360	1,035
Income tax expense	(203)	(246)
Net earnings	$1,157	$789
Earnings per common share		
Basic	$4.05	$2.72
Diluted	$4.02	$2.69
Cash dividends paid per common share	$2.00	$1.82

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

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Lockheed Martin Corporation
Consolidated Statements of Comprehensive Income
(unaudited; in millions)

	Quarters Ended	
	March 25, 2018	March 26, 2017
Net earnings	$1,157	$789
Other comprehensive income, net of tax		
Postretirement benefit plans		
Amounts reclassified from accumulated other comprehensive loss	300	202
Other comprehensive gain recognized during the period	—	3
Other, net	58	5
Other comprehensive income, net of tax	358	210
Comprehensive income	$1,515	$999

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

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Lockheed Martin Corporation
Consolidated Balance Sheets
(unaudited; in millions, except par value)

	March 25, 2018	December 31, 2017
Assets		
Current assets		
Cash and cash equivalents	$2,393	$2,861
Receivables, net	2,373	2,265
Contract assets	9,405	7,992
Inventories	3,196	2,878
Other current assets	449	1,509
Total current assets	17,816	17,505
Property, plant and equipment, net	5,749	5,775
Goodwill	10,806	10,807
Intangible assets, net	3,730	3,797
Deferred income taxes	3,084	3,156
Other noncurrent assets	5,449	5,580
Total assets	$46,634	$46,620
Liabilities and equity		
Current liabilities		
Accounts payable	$2,715	$1,467
Contract liabilities	6,550	7,028
Salaries, benefits and payroll taxes	1,771	1,785
Current maturities of long-term debt	750	750
Other current liabilities	2,188	1,883
Total current liabilities	13,974	12,913
Long-term debt, net	13,473	13,513
Accrued pension liabilities	14,199	15,703
Other postretirement benefit liabilities	713	719
Other noncurrent liabilities	4,386	4,548
Total liabilities	46,745	47,396
Stockholders’ equity		
Common stock, $1 par value per share	284	284
Additional paid-in capital	—	—
Retained earnings	14,123	11,405
Accumulated other comprehensive loss	(14,589)	(12,539)
Total stockholders’ deficit	(182)	(850)
Noncontrolling interests in subsidiary	71	74
Total deficit	(111)	(776)
Total liabilities and equity	$46,634	$46,620

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

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Lockheed Martin Corporation
Consolidated Statements of Cash Flows
(unaudited; in millions)

	Quarters Ended	
	March 25, 2018	March 26, 2017
Operating activities		
Net earnings	$1,157	$789
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	279	285
Stock-based compensation	38	44
Changes in assets and liabilities		
Receivables, net	(108)	(799)
Contract assets	(1,413)	(62)
Inventories	(318)	(225)
Accounts payable	1,290	1,111
Contract liabilities	(478)	(185)
Postretirement benefit plans	(1,145)	345
Income taxes	1,064	175
Other, net	266	188
Net cash provided by operating activities	632	1,666
Investing activities		
Capital expenditures	(216)	(170)
Other, net	130	4
Net cash used for investing activities	(86)	(166)
Financing activities		
Repurchases of common stock	(300)	(500)
Dividends paid	(586)	(544)
Proceeds from stock option exercises	33	31
Other, net	(161)	(108)
Net cash used for financing activities	(1,014)	(1,121)
Net change in cash and cash equivalents	(468)	379
Cash and cash equivalents at beginning of period	2,861	1,837
Cash and cash equivalents at end of period	$2,393	$2,216

