

LOCKHEED MARTIN CORP
Form 10-Q
July 25, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the quarterly period ended June 24, 2012
Commission File Number: 1-11437

LOCKHEED MARTIN CORPORATION

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

6801 Rockledge Drive, Bethesda, Maryland
(Address of principal executive offices)

(301) 897-6000

(Registrant's telephone number, including area code)

52-1893632
(I.R.S. Employer

Identification Number)

20817
(Zip Code)

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

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

Large Accelerated Filer x Accelerated Filer " Non Accelerated Filer " Smaller Reporting Company "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES " NO x

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

| Class | Outstanding as of June 24, 2012 |
|---------------------------------------|--|
| Common stock, \$1 par value per share | 324,416,270 |

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Lockheed Martin Corporation

Form 10-Q

For the Quarterly Period Ended June 24, 2012

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

| | Quarters Ended | | Six Months Ended | |
|---|----------------|---------------|------------------|-----------------|
| | June 24, | June 26, | June 24, | June 26, |
| | 2012 | 2011 | 2012 | 2011 |
| Net sales | | | | |
| Products | \$ 9,543 | \$ 9,113 | \$ 18,691 | \$ 17,613 |
| Services | 2,378 | 2,430 | 4,523 | 4,556 |
| Total net sales | 11,921 | 11,543 | 23,214 | 22,169 |
| Cost of sales | | | | |
| Products | (8,351) | (8,107) | (16,431) | (15,694) |
| Services | (2,115) | (2,177) | (4,032) | (4,103) |
| Severance charges | | (97) | | (97) |
| Other unallocated costs | (275) | (256) | (594) | (555) |
| Total cost of sales | (10,741) | (10,637) | (21,057) | (20,449) |
| Gross profit | 1,180 | 906 | 2,157 | 1,720 |
| Other income, net | 20 | 87 | 55 | 137 |
| Operating profit | 1,200 | 993 | 2,212 | 1,857 |
| Interest expense | (96) | (84) | (192) | (169) |
| Other non-operating income, net | 13 | 9 | 48 | 28 |
| Earnings from continuing operations before income taxes | 1,117 | 918 | 2,068 | 1,716 |
| Income tax expense | (336) | (170) | (619) | (412) |
| Net earnings from continuing operations | 781 | 748 | 1,449 | 1,304 |
| Net loss from discontinued operations | | (6) | | (32) |
| Net earnings | \$ 781 | \$ 742 | \$ 1,449 | \$ 1,272 |
| Earnings (loss) per common share | | | | |
| Basic | | | | |
| Continuing operations | \$ 2.41 | \$ 2.18 | \$ 4.47 | \$ 3.77 |
| Discontinued operations | | (.02) | | (.09) |
| Basic earnings per common share | \$ 2.41 | \$ 2.16 | \$ 4.47 | \$ 3.68 |
| Diluted | | | | |
| Continuing operations | \$ 2.38 | \$ 2.16 | \$ 4.41 | \$ 3.73 |
| Discontinued operations | | (.02) | | (.09) |
| Diluted earnings per common share | \$ 2.38 | \$ 2.14 | \$ 4.41 | \$ 3.64 |
| Cash dividends paid per common share | \$ 1.00 | \$.75 | \$ 2.00 | \$ 1.50 |

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

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

| | Quarters Ended | | Six Months Ended | |
|--|-----------------------|-----------------|-------------------------|-----------------|
| | June 24, | June 26, | June 24, | June 26, |
| | 2012 | 2011 | 2012 | 2011 |
| Net earnings | \$781 | \$742 | \$1,449 | \$1,272 |
| Other comprehensive income, net of tax | | | | |
| Recognition of previously deferred postretirement benefit plan amounts | 203 | 165 | 406 | 330 |
| Other, net | (37) | (8) | (13) | 9 |
| Other comprehensive income, net of tax | 166 | 157 | 393 | 339 |
| Comprehensive income | \$947 | \$899 | \$1,842 | \$1,611 |

