OMNICELL INC /CA/
Form DEF 14A
March 28, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
Filed by a Party other than the Registrant o
Check the appropriate box:

o	Preliminary Proxy Statement
o	**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x	Definitive Proxy Statement
o	Definitive Additional Materials
o	Soliciting Material Pursuant to §240.14a-12

OMNICELL, INC.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x	No fee required.	
o	Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.	
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o	Fee paid previously with preliminary materials.	
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OMNICELL, INC.
1201 Charleston Road
Mountain View, CA 94043

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held On April 25, 2006

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders of Omnicell, Inc., a Delaware corporation (the Company). The meeting will be held on April 25, 2006 at 8:30 a.m. local time at the Monterey Plaza Hotel and Spa, 400 Cannery Row, Monterey, California, 93940 for the following purposes:

1. To elect three (3) directors to hold office until the 2009 Annual Meeting of Stockholders.

2. To ratify the selection by the Audit Committee of the Board of Directors of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2006.

3. To conduct any other business properly brought before the meeting.

These items of business are more fully described in the Proxy Statement accompanying this Notice.

The record date for the Annual Meeting of Stockholders is March 10, 2006. Only stockholders of record at the close of business on that date may vote at the meeting or any adjournment thereof.

By Order of the Board of Directors
/s/ ROBERT J. BRIGHAM
Robert J. Brigham,
Secretary

Mountain View, California
March 28, 2006

You are cordially invited to attend the meeting in person. Whether or not you expect to attend the meeting, please complete, date, sign and return the enclosed proxy, or vote over the telephone or the Internet as instructed in these materials, as promptly as possible in order to ensure your representation at the meeting. A return envelope (which is postage prepaid if mailed in the United States) is enclosed for your convenience. Even if you have voted by proxy, you may still vote in person if you attend the meeting. Please note, however, that if your shares are held of record by a broker, bank or other nominee and you wish to vote at the meeting, you must obtain a proxy issued in your name from that record holder.

OMNICELL, INC.
1201 Charleston Road
Mountain View, CA 94043

PROXY STATEMENT
FOR THE 2006 ANNUAL MEETING OF STOCKHOLDERS

April 25, 2006

QUESTIONS AND ANSWERS ABOUT THIS PROXY MATERIAL AND VOTING

Why am I receiving these materials?

We sent you this proxy statement and the enclosed proxy card because the Board of Directors of Omnicell, Inc. (sometimes referred to as the Company or Omnicell) is soliciting your proxy to vote at the 2006 Annual Meeting of Stockholders. You are invited to attend the annual meeting to vote on the proposals described in this proxy statement. However, you do not need to attend the meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card, or follow the instructions below to submit your proxy over the telephone or on the Internet.

The Company intends to mail this proxy statement and accompanying proxy card on or about March 28, 2006 to all stockholders of record entitled to vote at the annual meeting.

Who can vote at the annual meeting?

Only stockholders of record at the close of business on March 10, 2006 will be entitled to vote at the annual meeting. On this record date, there were 26,578,016 shares of common stock outstanding and entitled to vote.

Stockholder of Record: Shares Registered in Your Name

If on March 10, 2006 your shares were registered directly in your name with Omnicell s transfer agent, Computershare Trust Company, N.A. (formerly EquiServe Trust Company, N.A.), then you are a stockholder of record. As a stockholder of record, you may vote in person at the meeting or vote by proxy. Whether or not you plan to attend the meeting, we urge you to fill out and return the enclosed proxy card or vote by proxy over the telephone or on the Internet as instructed below to ensure your vote is counted.

Beneficial Owner: Shares Registered in the Name of a Broker or Bank

If on March 10, 2006 your shares were held, not in your name, but rather in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered to be the stockholder of record for purposes of voting at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent on how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

What am I voting on?

There are two matters scheduled for a vote:

- Election of three (3) directors;
- Ratification of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2006.

How do I vote?

You may either vote For all the nominees to the Board of Directors or you may Withhold your vote for any nominee you specify. For each of the other matters to be voted on, you may vote For or Against or abstain from voting. The procedures for voting are as follows:

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record, you may vote in person at the annual meeting, vote by proxy using the enclosed proxy card, vote by proxy over the telephone, or vote by proxy on the Internet. Whether or not you plan to attend the meeting, we urge you to vote by proxy to ensure your vote is counted. You may still attend the meeting and vote in person if you have already voted by proxy.

- To vote in person, come to the annual meeting and we will give you a ballot when you arrive.

- To vote using the proxy card, simply complete, sign and date the enclosed proxy card and return it promptly in the envelope provided. If you return your signed proxy card to us before the annual meeting, we will vote your shares as you direct.

- To vote over the telephone, dial toll-free 1-877-PRX-VOTE (1-877-8683) using a touch-tone phone and follow the recorded instructions. You will be asked to provide the company number and control number from the enclosed proxy card. Your vote must be received by 11:59 p.m. on April 24, 2006 to be counted.

- To vote on the Internet, go to http://www.eproxyvote.com/omcl to complete an electronic proxy card. You will be asked to provide the company number and control number from the enclosed proxy card. Your vote must be received by 11:59 p.m. on April 24, 2006 to be counted.

Beneficial Owner: Shares Registered in the Name of Broker or Bank

If you are a beneficial owner of shares registered in the name of your broker, bank, or other agent, you should have received a proxy card and voting instructions with these proxy materials from that organization rather than from Omnicell. Simply complete and mail the proxy card to ensure that your vote is counted. Alternatively, you may vote by telephone or over the Internet as instructed by your broker or bank. To vote in person at the annual meeting, you must obtain a valid proxy from your broker, bank, or other agent. Follow the instructions from your broker or bank included with these proxy materials, or contact your broker or bank to request a proxy form.

We provide Internet proxy voting to allow you to vote your shares on-line, with procedures designed to ensure the authenticity and correctness of your proxy vote instructions. However, please be aware that you must bear any costs associated with your Internet access, such as usage charges from Internet access providers and telephone companies.

How many votes do I have?

On each matter to be voted upon, you have one vote for each share of common stock you own as of March 10, 2006.

What if I return a proxy card but do not make specific choices?

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted For the election of all three (3) nominees for director, and For the ratification of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2006. If any other matter is properly presented at the meeting, your proxy (one of the individuals named on your proxy card) will vote your shares using his or her best judgment.

Who is paying for this proxy solicitation?

We will pay for the entire cost of soliciting proxies. In addition to these mailed proxy materials, our directors and employees may also solicit proxies in person, by telephone, or by other means of communication. Directors and employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners.

What does it mean if I receive more than one proxy card?

If you receive more than one proxy card, your shares are registered in more than one name or are registered in different accounts. Please complete, sign and return **each** proxy card to ensure that all of your shares are voted.

Can I change my vote after submitting my proxy?

Yes. You can revoke your proxy at any time before the final vote at the meeting. If you are the record holder of your shares, you may revoke your proxy in any one of three ways:

- You may submit another properly completed proxy card with a later date;
- You may send a written notice that you are revoking your proxy to Omnicell s Secretary at 1201 Charleston Road, Mountain View, CA 94043; or
- You may attend the annual meeting and vote in person. Simply attending the meeting will not, by itself, revoke your proxy.

If your shares are held by your broker or bank as a nominee or agent, you should follow the instructions provided by your broker or bank.

When are stockholder proposals due for next year s annual meeting?

To be considered for inclusion in next year s proxy materials, your proposal must be submitted in writing by November 28, 2006, to Omnicell s Secretary at 1201 Charleston Road, Mountain View, California 94043. However, if Omnicell s 2007 Annual Meeting of Stockholders is not held between March 26, 2007 and May 25, 2007, then the deadline will be a reasonable time prior to the time we begin to print and mail our proxy materials. If you wish to bring a proposal before the stockholders at next year s annual meeting that is not to be included in next year s proxy materials, you must notify Omnicell s Secretary, in writing, no earlier than close of business on December 26, 2006 and no later than the close of business on January 25, 2007. We also advise you to review Omnicell s Bylaws, which contain additional requirements about advance notice of stockholder proposals and director nominations. If you do not comply with these requirements, you will not be able to make a stockholder proposal or nomination at next year s Annual Meeting.

How are votes counted?

Votes will be counted by the inspector of election appointed for the meeting, who will separately count For and Withhold and, with respect to proposals other than the election of directors, Against votes, abstentions and broker non-votes. Abstentions will be counted towards the vote total for each proposal, and will have the same effect as Against votes. Broker non-votes have no effect and will not be counted towards the vote total for any proposal.

If your shares are held by your broker as your nominee (that is, in street name), you will need to obtain a proxy form from the institution that holds your shares and follow the instructions included on that form regarding how to instruct your broker to vote your shares. If you do not give instructions to your broker, your broker can vote your shares with respect to discretionary items, but not with respect to non-discretionary items. Discretionary items are proposals considered routine under the rules of the New York Stock Exchange on which your broker may vote shares held in street name in the absence of your voting instructions. On non-discretionary items for which you do not give your broker instructions, the shares will be treated as broker non-votes.

How many votes are needed to approve each proposal?

- For the election of directors, the three (3) nominees receiving the most For votes (among votes properly cast in person or by proxy) will be elected.

- For the ratification of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2006, Proposal No. 2 must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

What is the quorum requirement?

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if at least a majority of the outstanding shares are represented by stockholders present at the meeting or by proxy. On the record date, there were 26,578,016 shares outstanding and entitled to vote. Therefore, 13,289,009 shares must be represented by stockholders present at the meeting or by proxy to have a quorum.

Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank or other nominee) or if you vote in person at the meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, a majority of the votes present at the meeting may adjourn the meeting to another date.

How can I find out the results of the voting at the annual meeting?

Preliminary voting results will be announced at the annual meeting. Final voting results will be published in the Company s quarterly report on Form 10-Q for the second quarter of 2006.

PROPOSAL 1

ELECTION OF DIRECTORS

Omnicell s Board of Directors is divided into three classes. Each class consists, as nearly as possible, of one-third of the total number of directors, and each class has a three-year term. Vacancies on the Board may be filled only by persons elected by a majority of the remaining directors. A director elected by the Board to fill a vacancy in a class shall serve for the remainder of the full term of that class, and until the director s successor is elected and qualified. This includes vacancies created by an increase in the number of directors.

The Board of Directors presently has ten (10) members. There are three (3) directors in the class whose term of office expires in 2006. Each of the nominees listed below, is currently a director of the Company who was previously elected by the stockholders. If elected at the annual meeting, each of these nominees would serve until the 2009 Annual Meeting and until his or her successor is elected and has qualified, or until the director s death, resignation or removal. It is the Company s policy to encourage directors to attend the Annual Meeting of Stockholders. Two (2) of the nominees for election as a director at the 2005 Annual Meeting of Stockholders and six (6) of the ten (10) directors who were members of the Board at the time attended the 2005 Annual Meeting of Stockholders.

The following is a brief biography of each nominee and each director whose term will continue after the annual meeting.

CLASS II NOMINEES FOR ELECTION FOR A THREE-YEAR TERM EXPIRING AT THE 2009 ANNUAL MEETING

Randall A. Lipps

Randall A. Lipps, age 48, has served as Chairman of the Board and a Director of Omnicell since founding Omnicell in September 1992 and as its President and Chief Executive Officer since October 2002. From 1989 to 1992, Mr. Lipps served as the Senior Vice President of ST. Holdings, Inc., a travel and marketing company. From 1987 to 1989, he served as Assistant Vice President of Sales & Operations for a subsidiary of AMR, the parent company of American Airlines, Inc. Mr. Lipps received both a B.S. in economics and a B.B.A. from Southern Methodist University.

Brock D. Nelson

Brock D. Nelson, age 55, has served as a Director of Omnicell since May 2003. Since February 2003, Mr. Nelson has served as the President and Chief Executive Officer of Regions Hospital, a private, full service hospital and part of HealthPartners, Inc. Mr. Nelson served as the Chief Executive of Children s Hospitals and Clinics from 1994 to January 2003 and served as the President of Children s Hospital St. Paul from 1983 to 1994. Mr. Nelson received a B.A. in economics from St. Olaf College and a master s degree in health care administration from the University of Minnesota.

Joseph E. Whitters

Joseph E. Whitters, age 48, has served as a Director of Omnicell since May 2003. From 1986 to January 2005, Mr. Whitters was employed in various capacities with First Health Group Corp., a national health benefits company, most recently as Executive Vice President. Mr. Whitters is a certified public accountant and received a bachelor s degree in accounting from Luther College. Mr. Whitters is also Chairman of the Board of Mentor Corporation and a director of Luminent Mortgage Capital, Inc.

**THE BOARD OF DIRECTORS RECOMMENDS
A VOTE IN FAVOR OF EACH NAMED NOMINEE.**

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CLASS III DIRECTORS CONTINUING IN OFFICE UNTIL THE 2007 ANNUAL MEETING

Kevin L. Roberg

Kevin L. Roberg, age 55, has served as a Director of Omnicell since June 1997 and served as Lead Director from February 2003 to August 2005. He has been a general partner of Delphi Ventures, a venture capital firm, since October 1999. From August 1998 to September 1999, Mr. Roberg was an independent venture capitalist. From December 1995 to June 1998, Mr. Roberg served as Chief Executive Officer and President of ValueRx, a pharmacy benefit and medication management company and a former subsidiary of Value Health, Inc., a healthcare benefit and information service provider. Mr. Roberg received a B.S. from the University of Iowa. Mr. Roberg is also a director of several privately held companies.

Donald C. Wegmiller

Donald C. Wegmiller, age 67, has served as a Director of Omnicell since May 2004 and as Lead Director since August 2005. Since 2003, Mr. Wegmiller has served as the Chairman of Clark Consulting - Healthcare Group, a national executive and physician compensation and benefits consulting firm. From 1993 to 2003, Mr. Wegmiller was the President and Chief Executive Officer of the predecessor firm, Healthcare Compensation Strategies. Mr. Wegmiller received both a bachelor s degree and master s degree in health administration from the University of Minnesota. Mr. Wegmiller serves as a director of ADESA, Inc., Possis Medical, Inc. and several privately held companies.

James T. Judson

James T. Judson, age 51, will become a Director of Omnicell effective April 1, 2006. Mr. Judson is currently the Vice President of Corporate Development at Omnicell. Mr. Judson joined Omnicell in February 2005 as Vice President of Finance, and was later appointed Executive Vice President of Finance and Interim Chief Financial Officer in April 2005, serving in that position until March 2006. Mr. Judson has over 20 years of financial management experience, most of it with Sun Microsystems, Inc. Mr. Judson served as Vice President of Finance and Planning for the worldwide operations group of Sun Microsystems, Inc., a computer software and platform company from 1998 until his retirement from the company in January 2002. Mr. Judson received a B.S. degree in industrial management from Purdue University and an M.B.A. in finance from Indiana University.

CLASS I DIRECTORS CONTINUING IN OFFICE UNTIL THE 2008 ANNUAL MEETING

Mary E. Foley

Mary E. Foley, age 54, has served as a Director of Omnicell since May 2005. Since 2004, Ms. Foley has served as the Associate Director of the Center for Research and Nursing Innovation at the University of California, San Francisco (UCSF), where she is also a Ph.D. student in nursing policy. From 2002 to 2004, Ms. Foley was a Regents Lecturer at UCSF and Visiting Assistant Professor in the Masters entry program. Ms. Foley has also served as the vice president of the American Nurses Association since 2004. From 1981 to 2000, Ms. Foley was a staff nurse and chief nurse executive at Saint Francis Memorial Hospital in San Francisco, a member of Catholic Healthcare West and from 1994 to 1999 was a part-time clinical faculty member at San Francisco State University School of Nursing, and was the faculty adviser for the student nurses association. Ms. Foley received a nursing diploma from New England Deaconess Hospital School of Nursing, a B.S.N. from Boston University School of Nursing, and an M.S. in nursing administration and occupational health from UCSF.

Randy D. Lindholm

Randy D. Lindholm, age 50, has served as a director of Omnicell since May 2003. Since April 2002, Mr. Lindholm has served as a consultant to medical device companies. From June 1999 to April 2002,

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Mr. Lindholm was the chairman, president and CEO of VidaMed, Inc. a medical device company, and served as its executive vice president, sales and marketing. From 1993 to 1998, Lindholm held senior field operations positions at Nellcor Puritan Bennett, a provider of solutions to diagnose, monitor and treat the respiratory-impaired patient. Mr. Lindholm received a B.S. in electrical engineering from Michigan Tech University. Mr. Lindholm is also a director of Rita Medical Systems, Inc. and several privately held companies.

Sara J. White

Sara J. White, age 60, has served as a Director of Omnicell since April 2003. Since 2004, Ms. White has served as a pharmacy leadership consultant. From 1992 to 2004, Ms. White was a clinical professor at the School of Pharmacy at the University of California, San Francisco and from 1995 to 2004 was an adjunct professor at the University of the Pacific, School of Pharmacy. From 1998 to 2003, she served as the Director of Pharmacy for Stanford Hospital and Clinics. Ms. White received a B.S. in pharmacy from Oregon State University and an M.S. in hospital pharmacy management from Ohio State University.

William H. Younger, Jr.

William H. Younger, Jr., age 56, has served as a Director of Omnicell since September 1992. Mr. Younger is a managing director of Sutter Hill Ventures, a venture capital firm, where he has been employed since 1981. Mr. Younger received a B.S. in electrical engineering from the University of Michigan and an M.B.A. from Stanford University. Mr. Younger is also a director of Cardica, Inc., and several privately held companies.

INDEPENDENCE OF THE BOARD OF DIRECTORS

As required under the Nasdaq Stock Market (Nasdaq) listing standards, a majority of the members of a listed company s Board of Directors must qualify as independent, as affirmatively determined by the Board of Directors. The Board consults with the Company s counsel to ensure that the Board s determinations are consistent with all relevant securities and other laws and regulations regarding the definition of independent, including those set forth in pertinent listing standards of the Nasdaq, as in effect from time to time.

Consistent with these considerations, after review of all relevant transactions or relationships between each director, or any of his or her family members, and the Company, its senior management and its independent registered public accounting firm, the Board has affirmatively determined that all of the Company s directors are independent directors within the meaning of the applicable Nasdaq listing standards, except for Mr. Lipps, the President and Chief Executive Officer of the Company and Mr. Judson, the Company s Vice President of Corporate Development.

INFORMATION REGARDING THE BOARD OF DIRECTORS AND ITS COMMITTEES

As required under applicable Nasdaq listing standards, in fiscal 2005 the Company s independent directors met in regularly scheduled executive sessions at which only independent directors were present. During fiscal year 2005, our Lead Director, who presided over such executive sessions, was Mr. Roberg from January 1, 2005 to July 31, 2005, and has been Mr. Wegmiller since August 1, 2005. Persons interested in communicating with the independent directors with their concerns or issues may address correspondence to a particular director, or to the independent directors generally, in care of Lead Director, Omnicell, Inc. at 1201 Charleston Road, Mountain View, California 94043. If no particular director is named, letters will be forwarded, depending on the subject matter, to the Chair of the Audit, Compensation, or Nominating and Corporate Governance Committee.

The Board has three committees: an Audit Committee, a Compensation Committee, and a Corporate Governance Committee. The following table provides membership and meeting information for fiscal 2005 for each of the Board committees:

Name	Audit	Compensation	Corporate Governance
Mary E. Foley			X
Randy D. Lindholm		X	
Brock D. Nelson		X	
Kevin L. Roberg	X		X *
Donald C. Wegmiller	X		
Sara J. White			X
Joseph E. Whitters	X *		
William H. Younger, Jr.		X *	
Total meetings in fiscal year 2005	4	10	4

* Committee Chairperson

Below is a description of each committee of the Board of Directors. The Board of Directors has determined that each member of each committee meets the applicable requirements regarding independence and that each member is free of any relationship that would interfere with this or her individual exercise of independent judgment with regard to the Company.

AUDIT COMMITTEE

The Audit Committee of the Board of Directors oversees the Company s corporate accounting and financial reporting process. For this purpose, the Audit Committee performs several functions: it recommends annually to the Board of Directors the firm of certified public accountants to be employed by the Company as its independent auditors for the ensuing year, which firm is ultimately accountable to the Audit Committee and the Board, as representatives of the Company s stockholders; reviews the engagement of the independent auditors, including the scope, extent and procedures of the audit; evaluates the performance of the independent auditors; receives written statements from the independent auditors delineating all relationships between them and the Company consistent with Independence Standards Board Standard No. 1 to consider and discuss with them any disclosed relationships or services that could affect the independent auditor s objectivity and independence; reviews the annual audited financial statements with management, including major issues regarding accounting and auditing principles and practices as well as the adequacy of internal controls that could significantly affect the Company s financial statements; discusses with the Company s independent auditors the results of the annual audit, including the firm s assessment of the quality of accounting principles, the reasonableness of significant financial reporting issues and judgments, the nature of significant risks and exposures, and the adequacy of the disclosures in the financial statements; meets to review the Company s annual audited financial statements and quarterly financial statements with management and the independent auditors, including reviewing the Company s disclosures under Management s Discussion and Analysis of Financial Condition and Results of Operations, and investigates any matter brought to the attention of the Audit Committee within the scope of its duties. The Audit Committee has the authority to engage legal counsel or other experts or consultants, as it deems appropriate to carry out its responsibilities. The Audit Committee has adopted a written Audit Committee Charter that is attached as Appendix A to these proxy materials.

Three (3) directors comprise the Audit Committee: Messrs. Roberg, Wegmiller, and Whitters. Mr. Whitters serves as the chair of the Audit Committee. The Audit Committee met four (4) times during the fiscal year. The Board of Directors annually reviews the Nasdaq listing standards definition of independence for Audit Committee members and has determined that all members of the Company s Audit Committee are independent (as independence is currently defined in Rule 4350(d)(2)(A)(i) and (ii) of the Nasdaq listing standards). Mr. Whitters qualifies as an Audit Committee Financial Expert as defined in applicable SEC rules.

COMPENSATION COMMITTEE

The Compensation Committee of the Board of Directors reviews and approves the overall compensation strategy and policies for the Company. The Compensation Committee reviews and approves corporate performance goals and objectives relevant to the compensation of the Company s executive officers and other senior management; reviews and approves the compensation and other terms of employment of the Company s Chief Executive Officer and other executive officers; establishes guidelines pursuant to which the Chief Executive Officer shall administer the Company s stock option plans with respect to options granted thereunder to all the Company s employees and consultants, other than the Company s executive officers, and oversees administration of the Company s stock option and purchase plans, profit sharing plans, stock bonus plans, deferred compensation plans and other similar programs.

Three (3) directors comprise the Compensation Committee: Messrs. Lindholm, Nelson and Younger. Mr. Younger serves as chair of the Compensation Committee. All members of the Company s Compensation Committee are independent (as independence is currently defined in Rule 4200(a)(15) of the Nasdaq listing standards). The Compensation Committee met ten (10) times during the fiscal year.

CORPORATE GOVERNANCE COMMITTEE

The Corporate Governance Committee of the Board of Directors administers and oversees all aspects of the Company s corporate governance functions on behalf of the Board. For this purpose, the Corporate Governance Committee performs several functions: it develops and reviews the corporate governance principles to be applied to the Company and makes recommendations to the Board regarding corporate governance issues; it oversees and reviews the processes and procedures used by the Company to provide information to the Board and its committees; it identifies, reviews and evaluates candidates to serve as directors of the Company and recommends such candidates to the Board; it assesses the performance of the Board, including Board committees and individual Board members; and it makes such other recommendations to the Board regarding affairs relating to the directors of the Company as the Committee deems appropriate. The Corporate Governance Committee has the authority to engage legal counsel or other experts or consultants, as it deems appropriate to carry out its responsibilities. Our Corporate Governance Committee charter can be found in the Corporate Governance section on our corporate website at *www.omnicell.com*, under Investor Relations.

Three (3) directors comprise the Corporate Governance Committee: Ms. Foley, Mr. Roberg and Ms. White. Mr. Roberg serves as chair of the Corporate Governance Committee. All members of the Corporate Governance Committee are independent (as independence is currently defined in Rule 4200(a)(15) of the Nasdaq listing standards). The Corporate Governance Committee met four (4) times during the fiscal year.

The Corporate Governance Committee believes that candidates for director should have certain minimum qualifications, including being able to read and understand basic financial statements, being over 21 years of age and having the highest personal integrity and ethics. The Committee also intends to consider such factors as possessing relevant expertise upon which to be able to offer advice and guidance to management, having sufficient time to devote to the affairs of the Company, demonstrated excellence in his or her field, having the ability to exercise sound business judgment and having the commitment to rigorously represent the long-term interests of the Company s stockholders. However, the Committee retains the right to modify these qualifications from time to time. Candidates for director nominees are reviewed in the context of the current composition of the Board, the operating requirements of the Company and the long-term interests of stockholders.

In conducting this assessment, the Committee considers diversity, age, skills and such other factors as it deems appropriate given the current needs of the Board and the Company, to maintain a balance of knowledge, experience and capability. In the case of incumbent directors whose terms of office are set to expire, the Corporate Governance Committee reviews such directors overall service to the Company during their term, including the number of meetings attended, level of participation, quality of performance, and any other relationships and transactions that might impair such directors independence. In the case of new director candidates, the committee also determines whether the nominee must be independent for Nasdaq purposes, which determination is based upon applicable Nasdaq listing standards, applicable SEC rules and regulations and the advice of counsel, if necessary. The Committee then uses its network of contacts to compile a list of potential candidates, but may also engage, if it deems appropriate, a professional search firm. The committee conducts any appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of the Board. The Committee meets to discuss and consider such candidates qualifications and then selects a nominee for recommendation to the Board by majority vote. To date, the Corporate Governance Committee has not paid a fee to any third party to assist in the process of identifying or evaluating director candidates.

At this time, the Corporate Governance Committee does not consider director candidates recommended by stockholders. The Committee believes that it is in the best position to identify, review, evaluate and select qualified candidates for Board membership, based on the comprehensive criteria for Board membership approved by the Board.

MEETINGS OF THE BOARD OF DIRECTORS

The Board of Directors met ten (10) times during the last fiscal year. Each Board member attended 75% or more of the aggregate of the meetings of the Board and of the committees on which he or she served, held during the period for which he or she was a director or committee member, respectively.