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

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Lockheed Martin Corporation
Consolidated Statements of Equity
(unaudited; in millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' (Deficit) Equity	Noncontrolling Interests in Subsidiary	Total (Deficit) Equity
Balance at December 31, 2017	$ 284	$ —	$ 11,405	$ (12,539)	$ (850)	$ 74	$ (776)
Net earnings	—	—	1,157	—	1,157	—	1,157
Other comprehensive income, net of tax	—	—	—	358	358	—	358
Repurchases of common stock	(1)	(25)	(274)	—	(300)	—	(300)
Dividends declared	—	—	(573)	—	(573)	—	(573)
Stock-based awards, ESOP activity and other	1	25	—	—	26	—	26
Reclassification of income tax effects from tax reform	—	—	2,408	(2,408)	—	—	—
Net decrease in noncontrolling interests in subsidiary	—	—	—	—	—	(3)	(3)
Balance at March 25, 2018	$ 284	$ —	$ 14,123	$ (14,589)	$ (182)	$ 71	$ (111)
Balance at December 31, 2016	$ 289	$ —	$ 13,195	$ (12,102)	$ 1,382	$ 95	$ 1,477
Net earnings	—	—	789	—	789	—	789
Other comprehensive income, net of tax	—	—	—	210	210	—	210
Repurchases of common stock	(2)	(29)	(469)	—	(500)	—	(500)
Dividends declared	—	—	(531)	—	(531)	—	(531)
Stock-based awards, ESOP activity and other	1	29	—	—	30	—	30
Net increase in noncontrolling interests in subsidiary	—	—	—	—	—	7	7
Balance at March 26, 2017	$ 288	$ —	$ 12,984	$ (11,892)	$ 1,380	$ 102	$ 1,482

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

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Lockheed Martin Corporation
Notes to Consolidated Financial Statements (unaudited)

NOTE 1 – BASIS OF PRESENTATION

We prepared these consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information, the instructions to Form 10-Q and Article 10 of U.S. Securities and Exchange Commission (SEC) Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements.

In the opinion of management, these consolidated financial statements reflect all adjustments that are of a normal recurring nature necessary for a fair presentation of our results of operations, financial condition and cash flows for the interim periods presented. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base these estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Our actual results may differ materially from these estimates. Significant estimates inherent in the preparation of our consolidated financial statements include, but are not limited to, accounting for sales and cost recognition, postretirement benefit plans, environmental receivables and liabilities, evaluation of goodwill and other assets for impairment, income taxes including deferred tax assets, fair value measurements and contingencies. The consolidated financial statements include the accounts of subsidiaries we control and variable interest entities if we are the primary beneficiary. We eliminate intercompany balances and transactions in consolidation.

We close our books and records on the last Sunday of the calendar quarter, which was on March 25 for the first quarter of 2018 and March 26 for the first quarter of 2017, to align our financial closing with our business processes. The consolidated financial statements and tables of financial information included herein are labeled based on that convention. This practice only affects interim periods as our fiscal year ends on December 31.

Effective January 1, 2018, we adopted Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, as amended (Topic 606) (commonly referred to as ASC 606), which changed the way we recognize revenue for certain contracts and significantly expanded disclosures about revenue recognition. In addition, effective January 1, 2018, we adopted ASU 2017-07, Compensation-Retirement Benefits, which changed the statement of earnings presentation of certain components of FAS pension and other postretirement benefit plan expense. The amounts for all periods presented in this Form 10-Q have been adjusted to reflect the new methods of accounting. See “Note 12 – Recent Accounting Pronouncements” for more information regarding the adoption of these standards.

Other than the changes in our accounting policies related to revenue recognition and the classification of certain components of FAS pension and other postretirement benefit plan expense, we followed the accounting policies disclosed in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Form 10-K) filed with the SEC.

The results of operations for the interim periods presented are not necessarily indicative of results to be expected for the full year or future periods. Unless otherwise noted, we present all per share amounts cited in these consolidated financial statements on a “per diluted share” basis. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2017 Form 10-K.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICY UPDATES

As described in “Note 1 – Basis of Presentation” and “Note 12 – Recent Accounting Pronouncements,” effective January 1, 2018, we adopted ASC 606, which changed the way we recognize revenue for certain contracts. Accounting policies that were significantly affected by the adoption of ASC 606 are discussed below.

Revenue Recognition

The majority of our net sales are generated from long-term contracts with the U.S. Government and international customers (including foreign military sales (FMS) contracted through the U.S. Government) for the research, design, development, manufacture, integration and sustainment of advanced technology systems, products and services. We provide our products and services under fixed-price and cost-reimbursable contracts.

