GENERAL DYNAMICS CORP
Form 10-Q
October 25, 2017

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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 1, 2017
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-3671

GENERAL DYNAMICS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	13-1673581
State or other jurisdiction of incorporation or organization	I.R.S. employer identification no.
2941 Fairview Park Drive, Suite 100 Falls Church, Virginia	22042-4513
Address of principal executive offices	Zip code

(703) 876-3000
Registrant’s telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes ü No ___
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ü No ___
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer ü Accelerated filer ___ Non-accelerated filer ___
Smaller reporting company ___ Emerging growth company ___
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ___
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ___ No ü
298,582,883 shares of the registrant’s common stock, $1 par value per share, were outstanding on October 1, 2017.

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PART I – FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

(Dollars in millions, except per-share amounts)	Three Months Ended October 1, 2017	October 2, 2016
Revenue:		
Products	$4,718	$ 4,749
Services	2,862	2,908
	7,580	7,657
Operating costs and expenses:		
Products	3,634	3,750
Services	2,384	2,421
General and administrative (G&A)	510	471
	6,528	6,642
Operating earnings	1,052	1,015
Interest, net	(27)	(23)
Other, net	2	2
Earnings from continuing operations before income tax	1,027	994
Provision for income tax, net	263	263
Earnings from continuing operations	764	731
Discontinued operations, net of tax benefit of $46 in 2016	—	(84)
Net earnings	$764	$ 647
Earnings per share		
Basic:		
Continuing operations	$2.56	$ 2.40
Discontinued operations	—	(0.27)
Net earnings	$2.56	$ 2.13
Diluted:		
Continuing operations	$2.52	$ 2.36
Discontinued operations	—	(0.27)
Net earnings	$2.52	$ 2.09

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

(Dollars in millions, except per-share amounts)	Nine Months Ended October 1, 2017	Nine Months Ended October 2, 2016
Revenue:		
Products	$13,851	$14,274
Services	8,845	8,633
	22,696	22,907
Operating costs and expenses:		
Products	10,664	11,274
Services	7,393	7,250
G&A	1,496	1,417
	19,553	19,941
Operating earnings	3,143	2,966
Interest, net	(76)	(68)
Other, net	2	13
Earnings from continuing operations before income tax	3,069	2,911
Provision for income tax, net	793	812
Earnings from continuing operations	2,276	2,099
Discontinued operations, net of tax benefit of $46 in 2016	—	(97)
Net earnings	$2,276	$2,002
Earnings per share		
Basic:		
Continuing operations	$7.59	$6.86
Discontinued operations	—	(0.31)
Net earnings	$7.59	$6.55
Diluted:		
Continuing operations	$7.45	$6.74
Discontinued operations	—	(0.31)
Net earnings	$7.45	$6.43

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in millions)	Three Months Ended October 1, 2017	Three Months Ended October 2, 2016	Nine Months Ended October 1, 2017	Nine Months Ended October 2, 2016
Net earnings	$764	$ 647	$2,276	$ 2,002
Gains on cash flow hedges	138	102	286	260
Unrealized gains (losses) on securities	1	(1)	8	(5)
Foreign currency translation adjustments	128	(42)	409	85
Change in retirement plans’ funded status	61	65	193	191
Other comprehensive income, pretax	328	124	896	531
Provision for income tax, net	57	49	160	133
Other comprehensive income, net of tax	271	75	736	398
Comprehensive income	$1,035	$ 722	$3,012	$ 2,400

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in millions)	October 1, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and equivalents	$ 2,722	$ 2,334
Accounts receivable	3,391	3,399
Unbilled receivables	5,609	4,212
Inventories	5,781	5,817
Other current assets	577	772
Total current assets	18,080	16,534
Noncurrent assets:		
Property, plant and equipment, net	3,461	3,477
Intangible assets, net	715	678
Goodwill	11,918	11,445
Other assets	740	1,038
Total noncurrent assets	16,834	16,638
Total assets	$ 34,914	$ 33,172
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Short-term debt and current portion of long-term debt	$ 903	$ 900
Accounts payable	2,718	2,538
Customer advances and deposits	6,610	6,827
Other current liabilities	2,978	3,185
Total current liabilities	13,209	13,450
Noncurrent liabilities:		
Long-term debt	3,979	2,988
Other liabilities	6,162	6,433
Commitments and contingencies (see Note M)		
Total noncurrent liabilities	10,141	9,421
Shareholders’ equity:		
Common stock	482	482
Surplus	2,841	2,819
Retained earnings	26,058	24,543
Treasury stock	(15,166)	(14,156)
Accumulated other comprehensive loss	(2,651)	(3,387)
Total shareholders’ equity	11,564	10,301
Total liabilities and shareholders’ equity	$ 34,914	$ 33,172

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in millions)	Nine Months Ended October 1, 2017	October 2, 2016
Cash flows from operating activities - continuing operations:		
Net earnings	$2,276	$ 2,002
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation of property, plant and equipment	269	270
Amortization of intangible assets	57	70
Equity-based compensation expense	75	76
Deferred income tax provision	155	148
Discontinued operations, net of tax	—	97
(Increase) decrease in assets, net of effects of business acquisitions:		
Accounts receivable	26	21
Unbilled receivables	(1,361)	(907)
Inventories	57	(206)
Increase (decrease) in liabilities, net of effects of business acquisitions:		
Accounts payable	167	305
Customer advances and deposits	(296)	(554)
Income taxes payable	223	(14)
Other, net	233	64
Net cash provided by operating activities	1,881	1,372
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(364)	(56)
Capital expenditures	(273)	(244)
Other, net	53	18
Net cash used by investing activities	(584)	(282)
Cash flows from financing activities:		
Purchases of common stock	(1,172)	(1,514)
Proceeds from fixed-rate notes	985	992
Dividends paid	(735)	(678)
Repayment of fixed-rate notes	—	(500)
Other, net	41	172
Net cash used by financing activities	(881)	(1,528)
Net cash used by discontinued operations	(28)	(44)
Net increase (decrease) in cash and equivalents	388	(482)
Cash and equivalents at beginning of period	2,334	2,785
Cash and equivalents at end of period	$2,722	$ 2,303
Supplemental cash flow information:		
Cash payments for:		
Income taxes	$398	$ 677
Interest	$66	$ 58

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

	Common Stock		Retained	Treasury	Accumulated Other Comprehensive	Total Shareholders'
(Dollars in millions)	Par	Surplus	Earnings	Stock	Loss	Equity
December 31, 2016	$482	$2,819	$24,543	$(14,156)	$ (3,387)	$ 10,301
Cumulative-effect adjustment (see Note A)	—	—	(3)	—	—	(3)
Net earnings	—	—	2,276	—	—	2,276
Cash dividends declared	—	—	(758)	—	—	(758)
Equity-based awards	—	22	—	127	—	149
Shares purchased	—	—	—	(1,137)	—	(1,137)
Other comprehensive income	—	—	—	—	736	736
October 1, 2017	$482	$2,841	$26,058	$(15,166)	$ (2,651)	$ 11,564
December 31, 2015	$482	$2,730	$22,903	$(12,392)	$ (3,283)	$ 10,440
Net earnings	—	—	2,002	—	—	2,002
Cash dividends declared	—	—	(701)	—	—	(701)
Equity-based awards	—	59	—	206	—	265
Shares purchased	—	—	—	(1,538)	—	(1,538)
Other comprehensive income	—	—	—	—	398	398
October 2, 2016	$482	$2,789	$24,204	$(13,724)	$ (2,885)	$ 10,866

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these financial statements.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in millions, except per-share amounts or unless otherwise noted)

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation and Classification. The unaudited Consolidated Financial Statements include the accounts of General Dynamics Corporation and our wholly owned and majority-owned subsidiaries. We eliminate all inter-company balances and transactions in the unaudited Consolidated Financial Statements. Some prior-year amounts have been reclassified among financial statement accounts or disclosures to conform to the current-year presentation.

Consistent with industry practice, we classify assets and liabilities related to long-term contracts as current, even though some of these amounts may not be realized within one year.

Further discussion of our significant accounting policies is contained in the other notes to these financial statements.