STOCKHOLDER COMMUNICATIONS WITH THE BOARD OF DIRECTORS

The Company s Board has adopted a formal process by which stockholders may communicate with the Board or any of its directors. Stockholders who wish to communicate with the Board may do so by sending written communications addressed to the Lead Director of Omnicell, Inc. at 1201 Charleston Road, Mountain View, California 94043. These communications will be reviewed by the Lead Director, who will determine whether they should be presented to the Board. The purpose of this screening is to allow the Board to avoid having to consider irrelevant or inappropriate communications (such as advertisements, solicitations and hostile communications). The screening procedures have been approved by a majority of the independent Directors of the Board. All communications directed to the Audit Committee in accordance with the Company s Open Door Policy for Reporting Complaints Regarding Accounting and Auditing Matters (the Omnicell Open Door Policy) that relate to questionable accounting or auditing matters involving the Company will be promptly and directly forwarded to the Audit Committee. The Omnicell Open Door Policy is available on our website *www.omnicell.com* under Investor Relations.

CODE OF CONDUCT

We have adopted the Omnicell Code of Conduct, a code of ethics with which every person who works for us is expected to comply. The Omnicell Code of Conduct is available in the Corporate Governance section on our corporate web site at *www.omnicell.com* under Investor Relations. If we make any substantive amendments to our Code of Conduct or grant any waiver from a provision of the Code to any executive officer or director, we will promptly disclose the nature of the amendment or waiver on our web site.

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS(1)

The Audit Committee oversees Omnicell s financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited financial statements in our Annual Report with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the financial statements.

The Audit Committee reviewed with Ernst & Young LLP (E&Y), the Company s independent registered public accounting firm, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of Omnicell s accounting principles and such other matters as are required by Statement on Auditing Standards No. 61. In addition, the Audit Committee has discussed with E&Y its independence from management and Omnicell, including the matters in the written disclosures required by Independence Standards Board Standard No. 1, and considered the compatibility of any non-audit services with E&Y s independence.

The Audit Committee discussed with E&Y the overall scope and plans for their audit. The Audit Committee met with E&Y, with and without management present, to discuss the results of their examination, their evaluation of Omnicell s internal controls and the overall quality of Omnicell s financial reporting. The Audit Committee held four (4) meetings during 2005.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board has approved, that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2005 for filing with the Securities and Exchange Commission. The Audit Committee and the Board have also recommended, subject to stockholder ratification, the selection of E&Y as Omnicell s independent registered public accounting firm for the year ending December 31, 2006.

AUDIT COMMITTEE
Joseph E. Whitters, Chairman
Kevin L. Roberg
Donald C. Wegmiller

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(1) The material in this report is not soliciting material, is not deemed filed with the SEC, and is not to be incorporated by reference into any filing of the Company under the 1933 Act or 1934 Act.

PROPOSAL 2

RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of the Board of Directors has selected Ernst & Young LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2006 and has further directed that management submit the selection of an independent registered public accounting firm for ratification by the stockholders at the Annual Meeting of Stockholders. Ernst & Young LLP has audited the Company s financial statements since 1997. Representatives of Ernst & Young LLP are expected to be present at the Annual Meeting of Stockholders. They will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Neither the Company s Bylaws nor other governing documents or law require stockholder ratification of the selection of Ernst & Young LLP as the Company s independent registered public accounting firm. However, the Audit Committee of the Board is submitting the selection of Ernst & Young LLP to the stockholders for ratification as a matter of good corporate practice. If the stockholders fail to ratify the selection, the Audit Committee of the Board will reconsider whether or not to retain that firm. Even if the selection is ratified, the Audit Committee of the Board in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if they determine that such a change would be in the best interests of the Company and its stockholders.

The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting of Stockholders will be required to ratify the selection of Ernst & Young LLP. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM S FEES

The following table represents aggregate fees billed to the Company for fiscal years ended December 31, 2004 and December 31, 2005, by Ernst & Young LLP, the Company s principal accountant.

	Fiscal Year Ended			
	2005		2004	
	(in thousands)			
Audit Fees	$	1,183	$	1,074
Tax Fees	6		93	
Total Fees	$	1,189	$	1,167

Audit Fees. Consists of fees billed for professional services rendered for the audit of the Company s financial statements and review of the interim financial statements included in quarterly reports, professional services associated with SEC registration statements and other documents filed with the SEC, consultations with the Company s management as to the accounting treatment of transactions or events and/or the actual or potential impact of final or proposed rules, standards or interpretations by the SEC, FASB or other standard-setting bodies, and other services that are normally provided by Ernst & Young LLP in connection with statutory and regulatory filings or engagements.

Tax Fees. Consists of fees billed for professional services for tax compliance, tax advice and tax planning. During each of the fiscal years ended December 31, 2005 and 2004, these services included general tax advice and planning. During 2004 these services also included studies of the Company s net operating loss carry-forwards and Research and Development credits.

The Audit Committee has determined that the rendering of the services other than audit services by Ernst & Young LLP is compatible with maintaining the principal accountant s independence.

PRE-APPROVAL OF THE AUDIT AND NON-AUDIT SERVICES

The Audit Committee pre-approves all audit and permissible non-audit services provided by its independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services. Prior to engaging Omnicell s independent registered public accounting firm to render an audit or permissible non-audit service, the Audit Committee specifically approves the engagement of Omnicell s independent registered public accounting firm to render that service. The pre-approval of services may be delegated to one or more of the Audit Committee s members, but the decision must be reported to the full Audit Committee at its next scheduled meeting. The Audit Committee has determined that the rendering of the services other than audit services by Ernst & Young LLP is compatible with maintaining the principal accountant s independence.

THE BOARD OF DIRECTORS RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 2.

SECURITY OWNERSHIP OF
CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the ownership of the Company s common stock as of March 10, 2006 by: (i) each director and nominee for director; (ii) each of the executive officers and directors named in the Summary of Compensation table; (iii) all executive officers and directors of the Company as a group; and (iv) all those known by the Company to be beneficial owners of more than five percent of its common stock.

	Beneficial Ownership (1)	
Beneficial Owner	**Number of Shares**	**Percent of Total**
Perry Corp.	2,677,609	10.07 %
767 Fifth Avenue, 19th Floor		
New York, NY 10153		
Entities affiliated with Sutter Hill Ventures(2)	2,587,564	9.74 %
755 Page Mill Road		
Suite A-200		
Palo Alto, CA 94304		
Cannell Capital, LLC	1,517,410	5.71 %
150 California Street, 5th Floor		
San Francisco, CA 94111		
Janus Venture Fund	1,474,009	5.55 %
151 Detroit Street		
Denver, Colorado 80206		
Mary E. Foley(6)	13,367	*
Randy D. Lindholm(6)	34,583	*
Randall A. Lipps(3)(6)	1,482,612	5.42 %
Brock D. Nelson(6)	42,534	*
Kevin L. Roberg(4)(6)	126,979	*
John D. Stobo, Jr.(6)	23,438	*
Donald C. Wegmiller(6)	43,783	*
Sara J. White(6)	37,229	*
Joseph E. Whitters(6)	232,117	*
William H. Younger, Jr.(5)(6)	1,303,829	4.89 %
J. Christopher Drew(6)	260,372	*
Dan S. Johnston(6)	104,164	*
James T. Judson(6)	116,665	*
Gary E. Wright(6)	264,862	*
All executive officers and directors as a group (16 persons)	4,161,239	14.57 %

* Less than one percent.

(1) This table is based upon information supplied by officers, directors and principal stockholders and Schedules 13D and 13G filed with the Securities and Exchange Commission (the SEC). Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, the Company believes that each of the stockholders named in this table has sole voting and investment power with respect to the shares indicated as beneficially owned. Applicable percentages are based on 26,578,016 shares outstanding on March 10, 2006, adjusted as required by

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rules promulgated by the SEC. Unless otherwise indicated, the address of each of the individuals and entities listed below is c/o Omnicell, Inc., 1201 Charleston Road, Mountain View, CA 94043.

(2) Includes 624,821 shares held by Sutter Hill Ventures, a California Limited Partnership, (Sutter Hill), 16,326 shares held by Sutter Hill Entrepreneurs Fund (AI), L.P. (Sutter Hill AI), 41,344 shares held by Sutter Hill Entrepreneurs Fund (QP), L.P. (Sutter Hill QP), 454,236 shares held by David L. Anderson, a Managing Director of Sutter Hill, 533,452 shares held by G. Leonard Baker, Jr., a Managing Director of Sutter Hill, 620,297 shares held by William H. Younger, Jr., a Managing Director of Sutter Hill, 236,781 shares held by Tench Coxe, a Managing Director of Sutter Hill, 17,942 shares held by Gregory P. Sands a Managing Director of Sutter Hill, 14,483 held by James C. Gaither, a Managing Director of Sutter Hill, 7,632 shares held by Jeffrey W. Bird, a Managing Director of Sutter Hill, and 20,250 shares held by David E. Sweet, a Managing Director of Sutter Hill.

(3) Includes 165,988 shares held directly by Mr. Lipps; 458,749 shares held in trust jointly with Mr. Lipps spouse; 76,368 shares held in trusts for the benefit of Mr. Lipps children; and 6,350 shares held directly by Mr. Lipps son.

(4) Includes 1,500 shares held by Mr. Roberg s spouse.

(5) Includes 624,821 shares held by Sutter Hill Ventures, A California Limited Partnership (Sutter Hill), 16,326 shares held by Sutter Hill Entrepreneurs Fund (AI), L.P. (Sutter Hill AI), 41,344 shares held by Sutter Hill Entrepreneurs Fund (QP), L.P. (Sutter Hill QP), 120,826 shares held directly by Mr. Younger, 229,497 shares held in trust for the benefit of Mr. Younger s family and 203,411 shares held by a retirement trust for the benefit of Mr. Younger. Mr. Younger, a director of the Company, is a Managing Director of the General Partner of Sutter Hill, and as such, may be deemed to share voting and investment power over all of such shares and therefore may be deemed a beneficial owner of such shares. Mr. Younger disclaims beneficial ownership of shares held by Sutter Hill, Sutter Hill AI or Sutter Hill QP except to the extent of his direct pecuniary interest therein. Mr. Younger also disclaims beneficial ownership of the trusts shares except as to Mr. Younger s pecuniary interest in the trusts.

(6) Includes shares which certain executive officers and directors of the Company have the right to acquire within 60 days after March 10, 2006 pursuant to outstanding options as follows: Randall A. Lipps, 775,157 shares; Mary E. Foley, 13,367 shares; Randy D. Lindholm, 28,583 shares; Brock D. Nelson, 42,534 shares; Kevin L. Roberg, 114,479 shares; John D. Stobo, Jr., 23,438 shares; Donald C. Wegmiller, 43,783 shares; Sara J. White, 35,229 shares; Joseph E. Whitters, 32,117 shares; William H. Younger, Jr., 67,604 shares; Gary E. Wright, 264,862 shares; J. Christopher Drew, 251,743 shares; Dan S. Johnston, 104,164 shares; James T. Judson, 116,665 shares; and all executive officers and directors as a group, 1,987,602 shares.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 (the 1934 Act) requires the Company s directors and executive officers, and persons who own more than ten percent of a registered class of the Company s equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Officers, directors and greater than ten percent stockholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file.

To the Company s knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required, during the fiscal year ended December 31, 2005, all Section 16(a) filing requirements applicable to its officers, directors and greater than ten percent (10%) beneficial owners were complied with.

EXECUTIVE COMPENSATION

COMPENSATION OF DIRECTORS

The members of our Board of Directors currently receive cash compensation in the amount of $5,000.00 per quarter for their services, and while they receive no per meeting fees, they are eligible for reimbursement for their expenses incurred in attending Board meetings in accordance with Company policy. The Board of Directors may, in the future, elect to modify the cash compensation terms for its non-employee directors.

Each non-employee director of the Company also receives stock option grants under the 1999 Equity Incentive Plan (which shall be referred to as the 1999 Plan). Options granted under the 1999 Plan to our non-employee directors are intended by the Company not to qualify as incentive stock options under the Internal Revenue Code.

Upon initial election or appointment to our Board of Directors, each person who is not an employee of Omnicell will be granted an initial grant on the date of his or her election or appointment to purchase 25,000 shares of our common stock. The 1999 Plan also provides that on the day following each annual stockholders meeting, each non-employee director will be granted an annual stock option grant to purchase 6,250 shares of our common stock. The exercise price of options granted under the 1999 Plan is 100% of the fair market value of the common stock subject to the option on the date of the option grant. The initial option shall become exercisable as to 1/36th of the option shares each month following the date of grant in accordance with its terms and any subsequent annual grant to a non-employee director shall become exercisable as to 1/12th of the option shares each month following the date of grant. The term of options granted to non-employee directors under the 1999 Plan is 10 years. In the event of a merger of the Company with or into another corporation or a consolidation, acquisition of assets or other change-in-control transaction involving the Company, each option will continue in full force and effect if the Company is the surviving entity. If the Company is not the surviving entity, each option will be assumed or an equivalent option will be substituted by the successor corporation. In the event any surviving corporation refuses to assume or continue such options, or to substitute similar stock awards for those outstanding, the time during which such options may be exercised shall be accelerated, and the options terminated if not exercised prior to such event.

In May 2005, each of Ms. Foley, Messrs. Lindholm, Nelson, Roberg, Stobo, Wegmiller, Whitters and Younger and Ms. White were granted an option to purchase 6,250 shares of the Common Stock of the Company, each at an exercise price per share of $6.40. In addition, Ms. Foley, as a new director, and Mr. Wegmiller, in connection with his appointment as Lead Director, were also granted options to purchase 25,000 shares of the Common Stock of the Company at exercise prices of $6.40 and $9.34, respectively. The exercise prices of all of the options granted to directors under the 1999 Plan during the last fiscal year are equal to the fair market value of such common stock on the date of grant.

COMPENSATION OF EXECUTIVE OFFICERS

SUMMARY OF COMPENSATION

The following table shows for the fiscal years ended December 31, 2003, 2004 and 2005, compensation awarded or paid to, or earned by, the Company s Chief Executive Officer, and its other four most highly compensated executive officers as of December 31, 2005 (the Named Executive Officers):

Summary Compensation Table

		Annual Compensation			Long-Term Compensation Awards	
					Securities	
				Other Annual	**Underlying**	**All Other**
		Salary	**Bonus**	**Compensation**(1)	**Options/**	**Compensation**
Name and Principal Position	**Year**	**($)**	**($)**	**($)**	**(#)**	**($)**
Randall A. Lipps	2005	400,250	85,470	2,983 (5)	150,000	
Chairman, President and	2004	380,000			200,000	
Chief Executive Officer	2003	285,007 (2)			80,000	
J. Christopher Drew	2005	275,100	49,204	10,768 (6)	150,000	
Executive Vice President,	2004	218,750			100,000	
Operations	2003	155,000	21,423		371,415	
Gary E. Wright	2005	296,000	48,563	119,222 (7)(8)		
Executive Vice President,	2004	280,000	150,000		100,000	
Worldwide Sales and Marketing	2003	280,000	162,460		135,000	
James T. Judson(3)	2005	200,000	42,945		200,000	
Executive Vice President,	2004					
Finance, and interim CFO	2003					
Dan S. Johnston(4)	2005	210,500	28,823		10,000	
Senior Vice President and	2004	200,000			30,000	
General Counsel	2003	20,833	10,000		140,000	

(1) As permitted by rules promulgated by the SEC, no amounts are shown with respect to certain perquisites, where such amounts do not exceed the lesser of 10% of bonus plus salary or $50,000.

(2) Mr. Lipps agreed to a salary in the first quarter of 2003 of $1.00, and thereafter received a base salary of $285,000 for the remainder of 2003, or $380,000 on an annualized basis.

(3) Mr. Judson joined Omnicell in March 2005.

(4) Mr. Johnston joined Omnicell in November 2003.

(5) Income for tax preparation.

(6) Donation of vacation hours to hurricane victims.

(7) Auto allowance in the amount of $3,150.

(8) ISO income in the amount of $116,070.

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STOCK OPTION GRANTS AND EXERCISES

The Company has granted options to its executive officers under its 1992 Equity Incentive Plan and 1995 Management Stock Option Plan, and continues to grant options to executive officers under its 1999 Equity Incentive Plan, 2003 Equity Incentive Plan and 2004 Equity Incentive Plan (the Incentive Plans). As of December 31, 2005, options to purchase a total of 6,579,137 shares were outstanding under the Incentive Plans and 334,353 shares remained available for grant under the Incentive Plans.

The following tables show for the fiscal year ended December 31, 2005, certain information regarding options granted to, exercised by, and held at year end by, the Named Executive Officers:

OPTION GRANTS IN LAST FISCAL YEAR

	Individual Grants					Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Name	Number of Securities Underlying Options Granted		% of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/Sh)	Expiration Date	5%($)	10%($)
Mr. Lipps	150,000	(1)	11.86 %	$ 10.58	12/07/15	$ 999,810	$ 2,523,330
Mr. Drew	50,000	(2)	3.95	10.41	01/05/15	327,915	827,595
	100,000	(1)	7.90	10.58	12/07/15	666,540	1,682,220
Mr. Wright							
Mr. Judson	200,000	(3)	15.81	7.40	03/02/15	932,400	2,353,200
Mr. Johnston	10,000	(3)	.79	6.50	06/01/15	40,950	103,350

(1) Options granted become exercisable as follows: 6.25% of the shares subject to the option vest on the three month anniversary of the vesting commencement date, with the balance of the shares vesting monthly over the following 45 months. The options expire ten years from the date of grant or earlier upon termination of employment.

(2) Options granted become exercisable as follows: 25% of the shares subject to the option vest on the one year anniversary of the vesting commencement date, with the balance of the shares vesting monthly over the following 36 months. The options expire ten years from the date of grant or earlier upon termination of employment.

(3) Options granted become exercisable as follows: monthly over a 24 month period. The options expire ten years from the date of grant or earlier upon termination of employment.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR, AND FY-END OPTION/ VALUES

The following table presents the aggregate option exercise, during 2005, and the number and value of securities underlying unexercised options that are held by each of the individuals listed in the Summary Compensation Table as of December 31, 2005.

Amounts shown under the column Value Realized are based on the closing sales price of our common stock as reported on the Nasdaq Stock Market on the date of exercise, less the exercise price. Amounts shown under the column Value of Unexercised In-the-Money Options at FY-End are based on the closing price of our common stock $11.95 on December 30, 2005 as reported on the Nasdaq Stock Market, less the exercise price, without taking into account any taxes that may be payable in connection with the transaction, multiplied by the number of shares underlying the option.

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options at FY-End (#) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options at FY-End ($) Exercisable/ Unexercisable
Mr. Lipps			702,243/325,001	$ 3,208,011/$608,508
Mr. Drew			181,227/287,170	999,228/681,616
Mr. Wright	12,000	$ 104,080	239,749/108,939	1,165,311/185,802
Mr. Judson			74,999/125,001	89,998/150,001
Mr. Johnston			7,500/32,500	6,000/30,000

EQUITY COMPENSATION PLAN INFORMATION

The following table provides certain information as of December 31, 2005 regarding our 1992 Incentive Stock Plan, 1995 Management Stock Option Plan, 1999 Equity Incentive Plan and 1997 Employee Stock Option Plan, each of which has been approved by our stockholders, as well as our 2003 Equity Incentive Plan, and 2004 Equity Incentive Plan, neither of which has been approved by our stockholders:

Plan description	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
1992 Incentive Stock Plan	173,748	$ 10.071	0
1995 Management Stock Option Plan	389,072	$ 8.016	0
1999 Equity Incentive Plan	5,690,917	$ 8.867	0 (1)
1997 Employee Stock Purchase Plan	0	n/a	490,847
2003 Equity Incentive Plan	325,400	$ 10.521	174,600
2004 Equity Incentive Plan	0	$ 0	200,000
Total	6,579,137	$ 8.931	334,353

(1) At December 31, 2005, there were no shares available for future issuance under the 1999 Plan. On January 1 of each year, the number of shares reserved for issuance under the 1999 Equity Incentive Plan increases automatically by the lesser of (i) 5.5% of the total number of shares of the Company s common stock then outstanding, or (ii) 3,000,000 shares. After applying the formula, the number of shares available for future issuance under the 1999 Equity Incentive Plan on January 1, 2006 was 1,444,897.

2003 EQUITY INCENTIVE PLAN

In April 2003, our Board of Directors adopted the 2003 Equity Incentive Plan (the 2003 Plan). A total of 500,000 shares of common stock have been reserved for issuance under the 2003 Plan and we currently have options outstanding to purchase 25,000 shares under the 2003 Plan. The 2003 Plan provides for the issuance of non-qualified options, stock bonuses and rights to acquire restricted stock to our employees, directors and consultants. Options granted under the 2003 Plan shall have an exercise price of not less than 70% of the fair market value of the stock on the date of grant and generally become exercisable over periods of up to four years, generally with one-fourth of the shares vesting one year from the vesting commencement date with respect to initial grants, and the remaining shares vesting in 36 equal monthly installments thereafter, however our Board of Directors may impose vesting at its discretion to any award. Options under the 2003 Plan generally expire ten years from the date of grant.

Our Board of Directors shall administer the 2003 Plan unless and until the Board delegates administration to a committee. Our Board may suspend or terminate the 2003 Plan at any time. Our Board may also amend the 2003 Plan at any time or from time to time. However, no amendment will be effective unless approved by our stockholders after its adoption by the Board to the extent stockholder approval is necessary to satisfy the requirements of any Nasdaq listing requirements.

If we sell, lease or dispose of all or substantially all of our assets, or are acquired pursuant to a merger or consolidation, then the surviving entity may assume or substitute all outstanding awards under the

2003 Plan. If the surviving entity does not assume or substitute these awards, then generally the vesting and exercisability of the stock awards will accelerate.

2004 EQUITY INCENTIVE PLAN

In February 2004, our Board of Directors adopted the 2004 Equity Incentive Plan (the 2004 Plan). A total of 200,000 shares of common stock has been reserved for issuance under the 2004 Plan and we currently have no outstanding granted options to purchase any shares under the 2004 Plan. The 2004 Plan provides for the issuance of non-qualified options to new employees as an inducement material to the individual s entering into employment with Omnicell. Options granted under the 2004 Plan have an exercise price not less than the fair market value of the stock on the date of grant and generally become exercisable over periods of up to four years, generally with one-fourth of the shares vesting one year from the vesting commencement date with respect to initial grants, and the remaining shares vesting in 36 equal monthly installments thereafter, however our Board of Directors may impose vesting at its discretion to any award. Options under the 2004 Plan generally expire ten years from the date of grant.

Our Board of Directors shall administer the 2004 Plan unless and until the board delegates administration to a committee. Our Board may suspend or terminate the 2004 Plan at any time. Our Board may also amend the 2004 Plan at any time or from time to time. However, no amendment will be effective unless approved by our stockholders after its adoption by the Board to the extent stockholder approval is necessary to satisfy the requirements of any Nasdaq listing requirements.

If we sell, lease or dispose of all or substantially all of our assets, or are acquired pursuant to a merger or consolidation, then the surviving entity may assume or substitute all outstanding awards under the 2004 Plan. If the surviving entity does not assume or substitute these awards, then generally the vesting and exercisability of the stock awards will accelerate.

EMPLOYMENT, SEVERANCE AND CHANGE OF CONTROL AGREEMENTS

In February 1998 and February 2000, our Board of Directors approved the acceleration, under certain circumstances, of all stock options granted to certain officers under the Incentive Plans. Under this arrangement, the unvested portion of each officer s stock options under the Incentive Plans becomes fully vested and exercisable if we are acquired and the officer is terminated without cause, the principal place of performance of the officer s responsibilities and duties is changed, or there is a material reduction in the officer s job responsibilities or duties.

In January 2006, our Board of Directors approved a modification of the change of control terms for each of our executive and certain of our other senior level officers which now provides that, in the event of (i) a change of control of Omnicell, and (ii) termination without cause or constructive termination of such officer s employment with Omnicell or its successor within 12 months of such change of control, such officer shall be entitled to receive (a) severance pay equivalent to 12 months salary at such officer s base rate of pay in effect immediately prior to such termination and (b) full acceleration of any outstanding unvested stock options granted to such officer, provided, in each case, that such officer executes Omnicell s standard waiver and release agreement.

In April 2003, the Company and Gary E. Wright entered into an employment agreement whereby Mr. Wright agreed to serve as Executive Vice President, Sales, Field Operations, Marketing and International of the Company. The agreement provides Mr. Wright with a base salary of $280,000. Mr. Wright was also granted an option to purchase 27,910 shares of common stock, subject to the same vesting acceleration provisions provided to other executive officers of the Company. In the event Mr. Wright s employment is terminated by Omnicell without cause, Mr. Wright will be entitled to receive a one-time payment of his annual base salary amount then in effect.

In November 2003, the Company and Dan S. Johnston entered into an employment agreement whereby Mr. Johnston agreed to serve as Senior Vice President and General Counsel of the Company. The agreement provides Mr. Johnston with a base salary of $200,000 plus an annual option to purchase 40,000 shares of Omnicell common stock in 2003 and 2004, wherein 25% of such grant may accelerate each quarter upon the Company s achievement of certain milestones. Mr. Johnston was also granted an option to purchase 100,000 shares of common stock, subject to the same vesting acceleration provisions provided to other executive officers of the Company. In the event Mr. Johnston s employment is terminated by Omnicell without cause, Mr. Johnston will be entitled to receive a one-time payment of his annual base salary amount then in effect.

In January 2006, the Company and Rob Seim entered into an employment agreement whereby Mr. Seim agreed to serve as Executive Vice President of Finance and Chief Financial Officer of the Company. The agreement provides Mr. Seim with a base salary of $220,000. Mr. Seim was also granted an option to purchase 190,000 shares of common stock, subject to the same vesting acceleration provisions provided to other executive officers of the Company. In the event Mr. Seim s employment is terminated by Omnicell without cause, Mr. Seim will be entitled to receive a one-time payment equal to six (6) months salary calculated at his base rate of pay in effect immediately prior to termination.

In March 2006, the Company and Renee Luhr entered into an employment agreement whereby Ms. Luhr agreed to serve as Vice President, Sales. The agreement provides Ms. Luhr with a base salary of $200,000. Ms. Luhr was also granted an option to purchase 100,000 shares of common stock, subject to the same vesting acceleration provisions provided to others executive officers of the Company. In the event of Ms. Luhr s employment is terminated by Omnicell without cause, Ms. Luhr will be entitled to receive a one-time payment equal to six (6) months salary calculated at her base rate of pay in effect immediately prior to termination.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS ON EXECUTIVE COMPENSATION(2)

Our executive compensation policies and practices are established and administered by the Compensation Committee of the Board. The Compensation Committee consists of three (3) non-employee directors: William H. Younger, Jr., Randy D. Lindholm and Brock D Nelson.