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

Table of Contents**Lockheed Martin Corporation****Consolidated Balance Sheets**

(in millions, except par value)

| | June 24, 2012 (unaudited) | December 31, 2011 |
|---|---------------------------------|----------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 3,802 | \$ 3,582 |
| Receivables, net | 6,569 | 6,064 |
| Inventories, net | 2,521 | 2,481 |
| Deferred income taxes | 1,327 | 1,339 |
| Other current assets | 581 | 628 |
| Total current assets | 14,800 | 14,094 |
| Property, plant, and equipment, net | 4,495 | 4,611 |
| Goodwill | 10,158 | 10,148 |
| Deferred income taxes | 4,186 | 4,388 |
| Other noncurrent assets | 4,747 | 4,667 |
| Total assets | \$38,386 | \$37,908 |
| Liabilities and stockholders' equity | | |
| Current liabilities | | |
| Accounts payable | \$ 2,359 | \$ 2,269 |
| Customer advances and amounts in excess of costs incurred | 6,287 | 6,399 |
| Salaries, benefits, and payroll taxes | 1,668 | 1,664 |
| Current portion of long-term debt | 150 | |
| Other current liabilities | 1,804 | 1,798 |
| Total current liabilities | 12,268 | 12,130 |
| Long-term debt, net | 6,343 | 6,460 |
| Accrued pension liabilities | 12,775 | 13,502 |
| Other postretirement benefit liabilities | 1,267 | 1,274 |
| Other noncurrent liabilities | 3,529 | 3,541 |
| Total liabilities | 36,182 | 36,907 |
| Stockholders' equity | | |
| Common stock, \$1 par value per share | 322 | 321 |
| Additional paid-in capital | 19 | |
| Retained earnings | 12,727 | 11,937 |
| Accumulated other comprehensive loss | (10,864) | (11,257) |
| Total stockholders' equity | 2,204 | 1,001 |
| Total liabilities and stockholders' equity | \$38,386 | \$37,908 |

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

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

| | Six Months Ended | |
|---|-------------------------|-----------------|
| | June 24, | June 26, |
| | 2012 | 2011 |
| Operating activities | | |
| Net earnings | \$1,449 | \$1,272 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 464 | 492 |
| Stock-based compensation | 87 | 79 |
| Severance charges | | 97 |
| Reduction in tax expense from resolution of certain tax matters | | (89) |
| Changes in operating assets and liabilities: | | |
| Receivables, net | (505) | (861) |
| Inventories, net | (38) | 148 |
| Accounts payable | 91 | 592 |
| Customer advances and amounts in excess of costs incurred | (111) | 151 |
| Postretirement benefit plans | (138) | 622 |
| Income taxes | (105) | 196 |
| Other, net | 109 | (86) |
| Net cash provided by operating activities | 1,303 | 2,613 |
| Investing activities | | |
| Capital expenditures | (306) | (328) |
| Net cash provided by short-term investment transactions | | 260 |
| Other, net | 8 | 236 |
| Net cash (used for) provided by investing activities | (298) | 168 |
| Financing activities | | |
| Repurchases of common stock | (423) | (1,313) |
| Dividends paid | (653) | (524) |
| Proceeds from stock option exercises | 235 | 60 |
| Other, net | 56 | 3 |
| Net cash used for financing activities | (785) | (1,774) |
| Net change in cash and cash equivalents | 220 | 1,007 |
| Cash and cash equivalents at beginning of period | 3,582 | 2,261 |
| Cash and cash equivalents at end of period | \$3,802 | \$3,268 |

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

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

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumu- lated Other Comprehen- sive Loss | Total Stock- holders Equity |
|--|-----------------|----------------------------------|----------------------|---|--------------------------------------|
| Balance at December 31, 2010 | \$346 | \$ | \$12,161 | \$ (9,010) | \$3,497 |
| Net earnings | | | 1,272 | | 1,272 |
| Other comprehensive income, net of tax | | | | 339 | 339 |
| Repurchases of common stock | (17) | (261) | (1,021) | | (1,299) |
| Dividends declared | | | (786) | | (786) |
| Stock-based awards and ESOP activity | 4 | 261 | | | 265 |
| Balance at June 26, 2011 | \$333 | \$ | \$11,626 | \$ (8,671) | \$3,288 |
| Balance at December 31, 2011 | \$321 | \$ | \$11,937 | \$(11,257) | \$1,001 |
| Net earnings | | | 1,449 | | 1,449 |
| Other comprehensive income, net of tax | | | | 393 | 393 |
| Repurchases of common stock | (5) | (423) | | | (428) |
| Dividends declared | | | (659) | | (659) |
| Stock-based awards and ESOP activity | 6 | 442 | | | 448 |
| Balance at June 24, 2012 | \$322 | \$ 19 | \$12,727 | \$(10,864) | \$2,204 |

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

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Consolidated Financial Statements****NOTE 1 BASIS OF PRESENTATION**

We prepared these consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. We followed the accounting policies used and disclosed in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Form 10-K) filed with the U.S. Securities and Exchange Commission.