Interim Financial Statements. The unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. These rules and regulations permit some of the information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) to be condensed or omitted.

Our fiscal quarters are 13 weeks in length. Because our fiscal year ends on December 31, the number of days in our first and fourth quarters varies slightly from year to year. Operating results for the three- and nine-month periods ended October 1, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

The unaudited Consolidated Financial Statements contain all adjustments that are of a normal recurring nature necessary for a fair presentation of our results of operations and financial condition for the three- and nine-month periods ended October 1, 2017, and October 2, 2016.

These unaudited Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016.

Discontinued Operations. In 2013, we settled litigation with the U.S. Navy related to the terminated A-12 aircraft contract in the company’s former tactical military aircraft business. In connection with the settlement, we released some rights to reimbursement of costs on ships under contract at our Bath, Maine, shipyard. As we progressed through the shipbuilding process, we determined that the cost associated with this settlement was greater than anticipated. Therefore, in the third quarter of 2016, we recognized an $84 loss, net of tax, to adjust the previously-recognized settlement value.

In 2015, we completed the sale of our axle business in the Combat Systems group. In the first nine months of 2016, we recognized a final adjustment of $13 to the loss on the sale of the business.

Accounting Standards Updates. On January 1, 2017, we adopted the following accounting standards issued by the Financial Accounting Standards Board (FASB) that have impacted our prior-period financial statements:

- Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers
- Accounting Standards Update (ASU) 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes

See Note Q for further discussion of each of these accounting standards.

We also adopted ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, on January 1, 2017. We recognized the cumulative effect of this standard as a $3 decrease to retained earnings on the date of adoption. ASU 2016-16 requires recognition of the current and deferred income tax effects of an intra-entity asset transfer, other than inventory, when the transfer occurs, as opposed to former GAAP, which required companies to defer the income tax effects of intra-entity asset transfers until the asset was sold to an outside party. The income tax effects of intra-entity inventory transfers will continue to be deferred until the inventory is sold.

There are several new accounting standards that have been issued by the FASB but are not yet effective, including the following:

- ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Specific to our business, ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income. The ASU eliminates the available-for-sale classification for equity investments that recognized changes in fair value as a component of other comprehensive income. We intend to adopt the standard on a modified retrospective basis with a cumulative-effect adjustment to the Consolidated Balance Sheet on the effective date of January 1, 2018. We do not expect the adoption of the ASU to have a material effect on our results of operations, financial condition or cash flows.
- ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires the recognition of lease rights and obligations as assets and liabilities on the balance sheet. Previously, lessees were not required to recognize on the balance sheet assets and liabilities arising from operating leases. The ASU also requires disclosure of key information about leasing arrangements. We intend to adopt the standard on the effective date of January 1, 2019, using the modified retrospective method of adoption. We are currently evaluating our population of leased assets in order to assess the impact of the ASU on our lease portfolio, and designing and implementing new processes and controls. Until this effort is completed, we cannot determine the effect of the ASU on our results of operations, financial condition or cash flows.
- ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 is intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the Consolidated Statement of Cash Flows by providing guidance on eight specific cash flow issues. We intend to adopt the standard retrospectively on the effective date of January 1, 2018. We do not expect the adoption of the ASU to have a material effect on our cash flows.
- ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. ASU 2017-07 requires the service cost component of net benefit cost to be reported separately from the other components of net benefit cost in the income statement. We expect the standard to increase our 2016 and 2017 operating earnings by $10 and $45, respectively, due to the reclassification of the non-service cost components of net benefit cost, and to decrease other income by the same amounts, with no impact to net earnings in either period. The ASU also allows only the service cost component of net benefit cost to be eligible for

capitalization. We do not expect this area of the ASU to have a material effect on our results of operations, financial condition or cash flows. We intend to adopt the standard on the effective date of January 1, 2018.

- ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. ASU 2017-12 is intended to simplify hedge accounting by better aligning an entity's financial reporting for hedging relationships with its risk management activities. The ASU also simplifies the application of the hedge accounting guidance. ASU 2017-12 is effective on January 1, 2019, with early adoption permitted. For cash flow hedges existing at the adoption date, the standard requires adoption on a modified retrospective basis with a cumulative-effect adjustment to the Consolidated Balance Sheet as of the beginning of the year of adoption. The amendments to presentation guidance and disclosure requirements are required to be adopted prospectively. We have not yet determined the effect of the ASU on our results of operations, financial condition or cash flows, nor have we selected a transition date.

B. REVENUE

The majority of our revenue is derived from long-term contracts and programs that can span several years. We account for revenue in accordance with ASC Topic 606, Revenue from Contracts with Customers, which we adopted on January 1, 2017, using the retrospective method. See Note Q for further discussion of the adoption, including the impact on our 2016 financial statements.

Performance Obligations. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of our contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. Some of our contracts have multiple performance obligations, most commonly due to the contract covering multiple phases of the product lifecycle (development, production, maintenance and support). For contracts with multiple performance obligations, we allocate the contract's transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. The primary method used to estimate standalone selling price is the expected cost plus a margin approach, under which we forecast our expected costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service.

Contract modifications are routine in the performance of our contracts. Contracts are often modified to account for changes in the contract specifications or requirements. In most instances, contract modifications are for goods or services that are not distinct, and, therefore, are accounted for as part of the existing contract.

Our performance obligations are satisfied over time as work progresses or at a point in time. Revenue from products and services transferred to customers over time accounted for 70% of our revenue for the three- and nine-month periods ended October 1, 2017, and 72% and 71% of our revenue for the three- and nine-month periods ended October 2, 2016, respectively. Substantially all of our revenue in the defense groups is recognized over time because control is transferred continuously to our customers. Typically, revenue is recognized over time using costs incurred to date relative to total estimated costs at completion to measure progress toward satisfying our performance obligations. Incurred cost represents work performed, which corresponds with, and thereby best depicts, the transfer of control to the customer. Contract costs include labor, material, overhead and, when appropriate, G&A expenses.

Revenue from goods and services transferred to customers at a point in time accounted for 30% of our revenue for the three- and nine-month periods ended October 1, 2017, and 28% and 29% of our revenue for the three- and nine-month periods ended October 2, 2016, respectively. The majority of our revenue recognized at a point in time is for the manufacture of business-jet aircraft in our Aerospace group. Revenue on these contracts is recognized when the customer obtains control of the asset, which is generally upon delivery and acceptance by the customer of the fully outfitted aircraft.

On October 1, 2017, we had $63.9 billion of remaining performance obligations, which we also refer to as total backlog. We expect to recognize approximately 50% of our remaining performance obligations as revenue by 2018, an additional 30% by 2020 and the balance thereafter.

Contract Estimates. Accounting for long-term contracts and programs involves the use of various techniques to estimate total contract revenue and costs. For long-term contracts, we estimate the profit on a contract as the difference between the total estimated revenue and expected costs to complete a contract and recognize that profit over the life of the contract.

Contract estimates are based on various assumptions to project the outcome of future events that often span several years. These assumptions include labor productivity and availability; the complexity of the work to be performed; the cost and availability of materials; the performance of subcontractors; and the availability and timing of funding from the customer.

The nature of our contracts gives rise to several types of variable consideration, including claims and award and incentive fees. We include in our contract estimates additional revenue for submitted contract modifications or claims against the customer when we believe we have an enforceable right to the modification or claim, the amount can be estimated reliably and its realization is probable. In evaluating these criteria, we consider the contractual/legal basis for the claim, the cause of any additional costs incurred, the reasonableness of those costs and the objective evidence available to support the claim. We include award or incentive fees in the estimated transaction price when there is a basis to reasonably estimate the amount of the fee. These estimates are based on historical award experience, anticipated performance and our best judgment at the time. Because of our certainty in estimating these amounts, they are included in the transaction price of our contracts and the associated remaining performance obligations.

As a significant change in one or more of these estimates could affect the profitability of our contracts, we review and update our contract-related estimates regularly. We recognize adjustments in estimated profit on contracts under the cumulative catch-up method. Under this method, the impact of the adjustment on profit recorded to date on a contract is recognized in the period the adjustment is identified. Revenue and profit in future periods of contract performance are recognized using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the total loss in the quarter it is identified.