PHILOSOPHY

The Compensation Committee has implemented compensation policies, plans and programs that seek to enhance stockholder value by aligning the financial interests of the executive officers with those of the stockholders. The objectives of the program established by the Compensation Committee are: (i) to attract and retain the people needed to define, create and market industry-leading products and services; (ii) tie compensation closely to achievement of Omnicell s business and performance objectives; and (iii) to reward individual performance that contributes to Omnicell s long term success.

ELEMENTS OF COMPENSATION

Our executive compensation is comprised of three components, each of which is intended to support the overall objectives of our compensation philosophy. They are: (i) base compensation; (ii) bonus compensation tied to each executive officer s and the Company s performance goals; and (iii) equity compensation in the form of periodic grants of stock options under Omnicell s stock option plans.

Base Compensation. The Compensation Committee recognizes the importance of maintaining compensation levels competitive with other leading technology companies with which Omnicell competes for personnel. In setting the base salaries for its executive officers, the Committee considers (i) individual and corporate performance; (ii) levels of responsibility; (iii) prior experience and breadth of knowledge of each executive officer; (iv) competitive pay practices; and (v) compensation data from peer group companies. The Compensation Committee reviews an annual salary plan, with the Chief Executive Officer, for Omnicell s executive officers, other than the Chief Executive Officer. The salary plan is modified, as deemed appropriate, and then formally approved by the Compensation Committee. The annual salary plan takes into account past performance and expected future contributions of the individual executive officer as well as executive salaries at comparable companies.

In fiscal 2005, base salaries for certain of our named executive officers were increased over base salaries paid for fiscal 2004. The increased base salaries are shown in the Summary of Compensation table on page 17. Mr. Drew s increase was due to a promotion. The Compensation Committee believes the base salaries paid to its executive officers are reasonable in light of the factors described above.

Bonus Compensation. In fiscal 2005, cash bonuses in the amounts set forth in the Summary of Compensation table on page 17 were paid to our named executive officers, in accordance with the terms of the Quarterly Executive Bonus Plan for fiscal year 2005 (the 2005 QEBP), approved by the Compensation Committee in March 2005. The 2005 QEBP is applicable to the Company s management team, director level and above, including executive officers.

(2) The material in this report is not soliciting material, is not deemed filed with the SEC, and is not to be incorporated by reference into any filing of the Company under the 1933 Act or 1934 Act.

For our executive officers to be eligible for the quarterly bonus, the 2005 QEBP required the Company to achieve both a minimum profitability target and sales backlog target as set by the Compensation Committee each quarter. If the Company s targets were achieved, each executive officer was eligible to receive 50% of his bonus amount. Each executive officer also was required to carry individual quarterly performance targets that, if achieved, allowed the executive officer to receive the remaining 50% of his bonus amount. In the case of the chief executive officer, the individual quarterly performance target is set by the Compensation Committee, and in the case of the other executive officers, the individual quarterly performance target is set by the chief executive officer and reviewed and approved by the Compensation Committee. No bonuses are paid under the 2005 QEBP in any quarter where the Company targets are not achieved; however, if the end of year sales bookings target is met, any quarterly bonuses that were not paid due solely to the failure to achieve that quarter s sales booking target will then be made up and paid. Also, in any quarter where the quarterly Company targets are achieved and the profitability target is exceeded, each executive officer can earn an additional 10% of his quarterly bonus for each incremental target achieved, as set by the Compensation Committee. The bonus is computed as a percentage of quarterly base salary, which is established by the Compensation Committee. In fiscal 2005, the bonus target levels for our executive officers ranged from 15% of quarterly salary to 40% of quarterly salary depending on the seniority level of the executive officer. The Compensation Committee can alter the incentive payout based on such factors as achievement of publicly announced targets, product milestones, strategic goals, cross-functional teamwork and collaboration, and unforeseen changes in the economy and/or geopolitical climate. In 2005, the Company reached the Company targets in each of the quarters under the 2005 QEBP, and the profitability target was exceeded in the fourth quarter.

In December 2005, the Compensation Committee altered the Quarterly Executive Bonus Plan for fiscal year 2006 (the 2006 QEBP) from the 2005 QEBP. For our executive officers to be eligible for the quarterly bonus, the 2006 QEBP requires the Company to achieve both a minimum profitability target and revenue growth target as set by the Compensation Committee each quarter. In fiscal 2006, the bonus target levels for our executive officers range from 25% of quarterly salary to 60% of quarterly salary depending on the seniority level of the executive officer. In all other respects, the 2006 QEBP contains equivalent terms to the 2005 QEBP.

Longer Term Incentive Compensation. Long-term equity incentives are provided through grants of stock options to executive officers and other employees pursuant to our 1999 Equity Incentive Plan, 2003 Equity Incentive Plan and 2004 Equity Incentive Plan. This component of compensation is intended to provide a longer-term incentive to its executive officers to grow revenues, provide quality returns on investment, enhance stockholder value and contribute to our long term growth. The Compensation Committee believes this element of the total compensation program directly links each executive officer s interests with those of the stockholders and our long-term value because stock options (i) are granted with exercise prices at not less than fair market value; (ii) generally vest over time for periods not to exceed five years and generally terminate 10 years after the date of grant. Specifically, the vesting provisions of the options are intended to insure that employees are provided with an incentive to increase value over the long term. The Compensation Committee determines the size of each option grant to its executive officers by considering, among other things, individual and corporate performance, level of responsibility and prior experience and breadth of knowledge. The Compensation Committee also considers the value of options granted to similarly situated executive officers of comparable companies.

In fiscal 2005, the Compensation Committee decided to grant new stock options to our executive officers. Out of a total of 1,371,300 options granted in fiscal 2005, our executive officers received grants for an aggregate of 640,000 shares, or approximately 46.67% of the total options granted in fiscal 2005. Executive officers are also eligible to participate in our 1997 Employee Stock Purchase Plan. Participation levels in such plan are at the discretion of each executive officer.

The Compensation Committee believes that the programs described above provide compensation that is competitive with comparable companies, link executive and stockholder interests and provide the basis to attract and retain qualified executives. The Compensation Committee also believes that the long-term equity incentives awarded to its executive officers during fiscal 2005 are reasonable in light of factors described above. The Compensation Committee will continue to monitor the relationship among executive compensation, our performance and stockholder value.

CHIEF EXECUTIVE OFFICER COMPENSATION

The Compensation Committee uses the procedures described above in setting the annual salary and equity awards for Randall A. Lipps, our President and Chief Executive Officer. The Compensation Committee reviews and establishes the base salary of Mr. Lipps based on compensation data for comparable companies and the Compensation Committee s assessment of his past performance and its expectation as to his future contributions in directing our long-term success. Mr. Lipps base salary for fiscal 2005 increased to $400,250 from $380,000 in fiscal 2004 which in turn was the same salary he received in fiscal 2003. In fiscal 2003, Mr. Lipps agreed to a salary in the first quarter of $1.00, and thereafter received a base salary of $285,000 for the remainder of fiscal 2003, or $380,000 on an annualized basis. For fiscal 2006 Mr. Lipps base salary will remain the same as fiscal 2005, but will have additional opportunities for cash bonus awards as described in the 2006 QEBP. In fiscal 2005, Mr. Lipps received approximately $85,000 under the 2005 QEBP for meeting company and personal performance metrics. The Compensation Committee believes that the base salary and bonus plan of Mr. Lipps is reasonable in light of factors considered by the Compensation Committee.

In fiscal 2005, the Compensation Committee also reviewed the performance of Mr. Lipps in relation to his equity compensation package. Mr. Lipps was granted an option to purchase 150,000 shares of common stock in fiscal 2005. The Compensation Committee believes the grant to Mr. Lipps is sufficient to maintain the overall competitiveness of his compensation package and to maintain the strength of the alignment of his interests with those of Omnicell s stockholders. The Compensation Committee intends to continue to monitor Mr. Lipps compensation levels in light of his performance, Omnicell s performance, and the compensation levels of chief executive officers at comparable companies.

FEDERAL TAX CONSIDERATIONS

Section 162(m) of the Internal Revenue Code (the Code) limits the Company to a deduction for federal income tax purposes of no more than $1 million of compensation paid to certain Named Executive Officers in a taxable year. Compensation above $1 million may be deducted if it is performance-based compensation within the meaning of the Code. The Compensation Committee has not yet established a policy for determining which forms of incentive compensation awarded to its Named Executive Officers shall be designed to qualify as performance-based compensation. The Compensation Committee intends to comply with Code Section 162(m) in the future to the extent consistent with the best interests of the Company.

COMPENSATION COMMITTEE
William H. Younger, Jr., Chairman
Randy D. Lindholm
Brock D. Nelson

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

As noted above, the Company s Compensation Committee consists of Messrs. Younger (chair), Lindholm and Nelson. None of these individuals is or has been an officer of Omnicell. None of our executive officers serves as a member of the Board of Directors or compensation committee of any entity that has one or more executive officers serving as a member of our Board of Directors or Compensation Committee.

PERFORMANCE MEASUREMENT COMPARISON(1)

The following graph shows the total stockholder return of an investment of $100 in cash on August 7, 2001 for (i) the Company s Common Stock, (ii) the Nasdaq National Market Index (the Nasdaq) and (iii) the S&P SuperComposite Healthcare Sector Index2 (the S&P SuperComposite Healthcare). All values assume reinvestment of the full amount of all dividends and are calculated as of the last day of each month:

COMPARISON OF 53 MONTH CUMULATIVE TOTAL RETURN*

AMONG OMNICELL, INC., THE NASDAQ STOCK MARKET (U.S.) INDEX
AND THE S & P SUPERCAP HEALTHCARE SECTOR

* $100 invested on 8/7/01 in stock and S & P or on 7/31/01 in Nasdaq-including reinvestment of dividends.
Fiscal year ending December 31.

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(1) This section is not soliciting material, is not deemed filed with the SEC, and is not to be incorporated by reference into any filing of the Company under the 1933 Act or 1934 Act, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing.

(2) The S&P SuperComposite Healthcare Index is calculated using a market cap weighing methodology.

CERTAIN TRANSACTIONS

The Company has entered into indemnity agreements with its executive officers and directors which provide, among other things, that the Company will indemnify such officer or director, under the circumstances and to the extent provided for therein, for expenses, damages, judgments, fines and settlements he or she may be required to pay in actions or proceedings which he or she is or may be made a party by reason of his or her position as a director, officer or other agent of the Company, and otherwise to the fullest extent permitted under Delaware law and the Company s Bylaws.

OTHER MATTERS

The Board of Directors knows of no other matters that will be presented for consideration at the Annual Meeting of Stockholders. If any other matters are properly brought before the meeting, it is the intention of the persons named in the accompanying proxy to vote on such matters in accordance with their best judgment.

By Order of the Board of Directors
/s/ ROBERT J. BRIGHAM
Robert J. Brigham
Secretary

March 28, 2006

DELIVERY OF THIS PROXY STATEMENT

The Securities and Exchange Commission has adopted rules that permit companies and intermediaries (e.g., brokers) to satisfy the delivery requirements for proxy statements with respect to two or more security holders sharing the same address by delivering a single proxy statement addressed to those security holders. This process, which is commonly referred to as householding, potentially means extra convenience for the securityholders and cost savings for companies.

This year, a number of brokers with account holders who are Omnicell stockholders will be householding our proxy materials. A single proxy statement will be delivered to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker or us that they will be householding communications to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, please notify your broker or direct your written request to Corporate Secretary, Omnicell, Inc., 1201 Charleston Road, Mountain View, CA 94043.

Stockholders who currently receive multiple copies of the proxy statement at their address and would like to request householding of their communications should contact their broker.

A copy of Omnicell s Annual Report to the Securities and Exchange Commission on Form 10-K for the fiscal year ended December 31, 2005 is available without charge upon written request to: Corporate Secretary, Omnicell, Inc., 1201 Charleston Road, Mountain View, CA 94043.

Appendix A

OMNICELL, INC.

AMENDED AND RESTATED CHARTER OF THE AUDIT COMMITTEE

PURPOSE AND POLICY

The Audit Committee shall provide assistance and guidance to the Board of Directors of the Company in fulfilling its oversight responsibilities to the Company s stockholders with respect to the Company s corporate accounting and reporting practices, the quality and integrity of the Company s financial statements and reports and the independence and performance of the Company s internal and external auditors. The policy of the Audit Committee, in discharging these obligations, shall be to maintain and foster an open avenue of communication between the Audit Committee and the independent auditors, the Company s financial management and internal auditors.

COMPOSITION AND ORGANIZATION

The Audit Committee shall consist of at least three (3) members of the Board of Directors. The members of the Audit Committee shall satisfy the independence and experience requirements of the Nasdaq National Market. In particular, the Chairman of the Audit Committee shall have accounting or related financial management expertise. The members of the Audit Committee shall be appointed by the Board of Directors.

The Audit Committee will hold at least four (4) regular meetings per year and additional meetings as the Committee deems appropriate. Minutes of each meeting of the Audit Committee shall be prepared and the Committee shall make regular reports to the Board of Directors. The operation of the Audit Committee shall be subject to the Bylaws of the Company as in effect from time to time and Section 141 of the Delaware General Corporation Law.

The Audit Committee shall have the authority to retain special legal, accounting or other consultants to advise the Committee. The Audit Committee may request any officer or employee of the Company or the Company s outside counsel or independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee.

RESPONSIBILITIES

In fulfilling its responsibilities, the Audit Committee believes that its functions and procedures should remain flexible in order to address changing conditions most effectively. To implement the policy of the Audit Committee, the Committee shall, to the extent it deems necessary or appropriate:

1. Recommend annually to the Board of Directors the firm of certified public accountants to be employed by the Company as its independent auditors for the ensuing year, which firm is ultimately accountable to the Audit Committee and the Board, as representatives of the Company s stockholders.

2. Review the engagement of the independent auditors, including the scope, extent and procedures of the audit and the compensation to be paid therefor, and all other matters the Audit Committee deems appropriate.

3. Evaluate, together with the Board, the performance of the independent auditors and whether it is appropriate to adopt a policy of rotating independent auditors, and if so determined by the Audit Committee, to recommend that the Board replace the independent auditors.

4. Receive written statements from the independent auditors delineating all relationships between the auditors and the Company consistent with Independence Standards Board Standard No. 1, to consider and discuss with the auditors any disclosed relationships or services that could affect the auditors

objectivity and independence and otherwise to take, and if so determined by the Audit Committee, to recommend that the Board take, appropriate action to oversee the independence of the auditors.

5. Review the annual audited financial statements with management prior to the filing of the Company s Form 10-K, including major issues regarding accounting and auditing principles and practices as well as the adequacy of internal controls that could significantly affect the Company s financial statements.

6. Discuss with the independent auditors the results of the annual audit, including the auditors assessment of the quality, not just acceptability, of accounting principles, the reasonableness of significant financial reporting issues and judgments, the nature of significant risks and exposures, the adequacy of the disclosures in the financial statements and any other matters required to be communicated to the Committee by the independent auditors under generally accepted accounting standards.

7. Discuss with the independent auditors the matters required to be disclosed by Statement on Auditing Standards No. 61 relating to the conduct of the audit.

8. Review with management and the independent auditors the effect of regulatory and accounting initiatives as well as off-balance sheet structures, if any, on the Company s financial statements.

9. Review with management and the independent auditors the Company s quarterly financial statements prior to the filing of its Form 10-Q, including the results of the independent auditors reviews of the quarterly financial statements.

10. Evaluate the cooperation received by the independent auditors during their audit examination, including any restrictions on the scope of their activities or access to required records, data and information.

11. Confer with the independent auditors and senior management in separate executive sessions to discuss any matters that the Audit Committee, the independent auditors or senior management believe should be discussed privately with the Audit Committee.

12. Approve the retention of the independent auditors for any non-audit service and the fee for such service.

13. Investigate any matter brought to the attention of the Audit Committee within the scope of its duties, with the power to retain outside counsel and a separate accounting firm for this purpose if, in the judgment of the Audit Committee, such investigation or retention is necessary or appropriate.

14. Prepare the report required by the rules of the Securities and Exchange Commission to be included in the Company s annual proxy statement.

15. Perform such other functions and to have such powers as may be necessary or appropriate in the efficient and lawful discharge of the foregoing.

16. Review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company s financial statements are complete and accurate and are in accordance with generally accepted accounting principles. These are the responsibilities of management and the independent auditors.

Proxy - Omnicell, Inc.

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby appoints Randall A. Lipps and Dan S. Johnston, jointly or individually, as proxies, each with full power of substitution, and hereby authorizes them to represent and to vote, as directed below, all common shares of beneficial interest, par value $0.001 per share, of Omnicell, Inc. (the Company), that the undersigned would be entitled to vote if personally present at the Annual Meeting of Stockholders of the Company to be held on Tuesday, April 25, 2006, or any adjournments thereof, as follows on the reverse side.

CONTINUED AND TO BE SIGNED ON REVERSE SIDE

Annual Meeting Proxy Card

Election of Directors

1. Nominees for Class II Directors:

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows by providing guidance on eight specific cash flow issues, including requirements that cash payments for debt prepayment or debt extinguishment

costs be classified as cash outflows for financing activities and proceeds from the settlement of corporate-owned life insurance policies be classified as cash inflows from investing activities. The provisions of ASU 2016-15 are effective for years beginning after December 15, 2017, with early adoption permitted. We elected to early adopt the requirements of the new standard in the first quarter of 2017 using the retrospective transition method, as required by the new standard. The adoption of this ASU had an immaterial impact to our consolidated statements of cash flows.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that restricted cash be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The provisions of ASU 2016-18 are effective for years beginning after December 15, 2017, with early adoption permitted. We elected to early adopt the requirements of the new standard in the first quarter of 2017 using the retrospective transition method, as required by the new standard. The adoption of this ASU had an immaterial impact to our consolidated statements of cash flows.

The following table provides a reconciliation of cash and cash equivalents, and restricted cash reported within the consolidated balance sheets that sum to the total of such amounts in the consolidated statements of cash flows:

(In millions)	Jul 2, 2017	Dec 31, 2016
Cash and cash equivalents	$2,167	$3,303
Restricted cash	8	—
Cash, cash equivalents and restricted cash shown in the consolidated statements of cash flows	$2,175	$3,303

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted, and must be adopted using the modified retrospective approach. We are currently evaluating the potential changes from this ASU to our future financial reporting and disclosures. We expect the standard to have an impact of approximately $1 billion on our assets and liabilities for the addition of right-of-use assets and lease liabilities, but we do not expect it to have a material impact to our results of operations or liquidity.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715), which changes certain presentation and disclosure requirements for employers that sponsor defined benefit pension and other postretirement benefit (PRB) plans.

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This requires the service cost component of the net benefit cost to be in the same line item as other compensation in operating income and the other components of net benefit cost to be presented outside of operating income on a retrospective basis. In addition, only the service cost component will be eligible for capitalization when applicable, on a prospective basis. The provisions of ASU 2017-07 are effective for years beginning after December 15, 2017. We are currently evaluating the potential changes from this ASU to our future financial reporting and disclosures. We expect the standard to increase 2016 and 2017 operating income due to the removal of the non-service component of Financial Accounting Standards (FAS) pension expense by $601 million and an estimated $800 million, respectively, and to decrease non-operating income by the same amount with zero impact to net income in both periods. We do not expect a material impact from the new requirement to only allow capitalization of the service cost component of net benefit cost.

Other new pronouncements issued but not effective until after July 2, 2017 are not expected to have a material impact on our financial position, results of operations or liquidity.

Note 3: Significant Accounting Policies Update
Our significant accounting policies are detailed in "Note 1: Summary of Significant Accounting Policies" of our Annual Report on Form 10-K for the year ended December 31, 2016. Significant changes to our accounting policies as a result of adopting Topic 606 are discussed below:

Revenue Recognition—The vast majority of our revenues are from long-term contracts associated with the design, development, manufacture or modification of complex aerospace or defense equipment or related services. These contracts primarily are with the U.S. government (including foreign military sales contracted through the U.S. government). Our contracts with the U.S. government typically are subject to the Federal Acquisition Regulation (FAR) and are priced based on estimated or actual costs of producing goods or providing services. The FAR provides guidance on the types of costs that are allowable in establishing prices for goods and services provided under U.S. government contracts. The pricing for non-U.S. government contracts is based on the specific negotiations with each customer.

Under the typical payment terms of our U.S. government fixed-price contracts, the customer pays us either performance-based payments (PBPs) or progress payments. PBPs are interim payments up to 90% of the contract price based on quantifiable measures of performance or on the achievement of specified events or milestones. Progress payments are interim payments up to 80% of costs incurred as the work progresses. Because the customer retains a small portion of the contract price until completion of the contract, our U.S. government fixed-price contracts generally result in revenue recognized in excess of billings which we present as contract assets on the balance sheet. Amounts billed and due from our customers are classified as receivables on the balance sheet. The portion of the payments retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer. For our U.S. government cost-type contracts, the customer generally pays us for our actual costs incurred within a short period of time. For non-U.S. government contracts, we typically receive interim payments as work progresses, although for some contracts, we may be entitled to receive an advance payment. We recognize a liability for these advance payments in excess of revenue recognized and present it as contract liabilities on the balance sheet. The advance payment typically is not considered a significant financing component because it is used to meet working capital demands that can be higher in the early stages of a contract and to protect us from the other party failing to adequately complete some or all of its obligations under the contract.

To determine the proper revenue recognition method for contracts for complex aerospace or defense equipment or related services, we evaluate whether two or more contracts should be combined and accounted for as one single contract and whether the combined or single contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment and the decision to combine a group of contracts or separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recorded in a given period. For most of our contracts, the customer contracts with us to provide a significant service of integrating a complex set of tasks and components into a single project or capability (even if that single project results in the delivery of multiple units). Hence, the entire contract is accounted for as one performance obligation. Less commonly, however, we may promise to provide distinct goods or services within a contract in which case we separate the contract into more than one performance obligation. If a contract is separated into more than one performance obligation, we allocate the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. We infrequently sell standard products with observable standalone sales. In cases where we do, the observable standalone sales are used to determine the standalone selling price. More frequently, we sell a customized customer specific solution, and in these cases we typically use the expected cost plus a margin approach to estimate the standalone selling price of each performance obligation.

We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. For certain contracts that meet the foregoing requirements, primarily international direct commercial sale contracts, we recognize revenue before obtaining all regulatory approvals where receipt of those regulatory approvals is virtually certain based upon all known facts and circumstances.

We generally recognize revenue over time as we perform because of continuous transfer of control to the customer. For U.S. government contracts, this continuous transfer of control 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. Similarly, for non-U.S. government contracts, the customer typically controls the work in process as evidenced either by contractual termination clauses or by our rights to payment for work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to the Company.

Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. We generally use the cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Under the 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 at completion of the performance obligation. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred. Costs to fulfill include labor, materials and subcontractors' costs, other direct costs and an allocation of indirect costs including pension and any other postretirement benefit (PRB) expense under U.S. government Cost Accounting Standards (CAS).

Due to the nature of the work required to be performed on many of our performance obligations, the estimation of total revenue and cost at completion (the process described below in more detail) is complex, subject to many variables and requires significant judgment. It is common for our long-term contracts to contain award fees, incentive fees, or other provisions that can either increase or decrease the transaction price. These variable amounts generally are awarded upon achievement of certain performance metrics, program milestones or cost targets and can be based upon customer discretion. We estimate variable consideration at the most likely amount to which we expect to be entitled. We include estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of our anticipated performance and all information (historical, current and forecasted) that is reasonably available to us.

Contracts are often modified to account for changes in contract specifications and requirements. We consider contract modifications to exist when the modification either creates new or changes the existing enforceable rights and obligations. Most of our contract modifications are for goods or services that are not distinct from the existing contract due to the significant integration service provided in the context of the contract and are accounted for as if they were part of that existing contract. The effect of a contract modification on the transaction price and our measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) on a cumulative catch-up basis.

We have a companywide standard and disciplined quarterly Estimate at Completion (EAC) process in which management reviews the progress and execution of our performance obligations. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (e.g., the number and type of milestone events), technical requirements (e.g., a newly-developed product versus a mature product) and other contract requirements. Management must make assumptions and estimates regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the performance obligation (e.g., to estimate increases in wages and prices for materials and related support cost allocations), execution by our subcontractors, the availability and timing of funding from our customer and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations, required under certain contracts.

Based on this analysis, any quarterly adjustments to net sales, cost of sales, and the related impact to operating income are recognized as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating income during the performance of individual performance obligations, if we determine we will be successful in mitigating risks surrounding the technical, schedule and cost aspects of those performance obligations or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating income if we determine we will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, cost of sales and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a performance obligation's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our performance obligations.

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When estimates of total costs to be incurred exceed total estimates of revenue to be earned, on a performance obligation related to complex aerospace or defense equipment or related services, or product maintenance or separately priced extended warranty, a provision for the entire loss on the performance obligation is recognized in the period the loss is recorded.

Net EAC adjustments had the following impact on our operating results:

	Three Months Ended		Six Months Ended	
(In millions, except per share amounts)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Operating income	$112	$134	$166	$155
Income from continuing operations attributable to Raytheon Company	73	87	108	112
Diluted EPS from continuing operations attributable to Raytheon Company	$0.25	$0.29	$0.37	$0.38

In addition, net revenue recognized from our performance obligations satisfied in previous periods was $139 million and $147 million in the second quarters of 2017 and 2016, respectively, and $214 million and $192 million in the first six months of 2017 and 2016, respectively. This primarily relates to EAC adjustments that impacted revenue.

We also sell security software through our Forcepoint™ segment. For the majority of these arrangements, we recognize revenue over the term of the agreement because the software requires continuous updates to provide the intended security functionality. To a lesser extent in all of our business segments, we enter into other types of contracts including service arrangements and non-subscription software and licensing agreements. We recognize revenue for these arrangements over time or at a point in time depending on our evaluation of when the customer obtains control of the promised goods or services. For software arrangements that include multiple performance obligations, including hardware, perpetual software licenses, subscriptions, term licenses and maintenance and/or services, we allocate revenue to each performance obligation based on estimates of the price that we would charge the customer for each promised product or service if it were sold on a standalone basis.

Receivables, Net—Receivables, net, include amounts billed and currently due from customers. The amounts due are stated at their net estimated realizable value. We maintain an allowance for doubtful accounts to provide for the estimated amount of receivables that will not be collected. The allowance is based upon an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivables and collateral to the extent applicable.

Contract Assets—Contract assets include unbilled amounts typically resulting from sales under long-term contracts when the cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer, and right to payment is not just subject to the passage of time. Amounts may not exceed their net realizable value. Contract assets are generally classified as current.