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Lockheed Martin Corporation
Notes to Consolidated Financial Statements (unaudited) (continued)

Under fixed-price contracts we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less profit or could incur a loss. Some fixed-price contracts have a performance-based component under which we may earn incentive payments or incur financial penalties based on our performance.

Cost-reimbursable contracts provide for the payment of allowable costs incurred during performance of the contract plus a fee up to a ceiling based on the amount that has been funded. Typically, we enter into three types of cost-reimbursable contracts: cost-plus-award-fee, cost-plus-incentive-fee, and cost-plus-fixed-fee.

Cost-plus-award-fee contracts provide for an award fee that varies within specified limits based on the customer's assessment of our performance against a predetermined set of criteria, such as targets based on cost, quality, technical and schedule criteria. Cost-plus-incentive-fee contracts provide for reimbursement of costs plus a fee, which is adjusted by a formula based on the relationship of total allowable costs to total target costs (i.e., incentive based on cost) or reimbursement of costs plus an incentive to exceed stated performance targets (i.e., incentive based on performance). The fixed-fee in a cost-plus-fixed-fee contract is negotiated at the inception of the contract and that fixed-fee does not vary with actual costs.

We account for a contract after it has been approved by all parties to the arrangement, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

We assess each contract at its inception to determine whether it should be combined with other contracts. When making this determination, we consider factors such as whether two or more contracts were negotiated and executed at or near the same time or were negotiated with an overall profit objective. If combined, we treat the combined contracts as a single contract for revenue recognition purposes.

We evaluate the products or services promised in each contract at inception to determine whether the contract should be accounted for as having one or more performance obligations. The products and services in our contracts are typically not distinct from one another due to their complex relationships and the significant contract management functions required to perform under the contract. Accordingly, our contracts are typically accounted for as one performance obligation. In limited cases, our contracts have more than one distinct performance obligation, which occurs when we perform activities that are not highly complex or interrelated or involve different product lifecycles. Significant judgment is required in determining performance obligations, and these decisions could change the amount of revenue and profit recorded in a given period. We classify net sales as products or services on our consolidated statements of earnings based on the predominant attributes of the performance obligations.

We determine the transaction price for each contract based on the consideration we expect to receive for the products or services being provided under the contract. For contracts where a portion of the price may vary we estimate variable consideration at the most likely amount, which is included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur. We analyze the risk of a significant revenue reversal and if necessary constrain the amount of variable consideration recognized in order to mitigate this risk.

At the inception of a contract we estimate the transaction price based on our current rights and do not contemplate future modifications (including unexercised options) or follow-on contracts until they become legally enforceable. Contracts are often subsequently modified to include changes in specifications, requirements or price, which may create new or change existing enforceable rights and obligations. Depending on the nature of the modification, we consider whether to account for the modification as an adjustment to the existing contract or as a separate contract. Generally, modifications to our contracts are not distinct from the existing contract due to the significant integration and interrelated tasks provided in the context of the contract. Therefore, such modifications are accounted for as if they were part of the existing contract and recognized as a cumulative adjustment to revenue.

For contracts with multiple performance obligations, we allocate the transaction price to each performance obligation based on the estimated standalone selling price of the product or service underlying each performance obligation. The standalone selling price represents the amount we would sell the product or service to a customer on a standalone basis (i.e., not bundled with any other products or services). Our contracts with the U.S. Government, including FMS contracts, are subject to the Federal Acquisition Regulations (FAR) and the price is typically based on estimated or actual costs plus a reasonable profit margin. As a result of these regulations, the standalone selling price of products or services in our contracts with the U.S. Government and FMS contracts are typically equal to the selling price stated in the contract. Therefore, we typically do not need to allocate (or reallocate) the transaction price to multiple performance obligations.