The impact of adjustments in contract estimates on our operating earnings can be reflected in either operating costs and expenses or revenue. The aggregate impact of adjustments in contract estimates increased our revenue, operating earnings and diluted earnings per share as follows:

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Revenue	$94	$ 94	$256	$ 217
Operating earnings	103	52	274	169
Diluted earnings per share	$0.22	$ 0.11	$0.58	$ 0.35

No adjustment on any one contract was material to our unaudited Consolidated Financial Statements for the three- and nine-month periods ended October 1, 2017, and October 2, 2016.
Revenue by Category. Our portfolio of products and services consists of over 10,000 active contracts. The following series of tables presents our revenue disaggregated by several categories.
Revenue by major product line was as follows:

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Aircraft manufacturing, outfitting and completions	$1,562	$ 1,482	$4,791	$ 4,700
Aircraft services	422	406	1,302	1,211
Pre-owned aircraft	11	37	54	79
Total Aerospace	1,995	1,925	6,147	5,990
Wheeled combat vehicles	623	587	1,749	1,695
Weapons systems, armament and munitions	412	363	1,167	1,059
Tanks and tracked vehicles	315	218	840	648
Engineering and other services	150	159	445	467
Total Combat Systems	1,500	1,327	4,201	3,869
C4ISR* solutions	1,086	1,254	3,226	3,559
Information technology (IT) services	1,068	1,076	3,178	3,314
Total Information Systems and Technology	2,154	2,330	6,404	6,873
Nuclear-powered submarines	1,248	1,357	3,794	4,022
Surface combatants	256	250	757	805
Auxiliary and commercial ships	129	190	427	491
Repair and other services	298	278	966	857
Total Marine Systems	1,931	2,075	5,944	6,175
Total revenue	$7,580	$ 7,657	$22,696	$ 22,907

* Command, control, communications, computers, intelligence, surveillance and reconnaissance.

Revenue by contract type was as follows:

Three Months Ended October 1, 2017	Aerospace	Combat Systems	Information Systems and Technology	Marine Systems	Total Revenue
Fixed-price	$ 1,835	$ 1,258	$ 971	$ 1,131	$ 5,195
Cost-reimbursement	—	233	989	797	2,019
Time-and-materials	160	9	194	3	366
Total revenue	$ 1,995	$ 1,500	$ 2,154	$ 1,931	$ 7,580
Three Months Ended October 2, 2016					
Fixed-price	$ 1,773	$ 1,102	$ 1,094	$ 1,241	$ 5,210
Cost-reimbursement	—	215	1,033	832	2,080
Time-and-materials	152	10	203	2	367
Total revenue	$ 1,925	$ 1,327	$ 2,330	$ 2,075	$ 7,657

Nine Months Ended October 1, 2017	Aerospace	Combat Systems	Information Systems and Technology	Marine Systems	Total Revenue
Fixed-price	$ 5,650	$ 3,538	$ 2,793	$ 3,514	$ 15,495
Cost-reimbursement	—	636	3,017	2,422	6,075
Time-and-materials	497	27	594	8	1,126
Total revenue	$ 6,147	$ 4,201	$ 6,404	$ 5,944	$ 22,696
Nine Months Ended October 2, 2016					
Fixed-price	$ 5,547	$ 3,207	$ 3,181	$ 3,785	$ 15,720
Cost-reimbursement	—	638	3,076	2,384	6,098
Time-and-materials	443	24	616	6	1,089
Total revenue	$ 5,990	$ 3,869	$ 6,873	$ 6,175	$ 22,907

Each of these contract types presents advantages and disadvantages. Typically, we assume more risk with fixed-price contracts. However, these types of contracts offer additional profits when we complete the work for less than originally estimated. Cost-reimbursement contracts generally subject us to lower risk. Accordingly, the associated base fees are usually lower than fees earned on fixed-price contracts. Under time-and-materials contracts, our profit may vary if actual labor-hour costs vary significantly from the negotiated rates. Also, because these contracts can provide little or no fee for managing material costs, the content mix can impact profitability.

Revenue by customer was as follows:

Three Months Ended October 1, 2017	Aerospace	Combat Systems	Information Systems and Technology	Marine Systems	Total Revenue
U.S. government:					
Department of Defense (DoD)	$ 40	$ 639	$ 1,207	$ 1,878	$ 3,764
Non-DoD	—	22	679	1	702
Foreign Military Sales (FMS)	8	93	17	42	160
Total U.S. government	48	754	1,903	1,921	4,626
U.S. commercial	958	63	78	6	1,105
Non-U.S. government	63	668	136	2	869
Non-U.S. commercial	926	15	37	2	980
Total revenue	$ 1,995	$ 1,500	$ 2,154	$ 1,931	$ 7,580
Three Months Ended October 2, 2016					
U.S. government:					
DoD	$ 77	$ 561	$ 1,398	$ 1,895	$ 3,931
Non-DoD	—	34	653	2	689
FMS	2	83	10	59	154
Total U.S. government	79	678	2,061	1,956	4,774
U.S. commercial	767	48	100	111	1,026
Non-U.S. government	171	586	135	8	900
Non-U.S. commercial	908	15	34	—	957
Total revenue	$ 1,925	$ 1,327	$ 2,330	$ 2,075	$ 7,657

Nine Months Ended October 1, 2017	Aerospace	Combat Systems	Information Systems and Technology	Marine Systems	Total Revenue
U.S. government:					
DoD	$ 112	$ 1,862	$ 3,519	$ 5,731	$ 11,224
Non-DoD	—	71	2,007	1	2,079
FMS	26	284	50	140	500
Total U.S. government	138	2,217	5,576	5,872	13,803
U.S. commercial	2,771	166	261	56	3,254
Non-U.S. government	132	1,764	467	10	2,373
Non-U.S. commercial	3,106	54	100	6	3,266
Total revenue	$ 6,147	$ 4,201	$ 6,404	$ 5,944	$ 22,696
Nine Months Ended October 2, 2016					
U.S. government:					
DoD	$ 187	$ 1,574	$ 3,902	$ 5,727	$ 11,390
Non-DoD	—	79	2,047	5	2,131
FMS	92	238	34	135	499
Total U.S. government	279	1,891	5,983	5,867	14,020
U.S. commercial	2,586	167	285	288	3,326
Non-U.S. government	486	1,736	476	20	2,718
Non-U.S. commercial	2,639	75	129	—	2,843
Total revenue	$ 5,990	$ 3,869	$ 6,873	$ 6,175	$ 22,907

Contract Balances. The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables (contract assets), and customer advances and deposits (contract liabilities) on the Consolidated Balance Sheet. In our defense groups, amounts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals (e.g., biweekly or monthly) or upon achievement of contractual milestones. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets. However, we sometimes receive advances or deposits from our customers, particularly on our international contracts, before revenue is recognized, resulting in contract liabilities. These assets and liabilities are reported on the Consolidated Balance Sheet on a contract-by-contract basis at the end of each reporting period. In our Aerospace group, we generally receive deposits from customers upon contract execution and upon achievement of contractual milestones. These deposits are liquidated when revenue is recognized. Changes in the contract asset and liability balances during the nine-month period ended October 1, 2017, were not materially impacted by any other factors. Revenue recognized for the three- and nine-month periods ended October 1, 2017, and October 2, 2016, that was included in the contract liability balance at the beginning of each year was $982 and $3.9 billion, and $911 and $3.7 billion, respectively. This revenue represented primarily the sale of business-jet aircraft.

C. ACQUISITIONS, GOODWILL AND INTANGIBLE ASSETS

Acquisitions. In the first nine months of 2017, we acquired three businesses for an aggregate of $364: a fixed-base-operations (FBO) facility in our Aerospace group, and a manufacturer of electronics and communications products and a provider of mission-critical support services and technology solutions in our Information Systems and Technology group. In 2016, we acquired an aircraft management and charter services provider in our Aerospace group and a manufacturer of unmanned underwater vehicles (UUVs) in our Information Systems and Technology group for an aggregate of $56.