Deferred Commissions—Our incremental direct costs of obtaining a contract, which consist of sales commissions primarily for our security software sales at Forcepoint, are deferred and amortized over the period of contract performance or a longer period, generally the estimated life of the customer relationship, if renewals are expected and the renewal commission is not commensurate with the initial commission. We classify deferred commissions as current or noncurrent based on the timing of when we expect to recognize the expense. The current and noncurrent portions of deferred commissions are included in prepaid expenses and other current assets and other assets, net, respectively, in our consolidated balance sheets. At both July 2, 2017 and December 31, 2016, we had $32 million of deferred commissions. We had $5 million and $3 million of amortization expense related to deferred commissions in the second quarters of 2017 and 2016, respectively, and $10 million and $5 million in the first six months of 2017 and

2016, respectively.

Contract Liabilities—Our contract liabilities consist of advance payments and billings in excess of revenue recognized and deferred revenue. We may also receive up-front payments related to software license sales primarily for Forcepoint, which in most cases we recognize ratably over the license term. Our contract assets and liabilities are reported in a net position on a contract-by-contract basis at the end of each reporting period. We classify advance payments and billings in excess of revenue recognized as current, and deferred revenue as current or noncurrent based on the timing of when we expect to recognize revenue. The noncurrent portion of deferred revenue is included in accrued retiree benefits and other long-term liabilities in our consolidated balance sheets.

In order to determine revenue recognized in the period from contract liabilities, we first allocate revenue to the individual contract liability balance outstanding at the beginning of the period until the revenue exceeds that balance.

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Remaining Performance Obligations—Remaining performance obligations represents the transaction price of firm orders for which work has not been performed and excludes unexercised contract options and potential orders under ordering-type contracts (e.g., indefinite-delivery, indefinite-quantity (IDIQ)). As of July 2, 2017, the aggregate amount of the transaction price allocated to remaining performance obligations was $36 billion. The Company expects to recognize revenue on approximately half and three-quarters of the remaining performance obligations over the next 12 and 24 months, respectively, with the remainder recognized thereafter.

Note 4: Earnings Per Share (EPS)

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

We include all unvested stock awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, in the number of shares outstanding in our basic EPS calculation as they are considered participating securities. As a result, we have included all of our outstanding unvested restricted stock awards (RSAs), as well as restricted stock units (RSUs) and Long-term Performance Plan (LTPP) awards that meet the retirement eligible criteria in our calculation of basic EPS. We disclose EPS for common stock and unvested stock-based payment awards, and separately disclose distributed and undistributed earnings. Distributed earnings represent common stock dividends and dividends earned on unvested RSAs and stock-based payment awards of retirement eligible employees. Undistributed earnings represent earnings that were available for distribution but were not distributed. Common stock and unvested stock-based payment awards earn dividends equally.

As described in "Note 8: Forcepoint Joint Venture", we record redeemable noncontrolling interest related to Vista Equity Partners' interest in Forcepoint. We reflect the redemption value adjustments for redeemable noncontrolling interest in both the basic and diluted EPS calculation for the portion of redemption value that is in excess of the fair value of noncontrolling interest.

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

	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.80	$0.73	$1.59	$1.46
Undistributed earnings	1.10	1.68	2.03	2.38
Total	$1.90	$2.41	$3.62	$3.84
Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$0.79	$0.73	$1.59	$1.46
Undistributed earnings	1.10	1.68	2.03	2.37
Total	$1.89	$2.41	$3.62	$3.83

Basic and diluted EPS from discontinued operations attributable to Raytheon Company common stockholders and unvested stock-based payment awards was a loss of less than $0.01 in the second quarters of 2017 and 2016, and earnings of $0.01 and earnings of less than $0.01 in the first six months of 2017 and 2016, respectively.

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Income attributable to participating securities was as follows:

(In millions)	Three Months Ended Jul 2, 2017	Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017	Six Months Ended Jul 3, 2016
Income from continuing operations attributable to participating securities	$ 6	$ 9	$ 13	$ 17
Income (loss) from discontinued operations, net of tax attributable to participating securities(1)	—	—	—	—
Net income attributable to participating securities	$ 6	$ 9	$ 13	$ 17

(1) Income (loss) from discontinued operations, net of tax attributable to participating securities was a loss of less than $1 million in the second quarters of 2017 and 2016, and income of less than $1 million in the first six months of 2017 and 2016.

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

(In millions)	Three Months Ended Jul 2, 2017	Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017	Six Months Ended Jul 3, 2016
Shares for basic EPS(1)	291.7	297.3	292.1	298.2
Dilutive effect of LTPP and RSUs	0.3	0.3	0.3	0.4
Shares for diluted EPS	292.0	297.6	292.4	298.6

(1) Includes 3.3 million and 3.8 million participating securities in the second quarters of 2017 and 2016, respectively, and 3.7 million and 4.3 million participating securities in the first six months of 2017 and 2016, respectively.

Note 5: Inventories

Inventories consisted of the following:

(In millions)	Jul 2, 2017	Dec 31, 2016
Materials and purchased parts	$ 67	$ 66
Work in process	500	532
Finished goods	14	10
Total	$ 581	$ 608

Precontract costs are costs incurred to fulfill a contract prior to contract award. Precontract costs, including general and administrative expenses that are specifically chargeable to the customer, are deferred in inventories if we determine that the costs are probable of recovery under a specific anticipated contract. All other precontract costs, including start-up costs, are expensed as incurred. Costs that are deferred are recognized as contract costs upon the receipt of the anticipated contract. We included deferred precontract costs of $170 million and $189 million in inventories as work in process at July 2, 2017 and December 31, 2016, respectively.

Note 6: Contract Assets and Contract Liabilities

Our contract assets consist of unbilled amounts typically resulting from sales under long-term contracts when the cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. Our contract liabilities consist of advance payments and billings in excess of costs incurred and deferred revenue. The noncurrent portion of deferred revenue is included in accrued retiree benefits and other long-term liabilities in our consolidated balance sheets.

Net contract assets (liabilities) consisted of the following:

(In millions, except percentages)	Jul 2, 2017	Dec 31, 2016	$ change	% change
Contract assets	$5,728	$5,041	$ 687	14 %
Contract liabilities—current	(2,704)	(2,646)	(58)	2 %
Contract liabilities—noncurrent	(113)	(128)	15	(12)%
Net contract assets (liabilities)	$2,911	$2,267	$ 644	28 %

The $644 million increase in our net contract assets (liabilities) from December 31, 2016 to July 2, 2017 was due to a $687 million increase in our contract assets, primarily due to timing of payments on certain international programs.

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In the second quarter and first six months of 2017, we recognized revenue of $340 million and $952 million, respectively, related to our contract liabilities at January 1, 2017. In the second quarter and first six months of 2016, we recognized revenue of $312 million and $958 million, respectively, related to our contract liabilities at January 1, 2016.

Impairment losses recognized on our receivables and contract assets were de minimis in the second quarters and first six months of 2017 and 2016.

Note 7: Acquisitions and Goodwill
In pursuing our business strategies, we acquire and make investments in certain businesses that meet strategic and financial criteria.

In February 2017, our Forcepoint business acquired the Skyfence cloud access security broker business for $39 million in cash, net of cash received, and exclusive of retention payments. Vista Equity Partners contributed 19.7% of the purchase price, which is reflected in contribution from noncontrolling interest in Forcepoint in our consolidated statements of cash flows. Skyfence solutions help companies to determine which cloud applications are in use by employees, analyze content in real-time to prevent malicious or unauthorized leakage and quickly identifies and blocks cyber-attacks. Skyfence will be integrated into our Forcepoint business to expand and enhance Forcepoint’s strategy to deliver cybersecurity systems that help customers understand people’s behaviors and intent as they interact with data and intellectual property wherever it may reside, including in the fast-growing cloud. In connection with this acquisition, we recorded $35 million of goodwill, primarily related to expected synergies from combining operations and the value of the existing workforce, all of which is expected to be deductible for tax purposes, and $5 million of intangible assets, primarily related to technology, with a weighted-average life of six years. We completed the purchase price allocation process in the second quarter of 2017.

Pro forma financial information and revenue from the date of acquisition has not been provided for this acquisition as it is not material.

A rollforward of goodwill by segment was as follows:

(In millions)	Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint(1)	Total
Balance at December 31, 2016	$ 1,702	$ 2,966	$ 4,154	$ 4,106	$ 1,860	$14,788
Acquisitions	—	—	—	—	35	35
Effect of foreign exchange rates and other	3	1	—	—	—	4
Balance at July 2, 2017	$ 1,705	$ 2,967	$ 4,154	$ 4,106	$ 1,895	$14,827

(1) At July 2, 2017, Forcepoint's fair value is estimated to exceed its net book value by approximately $410 million. As discussed in "Note 8: Forcepoint Joint Venture", we are required to determine Forcepoint's fair value on a quarterly basis due to the accounting related to the redeemable noncontrolling interest.

Note 8: Forcepoint Joint Venture
In May 2015, we created Forcepoint, a new cybersecurity joint venture company (with Vista Equity Partners), through a series of transactions by which we acquired Websense from Vista Equity Partners and combined it with Raytheon Cyber Products, formerly part of our Intelligence, Information and Services (IIS) segment. We then sold 19.7% of the equity interest in the combined company to Vista Equity Partners for $343 million.

The joint venture agreement between Raytheon and Vista Equity Partners provides Vista Equity Partners with certain rights to require Forcepoint to pursue an initial public offering at any time after four years and three months following the closing date of May 29, 2015, or pursue a sale of the company at any time after five years following the closing date. In either of these events, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint for cash at a price equal to fair value as determined under the joint venture agreement. Additionally, Vista Equity Partners has the ability to liquidate its ownership through a put option, which became exercisable on May 29, 2017. The put option allows Vista Equity Partners to require Raytheon to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint for cash at a price equal to fair value as determined under the joint venture agreement. Lastly, at any time on or after three years following the closing date, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint at a price equal to fair value as determined under the joint venture agreement. The joint venture agreement provides for the process under which the parties would determine the fair value of the interest and could result in a payment by Raytheon shortly after the exercise of the put option; however, the ultimate timing will depend on the actions of the parties and other factors. The estimate of fair value for purposes of presenting the redeemable noncontrolling interest in our consolidated balance sheets could differ from the parties' determination of fair value for the put option under the joint venture agreement.

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Vista Equity Partners' interest in Forcepoint is presented as redeemable noncontrolling interest, outside of stockholders' equity, in our consolidated balance sheets. The redeemable noncontrolling interest is recognized at the greater of the estimated redemption value as of the balance sheet date, which was $349 million at July 2, 2017, or the carrying value, defined as the initial value adjusted for Vista Equity Partners' share of the cumulative impact of net income (loss), other changes in accumulated other comprehensive income (loss) and additional contributions, which was $321 million at July 2, 2017. Adjustments to the redemption value over the period from the date of acquisition to the date the redemption feature becomes puttable are immediately recorded to retained earnings.

A rollforward of redeemable noncontrolling interest was as follows:

(In millions)	Six Months Ended Jul 2, 2017	Jul 3, 2016
Beginning balance	$449	$355
Net income (loss)	(12)	(13)
Other comprehensive income (loss), net of tax[1]	1	—
Contribution from noncontrolling interest	8	11
Adjustment of noncontrolling interest to redemption value	(97)	(10)
Ending balance	$349	$343

(1) Other comprehensive income (loss), net of tax, was a loss of less than $1 million in the first six months of 2016.

Note 9: Derivatives and Other Financial Instruments

Derivatives—Our primary market exposures are to foreign exchange rates and interest rates, and we use certain derivative financial instruments to help manage these exposures. We execute these instruments with financial institutions that we judge to be credit-worthy, and the majority of our foreign currency forward contracts are denominated in currencies of major industrial countries. We do not hold or issue derivative financial instruments for trading or speculative purposes.

The fair value of asset derivatives included in other assets, net and liability derivatives included in other current liabilities in our consolidated balance sheets related to foreign currency contracts were $40 million and $25 million, respectively, at July 2, 2017 and $53 million and $48 million, respectively, at December 31, 2016. The fair values of these derivatives are Level 2 in the fair value hierarchy at July 2, 2017 and December 31, 2016 because they are determined based on a market approach utilizing externally quoted forward rates for similar contracts.

We use foreign currency forward contracts to fix the functional currency value of specific commitments, payments and receipts. The aggregate notional amount of the outstanding foreign currency forward contracts was $1,097 million and $1,277 million at July 2, 2017 and December 31, 2016, respectively. The net notional exposure of these contracts was approximately $197 million and $342 million at July 2, 2017 and December 31, 2016, respectively.

Our foreign currency forward contracts contain offset or netting provisions to mitigate credit risk in the event of counterparty default, including payment default and cross default. At July 2, 2017 and December 31, 2016, the fair value of our counterparty default exposure was less than $1 million and spread across numerous highly rated counterparties.

There were no interest rate swaps outstanding at July 2, 2017 and December 31, 2016.

Other Financial Instruments—We invest in marketable securities in accordance with our short-term investment policy and cash management strategy. These marketable securities are classified as available-for-sale and are recorded at fair value as short-term investments in our consolidated balance sheets. These investments are deemed Level 2 assets under the fair value hierarchy at July 2, 2017 and December 31, 2016, as their fair value is determined under a market approach using valuation models that utilize observable inputs, including maturity date, issue date, settlement date and current rates. At July 2, 2017 and December 31, 2016, we had short-term investments of $410 million and $100 million, respectively, consisting of highly rated bank certificates of deposit with a minimum long-term debt rating of A or A2 and a minimum short-term debt rating of A-1 and P-1. As of July 2, 2017, our short-term investments had an average maturity of approximately one month. The amortized cost of these securities closely approximated their fair value at July 2, 2017 and December 31, 2016. There were no securities deemed to have other than temporary declines in value in the second quarter of 2017. In the second quarter and first six months of 2017, we recorded unrealized gains on short-term investments of less than $1 million, net of tax, in accumulated other comprehensive loss (AOCL). In the second quarter and first six months of 2016, we recorded unrealized losses on short-term investments of less than $1 million, net of tax, in AOCL, and unrealized gains on short-term investments of less than $1 million, net of tax, in AOCL, respectively. We did not have any sales of short-term investments in the second quarters and first six months of 2017 and 2016. For purposes of computing realized gains and losses on available-for-sale securities, we determine cost on a specific identification basis.

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In addition to the financial instruments discussed above, we hold other financial instruments, including cash and cash equivalents, notes receivable, commercial paper and long-term debt. The carrying amounts for cash and cash equivalents, notes receivable and commercial paper approximated their fair values. The carrying value of long-term debt was recorded at amortized cost. The estimated fair value of long-term debt was determined based on quoted prices in inactive markets, which falls within Level 2 of the fair value hierarchy. The carrying value and estimated fair value of long-term debt were as follows:

(In millions)	Jul 2, 2017	Dec 31, 2016
Carrying value of long-term debt	$4,747	$5,335
Fair value of long-term debt	5,288	5,848

In addition, we did not have any transfers of assets or liabilities between levels of the fair value hierarchy during the first six months of 2017.

In the second quarter of 2017, we received net proceeds of $300 million from the issuance of short-term commercial paper and we exercised our call rights to repurchase, at prices based on fixed spreads to the U.S. Treasury rates, $591 million of our long-term debt due March and December 2018 at a loss of $39 million pretax, $25 million after tax, which is included in other (income) expense, net. The commercial paper notes outstanding have original maturities of not more than 90 days from the date of issuance. At July 2, 2017, short-term commercial paper borrowings outstanding were $300 million, which had a weighted average interest rate and original maturity period of 1.221% and 25 days, respectively. At December 31, 2016, there were no commercial paper borrowings outstanding.

Note 10: Commitments and Contingencies

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

(In millions, except percentages)	Jul 2, 2017	Dec 31, 2016
Total remediation costs—undiscounted	$210	$219
Weighted average discount rate	5.2 %	5.2 %
Total remediation costs—discounted	$146	$147
Recoverable portion	95	92

We also lease certain government-owned properties and generally are not liable for remediation of preexisting environmental contamination at these sites. As a result, we generally do not provide for these costs in our consolidated financial statements.

Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage and the unresolved extent of our responsibility, it is difficult to determine the ultimate outcome of environmental matters. However, we do not expect any additional liability to have a material adverse effect on our financial position, results of operations or liquidity.

Financing Arrangements and Other—We issue guarantees, and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. These instruments expire on various dates through 2025. Additional guarantees of project performance for which there is no stated value also remain outstanding. The stated values outstanding consisted of the following:

(In millions)	Jul 2, 2017	Dec 31, 2016
Guarantees	$ 208	$ 190
Letters of credit	2,560	2,345
Surety bonds	127	127

Included in guarantees and letters of credit described above were $208 million and $45 million, respectively, at July 2, 2017, and $180 million and $44 million, respectively, at December 31, 2016, related to our joint venture in Thales-Raytheon Systems Co. Ltd. (TRS). As previously disclosed in our Form 10-K for the year ended December 31, 2016, the joint venture agreement for the

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TRS joint venture was amended and restated in 2016, reducing the scope of the joint venture to Thales-Raytheon Systems Air and Missile Defense Command and Control S.A.S. (TRS AMDC2) only. We provide these guarantees and letters of credit to TRS AMDC2 and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. While we expect these entities to satisfy their loans and meet their project performance and other contractual obligations, their failure to do so may result in a future obligation to us. We periodically evaluate the risk of TRS AMDC2 and other affiliates failing to meet their obligations described above. At July 2, 2017, we believe the risk that TRS AMDC2 and other affiliates will not be able to meet their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at July 2, 2017. We had an estimated liability of $3 million at July 2, 2017 and December 31, 2016 related to these guarantees and letters of credit.

As discussed in "Note 8: Forcepoint Joint Venture", under the joint venture agreement between Raytheon Company and Vista Equity Partners, Raytheon may be required to purchase Vista Equity Partners' interest in Forcepoint.

We have entered into industrial cooperation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. At July 2, 2017, the aggregate amount of our offset agreements, both agreed to and anticipated to be agreed to, had an outstanding notional value of approximately $8.8 billion. These agreements are designed to return economic value to the foreign country by requiring us to engage in activities supporting local defense or commercial industries, promoting a balance of trade, developing in-country technology capabilities or addressing other local development priorities. Offset agreements may be satisfied through activities that do not require a direct cash payment, including transferring technology, providing manufacturing, training and other consulting support to in-country projects, and the purchase by third parties (e.g., our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for activities such as subcontracting with local partners, purchasing supplies from in-country vendors, providing financial support for in-country projects and making investments in local ventures. Such activities may also vary by country depending upon requirements as dictated by their governments. We typically do not commit to offset agreements until orders for our products or services are definitive. The amounts ultimately applied against our offset agreements are based on negotiations with the customers and typically require cash outlays that represent only a fraction of the notional value in the offset agreements. Offset programs usually extend over several or more years and may provide for penalties in the event we fail to perform in accordance with offset requirements. We have historically not been required to pay any such penalties.

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

In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against, or initiated by, us. We do not expect any of these proceedings to result in any additional liability or gains that would materially affect our financial position, results of operations or liquidity. In connection with certain of our legal matters, we may be entitled to insurance recovery for qualified legal costs or other incurred costs. We do not expect any insurance recovery to have a material impact on the financial exposure that could result from these matters.

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Note 11: Stockholders' Equity

The changes in shares of our common stock outstanding were as follows:

(In millions)	Six Months Ended Jul 2, 2017	Jul 3, 2016
Beginning balance	292.8	299.0
Stock plans activity	1.1	1.6
Share repurchases	(3.8)	(5.5)
Ending balance	290.1	295.1

From time to time, our Board of Directors authorizes the repurchase of shares of our common stock. In November 2015, our Board authorized the repurchase of up to $2.0 billion of our outstanding common stock. At July 2, 2017, we had approximately $1.1 billion available under the 2015 repurchase program. Share repurchases will take place from time to time at management's discretion depending on market conditions.

Share repurchases also include shares surrendered by employees to satisfy tax withholding obligations in connection with RSAs, RSUs and LTPP awards issued to employees.

Our share repurchases were as follows:

(In millions)	Six Months Ended Jul 2, 2017		Jul 3, 2016	
	$	Shares	$	Shares
Shares repurchased under our share repurchase programs	$500	3.3	$602	4.8
Shares repurchased to satisfy tax withholding obligations	79	0.5	92	0.7
Total share repurchases	$579	3.8	$694	5.5

In March 2017, our Board of Directors authorized an 8.9% increase to our annual dividend payout rate from $2.93 to $3.19 per share. Our Board of Directors also declared dividends of $1.595 per share during the first six months of 2017, compared to dividends of $1.465 per share during the first six months of 2016. Dividends are subject to quarterly approval by our Board of Directors.

Stock-based Compensation Plans

RSAs and RSUs—During the first six months of 2017, we granted 1.0 million combined RSAs and RSUs with a weighted-average grant-date fair value of $152.08, calculated under the intrinsic value method. These awards generally vest in equal installments on each of the second, third and fourth anniversary dates of the award's grant date.

LTPP—During the first six months of 2017, we granted RSUs subject to the 2017–2019 LTPP plan with an aggregate target award of 0.1 million units and a weighted-average grant-date fair value of $151.94. The performance goals for the 2017–2019 LTPP award are independent of each other and based on three metrics, as defined in the award agreements: return on invested capital (ROIC), weighted at 50%; total shareholder return (TSR) relative to a peer group, weighted at 25%; and cumulative free cash flow from continuing operations (CFCF), weighted at 25%. The ultimate award, which is determined at the end of the three-year cycle, can range from zero to 200% of the target award and includes dividend equivalents, which are not included in the aggregate target award numbers. The grant-date fair value is based upon the value determined under the intrinsic value method for the CFCF and ROIC portions of the award and the Monte Carlo simulation method for the TSR portion of the award.

Forcepoint Plans—In 2015, Forcepoint established long-term incentive plans that provide for awards of unit appreciation rights and profits interests in the joint venture to Forcepoint management and key employees. Awards are approved by the Board of Forcepoint. These awards vest over a specified period of time and settlement is subject to a liquidity event defined as either a change in control or an initial public offering of the joint venture. In certain limited circumstances other vesting conditions may apply and the expense attributable to these vesting conditions was $2 million and $1 million in the second quarter and first six months of 2017, respectively. At July 2, 2017, there were 131 thousand combined units and/or profits interests authorized for award under these plans.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes gains and losses associated with pension and PRB, foreign exchange translation adjustments, the effective portion of gains and losses on derivative instruments qualified as cash flow hedges, and unrealized gains (losses) on available-for-sale investments. The computation of other comprehensive income (loss) and its components are presented in the consolidated statements of comprehensive income.

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A rollforward of accumulated other comprehensive income (loss) was as follows:

(In millions)	Pension and PRB plans, net[(1)]	Foreign exchange translation	Cash flow hedges[(2)]	Unrealized gains (losses) on investments and other, net[(3)]	Total
Balance at December 31, 2016	$(7,234)	$ (175)	$ —	$ (2)	$(7,411)
Before tax amount	565	44	8	—	617
Tax (expense) or benefit	(197)	—	(3)	—	(200)
Net of tax amount	368	44	5	—	417
Balance at July 2, 2017	$(6,866)	$ (131)	$ 5	$ (2)	$(6,994)
Balance at December 31, 2015	$(7,088)	$ (60)	$ (16)	$ (12)	$(7,176)
Before tax amount	496	(46)	8	2	460
Tax (expense) or benefit	(178)	—	(4)	(1)	(183)
Net of tax amount	318	(46)	4	1	277
Balance at July 3, 2016	$(6,770)	$ (106)	$ (12)	$ (11)	$(6,899)

(1) Pension and PRB plans, net, is shown net of tax benefits of $3,684 million and $3,881 million at July 2, 2017 and December 31, 2016, respectively.

(2) Cash flow hedges are shown net of tax expense of $2 million and tax benefit of $1 million at July 2, 2017 and December 31, 2016, respectively.

(3) Unrealized gains (losses) on investments and other, net are shown net of tax expense of $1 million at both July 2, 2017 and December 31, 2016.

Material amounts reclassified out of AOCL were related to amortization of net actuarial loss associated with our pension and PRB plans and were $563 million and $491 million before tax in the first six months of 2017 and 2016, respectively. This component of AOCL is included in the calculation of net periodic pension expense (income) (see "Note 12: Pension and Other Employee Benefits" for additional details).

We expect $5 million of after tax net unrealized gains on our cash flow hedges at July 2, 2017 to be reclassified into earnings at then-current values over the next 12 months as the underlying hedged transactions occur.

Note 12: Pension and Other Employee Benefits

We have pension plans covering the majority of our employees hired prior to January 1, 2007, including certain employees in foreign countries (Pension Benefits). Our primary pension obligations relate to our domestic Internal Revenue Service (IRS) qualified pension plans. In addition, we provide certain health care and life insurance benefits to retired employees and to eligible employees upon retirement through PRB plans.

We also sponsor nonqualified defined benefit and defined contribution plans to provide benefits in excess of qualified plan limits. We have set aside certain assets in a separate trust, which we expect to be used to pay for trust obligations. The fair value of marketable securities held in trust, which are considered Level 1 assets under the fair value hierarchy, consisted of the following:

(In millions)	Jul 2, 2017	Dec 31, 2016
Marketable securities held in trust	$587	$ 550

Included in marketable securities held in trust in the table above was $375 million and $354 million at July 2, 2017 and December 31, 2016, respectively, related to the nonqualified defined contribution plans. The liabilities related to the nonqualified defined contribution plans were $384 million and $360 million at July 2, 2017 and December 31, 2016, respectively.

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The components of net periodic pension expense (income) were as follows:

(In millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Service cost	$116	$123	$233	$246
Interest cost	267	273	534	545
Expected return on plan assets	(345)	(380)	(690)	(759)
Amounts reflected in net funded status	38	16	77	32
Amortization of prior service cost included in net periodic pension expense	1	1	2	2
Recognized net actuarial loss	280	245	559	490
Loss due to settlements	—	—	—	3
Amounts reclassified during the period	281	246	561	495
Net periodic pension expense (income)	$319	$262	$638	$527

Net periodic pension expense (income) includes expense of less than $1 million and income of $1 million from foreign Pension Benefits plans in the second quarters of 2017 and 2016, respectively, and expense of $1 million and income of $2 million in the first six months of 2017 and 2016, respectively.

Net periodic PRB expense was $5 million and $3 million in the second quarters of 2017 and 2016, respectively, and $11 million and $7 million in the first six months of 2017 and 2016, respectively.