In the opinion of management, the interim financial information in this Form 10-Q reflects all adjustments, that are of a normal recurring nature, necessary for a fair presentation of our results of operations and financial condition for the interim periods presented. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and the related disclosures of contingencies. We base these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The consolidated financial statements include the accounts of subsidiaries we control and other entities for which we are the primary beneficiary. We eliminate intercompany balances and transactions in consolidation. We have reclassified certain amounts in prior periods to conform to the current year presentation.

We close our books and records on the Sunday prior to the end of the calendar quarter to align our financial closing with our business processes. The interim financial statements and tables of financial information included herein are labeled based on that convention. This practice only affects interim periods, as our fiscal year ends on December 31.

The results of operations for the interim periods presented are not necessarily indicative of results to be expected for the full year or future periods. Unless otherwise noted, we present all per share amounts cited in these consolidated financial statements on a per diluted share basis from continuing operations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2011 Form 10-K.

NOTE 2 EARNINGS PER COMMON SHARE

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

| | Quarters Ended June 24, | | Six Months Ended June 24, | |
|--|----------------------------|------------------|------------------------------|------------------|
| | 2012 | June 26, 2011 | 2012 | June 26, 2011 |
| Weighted average common shares outstanding for basic computations | 324.5 | 342.8 | 324.3 | 345.6 |
| Weighted average dilutive effect of stock options and restricted stock units | 4.3 | 3.8 | 4.4 | 4.0 |
| Weighted average common shares outstanding for diluted computations | 328.8 | 346.6 | 328.7 | 349.6 |

We compute basic and diluted earnings per common share by dividing net earnings by the respective weighted average number of common shares outstanding for the periods presented. Our calculation of diluted earnings per common share includes the dilutive effects for the assumed exercise of stock options and vesting of restricted stock units based on the treasury stock method.

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Lockheed Martin Corporation

Notes to Unaudited Consolidated Financial Statements (continued)

The computation of diluted earnings per common share for both the quarters and six months ended June 24, 2012 and June 26, 2011 excluded 9.6 million and 16.9 million stock options because their inclusion would have been anti-dilutive.

NOTE 3 BUSINESS SEGMENT INFORMATION

We operate in four business segments: Aeronautics, Electronic Systems, Information Systems & Global Solutions (IS&GS), and Space Systems. We organize our business segments based on the nature of the products and services offered.

Net sales of our business segments exclude intersegment sales as these activities are eliminated in consolidation. Intercompany transactions are generally negotiated under terms and conditions similar to our third-party contracts.

Operating profit of our business segments includes the equity earnings or losses from investees in which certain of our business segments hold equity interests, because the activities of the investees are closely aligned with the operations of those business segments. Operating profit of our business segments excludes the non-cash FAS/CAS pension adjustment described below; expense for stock-based compensation programs; the effects of items not considered part of management's evaluation of segment operating performance, such as charges related to material severance actions in 2011 (Note 8, under the caption "Severance Activities"); gains or losses from divestitures; the effects of legal settlements; corporate costs not allocated to our business segments; and other miscellaneous corporate activities. These items are included in the reconciling item

Unallocated expense, net between operating profit from our business segments and our consolidated operating profit.

The results of operations of our business segments include pension expense only as determined and funded in accordance with U.S. Government Cost Accounting Standards (CAS). The non-cash FAS/CAS pension adjustment represents the difference between pension expense or income calculated in accordance with GAAP and pension costs calculated and funded in accordance with CAS. CAS is a major factor in determining our pension funding requirements, and governs the extent to which pension costs can be allocated to and recovered on U.S. Government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts and, therefore, is recognized in each of our business segments' net sales and cost of sales.