The operating results of these acquisitions have been included with our reported results since the respective closing dates. The purchase prices of the acquisitions have been allocated to the estimated fair value of net tangible and intangible assets acquired, with any excess purchase price recorded as goodwill.

Goodwill. The changes in the carrying amount of goodwill by reporting unit for the nine-month period ended October 1, 2017, were as follows:

	Aerospace	Combat Systems	Information Systems and Technology	Marine Systems	Total Goodwill
December 31, 2016 (a)	$ 2,537	$ 2,598	$ 6,013	$ 297	$ 11,445
Acquisitions (b)	32	—	244	—	276
Other (c)	88	87	22	—	197
October 1, 2017 (a)	$ 2,657	$ 2,685	$ 6,279	$ 297	$ 11,918

(a)Goodwill on December 31, 2016, and October 1, 2017, in the Information Systems and Technology reporting unit is net of $2 billion of accumulated impairment losses.

(b)Includes adjustments during the purchase price allocation period.

(c)Consists primarily of adjustments for foreign currency translation.

Intangible Assets. Intangible assets consisted of the following:

	Gross Carrying Amount (a)	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount (a)	Accumulated Amortization	Net Carrying Amount
	October 1, 2017			December 31, 2016		
Contract and program intangible assets (b)	$1,679	$ (1,300)	$ 379	$1,633	$ (1,281)	$ 352
Trade names and trademarks	469	(158)	311	446	(139)	307
Technology and software	130	(106)	24	121	(102)	19
Other intangible assets	155	(154)	1	154	(154)	—
Total intangible assets	$2,433	$ (1,718)	$ 715	$2,354	$ (1,676)	$ 678

(a) Change in gross carrying amounts consists primarily of adjustments for acquired intangible assets and foreign currency translation.

(b) Consists of acquired backlog and probable follow-on work and associated customer relationships.

Amortization expense was $19 and $57 for the three- and nine-month periods ended October 1, 2017, and $20 and $70 for the three- and nine-month periods ended October 2, 2016.

D. EARNINGS PER SHARE

We compute basic earnings per share (EPS) using net earnings for the period and the weighted average number of common shares outstanding during the period. Basic weighted average shares outstanding have decreased in 2017 and 2016 due to share repurchases. See Note K for further discussion of our share repurchases. Diluted EPS incorporates the additional shares issuable upon the assumed exercise of stock options and the release of restricted stock and restricted stock units (RSUs).

Basic and diluted weighted average shares outstanding were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Basic weighted average shares outstanding	298,145	303,938	299,902	305,445
Dilutive effect of stock options and restricted stock/RSUs*	5,606	5,790	5,599	5,679
Diluted weighted average shares outstanding	303,751	309,728	305,501	311,124

* Excludes outstanding options to purchase shares of common stock that had exercise prices in excess of the average market price of our common stock during the period and, therefore, the effect of including these options would be antidilutive. These options totaled 1,850 and 1,449 for the three- and nine-month periods ended October 1, 2017, and 4,622 and 4,080 for the three- and nine-month periods ended October 2, 2016, respectively.

E. FAIR VALUE

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between marketplace participants. Various valuation approaches can be used to determine fair value, each requiring different valuation inputs. The following hierarchy classifies the inputs used to determine fair value into three levels:

- Level 1 – quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs, other than quoted prices, observable by a marketplace participant either directly or indirectly; and
- Level 3 – unobservable inputs significant to the fair value measurement.

We did not have any significant non-financial assets or liabilities measured at fair value on October 1, 2017, or December 31, 2016.

Our financial instruments include cash and equivalents and other investments, accounts receivable and payable, short- and long-term debt, and derivative financial instruments. The carrying values of cash and equivalents, accounts receivable and payable, and short-term debt on the unaudited Consolidated Balance Sheet approximate their fair value. The following tables present the fair values of our other financial assets and liabilities on October 1, 2017, and December 31, 2016, and the basis for determining their fair values:

Financial Assets (Liabilities) (a)	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) (b)
	October 1, 2017			
Available-for-sale securities	$174	$174	$ 60	$ 114
Cash flow hedges	(168)	(168)	—	(168)
Short- and long-term debt principal	(4,935)	(4,889)	—	(4,889)
	December 31, 2016			
Available-for-sale securities	$177	$177	$ 59	$ 118
Cash flow hedges	(477)	(477)	—	(477)
Short- and long-term debt principal	(3,924)	(3,849)	—	(3,849)

(a)We had no Level 3 financial instruments on October 1, 2017, or December 31, 2016.
(b)Determined under a market approach using valuation models that incorporate observable inputs such as interest rates, bond yields and quoted prices for similar assets and liabilities.

F. INCOME TAXES

Net Deferred Tax Asset. Our deferred tax assets and liabilities are included in other noncurrent assets and liabilities on the Consolidated Balance Sheet. Our net deferred tax asset consisted of the following:

	October 1, 2017	December 31, 2016
Deferred tax asset	$ 263	$ 564
Deferred tax liability	(212)	(183)
Net deferred tax asset	$ 51	$ 381

Tax Uncertainties. For all periods open to examination by tax authorities, we periodically assess our liabilities and contingencies based on the latest available information. Where we believe there is more than a 50 percent chance that our tax position will not be sustained, we record our best estimate of the resulting tax liability, including interest, in the Consolidated Financial Statements. We include any interest or penalties incurred in connection with income taxes as part of income tax expense. The total amount of these tax liabilities on October 1, 2017, was not material to our results of operations, financial condition or cash flows.

We participate in the Internal Revenue Service (IRS) Compliance Assurance Process (CAP), a real-time audit of our consolidated federal corporate income tax return. The IRS has examined our consolidated federal income tax returns through 2016. We do not expect the resolution of tax matters for open years to have a material impact on our results of operations, financial condition, cash flows or effective tax rate.

Based on all known facts and circumstances and current tax law, we believe the total amount of any unrecognized tax benefits on October 1, 2017, is not material to our results of operations, financial condition or cash flows, and if recognized, would not have a material impact on our effective tax rate. In addition, there are no tax positions for which it is reasonably possible that the unrecognized tax benefits will vary significantly over the next 12 months, producing, individually or in the aggregate, a material effect on our results of operations, financial condition or cash flows.

G. UNBILLED RECEIVABLES

Unbilled receivables represent revenue recognized on long-term contracts less associated advances and progress billings. These amounts will be billed in accordance with the agreed-upon contractual terms or upon achievement of contractual milestones. Unbilled receivables consisted of the following:

	October 1, 2017	December 31, 2016
Unbilled revenue	$ 28,923	$ 25,543
Advances and progress billings	(23,314)	(21,331)
Net unbilled receivables	$ 5,609	$ 4,212

The increase in net unbilled receivables during the nine-month period ended October 1, 2017, is due in part to the timing of billings on a large contract for a Middle Eastern customer in our Combat Systems group.

H. INVENTORIES

The majority of our inventories are for business-jet aircraft. Our inventories are stated at the lower of cost or net realizable value. Work in process represents largely labor, material and overhead costs associated with aircraft in the manufacturing process and is based primarily on the estimated average unit cost in a production lot. Raw materials are valued primarily on the first-in, first-out method. We record pre-owned aircraft acquired in connection with the sale of new aircraft at the lower of the trade-in value or the estimated net realizable value.

Inventories consisted of the following:

	October 1, 2017	December 31, 2016
Work in process	$ 3,884	$ 3,643
Raw materials	1,359	1,429
Finished goods	32	24
Pre-owned aircraft	—	22
Other contract costs	506	699
Total inventories	$ 5,781	$ 5,817

Other contract costs represent amounts that are not currently allocable to government contracts, such as a portion of our estimated workers' compensation obligations, other insurance-related assessments, pension and other post-retirement benefits, and environmental expenses. These costs will become allocable to contracts generally after they are paid. We expect to recover these costs through ongoing business, including existing backlog and probable follow-on contracts. If the backlog in the future does not support the continued deferral of these costs, the profitability of our remaining contracts could be adversely affected.