Long-term pension and PRB liabilities consisted of the following:

(In millions)	Jul 2, 2017	Dec 31, 2016
Long-term pension liabilities	$7,061	$7,074
Long-term PRB liabilities	357	358
Total long-term pension and PRB liabilities	$7,418	$7,432

We made the following contributions to our pension and PRB plans:

(In millions)	Six Months Ended	
	Jul 2, 2017	Jul 3, 2016
Required pension contributions	$74	$ 79
PRB contributions	11	10

We did not make any discretionary contributions to our pension plans during the first six months of 2017 and 2016; however, we periodically evaluate whether to make discretionary contributions.

Note 13: Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. We have participated in the IRS Compliance Assurance Process (CAP) program since 2011. All IRS examinations of our tax years prior to 2015 are closed. We continue to participate in the CAP program for the 2015, 2016 and 2017 tax years. We are also under audit by multiple state and foreign tax authorities.

There has been no material change in our unrecognized tax benefit since December 31, 2016.

Note 14: Business Segment Reporting

Our reportable segments, organized based on capabilities and technologies, are: Integrated Defense Systems (IDS); Intelligence, Information and Services (IIS); Missile Systems (MS); Space and Airborne Systems (SAS); and Forcepoint. Segment total net sales and operating income include intersegment sales and profit generally recorded at cost-plus a specified fee, which may differ from what the selling entity would be able to obtain on sales to external customers. Eliminations includes intersegment sales and profit eliminations. Corporate operating income includes expenses that represent unallocated costs and certain other corporate costs not considered part of management's evaluation of reportable segment operating performance. Acquisition Accounting Adjustments include the adjustments to record acquired deferred revenue at fair value as part of our purchase price allocation process and the amortization of acquired intangible assets related to historical acquisitions.

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As previously announced, effective January 1, 2017, we elected to early adopt the requirements of Topic 606 using the full retrospective method as discussed in "Note 2: Accounting Standards". The amounts and presentation of our business segments, including corporate and eliminations for intersegment activity, set forth in this Form 10-Q reflect these changes.

Segment financial results were as follows:

Total Net Sales (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$1,462	$1,399	$2,860	$2,735
Intelligence, Information and Services	1,555	1,587	3,062	3,119
Missile Systems	1,901	1,706	3,657	3,429
Space and Airborne Systems	1,608	1,547	3,163	2,992
Forcepoint	138	137	282	276
Eliminations	(372)	(326)	(722)	(673)
Total business segment sales	6,292	6,050	12,302	11,878
Acquisition Accounting Adjustments	(11)	(21)	(21)	(47)
Total	$6,281	$6,029	$12,281	$11,831

Intersegment Sales (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$17	$16	$32	$33
Intelligence, Information and Services	173	165	350	332
Missile Systems	37	33	65	68
Space and Airborne Systems	140	109	266	234
Forcepoint	5	3	9	6
Total	$372	$326	$722	$673

Operating Income (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$245	$376	$457	$522
Intelligence, Information and Services	115	120	226	224
Missile Systems	236	233	452	425
Space and Airborne Systems	218	205	408	372
Forcepoint	2	10	18	28
Eliminations	(37)	(34)	(74)	(67)
Total business segment operating income	779	910	1,487	1,504
Acquisition Accounting Adjustments	(42)	(51)	(84)	(109)
FAS/CAS Adjustment	109	109	217	214
Corporate	3	4	(30)	(24)
Total	$849	$972	$1,590	$1,585

	Three Months Ended		Six Months Ended	

Intersegment Operating Income (in millions)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$1	$ 1	$2	$ 1
Intelligence, Information and Services	17	16	34	32
Missile Systems	3	3	6	6
Space and Airborne Systems	13	10	26	22
Forcepoint	3	4	6	6
Total	$37	$ 34	$74	$ 67

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The FAS/CAS Adjustment, which is reported as a separate line in our segment results above, represents the difference between our pension and PRB expense or income under FAS in accordance with U.S. GAAP and our pension and PRB expense under U.S. government CAS. The results of each segment only include pension and PRB expense under CAS that we generally recover through the pricing of our products and services to the U.S. government. The components of the FAS/CAS Adjustment were as follows:

FAS/CAS Adjustment Income (Expense) (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
FAS/CAS Pension Adjustment	$109	$108	$218	$213
FAS/CAS PRB Adjustment	—	1	(1)	1
FAS/CAS Adjustment	$109	$109	$217	$214

Total assets for each of our business segments were as follows:

Total Assets (in millions)	Jul 2, 2017	Dec 31, 2016
Integrated Defense Systems(1)	$4,906	$4,573
Intelligence, Information and Services(1)	4,300	4,315
Missile Systems(1)	7,757	6,970
Space and Airborne Systems(1)	6,543	6,564
Forcepoint(1)	2,483	2,548
Corporate	4,240	5,268
Total	$30,229	$30,238

(1) Total assets includes intangible assets. Related amortization expense is included in Acquisition Accounting Adjustments.

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We disaggregate our revenue from contracts with customers by geographic location, customer-type and contract-type for each of our segments, as we believe it best depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors. See details in the tables below.

Disaggregation of Total Net Sales (in millions)	Three Months Ended July 2, 2017 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Other	Total
United States							
Sales to the U.S. government[(1)]							
Fixed-price contracts	$216	$ 256	$ 657	$ 512	$ 25	$—	$1,666
Cost-type contracts	388	912	507	717	3	—	2,527
Direct commercial sales and other							
Fixed-price contracts	1	37	—	7	42	—	87
Cost-type contracts	—	2	—	1	—	—	3
Asia/Pacific							
Foreign military sales through the U.S. government							
Fixed-price contracts	41	45	116	24	—	—	226
Cost-type contracts	38	13	16	2	—	—	69
Direct commercial sales and other							
Fixed-price contracts	142	47	78	64	15	—	346
Cost-type contracts	42	—	—	—	—	—	42
Middle East and North Africa							
Foreign military sales through the U.S. government							
Fixed-price contracts	258	6	88	46	—	—	398
Cost-type contracts	41	—	6	5	—	—	52
Direct commercial sales and other							
Fixed-price contracts	233	5	265	47	5	—	555
Cost-type contracts	—	—	—	—	—	—	—
All other (principally Europe)							
Foreign military sales through the U.S. government							
Fixed-price contracts	2	1	36	11	—	—	50
Cost-type contracts	6	1	23	1	—	—	31
Direct commercial sales and other							
Fixed-price contracts	34	51	71	31	32	—	219
Cost-type contracts	3	6	1	—	—	—	10
Total net sales	1,445	1,382	1,864	1,468	122	—	6,281
Intersegment sales	17	173	37	140	5	(372)	—
Acquisition Accounting Adjustments	—	—	—	—	11	(11)	—
Reconciliation to business segment sales	$1,462	$ 1,555	$ 1,901	$ 1,608	$ 138	$(383)	$6,281

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Geographic Areas (in millions)	Three Months Ended July 2, 2017 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total

United States	$605	$ 1,207	$ 1,164	$ 1,237	$ 70	$4,283
Asia/Pacific	263	105	210	90	15	683
Middle East and North Africa	532	11	359	98	5	1,005
All other (principally Europe)	45	59	131	43	32	310
Total net sales	$1,445	$ 1,382	$ 1,864	$ 1,468	$ 122	$6,281

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Total Net Sales by Major Customers (in millions)	Three Months Ended July 2, 2017 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Sales to the U.S. government[(1)]	$604	$ 1,168	$ 1,164	$ 1,229	$ 28	$4,193
U.S. direct commercial sales and other	1	39	—	8	42	90
Foreign military sales through the U.S. government	386	66	285	89	—	826
Foreign direct commercial sales and other[(1)]	454	109	415	142	52	1,172
Total net sales	$1,445	$ 1,382	$ 1,864	$ 1,468	$ 122	$6,281

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Contract Type (in millions)	Three Months Ended July 2, 2017 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Fixed-price contracts	$927	$ 448	$ 1,311	$ 742	$ 119	$3,547
Cost-type contracts	518	934	553	726	3	2,734
Total net sales	$1,445	$ 1,382	$ 1,864	$ 1,468	$ 122	$6,281

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Disaggregation of Total Net Sales (in millions)	Three Months Ended July 3, 2016 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Other	Total
United States							
Sales to the U.S. government[1]							
Fixed-price contracts	$198	$ 330	$ 599	$ 632	$ 18	$—	$1,777
Cost-type contracts	357	839	502	523	3	—	2,224
Direct commercial sales and other							
Fixed-price contracts	—	37	—	7	47	—	91
Cost-type contracts	3	18	—	—	—	—	21
Asia/Pacific							
Foreign military sales through the U.S. government							
Fixed-price contracts	42	42	66	27	—	—	177
Cost-type contracts	27	15	26	2	—	—	70
Direct commercial sales and other							
Fixed-price contracts	130	40	58	65	12	—	305
Cost-type contracts	46	—	—	—	—	—	46
Middle East and North Africa							
Foreign military sales through the U.S. government							
Fixed-price contracts	202	28	84	41	—	—	355
Cost-type contracts	45	1	9	—	—	—	55
Direct commercial sales and other							
Fixed-price contracts	288	9	244	98	4	—	643
Cost-type contracts	—	—	—	—	—	—	—
All other (principally Europe)							
Foreign military sales through the U.S. government							
Fixed-price contracts	—	—	25	3	—	—	28
Cost-type contracts	5	—	26	2	—	—	33
Direct commercial sales and other							
Fixed-price contracts	39	55	34	38	29	—	195
Cost-type contracts	1	8	—	—	—	—	9
Total net sales	1,383	1,422	1,673	1,438	113	—	6,029
Intersegment sales	16	165	33	109	3	(326)	—
Acquisition Accounting Adjustments	—	—	—	—	21	(21)	—
Reconciliation to business segment sales	$1,399	$ 1,587	$ 1,706	$ 1,547	$ 137	$(347)	$6,029

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Geographic Areas (in millions)	Three Months Ended July 3, 2016 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
United States	$558	$ 1,224	$ 1,101	$ 1,162	$ 68	$4,113
Asia/Pacific	245	97	150	94	12	598
Middle East and North Africa	535	38	337	139	4	1,053

All other (principally Europe)	45	63	85	43	29	265
Total net sales	$1,383	$ 1,422	$ 1,673	$ 1,438	$ 113	$6,029

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Total Net Sales by Major Customers (in millions)	Three Months Ended July 3, 2016					
	Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Sales to the U.S. government[1]	$555	$ 1,169	$ 1,101	$ 1,155	$ 21	$4,001
U.S. direct commercial sales and other	3	55	—	7	47	112
Foreign military sales through the U.S. government	321	86	236	75	—	718
Foreign direct commercial sales and other[1]	504	112	336	201	45	1,198
Total net sales	$1,383	$ 1,422	$ 1,673	$ 1,438	$ 113	$6,029

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Contract Type (in millions)	Three Months Ended July 3, 2016					
	Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Fixed-price contracts	$899	$ 541	$ 1,110	$ 911	$ 110	$3,571
Cost-type contracts	484	881	563	527	3	2,458
Total net sales	$1,383	$ 1,422	$ 1,673	$ 1,438	$ 113	$6,029

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Disaggregation of Total Net Sales (in millions)	Six Months Ended July 2, 2017 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Other	Total
United States							
Sales to the U.S. government[1]							
Fixed-price contracts	$401	$ 519	$ 1,260	$ 1,043	$ 47	$—	$3,270
Cost-type contracts	757	1,774	991	1,379	6	—	4,907
Direct commercial sales and other							
Fixed-price contracts	3	70	1	13	95	—	182
Cost-type contracts	1	4	—	1	—	—	6
Asia/Pacific							
Foreign military sales through the U.S. government							
Fixed-price contracts	85	88	187	42	—	—	402
Cost-type contracts	72	29	33	4	—	—	138
Direct commercial sales and other							
Fixed-price contracts	301	85	125	138	26	—	675
Cost-type contracts	81	—	—	—	—	—	81
Middle East and North Africa							
Foreign military sales through the U.S. government							
Fixed-price contracts	528	10	193	94	—	—	825
Cost-type contracts	78	2	12	5	—	—	97
Direct commercial sales and other							
Fixed-price contracts	456	12	497	91	11	—	1,067
Cost-type contracts	—	—	—	—	—	—	—
All other (principally Europe)							
Foreign military sales through the U.S. government							
Fixed-price contracts	2	2	63	20	—	—	87
Cost-type contracts	11	1	39	3	—	—	54
Direct commercial sales and other							
Fixed-price contracts	44	104	189	64	67	—	468
Cost-type contracts	8	12	2	—	—	—	22
Total net sales	2,828	2,712	3,592	2,897	252	—	12,281
Intersegment sales	32	350	65	266	9	(722)	—
Acquisition Accounting Adjustments	—	—	—	—	21	(21)	—
Reconciliation to business segment sales	$2,860	$ 3,062	$ 3,657	$ 3,163	$ 282	$(743)	$12,281

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Geographic Areas (in millions)	Six Months Ended July 2, 2017 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
United States	$1,162	$ 2,367	$ 2,252	$ 2,436	$ 148	$8,365
Asia/Pacific	539	202	345	184	26	1,296

Middle East and North Africa	1,062	24	702	190	11	1,989
All other (principally Europe)	65	119	293	87	67	631
Total net sales	$2,828	$ 2,712	$ 3,592	$ 2,897	$ 252	$12,281

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	Six Months Ended July 2, 2017					
Total Net Sales by Major Customers (in millions)	Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Sales to the U.S. government(1)	$1,158	$ 2,293	$ 2,251	$ 2,422	$ 53	$8,177
U.S. direct commercial sales and other	4	74	1	14	95	188
Foreign military sales through the U.S. government	776	132	527	168	—	1,603
Foreign direct commercial sales and other(1)	890	213	813	293	104	2,313
Total net sales	$2,828	$ 2,712	$ 3,592	$ 2,897	$ 252	$12,281

(1) Excludes foreign military sales through the U.S. government.

	Six Months Ended July 2, 2017					
Total Net Sales by Contract Type (in millions)	Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Fixed-price contracts	$1,820	$ 890	$ 2,515	$ 1,505	$ 246	$6,976
Cost-type contracts	1,008	1,822	1,077	1,392	6	5,305
Total net sales	$2,828	$ 2,712	$ 3,592	$ 2,897	$ 252	$12,281

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Disaggregation of Total Net Sales (in millions)	Six Months Ended July 3, 2016 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Other	Total
United States							
Sales to the U.S. government(1)							
Fixed-price contracts	$377	$ 598	$ 1,248	$ 1,161	$ 37	$—	$3,421
Cost-type contracts	734	1,694	981	1,068	7	—	4,484
Direct commercial sales and other							
Fixed-price contracts	6	76	—	17	92	—	191
Cost-type contracts	4	30	—	1	—	—	35
Asia/Pacific							
Foreign military sales through the U.S. government							
Fixed-price contracts	61	84	146	59	—	—	350
Cost-type contracts	56	17	39	4	—	—	116
Direct commercial sales and other							
Fixed-price contracts	250	74	94	120	23	—	561
Cost-type contracts	91	—	1	—	—	—	92
Middle East and North Africa							
Foreign military sales through the U.S. government							
Fixed-price contracts	392	36	184	83	—	—	695
Cost-type contracts	94	1	17	—	—	—	112
Direct commercial sales and other							
Fixed-price contracts	534	53	421	154	7	—	1,169
Cost-type contracts	—	—	—	—	—	—	—
All other (principally Europe)							
Foreign military sales through the U.S. government							
Fixed-price contracts	7	1	59	16	—	—	83
Cost-type contracts	12	—	47	3	—	—	62
Direct commercial sales and other							
Fixed-price contracts	78	106	123	72	57	—	436
Cost-type contracts	6	17	1	—	—	—	24
Total net sales	2,702	2,787	3,361	2,758	223	—	11,831
Intersegment sales	33	332	68	234	6	(673)	—
Acquisition Accounting Adjustments	—	—	—	—	47	(47)	—
Reconciliation to business segment sales	$2,735	$ 3,119	$ 3,429	$ 2,992	$ 276	$(720)	$11,831

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Geographic Areas (in millions)	Six Months Ended July 3, 2016 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
United States	$1,121	$ 2,398	$ 2,229	$ 2,247	$ 136	$8,131
Asia/Pacific	458	175	280	183	23	1,119

Middle East and North Africa	1,020	90	622	237	7	1,976
All other (principally Europe)	103	124	230	91	57	605
Total net sales	$2,702	$ 2,787	$ 3,361	$ 2,758	$ 223	$11,831

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Total Net Sales by Major Customers (in millions)	Six Months Ended July 3, 2016 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Sales to the U.S. government[1]	$1,111	$ 2,292	$ 2,229	$ 2,229	$ 44	$7,905
U.S. direct commercial sales and other	10	106	—	18	92	226
Foreign military sales through the U.S. government	622	139	492	165	—	1,418
Foreign direct commercial sales and other[1]	959	250	640	346	87	2,282
Total net sales	$2,702	$ 2,787	$ 3,361	$ 2,758	$ 223	$11,831

(1) Excludes foreign military sales through the U.S. government.

Total Net Sales by Contract Type (in millions)	Six Months Ended July 3, 2016 Integrated Defense Systems	Intelligence, Information and Services	Missile Systems	Space and Airborne Systems	Forcepoint	Total
Fixed-price contracts	$1,705	$ 1,028	$ 2,275	$ 1,682	$ 216	$6,906
Cost-type contracts	997	1,759	1,086	1,076	7	4,925
Total net sales	$2,702	$ 2,787	$ 3,361	$ 2,758	$ 223	$11,831

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With respect to the unaudited consolidated financial information of Raytheon Company for the six months ended July 2, 2017 and July 3, 2016, PricewaterhouseCoopers LLP (PricewaterhouseCoopers) reported that it has applied limited procedures in accordance with professional standards for a review of such information. Its report dated July 27, 2017, appearing below, states that the firm did not audit and does not express an opinion on that unaudited consolidated financial information. Accordingly, the degree of reliance on its report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers is not subject to the liability provisions of Section 11 of the Securities Act of 1933, as amended (Securities Act) for its report on the unaudited consolidated financial information because that report is not a "report" or a "part" of a registration statement prepared or certified by PricewaterhouseCoopers within the meaning of Sections 7 and 11 of the Securities Act.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Raytheon Company:

We have reviewed the accompanying consolidated balance sheet of Raytheon Company and its subsidiaries as of July 2, 2017, and the related consolidated statements of operations and of comprehensive income for the three-month and six-month periods ended July 2, 2017 and July 3, 2016 and the consolidated statements of equity and of cash flows for the six-month periods ended July 2, 2017 and July 3, 2016. This interim financial information is the responsibility of the Company's management.

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

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

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, of comprehensive income, of equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 15, 2017, which included a paragraph describing a change in the manner of accounting for the income tax effects of share-based payment transactions, we expressed an unqualified opinion on those consolidated financial statements. As discussed in Note 2 to the accompanying consolidated interim financial information, the Company changed its method of accounting for revenue transactions in 2017. The accompanying December 31, 2016 consolidated balance sheet reflects this change.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Boston, Massachusetts
July 27, 2017

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

OVERVIEW

We develop technologically advanced and integrated products, services and solutions in our core markets: sensing; effects; command, control, communications, computers, cyber and intelligence; mission support; and cybersecurity. We serve both domestic and international customers, primarily as a prime contractor or subcontractor on a broad portfolio of defense and related programs for government customers.

We operate in five segments: Integrated Defense Systems (IDS); Intelligence, Information and Services (IIS); Missile Systems (MS); Space and Airborne Systems (SAS); and Forcepoint. For a more detailed description of our segments, see “Business Segments” within Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2016.

As previously announced, effective January 1, 2017, we elected to early adopt the requirements of Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) using the full retrospective method as discussed in "Note 2: Accounting Standards" within Item 1 of this Form 10-Q. All amounts and disclosures set forth in this Form 10-Q reflect these changes.

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016 and our unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q.

CRITICAL ACCOUNTING ESTIMATES UPDATE

Our consolidated financial statements are based on the application of U.S. Generally Accepted Accounting Principles (GAAP), which require us to make estimates and assumptions about future events that affect the amounts reported in our unaudited consolidated financial statements and the accompanying notes. Our critical accounting estimates are detailed in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2016. Significant changes to our critical accounting estimates as a result of adopting Topic 606 are discussed below:

Revenue Recognition

We determine the appropriate revenue recognition for our contracts with customers by analyzing the type, terms and conditions of each contract or arrangement with a customer. We classify contract revenues as product or service according to the predominant attributes of the relevant underlying contracts unless the contract can clearly be split between product and service. We define service revenue as revenue from activities that are not associated with the design, development or production of tangible assets, the delivery of software code or a specific capability. Our service revenue is primarily related to our IIS business segment.

The following provides additional information about our contracts with customers, the judgments we make in accounting for those contracts, and the resulting amounts recognized in our financial statements.

Accounting for long-term contracts for complex aerospace or defense equipment (or related services)—To determine the proper revenue recognition method for contracts for complex aerospace or defense equipment or related services, we evaluate whether two or more contracts should be combined and accounted for as one single contract and whether the combined or single contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment and the decision to combine a group of contracts or separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recorded in a given period. For most of our contracts, the customer contracts with us to provide a significant service of integrating a complex set of tasks and components into a single project or capability (even if that single project results in the delivery of multiple units). Hence, the entire contract is accounted for as one performance obligation. Less commonly, however, we may promise to provide distinct goods or services within a contract in which case we separate the contract into more than one performance obligation. If a contract is separated into more than one performance obligation, we allocate the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. We infrequently sell standard products with observable standalone sales. In cases where we do, the observable standalone sales are used to determine the standalone selling price. More frequently, we sell a customized customer specific solution, and in these cases we typically use the expected cost plus a margin approach to estimate the standalone selling price of each performance obligation.

We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. For certain contracts that meet the foregoing requirements, primarily international direct commercial sale contracts, we recognize revenue before obtaining all regulatory approvals where receipt of those regulatory approvals is virtually certain based upon all known facts and circumstances.

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We generally recognize revenue over time as we perform because of continuous transfer of control to the customer. For U.S. government contracts, this continuous transfer of control 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. Similarly, for non-U.S. government contracts, the customer typically controls the work in process as evidenced either by contractual termination clauses or by our rights to payment for work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to the Company.

Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. We generally use the cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Under the 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 at completion of the performance obligation. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred. Costs to fulfill include labor, materials and subcontractors’ costs, other direct costs and an allocation of indirect costs including pension and any other postretirement benefit (PRB) expense under U.S. government Cost Accounting Standards (CAS).

Due to the nature of the work required to be performed on many of our performance obligations, the estimation of total revenue and cost at completion (the process described below in more detail) is complex, subject to many variables and requires significant judgment. It is common for our long-term contracts to contain award fees, incentive fees, or other provisions that can either increase or decrease the transaction price. These variable amounts generally are awarded upon achievement of certain performance metrics, program milestones or cost targets and can be based upon customer discretion. We estimate variable consideration at the most likely amount to which we expect to be entitled. We include estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of our anticipated performance and all information (historical, current and forecasted) that is reasonably available to us.

Contracts are often modified to account for changes in contract specifications and requirements. We consider contract modifications to exist when the modification either creates new or changes the existing enforceable rights and obligations. Most of our contract modifications are for goods or services that are not distinct from the existing contract due to the significant integration service provided in the context of the contract and are accounted for as if they were part of that existing contract. The effect of a contract modification on the transaction price and our measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) on a cumulative catch-up basis.

We have a companywide standard and disciplined quarterly Estimate at Completion (EAC) process in which management reviews the progress and execution of our performance obligations. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (e.g., the number and type of milestone events), technical requirements (e.g., a newly-developed product versus a mature product) and other contract requirements. Management must make assumptions and estimates regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the performance obligation (e.g., to estimate increases in wages and prices for materials and related support cost allocations), execution by our subcontractors, the availability and timing of funding from our customer and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations, required under certain contracts.

Based on this analysis, any quarterly adjustments to net sales, cost of sales, and the related impact to operating income are recognized as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating income during the performance of individual performance obligations, if we determine we will be successful in mitigating risks surrounding the technical, schedule and cost aspects of those performance obligations or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating income if we determine we will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, cost of sales and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a performance obligation's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our performance obligations. When estimates of total costs to be incurred exceed total estimates of revenue to be earned, on a performance obligation related to complex aerospace or defense equipment or related services, or product maintenance or separately priced extended warranty, a provision for the entire loss on the performance obligation is recognized in the period the loss is recorded.

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Net EAC adjustments had the following impact on our operating results:

(In millions, except per share amounts)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Operating income	$112	$134	$166	$155
Income from continuing operations attributable to Raytheon Company	73	87	108	112
Diluted earnings per share (EPS) from continuing operations attributable to Raytheon Company	$0.25	$0.29	$0.37	$0.38

In addition, net revenue recognized from our performance obligations satisfied in previous periods was $139 million and $147 million in the second quarters of 2017 and 2016, respectively, and $214 million and $192 million in the first six months of 2017 and 2016, respectively. This primarily relates to EAC adjustments that impacted revenue.

CONSOLIDATED RESULTS OF OPERATIONS

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

Total Net Sales

The composition of external net sales by products and services for each segment in the second quarter of 2017 was approximately the following:

(% of segment total external net sales)	IDS	IIS	MS	SAS	Forcepoint
Products	90 %	45 %	95 %	95 %	90 %
Services	10 %	55 %	5 %	5 %	10 %

(In millions, except percentages)	Three Months Ended		% of Total Net Sales	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Net sales				
Products	$5,275	$5,032	84.0 %	83.5 %
Services	1,006	997	16.0 %	16.5 %
Total net sales	$6,281	$6,029	100.0%	100.0%

Total Net Sales - Second Quarter of 2017 vs. Second Quarter of 2016—The increase in total net sales of $252 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to higher external net sales of $191 million at MS primarily due to higher net sales on the Standard Missile-2 (SM-2) program due to the recognition of previously deferred precontract costs based on contract award in the second quarter of 2017, higher net sales on the Standard Missile-3 (SM-3®) program primarily due to planned increases in production and higher net sales on the Paveway™ program principally driven by international requirements.

Products and Services Net Sales - Second Quarter of 2017 vs. Second Quarter of 2016—The increase in products net sales of $243 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to higher external products net sales of $164 million at MS primarily due to the programs described above in Total Net Sales. Services net sales in the second quarter of 2017 were relatively consistent with the second quarter of 2016.