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For non-U.S. Government contracts with multiple performance obligations, we evaluate whether the stated selling prices for the products or services represent their standalone selling prices. We primarily sell customized solutions unique to a customer's specifications. When it is necessary to allocate the transaction price to multiple performance obligations, we typically use the expected cost plus a reasonable profit margin to estimate the standalone selling price of each product or service. We occasionally sell standard products or services with observable standalone sales transactions. In these situations, the observable standalone sales transactions are used to determine the standalone selling price.

We recognize revenue as performance obligations are satisfied and the customer obtains control of the products and services. In determining when performance obligations are satisfied, we consider factors such as contract terms, payment terms and whether there is an alternative future use of the product or service. Substantially all of our revenue is recognized over a period of time as we perform under the contract because control of the work in process transfers continuously to the customer. For contracts with the U.S. Government and FMS contracts, this continuous transfer of control of the work in process to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit, and take control of any work in process. Our non-U.S. Government contracts, primarily international direct commercial contracts, typically do not include termination for convenience provisions. However, continuous transfer of control to our customer is supported as, if our customer were to terminate the contract for reasons other than our non-performance, we would have the right to recover damages which would include, among other potential damages, the right to payment for our work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to us.

For performance obligations to deliver products with continuous transfer of control to the customer, revenue is recognized based on the extent of progress towards completion of the performance obligation, generally using the percentage-of-completion cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer as we incur costs on our contracts. Under the percentage-of-completion cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs to complete the performance obligation(s). For performance obligations to provide services to the customer, revenue is recognized over a period of time based on costs incurred or the right to invoice method (in situations where the value transferred matches our billing rights) as our customer receives and consumes the benefits.

For performance obligations in which control does not continuously transfer to the customer, we recognize revenue at the point in time in which each performance obligation is fully satisfied. This coincides with the point in time the customer obtains control of the product or service, which typically occurs upon customer acceptance or receipt of the product or service, given that we maintain control of the product or service until that point.

Backlog (i.e., unfulfilled or remaining performance obligations) represents the sales we expect to recognize for our products and services for which control has not yet transferred to the customer. For our cost-reimbursable and fixed-priced-incentive contracts, the estimated consideration we expect to receive pursuant to the terms of the contract may exceed the contractual award amount. The estimated consideration is determined at the outset of the contract and considers the risks related to the technical, schedule and cost impacts to complete the contract and an estimate of any variable consideration. Periodically, we review these risks and may increase or decrease backlog accordingly. As the risks on such contracts are successfully retired, the estimated consideration from customers may be reduced, resulting in a reduction of backlog without a corresponding recognition of sales. As of March 25, 2018, our ending backlog was $104.8 billion. We expect to recognize approximately 40% over the next 12 months and approximately 65% over the next 24 months as revenue, with the remainder recognized thereafter.

For arrangements with the U.S. Government and FMS contracts, we generally do not begin work on contracts until funding is appropriated by the customer. Billing timetables and payment terms on our contracts vary based on a number of factors, including the contract type. Typical payment terms under fixed-price contracts with the U.S. Government provide that the customer pays either performance-based payments (PBPs) based on the achievement of contract milestones or progress payments based on a percentage of costs we incur. For the majority of our international direct commercial contracts to deliver complex systems, we typically receive advance payments prior to commencement of work, as well as milestone payments that are paid in accordance with the terms of our contract as we perform. We recognize a liability for payments in excess of revenue recognized, which is presented as a contract liability on the balance sheet. The portion of payments retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer from our failure to adequately complete some or all of the obligations under the contract. Payments received from customers in advance of revenue recognition are not considered to be significant financing components because they are used to meet working capital demands that can be higher in the early stages of a contract.

For fixed-price and cost-reimbursable contracts, we present revenues recognized in excess of billings as contract assets on the balance sheet. Amounts billed and due from our customers under both contract types are classified as receivables on the balance sheet.