I. DEBT

Debt consisted of the following:

		October 1, 2017	December 31, 2016
Fixed-rate notes due:	Interest rate:		
November 2017	1.000%	$ 900	$ 900
July 2021	3.875%	500	500
November 2022	2.250%	1,000	1,000
August 2023	1.875%	500	500
November 2024	2.375%	500	—
August 2026	2.125%	500	500
November 2027	2.625%	500	—
November 2042	3.600%	500	500
Other	Various	35	24
Total debt principal		4,935	3,924
Less unamortized debt issuance costs and discounts		53	36
Total debt		4,882	3,888
Less current portion		903	900
Long-term debt		$ 3,979	$ 2,988

Our fixed-rate notes are fully and unconditionally guaranteed by several of our 100%-owned subsidiaries. See Note P for condensed consolidating financial statements. We have the option to redeem the notes prior to their maturity in whole or in part for the principal plus any accrued but unpaid interest and applicable make-whole amounts.

In the third quarter of 2017, we issued $1 billion of fixed-rate notes. The proceeds will be used to repay $900 of fixed-rate notes maturing in November of 2017 and for general corporate purposes.

On October 1, 2017, we had no commercial paper outstanding, but we maintain the ability to access the commercial paper market in the future. We have $2 billion in committed bank credit facilities for general corporate purposes and working capital needs. These credit facilities include a $1 billion multi-year facility expiring in July 2018 and a $1 billion multi-year facility expiring in November 2020. We may renew or replace these credit facilities in whole or in part at or prior to their expiration dates. Our bank credit facilities are guaranteed by several of our 100%-owned subsidiaries. We also have an effective shelf registration on file with the SEC that allows us to access the debt markets.

Our financing arrangements contain a number of customary covenants and restrictions. We were in compliance with all covenants on October 1, 2017.

J. OTHER LIABILITIES

A summary of significant other liabilities by balance sheet caption follows:

	October 1, 2017	December 31, 2016
Salaries and wages	$ 795	$ 693
Fair value of cash flow hedges	239	521
Workers' compensation	340	337
Retirement benefits	294	303
Other (a)	1,310	1,331
Total other current liabilities	$ 2,978	$ 3,185
Retirement benefits	$ 4,211	$ 4,393
Customer deposits on commercial contracts	636	719
Deferred income taxes	212	183
Other (b)	1,103	1,138
Total other liabilities	$ 6,162	$ 6,433

(a)Consists primarily of dividends payable, taxes payable, environmental remediation reserves, warranty reserves, deferred revenue and supplier contributions in the Aerospace group, liabilities of discontinued operations, and insurance-related costs.

(b)Consists primarily of warranty reserves, workers' compensation liabilities and liabilities of discontinued operations.

K. SHAREHOLDERS' EQUITY

Share Repurchases. Our board of directors authorizes management's repurchase of outstanding shares of our common stock on the open market from time to time. On March 1, 2017, the board of directors authorized management to repurchase up to 10 million additional shares of the company's outstanding stock. In the nine-month period ended October 1, 2017, we repurchased 5.9 million of our outstanding shares for $1.1 billion. On October 1, 2017, 9.5 million shares remained authorized by our board of directors for repurchase, approximately 3 percent of our total shares outstanding. We repurchased 11.2 million shares for $1.5 billion in the nine-month period ended October 2, 2016.

Dividends per Share. Dividends declared per share were $0.84 and $2.52 for the three- and nine-month periods ended October 1, 2017, and $0.76 and $2.28 for the three- and nine-month periods ended October 2, 2016, respectively. Cash dividends paid were $252 and $735 for the three- and nine-month periods ended October 1, 2017, and $231 and $678 for the three- and nine-month periods ended October 2, 2016, respectively.

Accumulated Other Comprehensive Loss. The changes, pretax and net of tax, in each component of accumulated other comprehensive loss (AOCL) consisted of the following:

	Losses on Cash Flow Hedges	Unrealized Gains on Securities	Foreign Currency Translation Adjustments	Changes in Retirement Plans' Funded Status	AOCL
December 31, 2016	$ (345)	$ 14	$ 69	$ (3,125)	$ (3,387)
Other comprehensive income, pretax	286	8	409	193	896
Provision for income tax, net	73	2	15	70	160
Other comprehensive income, net of tax	213	6	394	123	736
October 1, 2017	$ (132)	$ 20	$ 463	$ (3,002)	$ (2,651)
December 31, 2015	$ (487)	$ 20	$ 181	$ (2,997)	$ (3,283)
Other comprehensive income, pretax	260	(5)	85	191	531
Provision for income tax, net	65	(2)	1	69	133
Other comprehensive income, net of tax	195	(3)	84	122	398
October 2, 2016	$ (292)	$ 17	$ 265	$ (2,875)	$ (2,885)

Amounts reclassified out of AOCL related primarily to changes in our retirement plans' funded status and consisted of pretax recognized net actuarial losses of $255 and $249 for the nine-month periods ended October 1, 2017, and October 2, 2016, respectively. This was offset partially by pretax amortization of prior service credit of $53 and $56 for the nine-month periods ended October 1, 2017, and October 2, 2016, respectively. These AOCL components are included in our net periodic pension and other post-retirement benefit cost. See Note N for additional details.

L. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to market risk, primarily from foreign currency exchange rates, interest rates, commodity prices and investments. We may use derivative financial instruments to hedge some of these risks as described below. We had $5.2 billion in notional forward exchange contracts outstanding on October 1, 2017, and $6.3 billion on December 31, 2016. We do not use derivative financial instruments for trading or speculative purposes. We recognize derivative financial instruments on the Consolidated Balance Sheet at fair value. See Note E for additional details.

Foreign Currency Risk and Hedging Activities. Our foreign currency exchange rate risk relates to receipts from customers, payments to suppliers and inter-company transactions denominated in foreign currencies. To the extent possible, we include terms in our contracts that are designed to protect us from this risk. Otherwise, we enter into derivative financial instruments, principally foreign currency forward purchase and sale contracts, designed to offset and minimize our risk. The dollar-weighted three-year average maturity of these instruments generally matches the duration of the activities that are at risk.

We record changes in the fair value of derivative financial instruments in operating costs and expenses in the Consolidated Statement of Earnings or in other comprehensive loss (OCL) within the Consolidated Statement of Comprehensive Income depending on whether the derivative is designated and qualifies for hedge accounting. Gains and losses related to derivative financial instruments that qualify as cash flow hedges are deferred in OCL until the underlying transaction is reflected in earnings. We adjust derivative financial instruments not designated as cash flow hedges to market value each period and record the gain or loss in the Consolidated Statement of Earnings. The gains and losses on these instruments generally offset losses and gains on the assets, liabilities and other transactions being hedged. Gains and losses resulting from hedge ineffectiveness are recognized in the Consolidated Statement of Earnings for all derivative financial instruments, regardless of designation.

Net gains and losses on derivative financial instruments recognized in earnings, including gains and losses related to hedge ineffectiveness, were not material to our results of operations for the three- and nine-month periods ended October 1, 2017, and October 2, 2016. Net gains and losses reclassified to earnings from OCL were not material to our results of operations for the three- and nine-month periods ended October 1, 2017, and October 2, 2016, and we do not expect the amount of these gains and losses that will be reclassified to earnings during the next 12 months to be material.

We had no material derivative financial instruments designated as fair value or net investment hedges on October 1, 2017, or December 31, 2016.

Interest Rate Risk. Our financial instruments subject to interest rate risk include fixed-rate long-term debt obligations and variable-rate commercial paper. However, the risk associated with these instruments is not material.

Commodity Price Risk. We are subject to rising labor and commodity price risk, primarily on long-term, fixed-price contracts. To the extent possible, we include terms in our contracts that are designed to protect us from these risks. Some of the protective terms included in our contracts are considered derivative financial instruments but are not accounted for separately because they are clearly and closely related to the host contract. We have not entered into any material commodity hedging contracts but may do so as circumstances warrant. We do not believe that changes in labor or commodity prices will have a material impact on our results of operations or cash flows.

Investment Risk. Our investment policy allows for purchases of fixed-income securities with an investment-grade rating and a maximum maturity of up to five years. On October 1, 2017, we held $2.7 billion in cash and equivalents, but held no marketable securities.