The operating results in the following table exclude businesses included in discontinued operations (Note 8, under the caption "Discontinued Operations"). During the quarter ended December 31, 2011, we realigned an immaterial supply chain services business from our Aeronautics business segment to our Electronic Systems business segment. The realignment had no effect on our consolidated results of operations, financial position, or cash flows. The financial information in the following table has been reclassified to reflect this realignment.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Consolidated Financial Statements (continued)**

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

| | Quarters Ended | | Six Months Ended | |
|---|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | | | | |
| Aeronautics | \$ 3,408 | \$ 3,390 | \$ 7,114 | \$ 6,542 |
| Electronic Systems | 3,866 | 3,780 | 7,475 | 7,262 |
| Information Systems & Global Solutions | 2,263 | 2,361 | 4,353 | 4,510 |
| Space Systems | 2,384 | 2,012 | 4,272 | 3,855 |
| Total net sales | \$11,921 | \$11,543 | \$23,214 | \$22,169 |
| Operating profit | | | | |
| Aeronautics | \$ 454 | \$ 397 | \$ 839 | \$ 725 |
| Electronic Systems | 526 | 478 | 1,067 | 910 |
| Information Systems & Global Solutions | 208 | 213 | 396 | 407 |
| Space Systems | 282 | 263 | 508 | 480 |
| Total business segment operating profit | 1,470 | 1,351 | 2,810 | 2,522 |
| Unallocated expense, net | | | | |
| Severance charges ^(a) | | (97) | | (97) |
| Other unallocated expense, net | (270) | (261) | (598) | (568) |
| Total consolidated operating profit | \$ 1,200 | \$ 993 | \$ 2,212 | \$ 1,857 |
| Intersegment sales | | | | |
| Aeronautics | \$ 51 | \$ 45 | \$ 90 | \$ 82 |
| Electronic Systems | 249 | 255 | 516 | 504 |
| Information Systems & Global Solutions | 220 | 213 | 428 | 408 |
| Space Systems | 26 | 26 | 52 | 51 |
| Total intersegment sales | \$ 546 | \$ 539 | \$ 1,086 | \$ 1,045 |

^(a) The severance charges for 2011 consist of amounts, net of state taxes, related to actions taken at our Aeronautics and Space Systems business segments (Note 8, under the caption "Severance Activities"). Severance charges for initiatives that are not material are included in business segment operating profit.

Total assets for each of our business segments were as follows (in millions):

| | June 24, 2012 | December 31, 2011 |
|--|------------------|----------------------|
| Assets | | |
| Aeronautics | \$ 6,005 | \$ 5,752 |
| Electronic Systems | 10,721 | 10,480 |
| Information Systems & Global Solutions | 5,758 | 5,838 |
| Space Systems | 3,255 | 3,121 |

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| | | |
|---------------------------------|-----------------|----------|
| Total business segment assets | 25,379 | 25,191 |
| Corporate assets ^(a) | 12,647 | 12,717 |
| Total assets | \$38,386 | \$37,908 |

^(a) Corporate assets primarily include cash and cash equivalents, deferred income taxes, environmental receivables, and investments held in a Rabbi Trust.

Our Aeronautics business segment includes our largest program, the F-35 Lightning II Joint Strike Fighter, an international multi-role, stealth fighter. Net sales for the F-35 program represented approximately 12% of our total consolidated net sales during the quarters ended June 24, 2012 and June 26, 2011 and approximately 13% of our total consolidated net sales during the six months ended June 24, 2012 and June 26, 2011.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Consolidated Financial Statements (continued)****NOTE 4 INVENTORIES, NET**

Inventories consisted of the following (in millions):

| | June 24, 2012 | December 31, 2011 |
|--|------------------|----------------------|
| Work-in-process, primarily related to long-term contracts and programs in progress | \$6,643 | \$7,129 |
| Less: customer advances and progress payments | (5,026) | (5,425) |
| | 1,617 | 1,704 |
| Other inventories | 904 | 777 |
| Total inventories, net | \$2,521 | \$2,481 |