(In millions, except percentages)	Six Months Ended		% of Total Net Sales	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Net sales				
Products	$10,319	$9,858	84.0 %	83.3 %
Services	1,962	1,973	16.0 %	16.7 %
Total net sales	$12,281	$11,831	100.0%	100.0%

Total Net Sales - First Six Months of 2017 vs. First Six Months of 2016—The increase in total net sales of $450 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to higher external net sales of $231 million at MS

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primarily due to higher net sales on the SM-3 program principally driven by planned increases in production, higher net sales on the Paveway program principally driven by international requirements, higher net sales on an international missile defense program due to planned increases in production and higher net sales on the SM-2 program due to the recognition of previously deferred precontract costs based on contract award in the second quarter of 2017, partially offset by lower net sales on the Advanced Medium-Range Air-to-Air Missile (AMRAAM®) program driven by the recognition of previously deferred precontract costs based on contract award in the first six months of 2016 and lower net sales on the Exoatmospheric Kill Vehicle (EKV) program due to planned production ramp down, with the remaining change spread across numerous programs with no individual or common significant driver.

Products and Services Net Sales - First Six Months of 2017 vs. First Six Months of 2016—The increase in products net sales of $461 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to higher external products net sales of $195 million at SAS and $186 million at MS. The increase in external products net sales at SAS was primarily due to higher net sales on the Next Generation Jammer (NGJ) program for the U.S. Navy, awarded in the second quarter of 2016 and higher net sales on a domestic classified program awarded in the third quarter of 2016, partially offset by lower net sales on an international classified program awarded in the first quarter of 2016 due to planned reduced schedule requirements, with the remaining change spread across numerous programs with no individual or common significant driver. The increase in external products net sales at MS was primarily due to the programs described above in Total Net Sales with the remaining change spread across numerous programs with no individual or common significant driver. Services net sales in the first six months of 2017 were relatively consistent with first six months of 2016. Included in the change in services net sales were lower external services net sales of $56 million at SAS primarily due to a decrease in volume on the Airborne Early Warning Radar Systems program, with the remaining change spread across numerous programs with no individual or common significant driver, and higher external services net sales of $45 million at MS was spread across numerous programs with no individual or common significant driver.

Sales to Major Customers - Second Quarter of 2017 vs. Second Quarter of 2016 and First Six Months of 2017 vs. First Six Months of 2016

(In millions, except percentages)	Three Months Ended		% of Total Net Sales	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Sales to the U.S. government(1)(2)	$4,193	$4,001	67 %	66 %
U.S. direct commercial sales and other	90	112	1 %	2 %
Foreign military sales through the U.S. government	826	718	13 %	12 %
Foreign direct commercial sales and other(1)	1,172	1,198	19 %	20 %
Total net sales	$6,281	$6,029	100%	100%

(1) Excludes foreign military sales through the U.S. government.

(2) Includes sales to the U.S. Department of Defense (DoD) of $4,024 million, or 64% of total net sales, in the second quarter of 2017 and $3,789 million, or 63% of total net sales, in the second quarter of 2016.

(In millions, except percentages)	Six Months Ended		% of Total Net Sales	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Sales to the U.S. government(1)(2)	$8,177	$7,905	67 %	67 %
U.S. direct commercial sales and other	188	226	1 %	2 %
Foreign military sales through the U.S. government	1,603	1,418	13 %	12 %
Foreign direct commercial sales and other(1)	2,313	2,282	19 %	19 %
Total net sales	$12,281	$11,831	100%	100%

(1) Excludes foreign military sales through the U.S. government.

(2) Includes sales to the U.S. DoD of $7,806 million, or 64% of total net sales, in the first six months of 2017 and $7,504 million, or 63% of total net sales, in the first six months of 2016.

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

	Three Months Ended		% of Total Net Sales	
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Cost of sales				
Products	$3,877	$3,549	61.7%	58.9%
Services	808	813	12.9%	13.5%
Total cost of sales	$4,685	$4,362	74.6%	72.4%

Total Cost of Sales - Second Quarter of 2017 vs. Second Quarter of 2016—The increase in total cost of sales of $323 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to higher external cost of sales of $181 million at IDS and $172 million at MS. The increase in external cost of sales at IDS was driven principally by the tax-free gain of $158 million from the sale of our equity method investment in Thales-Raytheon Systems Company S.A.S. (TRS SAS) in the second quarter of 2016. In the second quarter of 2016, we amended the joint venture agreement for the Thales-Raytheon Systems Co. Ltd. (TRS) joint venture, reducing the scope of the joint venture to Thales-Raytheon Systems Air and Missile Defense Command and Control S.A.S. (TRS AMDC2) only, which we account for using the equity method. As a result of the amendment, we acquired Thales S.A.'s noncontrolling interest in Raytheon Command and Control Solutions LLC (RCCS LLC) and sold our equity method investment in TRS SAS. We recorded the sale of our equity method investment in TRS SAS at fair value, which resulted in a tax-free gain of $158 million that was recorded in operating income through a reduction in cost of sales at our IDS segment. The increase in external cost of sales at MS was primarily due to the programs discussed above in Total Net Sales.

Products and Services Cost of Sales - Second Quarter of 2017 vs. Second Quarter of 2016—The increase in products cost of sales of $328 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to higher external products cost of sales of $190 million at IDS and $152 million at MS. The increase in external products cost of sales at IDS was driven principally by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016. The increase in external products cost of sales at MS was due to the programs described above in Total Net Sales. Services cost of sales in the second quarter of 2017 were relatively consistent with the second quarter of 2016.

	Six Months Ended		% of Total Net Sales	
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Cost of sales				
Products	$7,633	$7,188	62.2%	60.8%
Services	1,582	1,615	12.9%	13.7%
Total cost of sales	$9,215	$8,803	75.1%	74.5%

Total Cost of Sales - First Six Months of 2017 vs. First Six Months of 2016—The increase in total cost of sales of $412 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to higher external cost of sales of $220 million at MS and $176 million at IDS. The increase in external cost of sales at MS was primarily due to the programs described above in Total Net Sales with the remaining change spread across numerous programs with no individual or common significant driver. The increase in external cost of sales at IDS was driven principally by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016.

Products and Services Cost of Sales - First Six Months of 2017 vs. First Six Months of 2016—The increase in products cost of sales of $445 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to higher external products cost of sales of $203 million at IDS and $186 million at MS. The increase in external products cost of sales at IDS was principally driven by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS. The increase in external products cost of sales at MS was primarily due to the programs described above in Total Net Sales with the remaining change spread across numerous programs with no individual or common significant driver. Services cost of sales in the first six months of 2017 were relatively consistent with the first six months of 2016.

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General and Administrative Expenses

(In millions, except percentages)	Three Months Ended		% of Total Net Sales	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Administrative and selling expenses	$547	$514	8.7 %	8.5 %
Research and development expenses	200	181	3.2 %	3.0 %
Total general and administrative expenses	$747	$695	11.9%	11.5%

The increase in administrative and selling expenses of $33 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to an increase in selling and marketing expenses of $16 million principally driven by increased selling and marketing expense of $10 million at Forcepoint, primarily driven by higher costs related to the sales organization due to increased salesforce staffing. The remaining change in administrative and selling expenses was spread across numerous items and is consistent with the increase in total net sales described above in Total Net Sales.

Included in administrative and selling expenses is the provision for state income taxes, which generally can be recovered through the pricing of products and services to the U.S. government. Net state income taxes (refunds) allocated to our contracts were $4 million and $(2) million in the second quarters of 2017 and 2016, respectively.

The increase in research and development expenses of $19 million in the second quarter of 2017 compared to the second quarter of 2016 was spread across numerous projects with no individual or common significant driver.

(In millions, except percentages)	Six Months Ended		% of Total Net Sales	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Administrative and selling expenses	$1,105	$1,063	9.0 %	9.0 %
Research and development expenses	371	380	3.0 %	3.2 %
Total general and administrative expenses	$1,476	$1,443	12.0%	12.2%

The increase in administrative and selling expenses of $42 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to an increase in selling and marketing expenses of $29 million principally driven by increased selling and marketing expense of $18 million at Forcepoint, primarily driven by higher costs related to the sales organization due to increased salesforce staffing.

Included in administrative and selling expenses is the provision for state income taxes, which generally can be recovered through the pricing of products and services to the U.S. government. Net state income taxes allocated to our contracts were $13 million and $11 million in the first six months of 2017 and 2016, respectively.

The decrease in research and development expenses of $9 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to decreased research and development expenses of $15 million at MS driven principally by lower independent research and development activity related to advanced technologies efforts that substantially completed in 2016.

Total Operating Expenses

(In millions, except percentages)	Three Months Ended	Six Months Ended

	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Total operating expenses	$5,432	$5,057	$10,691	$10,246
% of Total Net Sales	86.5 %	83.9 %	87.1 %	86.6 %

The increase in total operating expenses of $375 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the increase in total cost of sales of $323 million, the primary drivers of which are described above in Total Cost of Sales.

The increase in total operating expenses of $445 million in the first six months of 2017 compared to the first six months of 2016 was due to the increase in total cost of sales of $412 million, the primary drivers of which are described above in Total Cost of Sales.

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Operating Income

(In millions, except percentages)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Operating income	$849	$972	$1,590	$1,585
% of Total Net Sales	13.5 %	16.1 %	12.9 %	13.4 %

The decrease in operating income of $123 million in the second quarter of 2017 compared to the second quarter of 2016 was due to the increase in total operating expenses of $375 million, the primary drivers of which are described above in Total Operating Expenses and include the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016 as described in Total Cost of Sales, partially offset by the increase in total net sales of $252 million, the primary drivers of which are described above in Total Net Sales.

Operating income in the first six months of 2017 was relatively consistent with the first six months of 2016. Included in Operating Income in the first six months of 2016 was the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016 as described in Total Cost of Sales.

Total Non-Operating (Income) Expense, Net

(In millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Non-operating (income) expense, net				
Interest expense	$51	$58	$109	$116
Interest income	(5)	(4)	(10)	(8)
Other (income) expense, net	35	(1)	28	(3)
Total non-operating (income) expense, net	$81	$53	$127	$105

The increase in total non-operating (income) expense, net of $28 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the $39 million pretax charge associated with the make-whole provision on the early repurchase of long-term debt in second quarter of 2017, partially offset by a decrease in interest expense of $7 million due to the repurchase of long-term debt in second quarter of 2017.

The increase in total non-operating (income) expense, net of $22 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to the $39 million pretax charge associated with the make-whole provision on the early repurchase of long-term debt in second quarter of 2017, partially offset by a $7 million change in the mark-to-market of marketable securities held in trust associated with certain of our nonqualified deferred compensation plans, due to net gains of $12 million in the first six months of 2017 compared to net gains of $5 million in the first six months of 2016, and a decrease in interest expense of $7 million due to the repurchase of long-term debt in second quarter of 2017.

Federal and Foreign Income Taxes

(In millions, except percentages)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Federal and foreign income taxes	$221	$205	$419	$362

Effective tax rate	28.8 %	22.3 %	28.6 %	24.5 %

Our effective tax rate in the second quarter of 2017 was 28.8% compared to 22.3% in the second quarter of 2016. The increase of 6.5% was primarily due to the tax-free gain related to the sale of our equity method investment in TRS SAS in the second quarter of 2016 disclosed above in Total Cost of Sales, which decreased the 2016 rate by 6.1%. The remaining decrease of 0.4% is composed of various items which individually or collectively are not significant.

Our effective tax rate in the second quarter of 2017 was 6.2% lower than the statutory federal rate primarily due to the tax benefit recognized upon settlement of equity awards, which decreased the rate by 2.9%, the domestic manufacturing deduction, which decreased the rate by 2.8%, and the research and development (R&D) tax credit, which decreased the rate by 1.3%. The offsetting increase of 0.8% is composed of various items which individually or collectively are not significant. In 2016, we elected to early adopt the requirements of ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which requires recognition of excess tax benefits and tax deficiencies in the income statement

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prospectively, and could result in fluctuations in our effective tax rate period over period depending on how many awards vest in a quarter as well as the volatility of our stock price.

Our effective tax rate in the second quarter of 2016 was 12.7% lower than the statutory federal rate primarily due to the tax-free gain related to the sale of our equity method investment in TRS SAS disclosed above in Total Cost of Sales, which decreased the rate by 6.1%, the tax benefit recognized upon settlement of equity awards, which decreased the rate by 3.1%, the domestic manufacturing deduction, which decreased the rate by 2.3%, and the R&D tax credit, which decreased the rate by 1.0%. The remaining decrease of 0.2% is composed of various items which individually or collectively are not significant.

Our effective tax rate in the first six months of 2017 was 28.6% compared to 24.5% in the first six months of 2016. The increase of 4.1% was primarily due to the tax-free gain related to the sale of our equity method investment in TRS SAS in the second quarter of 2016 disclosed above in Total Cost of Sales, which decreased the 2016 rate by 3.8%. The remaining increase of 0.3% is composed of various items which individually or collectively are not significant.

Our effective tax rate in the first six months of 2017 was 6.4% lower than the statutory federal rate primarily due to the domestic manufacturing deduction, which decreased the rate by 2.9%, the tax benefit recognized upon settlement of equity awards, which decreased the rate by 2.4%, and the R&D tax credit, which decreased the rate by 1.4%. The offsetting increase of 0.3% is composed of various items which individually or collectively are not significant.

Our effective tax rate in the first six months of 2016 was 10.5% lower than the statutory federal rate primarily due to the tax-free gain related to the sale of our equity method investment in TRS SAS disclosed above in Total Cost of Sales, which decreased the rate by 3.8%, the tax benefit recognized upon settlement of equity awards, which decreased the rate by 3.0%, the domestic manufacturing deduction, which decreased the rate by 2.8%, and the R&D tax credit, which decreased the rate by 1.2%. The remaining increase of 0.3% is composed of various items which individually or collectively are not significant.

Income from Continuing Operations

	Three Months Ended		Six Months Ended	
(In millions)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Income from continuing operations	$547	$714	$1,044	$1,118

The decrease in income from continuing operations of $167 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to a decrease of $123 million in operating income, the primary drivers of which are described above in Operating Income, and include the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016 as described in Total Cost of Sales.

The decrease in income from continuing operations of $74 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to an increase of $57 million in federal and foreign income taxes, related primarily to the increase in our effective tax rate, principally driven by the tax-free gain of $158 million related to the sale of our equity method investment in TRS SAS in the second quarter of 2016 disclosed above in Total Cost of Sales.

Net Income

	Three Months	Six Months Ended

	Ended			
(In millions)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Net income	$547	$713	$1,047	$1,118

The decrease in net income of $166 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the $167 million decrease in income from continuing operations, the primary drivers of which are described above in Income from Continuing Operations.

The decrease in net income of $71 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to the $74 million decrease in income from continuing operations, the primary drivers of which are described above in Income from Continuing Operations.

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Diluted EPS from Continuing Operations Attributable to Raytheon Company Common Stockholders

(In millions, except per share amounts)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Income from continuing operations attributable to Raytheon Company	$553	$718	$1,056	$1,145
Diluted weighted-average shares outstanding	292.0	297.6	292.4	298.6
Diluted EPS from continuing operations attributable to Raytheon Company	$1.89	$2.41	$3.62	$3.83

The decrease in diluted EPS from continuing operations attributable to Raytheon Company common stockholders of $0.52 in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the decrease in income from continuing operations described above partially offset by a decrease in weighted-average shares outstanding, which was affected by the common stock share activity shown in the table below.

The decrease in diluted EPS from continuing operations attributable to Raytheon Company common stockholders of $0.21 in the first six months of 2017 compared to the first six months of 2016 was primarily due to the decrease in income from continuing operations described above partially offset by a decrease in weighted-average shares outstanding, which was affected by the common stock share activity shown in the table below.

Our common stock share activity was as follows:

(In millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Beginning balance	291.0	296.9	292.8	299.0
Stock plans activity	—	0.2	1.1	1.6
Share repurchases	(0.9)	(2.0)	(3.8)	(5.5)
Ending balance	290.1	295.1	290.1	295.1

Diluted EPS Attributable to Raytheon Company Common Stockholders

(In millions, except per share amounts)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Net income attributable to Raytheon Company	$553	$717	$1,059	$1,145
Diluted weighted-average shares outstanding	292.0	297.6	292.4	298.6
Diluted EPS attributable to Raytheon Company	$1.89	$2.41	$3.63	$3.84

The decrease in diluted EPS attributable to Raytheon Company common stockholders of $0.52 in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the $0.52 decrease in diluted EPS from continuing operations attributable to Raytheon Company common stockholders described above.

The decrease in diluted EPS attributable to Raytheon Company common stockholders of $0.21 in the first six months of 2017 compared to the first six months of 2016 was primarily due to the $0.21 decrease in diluted EPS from continuing operations attributable to Raytheon Company common stockholders described above.

SEGMENT RESULTS

We report our results in the following segments: Integrated Defense Systems (IDS); Intelligence, Information and Services (IIS); Missile Systems (MS); Space and Airborne Systems (SAS); and Forcepoint.

As previously announced, effective January 1, 2017, we elected to early adopt the requirements of Topic 606 using the full retrospective method as discussed in "Note 2: Accounting Standards" within Item 1 of this Form 10-Q . The amounts and presentation of our business segments, including corporate and eliminations for intersegment activity, set forth in this Form 10-Q reflect these changes.

The following provides some context for viewing our segment performance through the eyes of management.

Given the nature of our business, bookings, total net sales and operating income (and the related operating margin percentage), which we disclose and discuss at the segment level, are most relevant to an understanding of management’s view of our segment

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performance, and often these measures have significant interrelated effects, as described below. In addition, we disclose and discuss backlog, which represents future sales that we expect to recognize over the remaining contract period, which is generally several years. We also disclose total operating expenses and the components of total operating expenses within our segment disclosures.

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

Bookings are impacted by the timing and amounts of awards in a given period, which are subject to numerous factors, including the desired capability by the customer and urgency of customer needs; customer budgets and other fiscal constraints; political and economic and other environmental factors; the timing of customer negotiations; the timing of governmental approvals and notifications; and the timing of option exercises or increases in scope. In addition, due to these factors, quarterly bookings tend to fluctuate from period to period, particularly on a segment basis. As a result, we believe comparing bookings on a quarterly basis or for periods less than one year is less meaningful than for longer periods and that shorter term changes in bookings may not necessarily indicate a material trend.

Bookings (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$1,231	$1,273	$2,862	$2,290
Intelligence, Information and Services	1,373	1,599	3,107	2,852
Missile Systems	2,755	1,891	3,498	3,523
Space and Airborne Systems	1,058	2,217	2,533	4,419
Forcepoint	115	123	220	220
Total	$6,532	$7,103	$12,220	$13,304

Included in bookings were international bookings of $2,265 million and $2,211 million in the second quarters of 2017 and 2016, respectively, and $4,157 million and $3,866 million in the first six months of 2017 and 2016, respectively, which included foreign military bookings through the U.S. government. International bookings amounted to 35% and 31% of total bookings in the second quarters of 2017 and 2016, respectively, and 34% and 29% of total bookings in the first six months of 2017 and 2016, respectively.

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

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Backlog—We disclose period-ending backlog for each segment, which is equivalent to our remaining performance obligations. Backlog represents the dollar value of firm orders for which work has not been performed. Backlog generally increases with bookings and generally converts into sales as we incur costs under the related contractual commitments. Therefore, we discuss changes in backlog, including any individually significant cancellations, for each of our segments, as we believe such discussion provides an understanding of the awarded but not executed portions of our contracts. Backlog excludes unexercised contract options and potential orders under ordering-type contracts (e.g., IDIQ). Backlog is affected by changes in foreign exchange rates.

Backlog (in millions)	Jul 2, 2017	Dec 31, 2016
Integrated Defense Systems	$10,055	$10,159
Intelligence, Information and Services	5,908	5,662
Missile Systems	11,382	11,568
Space and Airborne Systems	8,398	8,834
Forcepoint(1)	425	486
Total	$36,168	$36,709

(1) Forcepoint backlog excludes the unfavorable impact of $25 million and $45 million at July 2, 2017 and December 31, 2016, respectively, related to the Acquisition Accounting Adjustments to record acquired deferred revenue at fair value.

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

Total net sales by segment were as follows:

	Three Months Ended		Six Months Ended	
Total Net Sales (in millions)	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$1,462	$1,399	$2,860	$2,735
Intelligence, Information and Services	1,555	1,587	3,062	3,119
Missile Systems	1,901	1,706	3,657	3,429
Space and Airborne Systems	1,608	1,547	3,163	2,992
Forcepoint	138	137	282	276
Eliminations	(372)	(326)	(722)	(673)
Total business segment sales	6,292	6,050	12,302	11,878
Acquisition Accounting Adjustments	(11)	(21)	(21)	(47)
Total	$6,281	$6,029	$12,281	$11,831

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

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

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

Changes in net EAC adjustments typically relate to the current period impact of revisions to total estimated revenues and costs at completion. These changes reflect improved or deteriorated operating performance or award fee rates. For a full description of our EAC process, refer to Critical Accounting Estimates. Given that we have thousands of individual contracts and the types and complexity of the assumptions and estimates we must make on an on-going basis, we have both favorable and unfavorable EAC adjustments. We had the following aggregate EAC adjustments for the periods presented:

EAC Adjustments (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Gross favorable	$236	$228	$465	$407
Gross unfavorable	(124)	(94)	(299)	(252)
Total net EAC adjustments	$112	$134	$166	$155

Significant EAC adjustments in the second quarters and first six months of 2017 and 2016 are discussed in the Operating Income and Margin section of each business segment's discussion below. The decrease in net EAC adjustments of $22 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the decrease in net EAC adjustments at SAS. The increase in net EAC adjustments of $11 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to the increase in net EAC adjustments at IDS partially offset by the decrease in net EAC adjustments at SAS. Refer to the individual segment results for further information.

Changes in contract mix and other program performance refer to changes in operating margin due to a change in the relative volume of contracts with higher or lower fee rates such that the overall average margin rate for the segment changes, and other drivers of program performance including margin rate increases or decreases due to EAC adjustments in prior periods. A higher or lower expected fee rate at the initial award of a contract typically correlates to the contract's risk profile, which is often specifically driven by the type of customer and related procurement regulations, the type of contract (e.g., fixed-price vs. cost-plus), the maturity of the product or service and the scope of work. Changes in contract mix and other performance also include all other items which are not related to volume or EAC adjustments.

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

Operating income by segment was as follows:

Operating Income (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Integrated Defense Systems	$245	$376	$457	$522
Intelligence, Information and Services	115	120	226	224
Missile Systems	236	233	452	425

Space and Airborne Systems	218	205	408	372
Forcepoint	2	10	18	28
Eliminations	(37)	(34)	(74)	(67)
Total business segment operating income	779	910	1,487	1,504
Acquisition Accounting Adjustments	(42)	(51)	(84)	(109)
FAS/CAS Adjustment	109	109	217	214
Corporate	3	4	(30)	(24)
Total	$849	$972	$1,590	$1,585

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Integrated Defense Systems

	Three Months Ended			Six Months Ended		
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Total net sales	$1,462	$1,399	4.5 %	$2,860	$2,735	4.6 %
Total operating expenses						
Cost of sales—labor	530	498	6.4 %	1,065	1,007	5.8 %
Cost of sales—materials and subcontractors	465	482	(3.5)%	884	935	(5.5)%
Other cost of sales and other operating expenses	222	43	416.3 %	454	271	67.5 %
Total operating expenses	1,217	1,023	19.0 %	2,403	2,213	8.6 %
Operating income	$245	$376	(34.8)%	$457	$522	(12.5)%
Operating margin	16.8 %	26.9 %		16.0 %	19.1 %	

Change in Operating Income (in millions)	Three Months Ended Jul 2, 2017 Versus Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017 Versus Six Months Ended Jul 3, 2016
Volume	$5	$5
Net change in EAC adjustments	5	45
Mix and other performance	(141)	(115)
Total change in operating income	$(131)	$(65)

	Three Months Ended			Six Months Ended		
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Bookings	$1,231	$1,273	(3.3)%	$2,862	$2,290	25.0 %

Total Net Sales—The increase in total net sales of $63 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to higher net sales of $44 million on an international early warning radar program awarded in the first quarter of 2017, $32 million on a U.S. Navy combat systems program driven by program schedule and $30 million on an international Patriot program driven by an award in the fourth quarter of 2016, partially offset by lower sales of $47 million on an international air and missile defense system program due to the scheduled completion of certain production phases of the program.

The increase in total net sales of $125 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to higher net sales of $109 million on an international early warning radar program awarded in the first quarter of 2017.

Total Operating Expenses—The increase in total operating expenses of $194 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to an increase in other cost of sales and other operating expenses of $179 million and an increase in labor costs of $32 million. The increase in other cost of sales and other operating expenses was principally driven by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016 as described in Consolidated Results of Operations. The increase in labor costs was primarily due to activity on the international early warning radar program described above in Total Net Sales.

The increase in total operating expenses of $190 million in the first six months of 2017 compared to the first six months of 2016 was due to an increase in other cost of sales and other operating expenses of $183 million and an increase in labor costs of $58 million, partially offset by a decrease in materials and subcontractors costs of $51 million. The increase in other cost of sales and other operating expenses was principally driven by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016 as described in

Consolidated Results of Operations. The increase in labor costs was primarily due to activity on the international early warning radar program described above in Total Net Sales. The decrease in materials and subcontractors costs was primarily due to lower activity on an international air and missile defense system program driven by the scheduled completion of certain production phases of the program.

Operating Income and Margin—The decrease in operating income of $131 million and the related decrease in operating margin in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to a change in mix and other performance of $141 million, principally driven by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter 2016 as described in Consolidated Results of Operations, partially offset by higher volume on the international Patriot program described above in Total Net Sales.

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The decrease in operating income of $65 million and the related decrease in operating margin in the first six months of 2017 compared to the first six months of 2016 was primarily due to a change in mix and other performance of $115 million, partially offset by a net change in EAC adjustments of $45 million. The change in mix and other performance was driven principally by the tax-free gain of $158 million from the sale of our equity method investment in TRS SAS in the second quarter of 2016 as described in Consolidated Results of Operations, partially offset by higher volume on an international Patriot program driven by an award in the fourth quarter of 2016. The net change in EAC adjustments was driven principally by a negative profit adjustment of $36 million in the first quarter of 2016 on an international command and control program driven by costs to replace or repair shelters which the subcontractor refused to remedy resulting in the subcontractor being terminated.

Backlog and Bookings—Backlog was $10,055 million at July 2, 2017 compared to $10,159 million at December 31, 2016. Bookings decreased by $42 million in the second quarter of 2017 compared to the second quarter of 2016. In the second quarter of 2017, IDS booked $364 million on the Air and Missile Defense Radar (AMDR) program for the U.S. Navy and $146 million on the Multi-Function RF System (MFRFS) program for the U.S. Army. IDS also booked $178 million on two international Patriot contracts. In the second quarter of 2016, IDS booked $487 million to provide advanced Patriot air and missile defense capabilities for Kuwait. IDS also booked $354 million on the Aegis weapon system for the U.S. Navy and international customers and $117 million for in-service support for the Collins class submarine for the Royal Australian Navy.