Foreign Currency Financial Statement Translation. We translate foreign currency balance sheets from our international businesses' functional currency (generally the respective local currency) to U.S. dollars at end-of-period exchange rates, and statements of earnings at average exchange rates for each period. The resulting foreign currency translation adjustments are a component of OCL.

We do not hedge the fluctuation in reported revenue and earnings resulting from the translation of these international operations' results into U.S. dollars. The impact of translating our non-U.S. operations' revenue into U.S. dollars was not material to our results of operations for the three- and nine-month periods ended October 1, 2017, and October 2, 2016. In addition, the effect of changes in foreign exchange rates on non-U.S. cash balances was not material for the nine-month periods ended October 1, 2017, and October 2, 2016.

M. COMMITMENTS AND CONTINGENCIES

Litigation

In 2015, Electric Boat Corporation, a subsidiary of General Dynamics Corporation, received a Civil Investigative Demand from the U.S. Department of Justice regarding an investigation of potential False Claims Act violations relating to alleged failures of Electric Boat's quality system with respect to allegedly non-conforming parts purchased from a supplier. In 2016, Electric Boat was made aware that it is a defendant in a lawsuit related to this matter filed under seal in U.S. district court. Also in 2016, the Suspending and Debarring Official for the U.S. Department of the Navy issued a Show Cause Letter to Electric Boat requesting that Electric Boat respond to the official's concerns regarding Electric Boat's oversight and management with respect to its quality assurance systems for subcontractors and suppliers. Electric Boat responded to the Show Cause Letter and has been engaged in discussions with the U.S. government. Given the current status of these matters, we are unable to express a view regarding the ultimate outcome or, if the outcome is adverse, to estimate an amount or range of reasonably possible loss. Depending on the outcome of these matters, there could be a material impact on our results of operations, financial condition and cash flows.

Additionally, various claims and legal proceedings incidental to the normal course of business are pending or threatened against us. These other matters relate to such issues as government investigations and claims, the protection of the environment, asbestos-related claims and employee-related matters. The nature of litigation is such that we cannot predict the outcome of these other matters. However, based on information currently available, we believe any potential liabilities in these proceedings, individually or in the aggregate, will not have a material impact on our results of operations, financial condition or cash flows.

Environmental

We are subject to and affected by a variety of federal, state, local and foreign environmental laws and regulations. We are directly or indirectly involved in environmental investigations or remediation at some of our current and former facilities and third-party sites that we do not own but where we have been designated a Potentially Responsible Party (PRP) by the U.S. Environmental Protection Agency or a state environmental agency. Based on historical experience, we expect that a significant percentage of the total remediation and compliance costs associated with these facilities will continue to be allowable contract costs and, therefore, recoverable under U.S. government contracts.

As required, we provide financial assurance for certain sites undergoing or subject to investigation or remediation. We accrue environmental costs when it is probable that a liability has been incurred and the amount can be reasonably estimated. Where applicable, we seek insurance recovery for costs related to environmental liabilities. We do not record insurance recoveries before collection is considered probable. Based on all known facts and analyses, we do not believe that our liability at any individual site, or in the aggregate, arising from such environmental conditions, will be material to our results of operations, financial condition or cash flows. We also do not believe that the range of reasonably possible additional loss beyond what has been recorded would be material to our results of operations, financial condition or cash flows.

Other

Government Contracts. As a government contractor, we are subject to U.S. government audits and investigations relating to our operations, including claims for fines, penalties, and compensatory and treble damages. We believe the outcome of such ongoing government audits and investigations will not have a material impact on our results of operations, financial condition or cash flows.

In the performance of our contracts, we routinely request contract modifications that require additional funding from the customer. Most often, these requests are due to customer-directed changes in the scope of work. While we are entitled to recovery of these costs under our contracts, the administrative process with our customer may be protracted. Based upon the circumstances, we periodically file requests for equitable adjustment (REAs) that are sometimes converted into claims. In some cases, these requests are disputed by our customer. We believe our outstanding modifications, REAs and claims will be resolved without material impact to our results of operations, financial condition or cash flows.

Letters of Credit and Guarantees. In the ordinary course of business, we have entered into letters of credit, bank guarantees, surety bonds and other similar arrangements with financial institutions and insurance carriers totaling approximately $1.2 billion on October 1, 2017. In addition, from time to time and in the ordinary course of business, we contractually guarantee the payments or performance of our subsidiaries arising under certain contracts.

Aircraft Trade-ins. In connection with orders for new aircraft in funded contract backlog, our Aerospace group has outstanding options with some customers to trade in aircraft as partial consideration in their new-aircraft transaction. These trade-in commitments are generally structured to establish the fair market value of the trade-in aircraft at a date 45 or fewer days preceding delivery of the new aircraft to the customer. At that time, the customer is required to either exercise the option or allow its expiration. Any excess of the pre-established trade-in price above the fair market value at the time the new aircraft is delivered is treated as a reduction of revenue in the new-aircraft sales transaction.

Product Warranties. We provide warranties to our customers associated with certain product sales. We record estimated warranty costs in the period in which the related products are delivered. The warranty liability recorded at each balance sheet date is based generally on the number of months of warranty coverage remaining for the products delivered and the average historical monthly warranty payments. Warranty obligations incurred in connection with long-term production contracts are accounted for within the contract estimates at completion. Our other warranty obligations, primarily for business-jet aircraft, are included in other current and noncurrent liabilities on the Consolidated Balance Sheet.

The changes in the carrying amount of warranty liabilities for the nine-month periods ended October 1, 2017, and October 2, 2016, were as follows:

Nine Months Ended	October 1, 2017	October 2, 2016
Beginning balance	$ 474	$ 434
Warranty expense	94	95
Payments	(74)	(72)
Adjustments	(28)	(14)
Ending balance	$ 466	$ 443

N. RETIREMENT PLANS

We provide defined-contribution benefits to eligible employees, as well as some remaining defined-benefit pension and other post-retirement benefits.

Net periodic defined-benefit pension and other post-retirement benefit cost for the three- and nine-month periods ended October 1, 2017, and October 2, 2016, consisted of the following:

	Pension Benefits		Other Post-retirement Benefits	
Three Months Ended	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Service cost	$42	$ 44	$ 3	$ 3
Interest cost	113	114	8	8
Expected return on plan assets	(169)	(178)	(8)	(8)
Recognized net actuarial loss (gain)	86	84	(1)	(1)
Amortization of prior service credit	(17)	(17)	(1)	(2)
Net periodic benefit cost	$55	$ 47	$ 1	$ —
Nine Months Ended				
Service cost	$126	$ 132	$ 9	$ 8
Interest cost	339	342	25	25
Expected return on plan assets	(508)	(534)	(25)	(24)
Recognized net actuarial loss (gain)	258	252	(3)	(3)
Amortization of prior service credit	(50)	(51)	(3)	(5)
Net periodic benefit cost	$165	$ 141	$ 3	$ 1

In 2017, we decreased the expected long-term rate of return on assets in our primary U.S. government and commercial pension plans by 75 basis points following an assessment of the historical and expected long-term returns of our various asset classes.

Our contractual arrangements with the U.S. government provide for the recovery of contributions to our pension and other post-retirement benefit plans covering employees working in our defense business groups. For non-funded plans, our government contracts allow us to recover claims paid. Following payment, these recoverable amounts are allocated to contracts and billed to the customer in accordance with the Cost Accounting Standards (CAS) and specific contractual terms. For some of these plans, the cumulative pension and other post-retirement benefit cost exceeds the amount currently allocable to contracts. To the extent recovery of the cost is considered probable based on our backlog and probable follow-on contracts, we defer the excess in other contract costs in inventory on the Consolidated Balance Sheet until the cost is allocable to contracts. See Note H for discussion of our other contract costs. For other plans, the amount allocated to contracts and included in revenue has exceeded the plans' cumulative benefit cost. We have deferred recognition of these excess earnings, classifying these deferrals against the plan assets on the Consolidated Balance Sheet.