NOTE 5 POSTRETIREMENT BENEFIT PLANS

The components of our net periodic benefit costs for our qualified defined benefit and retiree medical and life insurance plans were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|--|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Qualified defined benefit pension plans | | | | |
| Service cost | \$ 263 | \$ 244 | \$ 527 | \$ 487 |
| Interest cost | 471 | 479 | 942 | 959 |
| Expected return on plan assets | (546) | (508) | (1,093) | (1,016) |
| Recognized net actuarial losses | 279 | 220 | 558 | 440 |
| Amortization of prior service cost | 19 | 21 | 37 | 41 |
| Total net pension expense | \$ 486 | \$ 456 | \$ 971 | \$ 911 |

Retiree medical and life insurance plans

| | | | | |
|--------------------------------------|-------|-------|-------|-------|
| Service cost | \$ 7 | \$ 8 | \$ 14 | \$ 16 |
| Interest cost | 33 | 40 | 66 | 81 |
| Expected return on plan assets | (33) | (35) | (66) | (70) |
| Recognized net actuarial losses | 8 | 9 | 16 | 17 |
| Amortization of prior service credit | (3) | (4) | (6) | (8) |
| Total net postretirement expense | \$ 12 | \$ 18 | \$ 24 | \$ 36 |

The recognized net actuarial losses and the amortization of prior service cost (credit) in the table above, as well as similar costs related to our other postretirement benefit plans, reflect amounts that were recorded as a component of net periodic benefit cost for the period. These amounts totaling \$203 million and \$165 million, net of tax expense of \$111 million and \$90 million, for the quarters ended June 24, 2012 and June 26, 2011, and \$406 million and \$330 million, net of tax expense of \$222 million and \$180 million, for the six months ended June 24, 2012 and June 26, 2011 are recorded on our Statements of Comprehensive Income as an increase to comprehensive income for all periods presented.

We generally determine funding requirements for our defined benefit pension plans in a manner consistent with CAS and the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act of 2006 (PPA). During the six months ended June 24, 2012, we made \$1.1 billion in contributions to our qualified defined benefit pension plans, including \$607 million during the quarter ended June 24, 2012, which completes our required funding for 2012. Consistent with prior years, we may review options for further

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contributions in the remainder of the year. We expect to make contributions of approximately \$110 million related to the retiree medical and life insurance plans in 2012, of which \$21 million was made during the quarter and six months ended June 24, 2012.

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Lockheed Martin Corporation

Notes to Unaudited Consolidated Financial Statements (continued)

NOTE 6 LEGAL PROCEEDINGS AND CONTINGENCIES

We are a party to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment. We believe the probability is remote that the outcome of each of these matters, including the legal proceedings discussed below, will have a material adverse effect on the Corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our net earnings in any particular interim reporting period. Among the factors that we consider in this assessment are the nature of existing legal proceedings and claims, the asserted or possible damages or loss contingency (if estimable), the progress of the case, existing law and precedent, the opinions or views of legal counsel and other advisers, our experience in similar cases and the experience of other companies, the facts available to us at the time of assessment, and how we intend to respond to the proceeding or claim. Our assessment of these factors may change over time as individual proceedings or claims progress. Unless otherwise indicated, a range of loss associated with any individual legal proceeding set forth below reasonably cannot be estimated. We cannot predict the outcome of legal proceedings with certainty. These matters include the following items.

Legal Proceedings

On July 20, 2011, the City of Pontiac General Employees Retirement System filed a class action lawsuit against us and three of our executive officers (Robert J. Stevens, Chairman and Chief Executive Officer; Bruce L. Tanner, Executive Vice President and Chief Financial Officer; and Linda R. Gooden, Executive Vice President, IS&GS) in the U.S. District Court for the Southern District of New York. The complaint was filed on behalf of purchasers of our common stock from April 21, 2009, through July 21, 2009, and alleges that we violated certain sections of the federal securities laws by allegedly making statements, primarily about the then-expected performance of our IS&GS business segment, that contained either false statements of material facts or omitted material facts necessary to make the statements made not misleading, or engaged in other acts that operated as an alleged fraud upon class members who purchased our common stock during that period. The complaint further alleges that the statutory safe harbor provided for forward-looking statements does not apply to any of the allegedly false statements. The complaint does not allege a specific amount of monetary damages. We believe that the allegations are without merit and are defending against them.