Significant estimates and assumptions are made in estimating contract sales and costs, including the profit booking rate. At the outset of a long-term contract, we identify and monitor risks to the achievement of the technical, schedule and cost aspects of the contract, as well as variable consideration, and assess the effects of those risks on our estimates of sales and total costs to complete the contract. The estimates consider the technical requirements (e.g., a newly-developed product versus a mature product), the schedule and associated tasks (e.g., the number and type of milestone events) and costs (e.g., material, labor, subcontractor, overhead, general and administrative and the estimated costs to fulfill our industrial cooperation agreements, sometimes referred to as offset agreements, required under certain contracts with international customers). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule and costs in the initial estimated total costs to complete the contract. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and cost aspects of the contract, which decreases the estimated total costs to complete the contract or may increase the variable consideration we expect to receive on the contract. Conversely, our profit booking rates may decrease if the estimated total costs to complete the contract increase or our estimates of variable consideration we expect to receive decrease. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate. When estimates of total costs to be incurred on a contract exceed total estimates of the transaction price, a provision for the entire loss is determined at the contract level and is recorded in the period in which the loss is determined.

Comparability of our segment sales, operating profit and operating margin may be impacted favorably or unfavorably by changes in profit booking rates on our contracts for which we recognize revenue over a period of time using the percentage-of-completion cost-to-cost method to measure progress towards completion. Increases in the profit booking rates, typically referred to as risk retirements, usually relate to revisions in the estimated total costs to fulfill the performance obligations that reflect improved conditions on a particular contract. Conversely, conditions on a particular contract may deteriorate, resulting in an increase in the estimated total costs to fulfill the performance obligations and a reduction in the profit booking rate. Increases or decreases in profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes. Segment operating profit and margin may also be impacted favorably or unfavorably by other items, which may or may not impact sales. Favorable items may include the positive resolution of contractual matters, cost recoveries on restructuring charges, insurance recoveries and gains on sales of assets. Unfavorable items may include the adverse resolution of contractual matters; restructuring charges, except for significant severance actions, which are excluded from segment operating results; reserves for disputes; certain asset impairments; and losses on sales of certain assets.

Our consolidated net adjustments not related to volume, including net profit booking rate adjustments and other matters, increased segment operating profit by approximately $420 million and $295 million during the quarters ended March 25, 2018 and March 26, 2017. These adjustments increased net earnings by approximately $332 million ($1.15 per share) and $192 million ($0.66 per share) during the quarters ended March 25, 2018 and March 26, 2017. During the quarters ended March 25, 2018 and March 26, 2017, we recognized net sales from performance obligations satisfied in prior periods of approximately $415 million and $380 million, which primarily relate to changes in profit booking rates that impacted revenue.

We have a program, EADGE-T, to design, integrate, and install an air missile defense command, control, communications, computers – intelligence (C4I) systems for an international customer that has experienced performance matters and for which we have periodically accrued reserves. During the quarter ended March 26, 2017, we revised our estimated costs to complete the EADGE-T contract as a consequence of ongoing performance matters and recorded an additional charge of $120 million ($74 million or $0.25 per share, after tax) at our Rotary and Mission Systems (RMS) business segment. As of March 25, 2018, cumulative losses remained at approximately $260 million on this program. We are continuing to monitor program requirements and our performance and could record additional charges in future periods. However, based on the reserves already accrued and our current estimate of the sales and costs to complete the program, at this time we do not anticipate that additional charges, if any, would be material.

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Notes to Consolidated Financial Statements (unaudited) (continued)

We have two commercial satellite programs at our Space business segment, for which we have experienced performance issues related to the development and integration of a modernized LM 2100 satellite platform. These commercial programs require the development of new satellite technology to enhance the LM 2100’s power, propulsion and electronics, among other items. The enhanced satellite is expected to benefit other commercial and government satellite programs. We have periodically revised our estimated costs to complete these developmental commercial programs. We have recorded cumulative losses of approximately $340 million through March 25, 2018. During the quarter ended March 25, 2018, we recorded losses of approximately $35 million ($26 million or $0.09 per share, after tax). While these losses reflect our estimated total losses on the programs, we will continue to incur unrecovered costs each period until we complete these programs and may have to record additional loss reserves in future periods, which could be material to our operating results. These programs remain developmental and further challenges in the delivery and integration of new satellite technology, anomalies discovered during system testing requiring repair or rework, further schedule delays and potential penalties could require that we record additional reserves. Currently, we do not expect to be able to meet the delivery schedule under the contracts and have informed the customers. The customers could seek to exercise a termination right under the contracts, in which case we would have to refund the payments we have received and pay certain penalties. However, we think the probability that the customers will seek to exercise any termination right is remote as the delay beyond the termination date is modest and the customers have an immediate need for the satellites.