O. BUSINESS GROUP INFORMATION

We operate in four business groups: Aerospace, Combat Systems, Information Systems and Technology, and Marine Systems. We organize our business groups in accordance with the nature of products and services offered. We measure each group's profitability based on operating earnings. As a result, we do not allocate net interest, other income and expense items, and income taxes to our business groups.

Summary financial information for each of our business groups follows:

	Revenue		Operating Earnings	
Three Months Ended	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Aerospace	$1,995	$1,925	$385	$377
Combat Systems	1,500	1,327	247	209
Information Systems and Technology	2,154	2,330	253	239
Marine Systems	1,931	2,075	179	197
Corporate*	—	—	(12)	(7)
Total	$7,580	$7,657	$1,052	$1,015
Nine Months Ended				
Aerospace	$6,147	$5,990	$1,253	$1,133
Combat Systems	4,201	3,869	677	601
Information Systems and Technology	6,404	6,873	729	710
Marine Systems	5,944	6,175	518	553
Corporate*	—	—	(34)	(31)
Total	$22,696	$22,907	$3,143	$2,966

* Corporate operating results consist primarily of stock option expense.

P. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The fixed-rate notes described in Note I are fully and unconditionally guaranteed on an unsecured, joint and several basis by several of our 100%-owned subsidiaries (the guarantors). The following condensed consolidating financial statements illustrate the composition of the parent, the guarantors on a combined basis (each guarantor together with its majority-owned subsidiaries) and all other subsidiaries on a combined basis.

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS (UNAUDITED)

Three Months Ended October 1, 2017	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Revenue	$—	$ 6,556	$ 1,024	$ —	$ 7,580
Cost of sales	(3)	5,217	804	—	6,018
G&A	15	420	75	—	510
Operating earnings	(12)	919	145	—	1,052
Interest, net	(24)	—	(3)	—	(27)
Other, net	2	—	—	—	2
Earnings before income tax	(34)	919	142	—	1,027
Provision for income tax, net	(26)	283	6	—	263
Equity in net earnings of subsidiaries	772	—	—	(772)	—
Net earnings	$764	$ 636	$ 136	$ (772)	$ 764
Comprehensive income	$1,035	$ 648	$ 371	$ (1,019)	$ 1,035
Three Months Ended October 2, 2016					
Revenue	$—	$ 6,716	$ 941	$ —	$ 7,657
Cost of sales	(1)	5,455	717	—	6,171
G&A	10	381	80	—	471
Operating earnings	(9)	880	144	—	1,015
Interest, net	(23)	(1)	1	—	(23)
Other, net	1	(4)	5	—	2
Earnings before income tax	(31)	875	150	—	994
Provision for income tax, net	(42)	290	15	—	263
Discontinued operations, net of tax	(84)	—	—	—	(84)
Equity in net earnings of subsidiaries	720	—	—	(720)	—
Net earnings	$647	$ 585	$ 135	$ (720)	$ 647
Comprehensive income	$722	$ 578	$ 168	$ (746)	$ 722

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS (UNAUDITED)

Nine Months Ended October 1, 2017	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Revenue	$—	$ 19,832	$ 2,864	$ —	$ 22,696
Cost of sales	(6)	15,858	2,205	—	18,057
G&A	39	1,230	227	—	1,496
Operating earnings	(33)	2,744	432	—	3,143
Interest, net	(71)	—	(5)	—	(76)
Other, net	2	—	—	—	2
Earnings before income tax	(102)	2,744	427	—	3,069
Provision for income tax, net	(119)	877	35	—	793
Equity in net earnings of subsidiaries	2,259	—	—	(2,259)	—
Net earnings	$2,276	$ 1,867	$ 392	$ (2,259)	$ 2,276
Comprehensive income	$3,012	$ 1,907	$ 1,005	$ (2,912)	$ 3,012
Nine Months Ended October 2, 2016					
Revenue	$—	$ 20,123	$ 2,784	$ —	$ 22,907
Cost of sales	1	16,360	2,163	—	18,524
G&A	30	1,162	225	—	1,417
Operating earnings	(31)	2,601	396	—	2,966
Interest, net	(69)	(1)	2	—	(68)
Other, net	11	(3)	5	—	13
Earnings before income tax	(89)	2,597	403	—	2,911
Provision for income tax, net	(93)	839	66	—	812
Discontinued operations, net of tax	(97)	—	—	—	(97)
Equity in net earnings of subsidiaries	2,095	—	—	(2,095)	—
Net earnings	$2,002	$ 1,758	$ 337	$ (2,095)	$ 2,002
Comprehensive income	$2,400	$ 1,746	$ 637	$ (2,383)	$ 2,400

CONDENSED CONSOLIDATING BALANCE SHEET (UNAUDITED)

October 1, 2017	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current assets:					
Cash and equivalents	$1,571	$—	$ 1,151	$ —	$ 2,722
Accounts receivable	—	1,027	2,364	—	3,391
Unbilled receivables	—	2,677	2,932	—	5,609
Inventories	198	5,494	89	—	5,781
Other current assets	133	182	262	—	577
Total current assets	1,902	9,380	6,798	—	18,080
Noncurrent assets:					
Property, plant and equipment (PP&E)	220	6,659	1,232	—	8,111
Accumulated depreciation of PP&E	(73)	(3,796)	(781)	—	(4,650)
Intangible assets, net	—	292	423	—	715
Goodwill	—	8,293	3,625	—	11,918
Other assets	371	226	143	—	740
Investment in subsidiaries	44,207	—	—	(44,207)	—
Total noncurrent assets	44,725	11,674	4,642	(44,207)	16,834
Total assets	$46,627	$ 21,054	$ 11,440	$ (44,207)	$ 34,914
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Short-term debt and current portion of long-term debt	$900	$ 2	$ 1	$ —	$ 903
Customer advances and deposits	—	3,730	2,880	—	6,610
Other current liabilities	563	3,509	1,624	—	5,696
Total current liabilities	1,463	7,241	4,505	—	13,209
Noncurrent liabilities:					
Long-term debt	3,949	21	9	—	3,979
Other liabilities	2,279	3,254	629	—	6,162
Total noncurrent liabilities	6,228	3,275	638	—	10,141
Intercompany	27,372	(27,238)	(134)	—	—
Shareholders' equity:					
Common stock	482	6	2,126	(2,132)	482
Other shareholders' equity	11,082	37,770	4,305	(42,075)	11,082
Total shareholders' equity	11,564	37,776	6,431	(44,207)	11,564
Total liabilities and shareholders' equity	$46,627	$ 21,054	$ 11,440	$ (44,207)	$ 34,914

CONDENSED CONSOLIDATING BALANCE SHEET (UNAUDITED)

December 31, 2016	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current assets:					
Cash and equivalents	$1,254	$—	$ 1,080	$ —	$ 2,334
Accounts receivable	—	1,155	2,244	—	3,399
Unbilled receivables	—	2,235	1,977	—	4,212
Inventories	304	5,417	96	—	5,817
Other current assets	330	204	238	—	772
Total current assets	1,888	9,011	5,635	—	16,534
Noncurrent assets:					
PP&E	197	6,586	1,146	—	7,929
Accumulated depreciation of PP&E	(67)	(3,653)	(732)	—	(4,452)
Intangible assets, net	—	265	413	—	678
Goodwill	—	8,050	3,395	—	11,445
Other assets	640	232	166	—	1,038
Investment in subsidiaries	41,956	—	—	(41,956)	—
Total noncurrent assets	42,726	11,480	4,388	(41,956)	16,638
Total assets	$44,614	$ 20,491	$ 10,023	$ (41,956)	$ 33,172
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Short-term debt and current portion of long-term debt	$898	$ 2	$ —	$ —	$ 900
Customer advances and deposits	—	4,339	2,488	—	6,827
Other current liabilities	564	3,465	1,694	—	5,723
Total current liabilities	1,462	7,806	4,182	—	13,450
Noncurrent liabilities:					
Long-term debt	2,966	22	—	—	2,988
Other liabilities	3,520	2,330	583	—	6,433
Total noncurrent liabilities	6,486	2,352	583	—	9,421
Intercompany	26,365	(25,827)	(538)	—	—
Shareholders' equity:					
Common stock	482	6	2,354	(2,360)	482
Other shareholders' equity	9,819	36,154	3,442	(39,596)	9,819
Total shareholders' equity	10,301	36,160	5,796	(41,956)	10,301
Total liabilities and shareholders' equity	$44,614	$ 20,491	$ 10,023	$ (41,956)	$ 33,172