An additional action was filed that repeats substantially the same allegations as those in the City of Pontiac General Employees Retirement System case (described above). On October 11, 2011, Renee Smith, individually and on behalf of others, filed a shareholder derivative action in the U.S. District Court for the Southern District of New York, naming Mr. Stevens, Mr. Tanner, and each of the current Directors of Lockheed Martin, as well as the individuals who were Directors at the time of the activities alleged in the complaint, and alleging breach of fiduciary duty, mismanagement, unjust enrichment, abuse of control, and waste of corporate assets relating to substantially the same allegations as the City of Pontiac General Employees Retirement System case. We believe that the allegations are without merit and are defending against them.

On April 24, 2009, we filed a declaratory judgment action against the New York Metropolitan Transportation Authority and its Capital Construction Company (collectively, the MTA) asking the U.S. District Court for the Southern District of New York to find that the MTA is in material breach of our agreement based on the MTA's failure to provide access to sites where work must be performed and customer-furnished equipment necessary to complete the contract. The MTA filed an answer and counterclaim alleging that we breached the contract, and subsequently terminated the contract for alleged default. The MTA is seeking monetary damages and other relief under the contract, including the cost to complete the contract and potential re-procurement costs. The contract had a total value of \$323 million, of which \$241 million was paid to us. We dispute the MTA's allegations and are defending against them.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Consolidated Financial Statements (continued)**

On September 11, 2006, we and Lockheed Martin Investment Management Company (LMIMCo), a subsidiary, were named as defendants in a lawsuit filed in the U.S. District Court for the Southern District of Illinois, seeking to represent a class of purportedly similarly situated participants and beneficiaries in two of our 401(k) plans. Plaintiffs allege that we or LMIMCo caused our plans to pay expenses that were higher than reasonable by, among other actions, permitting service providers of the plans to engage in revenue sharing, paying investment management fees for the company stock funds, and causing the company stock funds to hold cash for liquidity, thus reducing the return on those funds. Plaintiffs also allege that we failed to disclose information appropriately relating to the fees associated with managing the plans. In August 2008, plaintiffs filed an amended complaint, adding allegations that we breached fiduciary duties under ERISA by providing inadequate disclosures with respect to the Stable Value Fund offered under our 401(k) plans. On March 31, 2009, the Judge dismissed a number of plaintiffs claims, leaving three claims for trial, specifically plaintiffs' claims involving the company stock funds, the Stable Value Fund, and overall fees. The Court also granted class certification on two of plaintiffs' claims. We appealed the class certification. On March 15, 2011, the U.S. Court of Appeals for the Seventh Circuit vacated the District Court's class certification order and remanded the case to the District Court. The complaint does not allege a specific calculation of damages, and we reasonably cannot estimate the possible loss, or range of loss, which could be incurred if plaintiffs were to prevail in the allegations, but believe that we have substantial defenses. We dispute the allegations and are defending against them.

On August 28, 2003, the U.S. Department of Justice (DOJ) filed complaints in partial intervention in two lawsuits filed under the qui tam provisions of the Civil False Claims Act in the U.S. District Court for the Western District of Kentucky, *United States ex rel. Natural Resources Defense Council, et al., v. Lockheed Martin Corporation, et al.*, and *United States ex rel. John D. Tillson v. Lockheed Martin Energy Systems, Inc., et al.* DOJ alleges that we committed violations of the Resource Conservation and Recovery Act at the Paducah Gaseous Diffusion Plant by not properly handling, storing, and transporting hazardous waste and that we violated the False Claims Act by misleading Department of Energy officials and state regulators about the nature and extent of environmental noncompliance at the plant. The complaint does not allege a specific calculation of damages, and we reasonably cannot estimate the possible loss, or range of loss, which could be incurred if the plaintiff were to prevail in the allegations, but believe that we have substantial defenses. We dispute the allegations and are defending against them.

Environmental Matters

We are involved in environmental proceedings and potential proceedings relating to soil and groundwater contamination, disposal of hazardous waste, and other environmental matters at several of our current or former facilities, or at third-party sites where we have been designated as a potentially responsible party (PRP). A substantial portion of environmental costs will be included in our net sales and cost of sales in future periods pursuant to U.S. Government regulations. At the time a liability is recorded for future environmental costs, we record a receivable for estimated future recovery considered probable through the pricing of products and services to agencies of the U.S. Government, regardless of the contract form (e.g., cost-reimbursable, fixed price). We continuously evaluate the recoverability of our environmental receivables by assessing, among other factors, U.S. Government regulations, our U.S. Government business base and contract mix, and our history of receiving reimbursement of such costs. We include the portion of those environmental costs expected to be allocated to our non-U.S. Government contracts, or that is determined to be unallowable for pricing under U.S. Government contracts, in our cost of sales at the time the liability is established.