Bookings increased by $572 million in the first six months of 2017 compared to the first six months of 2016. In addition to the bookings noted above, in the first six months of 2017, IDS booked $987 million for the Upgraded Early Warning Radar (UEWR) system for Qatar and $232 million to provide Patriot engineering services support for U.S. and international customers. In addition to the bookings noted above, in the first six months of 2016, IDS booked $191 million to provide Patriot engineering services support for U.S. and international customers and $84 million to provide advanced Patriot air and missile defense capability for the U.S. Army. IDS also booked $198 million on a classified program.

Intelligence, Information and Services

	Three Months Ended			Six Months Ended		
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Total net sales	$1,555	$1,587	(2.0)%	$3,062	$3,119	(1.8)%
Total operating expenses						
Cost of sales—labor	651	650	0.2 %	1,307	1,292	1.2 %
Cost of sales—materials and subcontractors	573	620	(7.6)%	1,119	1,216	(8.0)%
Other cost of sales and other operating expenses	216	197	9.6 %	410	387	5.9 %
Total operating expenses	1,440	1,467	(1.8)%	2,836	2,895	(2.0)%
Operating income	$115	$120	(4.2)%	$226	$224	0.9 %
Operating margin	7.4 %	7.6 %		7.4 %	7.2 %	

Change in Operating Income (in millions)	Three Months Ended Jul 2, 2017 Versus Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017 Versus Six Months Ended Jul 3, 2016
Volume	$(3)	$(5)
Net change in EAC adjustments	4	(4)
Mix and other performance	(6)	11
Total change in operating income	$(5)	$2

	Three Months Ended		Six Months Ended	
(In millions, except percentages)		% Change		% Change

	Jul 2, 2017	Jul 3, 2016		Jul 2, 2017	Jul 3, 2016	
Bookings	$1,373	$1,599	(14.1)%	$3,107	$2,852	8.9 %

Total Net Sales—Total net sales in the second quarter of 2017 were relatively consistent with the second quarter of 2016. Included in the change in total net sales was lower net sales of $21 million on a program for the U.S. Army which substantially completed in 2016 and higher net sales of $35 million on programs in support of the U.S. Army's Warfighter FOCUS activities driven principally by customer determined activity levels.

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Total net sales in the first six months of 2017 were relatively consistent with the first six months of 2016. Included in the change was lower net sales of $41 million on a program for the U.S. Army which substantially completed in 2016, lower net sales of $38 million on a classified program for an international customer, which substantially completed in 2016, higher net sales of $49 million on programs in support of the U.S. Army's Warfighter FOCUS activities driven principally by customer determined activity levels and higher net sales of $42 million on a U.S. Air Force program due to increased contract activities.

Total Operating Expenses—Total operating expenses in the second quarter of 2017 were relatively consistent with the second quarter of 2016. The decrease in materials and subcontractors costs of $47 million was driven principally by the programs described above in Total Net Sales with the remaining change spread across numerous programs with no individual or common significant driver. The increase in other cost of sales and other operating expenses of $19 million was spread across numerous programs with no individual or common significant driver.

Total operating expenses in the first six months of 2017 were relatively consistent with the first six months of 2016. Over half of the decrease in material and subcontractors costs of $97 million was driven principally by activity on the program for the U.S. Army and on the classified program for an international customer, both described above in Total Net Sales. This was partially offset by activity on the programs in support of the U.S. Army's Warfighter FOCUS activities described above in Total Net Sales, with the remaining change spread across numerous programs with no individual or common significant driver. The increase in other cost of sales and other operating expenses of $23 million was spread across numerous programs with no individual or common significant driver.

Operating Income and Margin—Operating income and margin in the second quarter of 2017 were relatively consistent with the second quarter of 2016.

Operating income and margin in the first six months of 2017 were relatively consistent with the first six months of 2016. Included in mix and other performance in the first six months of 2017 was a $2 million gain on a real estate transaction in the first quarter of 2017.

Backlog and Bookings—Backlog was $5,908 million at July 2, 2017 compared to $5,662 million at December 31, 2016. The increase in backlog of $246 million or 4% at July 2, 2017 compared to December 31, 2016 was primarily due to the U.S. Air Force programs bookings described below. Bookings decreased by $226 million in the second quarter of 2017 compared to the second quarter of 2016. In the second quarter of 2017, IIS booked $308 million on domestic training programs and $66 million on foreign training programs in support of Warfighter FOCUS activities. IIS also booked $555 million on a number of classified contracts, including $228 million on a multi-year award for a classified customer. In the second quarter of 2016, IIS booked $445 million on domestic training programs and $129 million on foreign training programs in support of Warfighter FOCUS activities. IIS also booked $483 million on a number of classified contracts.

Bookings increased by $255 million in the first six months of 2017 compared to the first six months of 2016. In addition to the bookings above, in the first six months of 2017, IIS booked approximately $1.1 billion on U.S. Air Force programs and $390 million on a number of classified contracts. In addition to the bookings above, in the first six months of 2016, IIS booked approximately $400 million on U.S. Air Force programs and $555 million on a number of classified contracts.

Missile Systems

	Three Months Ended			Six Months Ended		
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Total net sales	$1,901	$1,706	11.4 %	$3,657	$3,429	6.6 %

Total operating expenses						
Cost of sales—labor	561	528	6.3 %	1,110	1,054	5.3 %
Cost of sales—materials and subcontractors	845	706	19.7 %	1,626	1,353	20.2 %
Other cost of sales and other operating expenses	259	239	8.4 %	469	597	(21.4)%
Total operating expenses	1,665	1,473	13.0 %	3,205	3,004	6.7 %
Operating income	$236	$233	1.3 %	$452	$425	6.4 %
Operating margin	12.4 %	13.7 %		12.4 %	12.4 %	

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Change in Operating Income (in millions)	Three Months Ended Jul 2, 2017 Versus Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017 Versus Six Months Ended Jul 3, 2016
Volume	$27	$28
Net change in EAC adjustments	(8)	(2)
Mix and other performance	(16)	1
Total change in operating income	$3	$27

(In millions, except percentages)	Three Months Ended			Six Months Ended		
	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Bookings	$2,755	$1,891	45.7 %	$3,498	$3,523	(0.7)%

Total Net Sales—The increase in total net sales of $195 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to $46 million of higher net sales on the Standard Missile-2 (SM-2) program due to the recognition of previously deferred precontract costs based on contract award in the second quarter of 2017, $38 million of higher net sales on the Standard Missile-3 (SM-3®) program primarily due to planned increases in production and $36 million of higher net sales on the Paveway™ program principally driven by international requirements.

The increase in total net sales of $228 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to $79 million of higher net sales on the SM-3 program principally driven by planned increases in production, $76 million of higher net sales on the Paveway program principally driven by international requirements, $47 million of higher net sales on an international missile defense program due to planned increases in production and $41 million of higher net sales on the SM-2 program due to the recognition of previously deferred precontract costs based on contract award in the second quarter of 2017, partially offset by $100 million of lower net sales on the Advanced Medium-Range Air-to-Air Missile (AMRAAM®) program driven by the recognition of previously deferred precontract costs based on contract award in the first six months of 2016 and $57 million of lower net sales on the Exoatmospheric Kill Vehicle (EKV) program due to planned production ramp down, with the remaining change spread across numerous programs with no individual or common significant driver.

Total Operating Expenses—The increase in total operating expenses of $192 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to an increase in materials and subcontractors costs of $139 million, an increase in labor costs of $33 million and an increase in other cost of sales and other operating expenses of $20 million. Approximately half of the increase in materials and subcontractors costs was driven by activity on the Woomera Mobile Range Upgrade program, the Phalanx® program and an international missile defense program, all driven by program requirements, with the remaining change spread across numerous programs with no individual or common significant driver. The increase in labor costs was primarily due to higher activity on certain classified programs. The increase in other cost of sales and other operating expenses was driven principally by higher general and administrative expenses driven by independent research and development activities, which had an impact of $45 million and the amount of previously deferred precontract costs based on contract awards, which had an impact of $33 million, partially offset by the timing of costs applied to contracts through rates, which had an impact of $29 million.

The increase in total operating expenses of $201 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to an increase in materials and subcontractors costs of $273 million and an increase in labor costs of $56 million, partially offset by a decrease in other cost of sales and other operating expenses of $128 million. A little less than half of the increase in materials and subcontractors costs was driven by activity on the Phalanx program due to program requirements and the Paveway and international missile defense programs both described above in Total Net Sales. The remaining change was spread across numerous programs with no individual or common significant driver. Approximately half of the increase in labor costs was driven by certain classified programs with the remaining change spread across numerous programs with no individual or common significant driver. The decrease in other cost of sales and other operating expenses was driven principally by the timing of costs applied to contracts through rates, which had an impact of $46 million and the amount of previously deferred precontract costs based on contract awards, which had an impact of $45 million.

Operating Income and Margin—Operating income in the second quarter of 2017 was relatively consistent with the second quarter of 2016. The decrease in operating margin in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to mix and other performance and the net change in EAC adjustments. The change in mix and other performance was spread across numerous programs with no individual or common significant driver. The net change in EAC adjustments was driven by increased labor costs on a land weapon system program.

The increase in operating income of $27 million in the first six months of 2017 compared to the first six months of 2016 was due to an increase in volume of $28 million. The increase in volume was spread across numerous programs with no individual or

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common significant driver. Operating margin in the first six months of 2017 was relatively consistent with the first six months of 2016.

Backlog and Bookings—Backlog was $11,382 million at July 2, 2017 compared to $11,568 million at December 31, 2016. Bookings increased by $864 million in the second quarter of 2017 compared to the second quarter of 2016. In the second quarter of 2017, MS booked $690 million for Paveway for international customers, $619 million for SM-2 for the U.S. Navy and international customers, $436 million for SM-3 for the Missile Defense Agency (MDA), $116 million for the Long Range Precision Fires (LRPF) Missile system for the U.S. Army, $113 million for AIM-9X Sidewinder™ short-range air-to-air missiles, and $90 million for AMRAAM. MS also booked $214 million on classified contracts. In the second quarter of 2016, MS booked $297 million for AIM-9X Sidewinder short-range air-to-air missiles for the U.S. Navy, U.S. Air Force, U.S. Army and international customers, $292 million for Paveway for the U.S. Air Force and international customers, $217 million for SM-3 for the MDA and an international customer, $186 million for the Woomera Mobile Range Upgrade program for the Royal Australian Air Force, $122 million for the Miniature Air Launched Decoy (MALD®) for the U.S. Air Force, $118 million for Evolved SeaSparrow Missiles (ESSM®) for the U.S. Navy and international customers, and $109 million for AMRAAM for the U.S. Air Force, U.S. Navy, and international customers. MS also booked $95 million on a number of classified contracts.

Bookings decreased by $25 million in the first six months of 2017 compared to the first six months of 2016. In addition to the bookings above, in the first six months of 2017, MS booked $203 million for AIM-9X Sidewinder short-range air-to-air missiles for U.S. and international customers and $159 million for Paveway for international customers. In addition to the bookings above, in the first six months of 2016, MS booked $646 million for AMRAAM for the U.S. Air Force, U.S. Navy and international customers, $272 million for Standard Missile-6 (SM-6®) for the U.S. Navy and $225 million for Paveway for the U.S. Air Force and international customers.

Space and Airborne Systems

(In millions, except percentages)	Three Months Ended Jul 2, 2017	Three Months Ended Jul 3, 2016	% Change	Six Months Ended Jul 2, 2017	Six Months Ended Jul 3, 2016	% Change
Total net sales	$1,608	$1,547	3.9 %	$3,163	$2,992	5.7 %
Total operating expenses						
Cost of sales—labor	659	625	5.4 %	1,325	1,225	8.2 %
Cost of sales—materials and subcontractors	478	462	3.5 %	920	854	7.7 %
Other cost of sales and other operating expenses	253	255	(0.8)%	510	541	(5.7)%
Total operating expenses	1,390	1,342	3.6 %	2,755	2,620	5.2 %
Operating income	$218	$205	6.3 %	$408	$372	9.7 %
Operating margin	13.6 %	13.3 %		12.9 %	12.4 %	

Change in Operating Income (in millions)	Three Months Ended Jul 2, 2017 Versus Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017 Versus Six Months Ended Jul 3, 2016
Volume	$9	$20
Net change in EAC adjustments	(23)	(28)
Mix and other performance	27	44
Total change in operating income	$13	$36

(In millions, except percentages)	Three Months Ended Jul 2, 2017	Three Months Ended Jul 3, 2016	% Change	Six Months Ended Jul 2, 2017	Six Months Ended Jul 3, 2016	% Change
Bookings	$1,058	$2,217	(52.3)%	$2,533	$4,419	(42.7)%

Total Net Sales—Total net sales increased $61 million in the second quarter of 2017 compared to the second quarter of 2016. Included in the change in total net sales were higher net sales of $32 million on a domestic classified program awarded in the third quarter of 2016 and lower net sales of $50 million on an international classified program awarded in the first quarter of 2016 due to planned reduced schedule requirements. The remaining change was spread across numerous programs with no individual or common significant driver.

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The increase in total net sales of $171 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to higher net sales of $68 million on the Next Generation Jammer (NGJ) program for the U.S. Navy, awarded in the second quarter of 2016 and higher net sales of $60 million on the domestic classified program awarded in the third quarter of 2016, partially offset by lower net sales of $61 million on an international classified program awarded in the first quarter of 2016 due to planned reduced schedule requirements. The remaining change was spread across numerous programs with no individual or common significant driver.

Total Operating Expenses—The increase in total operating expenses of $48 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to an increase in labor costs of $34 million, approximately half of which was driven by activity on the domestic classified program described above in Total Net Sales, with the remaining change spread across numerous programs with no individual or common significant driver.

The increase in total operating expenses of $135 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to an increase in labor costs of $100 million and an increase in materials and subcontractors costs of $66 million, partially offset by a decrease in other costs of sales and other operating expenses of $31 million. The increase in labor costs was primarily driven by activity on the NGJ and domestic classified programs described above in Total Net Sales. The increase in materials and subcontractors costs was primarily driven by the activity on certain classified programs and activity on the NGJ program described above in Total Net Sales, partially offset by activity on the international classified program awarded in the first quarter of 2016 described above in Total Net Sales. The decrease in other cost of sales and other operating expenses was primarily due to a gain of $15 million on a real estate transaction in the second quarter of 2017 and the amount of previously deferred precontract costs based on contract awards, which had an impact of $13 million, partially offset by the timing of costs applied to contracts through rates, which had an impact of $26 million. The remaining change in other cost of sales and other operating expenses was spread across numerous programs with no individual or common significant driver.

Operating Income and Margin—The increase in operating income of $13 million in the second quarter of 2017 compared to the second quarter of 2016 was due primarily to a change in mix and other performance of $27 million and an increase in volume of $9 million, partially offset by a net change in EAC adjustments of $23 million. The increase in mix and other performance was driven primarily by a gain of $15 million on a real estate transaction in the second quarter of 2017. The increase in volume was spread across numerous programs with no individual or common significant driver. The net change in EAC adjustments was principally driven by labor and material production efficiencies on tactical radar systems programs in the second quarter of 2016. The increase in operating margin in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the change in mix and other performance, partially offset by the net change in EAC adjustments.

The increase in operating income of $36 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to a change in mix and other performance of $44 million and an increase in volume of $20 million, partially offset by a net change in EAC adjustments of $28 million. The increase in mix and other performance was primarily driven by a gain of $15 million on a real estate transaction in the second quarter of 2017 with the remaining change spread across numerous programs with no individual or common significant driver. Approximately half of the increase in volume was driven by activity on the programs discussed above in Total Net Sales, with the remaining change spread across numerous programs with no individual or common significant driver. The net change in EAC adjustments was primarily driven by labor and material production efficiencies on tactical radar systems programs in the first six months of 2016. The increase in operating margin in the first six months of 2017 compared to the first six months of 2016 was primarily due to the change in mix and other performance, partially offset by the net change in EAC adjustments.

Backlog and Bookings—Backlog was $8,398 million at July 2, 2017 compared to $8,834 million at December 31, 2016. The decrease in backlog of $436 million or 5% at July 2, 2017 compared to December 31, 2016 was primarily due to sales in excess of bookings principally within the Intelligence, Surveillance and Reconnaissance Systems product line. Bookings decreased by $1,159 million in the second quarter of 2017 compared to the second quarter of 2016. In the second quarter of 2017, SAS booked $91 million for radar components for the U.S. Navy. SAS also booked $137 million on a number of classified contracts. In the second quarter of 2016, SAS booked $992 million on the NGJ program for the U.S. Navy and $90 million on the next-generation Multi-Spectral Targeting System (MTS) for the U.S. Air Force. SAS also booked $424 million on a number of classified contracts.

Bookings decreased by $1,886 million in the first six months of 2017 compared to the first six months of 2016. In addition to the bookings noted above, in the first six months of 2017, SAS booked $256 million for Active Electronically Scanned Array (AESA) radars for the U.S. Air Force and $250 million on two contracts for international customers, one for military processors and one for radar warning receivers. SAS also booked $402 million on a number of classified contracts. In addition to the bookings noted above, in the first six months of 2016, SAS booked over $650 million on an international classified program, $553 million on the Joint Polar Satellite System (JPSS) program for NASA, and $470 million on a number of domestic classified contracts.

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Forcepoint

	Three Months Ended			Six Months Ended		
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Total net sales	$138	$137	0.7 %	$282	$276	2.2 %
Total operating expenses						
Cost of sales	26	28	(7.1)%	51	52	(1.9)%
Selling and marketing	58	48	20.8 %	112	94	19.1 %
Research and development	35	32	9.4 %	67	64	4.7 %
General and administrative	17	19	(10.5)%	34	38	(10.5)%
Total operating expenses	136	127	7.1 %	264	248	6.5 %
Operating income (loss)	$2	$10	(80.0)%	$18	$28	(35.7)%
Operating margin	1.4 %	7.3 %		6.4 %	10.1 %	

	Three Months Ended			Six Months Ended		
(In millions, except percentages)	Jul 2, 2017	Jul 3, 2016	% Change	Jul 2, 2017	Jul 3, 2016	% Change
Bookings	$115	$123	(6.5)%	$220	$220	—%

Total Net Sales— Total net sales in the second quarter of 2017 were relatively consistent with the second quarter of 2016. Included in total net sales was $4 million of higher Network Security sales primarily due to new business growth and $5 million of lower sales related to filtering products within Cloud Security. Total net sales excluded the unfavorable impact related to the deferred revenue acquisition accounting adjustments described below in Acquisition Accounting Adjustments.

The increase in total net sales of $6 million in the first six months of 2017 compared to the first six months of 2016 was primarily driven by $9 million of higher sales due to a higher mix of bookings with upfront sales recognition within Cloud Security and Data & Insider Threat Security and $8 million of higher Network Security sales due to new business growth, partially offset by $11 million of lower sales related to filtering products within Cloud Security. Total net sales excluded the unfavorable impact related to the deferred revenue acquisition accounting adjustments described below in Acquisition Accounting Adjustments.

Total Operating Expenses—We disclose our operating expenses for the segment, which excludes amortization of acquired intangible assets and certain other acquisition and acquisition related expenses, in terms of the following:

- Cost of sales—labor and overhead costs associated with analytic and technical support services; infrastructure costs associated with maintaining our databases; and labor, materials and overhead costs associated with providing our product offerings.
- Selling and marketing—labor costs related to personnel engaged in selling and marketing and customer support functions; costs related to public relations, advertising, promotions and travel; and related overhead costs.
- Research and development—labor costs for the development and management of new and existing products; and related overhead costs.
- General and administrative expenses—labor costs for our executive, finance and administrative personnel; third party professional service fees; and related overhead costs.

Total operating expenses in the second quarter of 2017 increased $9 million compared to the second quarter of 2016 primarily due to an increase in selling and marketing expense of $10 million, which was principally driven by higher costs related to the sales organization due to increased salesforce staffing. Total operating expenses excluded amortization of acquired intangible assets as described below in Acquisition Accounting Adjustments and certain unallocated costs which are included in Corporate.

Total operating expenses in the first six months of 2017 increased $16 million compared to the first six months of 2016 primarily driven by an increase in selling and marketing expense of $18 million, which was principally driven by higher costs related to the sales organization due to increased salesforce staffing. Total operating expenses excluded amortization of acquired intangible assets as described below in Acquisition Accounting Adjustments and certain unallocated costs which are included in Corporate.

Operating Income and Margin—The decrease in operating income of $8 million and the related decrease in operating margin in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to the increase in total operating expenses described above.

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The decrease in operating income of $10 million and the related decrease in operating margin in the first six months of 2017 compared to the first six months of 2016 was primarily due to the increase in total operating expenses described above, partially offset by the increase in total net sales described above.

Backlog and Bookings—Backlog was $425 million at July 2, 2017 compared to $486 million at December 31, 2016. The decrease in backlog of $61 million or 13% at July 2, 2017 compared to December 31, 2016 was primarily due to the seasonality of the Cloud Security and Data & Insider Threat Security products experiencing lower bookings in the first half of each year.

Bookings decreased by $8 million in the second quarter of 2017 compared to the second quarter of 2016 primarily due to a $7 million decrease in Cloud Security bookings principally driven by filtering products.

Bookings in the first six months of 2017 were relatively consistent with the first six months of 2016. Included in the change in bookings was a $13 million decrease in Cloud Security bookings principally driven by filtering products, an $8 million increase in Data & Insider Threat Security bookings and a $7 million increase in Network Security bookings.

Acquisition Accounting Adjustments

Acquisition Accounting Adjustments include the adjustments to record acquired deferred revenue at fair value as part of our purchase price allocation process, referred to as the deferred revenue adjustment, and the amortization of acquired intangible assets related to historical acquisitions. These adjustments are not considered part of management's evaluation of segment results.

The components of Acquisition Accounting Adjustments were as follows:

(In millions)	Three Months Ended Jul 2, 2017	Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017	Six Months Ended Jul 3, 2016
Deferred revenue adjustment	$(11)	$(21)	$(21)	$(47)
Amortization of acquired intangibles	(31)	(30)	(63)	(62)
Total Acquisition Accounting Adjustments	$(42)	$(51)	$(84)	$(109)

The deferred revenue adjustment for the second quarters and first six months of 2017 and 2016 relates to the Forcepoint segment.

Amortization of acquired intangibles by segment was as follows:

(In millions)	Three Months Ended Jul 2, 2017	Three Months Ended Jul 3, 2016	Six Months Ended Jul 2, 2017	Six Months Ended Jul 3, 2016
Integrated Defense Systems	$—	$ —	$—	$ —
Intelligence, Information and Services	5	4	10	9
Missile Systems	1	1	1	1
Space and Airborne Systems	2	4	5	9
Forcepoint	23	21	47	43
Total	$31	$ 30	$63	$ 62

The change in our Acquisition Accounting Adjustments of $9 million in the second quarter of 2017 compared to the second quarter of 2016 was primarily due to a $10 million decrease in the deferred revenue adjustment, principally driven by the acquisition of Websense in the second quarter of 2015. Amortization of acquired intangibles in the second quarter of 2017 was relatively consistent with the second quarter of 2016.

The change in our Acquisition Accounting Adjustments of $25 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to a $26 million decrease in the deferred revenue adjustment, principally driven by the acquisition of Websense in the second quarter of 2015. Amortization of acquired intangibles in the first six months of 2017 was relatively consistent with the first six months of 2016.

FAS/CAS Adjustment

The FAS/CAS Adjustment represents the difference between our pension and other postretirement benefit (PRB) expense or income under Financial Accounting Standards (FAS) requirements under GAAP and our pension and PRB expense under U.S. government Cost Accounting Standards (CAS). The results of each segment only include pension and PRB expense under CAS that we generally recover through the pricing of our products and services to the U.S. government.

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The components of the FAS/CAS Adjustment were as follows:

FAS/CAS Adjustment Income (Expense) (in millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
FAS/CAS Pension Adjustment	$109	$108	$218	$213
FAS/CAS PRB Adjustment	—	1	(1)	1
FAS/CAS Adjustment	$109	$109	$217	$214

The components of the FAS/CAS Pension Adjustment were as follows:

(In millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
FAS (expense)	$(319)	$(262)	$(638)	$(527)
CAS expense	428	370	856	740
FAS/CAS Pension Adjustment	$109	$108	$218	$213

The change in our FAS/CAS Pension Adjustment of $1 million in the second quarter of 2017 compared to the second quarter of 2016 was driven by a $58 million increase in our CAS expense and a $57 million increase in our FAS expense. The change in our FAS/CAS Pension Adjustment of $5 million in the first six months of 2017 compared to the first six months of 2016 was driven by a $116 million increase in our CAS expense and a $111 million increase in our FAS expense. The increase in our CAS expense in the second quarter and first six months of 2017 was primarily due to the CAS Harmonization phased transition to the use of a discount rate based on high quality corporate bonds, consistent with the Pension Protection Act of 2006, to measure liabilities in determining the CAS pension expense. The change in the discount rate used to measure liabilities for purposes of determining CAS pension expense has been included in our contracts through our overhead forward pricing rates. The increase in our FAS expense in the second quarter and first six months of 2017 was primarily due to the decrease in our long-term return on assets (ROA) assumption as described in our Annual Report on Form 10-K for the year ended December 31, 2016 and, to a lesser extent, the lower discount rate at December 31, 2016 compared to the discount rate at December 31, 2015.

Corporate

Corporate operating income consists of unallocated costs and certain other corporate costs not considered part of management’s evaluation of reportable segment operating performance.

Operating income related to Corporate was as follows:

(In millions)	Three Months Ended		Six Months Ended	
	Jul 2, 2017	Jul 3, 2016	Jul 2, 2017	Jul 3, 2016
Corporate	$ 3	$ 4	$(30)	$(24)

Operating income related to Corporate in the second quarter and first six months of 2017 was relatively consistent with the second quarter and first six months of 2016, respectively.

FINANCIAL CONDITION AND LIQUIDITY

Overview

We pursue a capital deployment strategy that balances funding for growing our business, including capital expenditures, acquisitions and research and development; prudently managing our balance sheet, including debt repayments and pension contributions; and returning cash to our shareholders, including dividend payments and share repurchases, as outlined below. Our need for, cost of and access to funds are dependent on future operating results, as well as other external conditions. We currently expect that cash and cash equivalents, available-for-sale securities, cash flow from operations and other available financing resources will be sufficient to meet anticipated operating, capital expenditure, investment, debt service and other financing requirements during the next 12 months and for the foreseeable future.