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS (UNAUDITED)

Nine Months Ended October 1, 2017	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Net cash provided by operating activities*	$145	$ 1,502	$ 234	$ —	$ 1,881
Cash flows from investing activities:					
Business acquisitions, net of cash acquired	—	(315)	(49)	—	(364)
Capital expenditures	(23)	(205)	(45)	—	(273)
Other, net	5	50	(2)	—	53
Net cash used by investing activities	(18)	(470)	(96)	—	(584)
Cash flows from financing activities:					
Purchases of common stock	(1,172)	—	—	—	(1,172)
Proceeds from fixed-rate notes	985	—	—	—	985
Dividends paid	(735)	—	—	—	(735)
Other, net	43	(2)	—	—	41
Net cash used by financing activities	(879)	(2)	—	—	(881)
Net cash used by discontinued operations	(28)	—	—	—	(28)
Cash sweep/funding by parent	1,097	(1,030)	(67)	—	—
Net increase in cash and equivalents	317	—	71	—	388
Cash and equivalents at beginning of period	1,254	—	1,080	—	2,334
Cash and equivalents at end of period	$1,571	$ —	$ 1,151	$ —	$ 2,722
Nine Months Ended October 2, 2016					
Net cash provided by operating activities*	$98	$ 1,161	$ 113	$ —	$ 1,372
Cash flows from investing activities:					
Capital expenditures	(5)	(208)	(31)	—	(244)
Other, net	3	(3)	(38)	—	(38)
Net cash used by investing activities	(2)	(211)	(69)	—	(282)
Cash flows from financing activities:					
Purchases of common stock	(1,514)	—	—	—	(1,514)
Proceeds from fixed-rate notes	992	—	—	—	992
Dividends paid	(678)	—	—	—	(678)
Repayment of fixed-rate notes	(500)	—	—	—	(500)
Other, net	173	(1)	—	—	172
Net cash used by financing activities	(1,527)	(1)	—	—	(1,528)
Net cash used by discontinued operations	(44)	—	—	—	(44)
Cash sweep/funding by parent	820	(949)	129	—	—
Net decrease in cash and equivalents	(655)	—	173	—	(482)
Cash and equivalents at beginning of period	1,732	—	1,053	—	2,785
Cash and equivalents at end of period	$1,077	$ —	$ 1,226	$ —	$ 2,303

* Continuing operations only.

Q. PRIOR-PERIOD FINANCIAL STATEMENTS

Our prior-period financial statements were restated for the adoption of two ASUs that are discussed below.

ASC Topic 606. We adopted ASC Topic 606 on January 1, 2017, using the retrospective method. The adoption of ASC Topic 606 had two primary impacts on our Consolidated Financial Statements. The impact of adjustments on profit recorded to date is now recognized in the period identified (cumulative catch-up method), rather than prospectively over the remaining contract term. For our contracts for the manufacture of business-jet aircraft, we now recognize revenue at a single point in time when control is transferred to the customer, generally upon delivery and acceptance of the fully outfitted aircraft. Prior to the adoption of ASC Topic 606, we recognized revenue for these contracts at two contractual milestones: when green aircraft were completed and accepted by the customer and when the customer accepted final delivery of the fully outfitted aircraft. The cumulative effect of the adoption was recognized as a decrease to retained earnings of $372 on January 1, 2015.

We applied the standard’s practical expedient that permits the omission of prior-period information about our remaining performance obligations. No other practical expedients were applied.

ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. We adopted ASU 2015-17 on January 1, 2017, using the retrospective method. ASU 2015-17 requires that deferred tax assets and liabilities be classified as noncurrent on the Consolidated Balance Sheet. The adoption of ASU 2015-17 resulted in reclassifications among accounts on the Consolidated Balance Sheet, but had no other impacts on our results of operations, financial condition or cash flows.

The following tables summarize the effects of adopting these accounting standards on our unaudited Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF EARNINGS (UNAUDITED)

(Dollars in millions, except per-share amounts)	Three Months Ended October 2, 2016 As Reported	Effect of the Adoption of ASC Topic 606	Effect of the Adoption of ASU 2015-17	Three Months Ended October 2, 2016 As Adjusted
Revenue:				
Products	$ 4,844	$ (95)	$ —	$ 4,749
Services	2,887	21	—	2,908
	7,731	(74)	—	7,657
Operating costs and expenses:				
Products	3,757	(7)	—	3,750
Services	2,434	(13)	—	2,421
G&A	471	—	—	471
	6,662	(20)	—	6,642
Operating earnings	1,069	(54)	—	1,015
Interest, net	(23)	—	—	(23)
Other, net	2	—	—	2
Earnings from continuing operations before income tax	1,048	(54)	—	994
Provision for income tax, net	281	(18)	—	263
Earnings from continuing operations	767	(36)	—	731
Discontinued operations, net of tax benefit of $46	(84)	—	—	(84)
Net earnings	$ 683	$ (36)	$ —	$ 647
Earnings per share				
Basic:				
Continuing operations	$ 2.52	$ (0.12)	$ —	$ 2.40
Discontinued operations	(0.27)	—	—	(0.27)
Net earnings	$ 2.25	$ (0.12)	$ —	$ 2.13
Diluted:				
Continuing operations	$ 2.48	$ (0.12)	$ —	$ 2.36
Discontinued operations	(0.27)	—	—	(0.27)
Net earnings	$ 2.21	$ (0.12)	$ —	$ 2.09

CONSOLIDATED STATEMENT OF EARNINGS (UNAUDITED)

(Dollars in millions, except per-share amounts)	Nine Months Ended October 2, 2016 As Reported	Effect of the Adoption of ASC Topic 606	Effect of the Adoption of ASU 2015-17	Nine Months Ended October 2, 2016 As Adjusted
Revenue:				
Products	$ 14,556	$ (282)	$ —	$ 14,274
Services	8,564	69	—	8,633
	23,120	(213)	—	22,907
Operating costs and expenses:				
Products	11,287	(13)	—	11,274
Services	7,224	26	—	7,250
G&A	1,417	—	—	1,417
	19,928	13	—	19,941
Operating earnings	3,192	(226)	—	2,966
Interest, net	(68)	—	—	(68)
Other, net	13	—	—	13
Earnings from continuing operations before income tax	3,137	(226)	—	2,911
Provision for income tax, net	882	(70)	—	812
Earnings from continuing operations	2,255	(156)	—	2,099
Discontinued operations, net of tax benefit of $46	(97)	—	—	(97)
Net earnings	$ 2,158	$ (156)	$ —	$ 2,002
Earnings per share				
Basic:				
Continuing operations	$ 7.38	$ (0.52)	$ —	$ 6.86
Discontinued operations	(0.31)	—	—	(0.31)
Net earnings	$ 7.07	$ (0.52)	$ —	$ 6.55
Diluted:				
Continuing operations	$ 7.25	$ (0.51)	$ —	$ 6.74
Discontinued operations	(0.31)	—	—	(0.31)
Net earnings	$ 6.94	$ (0.51)	$ —	$ 6.43

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended October 2, 2016	Effect of the Adoption of		Three Months Ended October 2, 2016
		ASC	ASU	
(Dollars in millions)	As Reported	Topic 606	2015-17	As Adjusted
Net earnings	$ 683	$ (36)	$ —	$ 647
Gains on cash flow hedges	102	—	—	102
Unrealized losses on securities	(1)	—	—	(1)
Foreign currency translation adjustments	(43)	1	—	(42)
Change in retirement plans' funded status	65	—	—	65
Other comprehensive income, pretax	123	1	—	124
Provision for income tax, net	49	—	—	49
Other comprehensive income, net of tax	74	1	—	75
Comprehensive income	$ 757	$ (35)	$ —	$ 722

Nine Months Ended October 2, 2016	Effect of the Adoption of		Nine Months Ended
	ASC	ASU	