Receivables, Net

Receivables, net represent our unconditional right to consideration under the contract and include amounts billed and currently due from customers. The amounts are stated at their net estimated realizable value. There were no significant impairment losses related to our receivables during the quarters ended March 25, 2018 and March 26, 2017.

On occasion, our customers may seek deferred payment terms to purchase our products. In connection with these transactions, we may, at our customer’s request, enter into arrangements for the non-recourse sale of customer receivables to unrelated third–party financial institutions. For accounting purposes, these transactions are not discounted and are treated as a sale of receivables as we have no continuing involvement. The sale proceeds from the financial institutions are reflected in our operating cash flows on the statement of cash flows. During the quarter ended March 25, 2018, we sold approximately $103 million of customer receivables. There were no gains or losses related to sales of these receivables.

Contract Assets

Contract assets include unbilled amounts typically resulting from sales under contracts when the percentage-of-completion cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. The amounts may not exceed their estimated net realizable value. Contract assets are classified as current based on our contract operating cycle.

Inventories

We record inventories at the lower of cost or estimated net realizable value. If events or changes in circumstances indicate that the utility of our inventories have diminished through damage, deterioration, obsolescence, changes in price or other causes, a loss is recognized in the period in which it occurs. We capitalize labor, material, subcontractor and overhead costs as work-in-process for contracts where control has not yet passed to the customer. In addition, we capitalize costs to fulfill incurred in advance of contract award in inventories as work-in-process if we determine that contract award is probable. We determine the costs of other product and supply inventories by using the first-in first-out or average cost methods.

Contract Liabilities

Contract liabilities (formerly referred to as customer advances and amounts in excess of costs incurred) include advance payments and billings in excess of revenue recognized. Contract liabilities are classified as current liabilities based on our contract operating cycle and reported on a contract-by-contract basis, net of revenue recognized, at the end of each reporting period.

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Lockheed Martin Corporation
Notes to Consolidated Financial Statements (unaudited) (continued)

NOTE 3 – EARNINGS PER COMMON SHARE

The weighted average number of shares outstanding used to compute earnings per common share were as follows (in millions):

	Quarters Ended	
	March 25, 2018	March 26, 2017
Weighted average common shares outstanding for basic computations	285.5	290.0
Weighted average dilutive effect of equity awards	2.4	2.8
Weighted average common shares outstanding for diluted computations	287.9	292.8

We compute basic and diluted earnings per common share by dividing net earnings by the respective weighted average number of common shares outstanding for the periods presented. Our calculation of diluted earnings per common share also includes the dilutive effects for the assumed vesting of outstanding restricted stock units (RSUs) and performance stock units (PSUs) and exercise of outstanding stock options based on the treasury stock method. There were no significant anti-dilutive equity awards during the quarters ended March 25, 2018 or March 26, 2017.

NOTE 4 – INFORMATION ON BUSINESS SEGMENTS

We operate in four business segments: Aeronautics, Missiles and Fire Control (MFC), RMS and Space. We organize our business segments based on the nature of the products and services offered.