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In addition, the following table highlights selected measures of our liquidity and capital resources at July 2, 2017 and December 31, 2016:

(In millions)	Jul 2, 2017	Dec 31, 2016
Cash and cash equivalents	$2,167	$3,303
Short-term investments	410	100
Working capital	4,350	4,346
Amount available under credit facilities	950	1,250

Operating Activities

(In millions)	Six Months Ended	
	Jul 2, 2017	Jul 3, 2016
Net cash provided by (used in) operating activities	$741	$1,071

The decrease in net cash provided by (used in) operating activities of $330 million in the first six months of 2017 compared to the first six months of 2016, was primarily due to the timing of vendor payments.

Pension Plan Contributions—We made the following contributions to our pension and PRB plans:

(In millions)	Six Months Ended	
	Jul 2, 2017	Jul 3, 2016
Required pension contributions	$74	$ 79
PRB contributions	11	10

Tax Payments and Refunds—We made or (received) the following net tax payments or (refunds):

(In millions)	Six Months Ended	
	Jul 2, 2017	Jul 3, 2016
Federal	$220	$165
Foreign	55	27
State	22	18

We expect full-year net federal, foreign and state tax payments to be approximately $868 million in 2017.

Interest Payments—We made interest payments on our outstanding debt of $116 million in both the first six months of 2017 and 2016.

Investing Activities

(In millions)	Six Months Ended	
	Jul 2, 2017	Jul 3, 2016
Net cash provided by (used in) investing activities	$(522)	$(186)

The change in net cash provided by (used in) investing activities of $336 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to our short-term investments activity, which is described below.

Additions to Property, Plant and Equipment and Capitalized Internal Use Software—Additions to property, plant and equipment and capitalized internal use software were as follows:

(In millions)	Six Months Ended Jul 2, 2017	Jul 3, 2016
Additions to property, plant and equipment	$181	$237
Additions to capitalized internal use software	33	26

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We expect full-year property, plant and equipment and internal use software expenditures to be between approximately $555–$585 million and $95–$110 million, respectively, in 2017, consistent with the anticipated needs of our business and for specific investments including capital assets and facility improvements.

Short-term Investments Activity—We invest in marketable securities in accordance with our short-term investment policy and cash management strategy. These marketable securities are classified as available-for-sale and are recorded at fair value as short-term investments in our consolidated balance sheets. Activity related to short-term investments was as follows:

(In millions)	Six Months Ended Jul 2, 2017	Jul 3, 2016
Purchases of short-term investments	$(399)	$(472)
Maturities of short-term investments	100	599

Acquisitions—In pursuing our business strategies, we acquire and make investments in certain businesses that meet strategic and financial criteria. Payments for purchases of acquired companies, net of cash acquired, were as follows:

(In millions)	Six Months Ended Jul 2, 2017	Jul 3, 2016
Payments for purchases of acquired companies, net of cash acquired	$(39)	$(57)

The decrease of $18 million in payments for purchases of acquired companies, net of cash acquired, in the first six months of 2017 compared to the first six months of 2016 was due to Forcepoint's acquisition of the Stonesoft next-generation firewall (NGFW) business, including the Sidewinder proxy firewall technology, in January 2016, offset by Forcepoint's acquisition of the Skyfence cloud access security broker business in February 2017.

Financing Activities

(In millions)	Six Months Ended Jul 2, 2017	Jul 3, 2016
Net cash provided by (used in) financing activities	$(1,347)	$(1,197)

We generally use cash provided by operating activities and proceeds from the issuance of new debt as our primary source for the repayment of debt, payment of dividends, pension contributions and the repurchase of our common stock. The change in net cash provided by (used in) financing activities of $150 million in the first six months of 2017 compared to the first six months of 2016 was primarily due to the $591 million repayment of long-term debt in the second quarter of 2017, partially offset by the net proceeds from commercial paper issuance of $300 million, the activity on our share repurchases and the $90 million net cash payment that we made to Thales S.A. in the second quarter of 2016 related to our acquisition of Thales S.A.'s noncontrolling interest in RCCS LLC and the sale of our equity method investment in TRS SAS as a result of the amendment to the joint venture agreement as described in Consolidated Results of Operations.

Commercial Paper—In the second quarter of 2017, we received net proceeds of $300 million from the issuance of short-term commercial paper.

Debt—In the second quarter of 2017, we exercised our call rights to repurchase, at prices based on fixed spreads to the U.S. Treasury rates, $591 million of our long-term debt due March and December 2018 at a loss of $39 million pretax,

$25 million after tax, which is included in other (income) expense, net.

Share Repurchases—From time to time, our Board of Directors authorizes the repurchase of shares of our common stock. In November 2015, our Board authorized the repurchase of up to $2.0 billion of our outstanding common stock. At July 2, 2017, we had approximately $1.1 billion available under the 2015 repurchase program. Share repurchases will take place from time to time at management's discretion depending on market conditions.

Share repurchases also include shares surrendered by employees to satisfy tax withholding obligations in connection with restricted stock awards (RSAs), restricted stock units (RSUs) and Long-term Performance Plan (LTPP) awards issued to employees.

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Our share repurchases were as follows:

(In millions)	Six Months Ended			
	Jul 2, 2017		Jul 3, 2016	
	$	Shares	$	Shares
Shares repurchased under our share repurchase programs	$500	3.3	$602	4.8
Shares repurchased to satisfy tax withholding obligations	79	0.5	92	0.7
Total share repurchases	$579	3.8	$694	5.5

Cash Dividends—Our Board of Directors authorized the following cash dividends:

(In millions, except per share amounts)	Six Months Ended	
	Jul 2, 2017	Jul 3, 2016
Cash dividends declared per share	$1.5950	$1.4650
Total dividends paid	447	419

In March 2017, our Board of Directors authorized an 8.9% increase to our annual dividend payout rate from $2.93 to $3.19 per share. Dividends are subject to quarterly approval by our Board of Directors.

CAPITAL RESOURCES

Total long-term debt was $4.7 billion and $5.3 billion at July 2, 2017 and December 31, 2016, respectively. Our outstanding debt bears contractual interest at fixed interest rates ranging from 2.5% to 7.2% and matures at various dates from 2020 through 2044.

Cash and Cash Equivalents and Short-term Investments—Cash and cash equivalents and short-term investments were $2.6 billion and $3.4 billion at July 2, 2017 and December 31, 2016, respectively. We may invest in U.S. Treasuries; AAA/Aaa rated money market funds; certificates of deposit, time deposits and commercial paper of banks with a minimum long-term debt rating of A or A2 and minimum short-term debt rating of A-1 and P-1; and commercial paper of corporations with a minimum long-term debt rating of A- or A3 and minimum short-term debt rating of A-2 and P-2. Cash and cash equivalents and short-term investments balances held at our foreign subsidiaries were approximately $786 million and $641 million at July 2, 2017 and December 31, 2016, respectively. Earnings from our foreign subsidiaries are currently deemed to be indefinitely reinvested. We do not expect such reinvestment to affect our liquidity and capital resources, and we continuously evaluate our liquidity needs and ability to meet global cash requirements as a part of our overall capital deployment strategy. Factors that affect our global capital deployment strategy include anticipated cash flows, the ability to repatriate cash in a tax efficient manner, funding requirements for operations and investment activities, acquisitions and divestitures and capital market conditions.

Commercial Paper—The Company may issue up to $1.25 billion of unsecured commercial paper notes, as the commercial paper is backed by our credit facility. The commercial paper notes outstanding have original maturities of not more than 90 days from the date of issuance. At July 2, 2017, short-term commercial paper borrowings outstanding were $300 million, which had a weighted average interest rate and original maturity period of 1.221% and 25 days, respectively. The maximum amount of short-term commercial paper borrowings outstanding during the first six months of 2017 was $300 million. At December 31, 2016, there were no commercial paper borrowings outstanding.

Credit Facilities—In November 2015, we entered into a $1.25 billion revolving credit facility maturing in November 2020. Under the $1.25 billion credit facility, we can borrow, issue letters of credit and backstop commercial paper. Borrowings under this facility bear interest at various rate options, including LIBOR plus a margin based on our credit ratings. Based on our credit ratings at July 2, 2017, borrowings would generally bear interest at LIBOR plus 80.5 basis points. The credit facility is composed of commitments from 20 separate highly rated lenders, each committing no more than 10% of the facility. As of July 2, 2017 and December 31, 2016, there were no borrowings outstanding under this credit facility and no outstanding letters of credit. At July 2, 2017, there was $300 million of commercial paper outstanding which reduced the remaining amount available for borrowing under the credit facility to $950 million.

Under the $1.25 billion credit facility we must comply with certain covenants, including a ratio of total debt to total capitalization of no more than 60%. We were in compliance with the credit facility covenants as of July 2, 2017. Our ratio of total debt to total capitalization, as those terms are defined in the credit facility, was 31.8% at July 2, 2017. We are providing this ratio as this metric is used by our lenders to monitor our leverage and is also a threshold that could limit our ability to utilize this facility.

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Shelf Registrations—We have an effective shelf registration with the Securities and Exchange Commission, filed in June 2016, which covers the registration of debt securities, common stock, preferred stock and warrants.

COMMITMENTS AND CONTINGENCIES

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

(In millions, except percentages)	Jul 2, 2017	Dec 31, 2016
Total remediation costs—undiscounted	$210	$219
Weighted average discount rate	5.2 %	5.2 %
Total remediation costs—discounted	$146	$147
Recoverable portion	95	92

We also lease certain government-owned properties and generally are not liable for remediation of preexisting environmental contamination at these sites. As a result, we generally do not provide for these costs in our consolidated financial statements.

Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage and the unresolved extent of our responsibility, it is difficult to determine the ultimate outcome of environmental matters. However, we do not expect any additional liability to have a material adverse effect on our financial position, results of operations or liquidity.

Financing Arrangements and Other—We issue guarantees, and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. These instruments expire on various dates through 2025. Additional guarantees of project performance for which there is no stated value also remain outstanding. The stated values outstanding consisted of the following:

(In millions)	Jul 2, 2017	Dec 31, 2016
Guarantees	$208	$ 190
Letters of credit	2,560	2,345
Surety bonds	127	127

Included in guarantees and letters of credit described above were $208 million and $45 million, respectively, at July 2, 2017, and $180 million and $44 million, respectively, at December 31, 2016, related to our joint venture in Thales-Raytheon Systems Co. Ltd. (TRS). As previously disclosed in our Form 10-K for the year ended December 31, 2016, the joint venture agreement for the TRS joint venture was amended and restated in 2016, reducing the scope of the joint venture to Thales-Raytheon Systems Air and Missile Defense Command and Control S.A.S. (TRS AMDC2) only. We provide these guarantees and letters of credit to TRS AMDC2 and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. While we expect these entities to satisfy their loans and meet their project performance and other contractual obligations, their failure to do so may result in a future obligation to us. We periodically evaluate the risk of TRS AMDC2 and other affiliates failing to meet their obligations described above. At July 2, 2017, we believe the risk that TRS AMDC2 and other affiliates will not be able to meet their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at July 2, 2017. We had an estimated liability of $3 million, at July 2, 2017 and December 31, 2016 related to these guarantees and letters of credit.

The joint venture agreement between Raytheon and Vista Equity Partners relating to Forcepoint provides Vista Equity Partners with certain rights to require Forcepoint to pursue an initial public offering at any time after four years and three months following the closing date of May 29, 2015, or pursue a sale of the company at any time after five years following the closing date. In either of these events, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint for cash at a price equal to fair value as determined under the joint venture agreement. Additionally, Vista Equity Partners has the ability to liquidate its ownership through a put option, which became exercisable on May 29, 2017. The put option allows Vista Equity Partners to require Raytheon to purchase all (but not less than all) of Vista Equity Partners' interest in Forcepoint for cash at a price equal to fair value as determined under the joint venture agreement. The joint venture agreement provides for the process

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under which the parties would determine the fair value of the interest and could result in a payment by Raytheon shortly after the exercise of the put option; however, the ultimate timing will depend on the actions of the parties and other factors. Lastly, at any time on or after three years following the closing date, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners’ interest in Forcepoint at a price equal to fair value as determined under the joint venture agreement. At July 2, 2017, the fair value of the noncontrolling interest is estimated at $349 million and is subject to change based upon market conditions and business performance. The estimate of fair value for purposes of presenting the redeemable noncontrolling interest, outside of stockholders' equity, in our consolidated balance sheets could differ from the parties' determination of fair value for the put option under the joint venture agreement.

We have entered into industrial cooperation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. At July 2, 2017, the aggregate amount of our offset agreements, both agreed to and anticipated to be agreed to, had an outstanding notional value of approximately $8.8 billion. These agreements are designed to return economic value to the foreign country by requiring us to engage in activities supporting local defense or commercial industries, promoting a balance of trade, developing in-country technology capabilities or addressing other local development priorities. Offset agreements may be satisfied through activities that do not require a direct cash payment, including transferring technology, providing manufacturing, training and other consulting support to in-country projects, and the purchase by third parties (e.g., our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for activities such as subcontracting with local partners, purchasing supplies from in-country vendors, providing financial support for in-country projects and making investments in local ventures. Such activities may also vary by country depending upon requirements as dictated by their governments. We typically do not commit to offset agreements until orders for our products or services are definitive. The amounts ultimately applied against our offset agreements are based on negotiations with the customers and typically require cash outlays that represent only a fraction of the notional value in the offset agreements. Offset programs usually extend over several or more years and may provide for penalties in the event we fail to perform in accordance with offset requirements. We have historically not been required to pay any such penalties.

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

We do not expect any material impact on our financial results from regional developments regarding Qatar. Almost all of our contracts in Qatar are foreign military sales contracts through the U.S. government and represent less than 6.5% of our backlog at July 2, 2017.

On June 23, 2016, the U.K. held a referendum in which British citizens approved an exit from the European Union (EU), commonly referred to as “Brexit”. As a result of the referendum, there has been a decline in the value of the British pound as compared to the U.S. dollar and volatility in exchange rates may continue as the U.K. negotiates its exit from the EU. The British pound is the functional currency for approximately 2% of our sales. In addition, for any contracts that are not denominated in the same currency as the functional currency (for example, contracts denominated in British pounds where the functional currency is the U.S. dollar), we enter into foreign currency forward contracts to hedge our risk related to foreign currency exchange rate fluctuations. As a result, we currently do not expect the U.K.’s exit from the EU to have a material impact on our financial position, results of operations or liquidity.

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In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against, or initiated by, us. We do not expect any of these proceedings to result in any additional liability or gains that would materially affect our financial position, results of operations or liquidity. In connection with certain of our legal matters, we may be entitled to insurance recovery for qualified legal costs or other incurred costs. We do not expect any insurance recovery to have a material impact on the financial exposure that could result from these matters.

Accounting Standards
In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which replaces numerous requirements in U.S. GAAP, including industry-specific requirements, and provides companies with a single revenue recognition model for recognizing revenue from contracts with customers. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented and the cumulative effect of applying the standard would be recognized at the earliest period shown, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. In July 2015, the FASB approved the deferral of the new standard's effective date by one year. The new standard is effective for annual reporting periods beginning after December 15, 2017. The FASB permits companies to adopt the new standard early, but not before the original effective date of annual reporting periods beginning after December 15, 2016.

Effective January 1, 2017, we elected to early adopt the requirements of Topic 606 using the full retrospective method. The impact to our fiscal quarters and year-ended 2016 and year-ended 2015 income from continuing operations after taxes, net income and basic and diluted earnings per share (EPS) was as follows:

	Three Months Ended				Twelve Months Ended	
(In millions, except per share amounts)	Dec 31, 2016	Oct 2, 2016	Jul 3, 2016	Apr 3, 2016	Dec 31, 2016	Dec 31, 2015
Income from continuing operations after taxes	$12	$18	$9	$ —	$39	$40
Net income	12	18	9	—	39	40
Basic EPS attributable to Raytheon Company common stockholders:						
Income from continuing operations after taxes	$0.04	$0.05	$0.02	$ —	$0.10	$0.12
Net income	0.04	0.05	0.02	—	0.11	0.11
Diluted EPS attributable to Raytheon Company common stockholders:						
Income from continuing operations after taxes	$0.03	$0.05	$0.03	$ —	$0.11	$0.12
Net income	0.04	0.05	0.03	—	0.11	0.11

In addition, the cumulative impact to our retained earnings at January 1, 2015 was $13 million.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows by providing guidance on eight specific cash flow issues, including requirements that cash payments for debt prepayment or debt extinguishment costs be classified as cash outflows for financing activities and proceeds from the settlement of corporate-owned life insurance policies be classified as cash inflows from investing activities. The provisions of ASU 2016-15 are effective for years beginning after December

15, 2017, with early adoption permitted. We elected to early adopt the requirements of the new standard in the first quarter of 2017 using the retrospective transition method, as required by the new standard. The adoption of this ASU had an immaterial impact to our consolidated statements of cash flows.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that restricted cash be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The provisions of ASU 2016-18 are effective for years beginning after December 15, 2017, with early adoption permitted. We elected to early adopt the requirements of the new standard in the first quarter of 2017 using the retrospective transition method, as required by the new standard. The adoption of this ASU had an immaterial impact to our consolidated statements of cash flows.

The following table provides a reconciliation of cash and cash equivalents, and restricted cash reported within the consolidated balance sheets that sum to the total of such amounts in the consolidated statements of cash flows:

(In millions)	Jul 2, 2017	Dec 31, 2016
Cash and cash equivalents	$2,167	$3,303
Restricted cash	8	—
Cash, cash equivalents and restricted cash shown in the consolidated statements of cash flows	$2,175	$3,303

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted, and must be adopted using the modified retrospective approach. We are currently evaluating the potential changes from this ASU to our future financial reporting and disclosures. We expect the standard to have an impact of approximately $1 billion on our assets and liabilities for the addition of right-of-use assets and lease liabilities, but we do not expect it to have a material impact to our results of operations or liquidity.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715), which changes certain presentation and disclosure requirements for employers that sponsor defined benefit pension and other postretirement benefit (PRB) plans. This requires the service cost component of the net benefit cost to be in the same line item as other compensation in operating income and the other components of net benefit cost to be presented outside of operating income on a retrospective basis. In addition, only the service cost component will be eligible for capitalization when applicable, on a prospective basis. The provisions of ASU 2017-07 are effective for years beginning after December 15, 2017. We are currently evaluating the potential changes from this ASU to our future financial reporting and disclosures. We expect the standard to increase 2016 and 2017 operating income due to the removal of the non-service component of FAS pension expense by $601 million and an estimated $800 million, respectively, and to decrease non-operating income by the same amount with zero impact to net income in both periods. We do not expect a material impact from the new requirement to only allow capitalization of the service cost component of net benefit cost.

Other new pronouncements issued but not effective until after July 2, 2017 are not expected to have a material impact on our financial position, results of operations or liquidity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market exposures are to interest rates and foreign exchange rates.

We generally supplement our working capital requirements with a combination of variable-rate short-term and fixed-rate long-term financing. We enter into foreign currency forward contracts with commercial banks to fix the foreign currency exchange rates on specific commitments and payments to vendors and customer receipts. We may enter into interest rate swap agreements with commercial and investment banks to manage interest rates associated with our financing arrangements. The market-risk sensitive instruments we use for hedging are entered into with commercial and investment banks and are directly related to a particular asset, liability or transaction for which a firm commitment is in place.

The following tables provide information as of July 2, 2017 and December 31, 2016 about our market risk exposure associated with changing interest rates. For long-term debt obligations, the table presents principal cash flows by maturity date and average interest rates related to outstanding obligations. There were no interest rate swaps outstanding at July 2, 2017 and December 31, 2016.

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Principal payments and interest rate detail for long-term debt by contractual maturity dates as of July 2, 2017 and December 31, 2016, respectively, were as follows:

(In millions, except percentages)	2017	2018	2019	2020	2021	Thereafter	Total	Fair Value
Fixed-rate debt	$ —	$ —	$ —	$1,500	$ —	$ 3,292	$4,792	$ 5,288
Average interest rate	—	—	—	3.550 %	—	4.229 %	4.017 %	

(In millions, except percentages)	2017	2018	2019	2020	2021	Thereafter	Total	Fair Value
Fixed-rate debt	$ —	$591	$ —	$1,500	$ —	$ 3,292	$5,383	$ 5,848
Average interest rate	—	6.549%	—	3.550 %	—	4.229 %	4.295 %	

In addition, the aggregate notional amount of the outstanding foreign currency forward contracts was $1,097 million and $1,277 million at July 2, 2017 and December 31, 2016, respectively. The net notional exposure of these contracts was approximately $197 million and $342 million at July 2, 2017 and December 31, 2016, respectively.

For foreign currency forward contracts designated and qualifying for hedge accounting, we record the effective portion of the gain or loss on the derivative in accumulated other comprehensive loss, net of tax, and reclassify it into earnings in the same period or periods during which the hedged revenue or cost of sales transaction affects earnings. Unrealized gains of $40 million and $53 million were included in other assets, net, and unrealized losses of $25 million and $48 million were included in other current liabilities at July 2, 2017 and December 31, 2016, respectively.

Realized gains and losses resulting from these cash flow hedges offset the foreign currency exchange gains and losses on the underlying assets or liabilities being hedged. We believe our exposure due to changes in foreign currency rates is not material due to our hedging policy.

At July 2, 2017, we had short-term investments with a fair value of $410 million, which are classified as available-for-sale and consist of highly rated bank certificates of deposit with a minimum long-term debt rating of A or A2 and a minimum short-term debt rating of A-1 and P-1. Our exposure due to changes in interest rates is not material due to the nature and amount of our short-term investments (i.e., high quality certificates of deposit which had an average maturity of one month).

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures
Management has conducted an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a–15(e) and 15d–15(e) of the Securities Exchange Act of 1934) as of July 2, 2017.

Conclusion of Evaluation—Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of July 2, 2017 were effective.

Inherent Limitations on Effectiveness of Controls—In designing and evaluating our disclosure controls and procedures, management recognizes that any control, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control Over Financial Reporting—There were no changes in our internal control over financial reporting during the second quarter of 2017 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We primarily engage in providing products and services under contracts with the U.S. government and, to a lesser degree, under direct foreign sales contracts, some of which the U.S. government funds. As a U.S. government contractor, we are subject to many levels of audit and investigation by the U.S. government relating to our contract performance and compliance with applicable

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rules and regulations. Agencies that oversee contract performance include: the Defense Contract Audit Agency (DCAA); the Defense Contract Management Agency (DCMA); the Inspectors General of the U.S. Department of Defense (DoD) and other departments and agencies; the Government Accountability Office (GAO); the Department of Justice (DoJ); and Congressional Committees. From time to time, these and other agencies investigate or conduct audits to determine whether our operations are being conducted in accordance with applicable requirements. Such investigations and audits may be initiated due to a number of reasons, including as a result of a whistleblower complaint. Such investigations and audits could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, the suspension of government export licenses or the suspension or debarment from future U.S. government contracting. U.S. government investigations often take years to complete and many result in no adverse action against us. Our final allowable incurred costs for each year are also subject to audit and have, from time to time, resulted in disputes between us and the U.S. government, with litigation resulting at the Court of Federal Claims (COFC) or the Armed Services Board of Contract Appeals (ASBCA) or their related courts of appeals. In addition, the DoJ has, from time to time, convened grand juries to investigate possible irregularities by us. We also provide products and services to customers outside of the U.S., and those sales are subject to local government laws, regulations and procurement policies and practices. Our compliance with such local government regulations or any applicable U.S. government regulations (e.g., the Foreign Corrupt Practices Act (FCPA) and International Traffic in Arms Regulations (ITAR)) may also be investigated or audited. Other than as specifically disclosed in this Form 10-Q, we do not expect these audits, investigations or disputes to have a material effect on our financial position, results of operations or liquidity, either individually or in the aggregate.

In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against us. We do not expect these proceedings to result in any additional liability that would materially affect our financial position, results of operations or liquidity.

ITEM 1A. RISK FACTORS

You should carefully review and consider the information regarding certain factors which could materially affect our business, financial condition or future results set forth under Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2016. There have been no material changes from the factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016, although we may disclose changes to such factors or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased [(1)]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Approximate Dollar Value (in billions) of Shares that May Yet Be Purchased Under the Plan [(2)]
April (April 3, 2017 - April 30, 2017)	29	$ 151.23	—	$ 1.2
May (May 1, 2017 - May 28, 2017)	81,894	159.36	81,528	1.2
June (May 29, 2017 - July 2, 2017)	760,944	162.23	537,180	1.1
Total	842,867	$ 161.95	618,708	

(1) Includes shares purchased related to activity under our stock plans. Such activity during the second quarter of 2017 includes the surrender by employees of 224,159 shares to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees.

(2)

In November 2015, our Board of Directors authorized the repurchase of up to $2.0 billion of our outstanding common stock.

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ITEM 6. EXHIBITS

The following list of exhibits includes exhibits submitted with this Form 10-Q as filed with the Securities and Exchange Commission and those incorporated by reference to other filings.

10.1	Raytheon 2017 Incentive Plan, filed as Appendix A to the Company's definitive proxy statement filed on April 21, 2017, is hereby incorporated by reference.
10.2	Raytheon 2010 Stock Plan, as amended as of May 24, 2017.*
10.3	Form of Restricted Stock Award Agreement under the Raytheon 2010 Stock Plan.*
10.4	Form of Restricted Stock Unit Award Agreement under the Raytheon 2010 Stock Plan.*
10.5	Form of Performance Stock Unit Award Agreement with respect to the Long-Term Performance Plan, under the Raytheon 2010 Stock Plan.*
10.6	Form of Restricted Stock Unit Award Agreement for Certain Retirement Eligible Employees under Raytheon 2010 Stock Plan.*
10.7	Form of Restricted Stock Unit Award Agreement for Certain Retirement Eligible Non U.S. Employees under Raytheon 2010 Stock Plan.*
15	PricewaterhouseCoopers LLP Awareness Letter.*
31.1	Certification of Thomas A. Kennedy pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Anthony F. O'Brien pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Thomas A. Kennedy pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of Anthony F. O'Brien pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101	The following materials from Raytheon Company's Quarterly Report on Form 10-Q for the quarter ended July 2, 2017, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements.*

* filed electronically herewith
** furnished electronically herewith, and not filed

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RAYTHEON COMPANY

By:	/s/ Michael J. Wood
	Michael J. Wood
	Vice President, Controller and Chief Accounting Officer
	Principal Accounting Officer

July 27, 2017