Net sales of our business segments exclude intersegment sales as these activities are eliminated in consolidation. Operating profit of our business segments includes our share of earnings or losses from equity method investees as the operating activities of the equity method investees are closely aligned with the operations of our business segments. In addition, operating profit of our business segments includes total pension costs recoverable on U.S. Government contracts as determined in accordance with U.S. Government cost accounting standards (CAS). Operating profit of the business segments excludes the FAS/CAS operating adjustment; expense for stock-based compensation; the effects of items not considered part of management’s evaluation of segment operating performance, such as charges related to significant severance actions and certain asset impairments; gains or losses from significant divestitures; the effects of certain legal settlements; corporate costs not allocated to our business segments; and other miscellaneous corporate activities. These items are included in the reconciling item “Unallocated items” between operating profit from our business segments and our consolidated operating profit. See “Note 2 – Significant Accounting Policy Updates” for a discussion related to certain factors that may impact the comparability of net sales and operating profit of our business segments.

Summary operating results for each of our business segments were as follows (in millions):

	Quarters Ended	
	March 25, 2018	March 26, 2017
Net sales		
Aeronautics	$4,398	$4,120
Missiles and Fire Control	1,677	1,549
Rotary and Mission Systems	3,223	3,127
Space	2,337	2,416
Total net sales	$11,635	$11,212
Operating profit		
Aeronautics	$474	$439
Missiles and Fire Control	261	234
Rotary and Mission Systems [a]	311	128
Space	264	290
Total business segment operating profit	1,310	1,091
Unallocated items		
FAS/CAS operating adjustment [b]	451	403
Stock-based compensation	(38)	(44)
Other, net [c]	2	(48)
Total unallocated items	415	311
Total consolidated operating profit	$1,725	$1,402
Intersegment sales		
Aeronautics	$25	$25
Missiles and Fire Control	95	73
Rotary and Mission Systems	461	445
Space	45	26
Total intersegment sales	$626	$569

(a) During the first quarter of 2017, we revised the total estimated costs to complete the EADGE-T contract as a consequence of ongoing performance matters and recorded an additional reserve of $120 million ($74 million, or $0.25 per share, after tax) at our RMS business segment.

(b) The FAS/CAS operating adjustment represents the difference between the service cost component of U.S. GAAP financial accounting standards pension expense and total pension costs recoverable on U.S. Government contracts as determined in accordance with U.S. Government CAS. For a detail of the FAS/CAS operating adjustment and the total net FAS/CAS adjustment, see the table below.

(c) During the first quarter of 2017, we recognized a $64 million charge ($40 million, or $0.14 per share, after tax), which represents our portion of a non-cash asset impairment charge recorded by our equity method investee, Advanced Military Maintenance, Repair and Overhaul Center LLC (AMMROC). See “Note 11 – Other” (under the caption “Equity Method Investee Impairment”) for more information.

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Our total FAS/CAS pension adjustment for the quarters ended March 25, 2018 and March 26, 2017, including the service and non-service cost components of FAS pension expense (in millions):

	Quarters Ended	
	March 25, 2018	March 26, 2017
Total FAS expense and CAS costs		
FAS pension expense	$(356)	$(345)
Less: CAS pension cost	608	562
Net FAS/CAS pension adjustment	$252	$217
Service and non-service cost reconciliation		
FAS pension service cost	$(157)	$(159)
Less: CAS pension cost	608	562
FAS/CAS operating adjustment	451	403
Non-operating FAS pension expense	(199)	(186)
Net FAS/CAS pension adjustment	$252	$217

We recover CAS pension cost through the pricing of our products and services on U.S. Government contracts and, therefore, recognize CAS pension cost in each of our business segments' net sales and cost of sales. Our consolidated financial statements must present FAS pension and other postretirement benefit plan expense calculated in accordance with financial accounting standards (FAS) requirements under U.S. GAAP. The operating portion of the FAS/CAS adjustment represents the difference between the service cost component of FAS pension expense and CAS. The non-service FAS pension cost component is included in other non-operating expense, net. The net FAS/CAS pension adjustment increases or decreases CAS pension cost to equal total FAS pension cost (both service and non-service).

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Net sales by total products and services, contract type, customer category and geographic region for each of our business segments were as follows (in millions):

	Quarter Ended March 25, 2018				
	Aeronautics	MFC	RMS	Space	Total
Net sales					
Products	$3,770	$1,353	$2,717	$1,922	$9,762
Services	628	324			