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Lockheed Martin Corporation

Notes to Unaudited Consolidated Financial Statements (continued)

At June 24, 2012 and December 31, 2011, the aggregate amount of liabilities recorded relative to environmental matters was \$961 million and \$932 million, of which \$843 million and \$814 million is recorded in other noncurrent liabilities on the Balance Sheets at June 24, 2012 and December 31, 2011, with the remainder recorded in other current liabilities. We have recorded receivables totaling \$834 million and \$808 million at June 24, 2012 and December 31, 2011, for the estimated future recovery of these costs, as we consider the recovery probable based on the factors previously mentioned. Of those amounts, \$732 million and \$706 million are recorded in other noncurrent assets on the Balance Sheets at June 24, 2012 and December 31, 2011, with the remainder recorded in other current assets. We project costs and recovery of costs over approximately twenty years.

Environmental cleanup activities usually span several years, which make estimating liabilities a matter of judgment because of such factors as changing remediation technologies, assessments of the extent of contamination, and continually evolving regulatory environmental standards. We consider these and other factors in estimates of the timing and amount of any future costs that may be required for remediation actions, which results in the calculation of a range of estimates for a particular environmental remediation site.

We perform quarterly reviews of the status of our environmental remediation sites and the related liabilities and receivables. We record a liability when it is probable that a liability has been incurred and the amount can be reasonably estimated. The amount of liability recorded is based on our estimate of the costs to be incurred for remediation at a particular site. We do not discount the recorded liabilities, as the amount and timing of future cash payments are not fixed or cannot be reliably determined.

We reasonably cannot determine the extent of our financial exposure in all cases at this time. There are a number of former operating facilities that we are monitoring or investigating for potential future remediation. In some cases, although a loss may be probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation activities because of uncertainties with respect to assessing the extent of the contamination or the applicable regulatory standard. We also are pursuing claims for contribution to site cleanup costs against other PRPs, including the U.S. Government.

Both the U.S. Environmental Protection Agency and the California Office of Environmental Health Hazard Assessment announced plans in January 2011 to regulate two chemicals, perchlorate and hexavalent chromium, to levels in drinking water that are expected to be substantially lower than the existing public health goals or standards established in California. The rulemaking processes are lengthy and may take one or more years to complete. If substantially lower standards are adopted, we would expect a material increase in our estimates for environmental liabilities and the related assets for the portion of the increased costs that are probable of future recovery in the pricing of our products and services for the U.S. Government. The amount that would be allocable to our non-U.S. Government contracts or that is determined to be unallowable for pricing under U.S. Government contracts would be expensed, which may have a material effect on our earnings in any particular interim reporting period.

We are conducting remediation activities, including under various consent decrees and orders, relating to soil, groundwater, sediment, or surface water contamination at certain sites of former or current operations. Under an agreement related to our Burbank and Glendale, California, sites, the U.S. Government reimburses us an amount equal to approximately 50% of expenditures for certain remediation activities in its capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

Letters of Credit, Surety Bonds, and Third-Party Guarantees

We have entered into standby letters of credit, surety bonds, and third-party guarantees with financial institutions and other third parties primarily relating to advances received from customers and the guarantee of future performance on certain contracts. Letters of credit and surety bonds generally are available for draw down in the event we do not perform.

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Lockheed Martin Corporation

Notes to Unaudited Consolidated Financial Statements (continued)

In some cases, we may guarantee the contractual performance of third parties such as joint venture partners. We had total outstanding letters of credit, surety bonds, and third-party guarantees aggregating \$3.4 billion and \$3.9 billion at June 24, 2012 and December 31, 2011. The decline between periods primarily was due to a scheduled reduction in a letter of credit issued to secure advance payments received under an F-16 contract from an international customer. The letter of credit was reduced as certain events occurred during the period of performance in accordance with the contract terms.

At June 24, 2012 and December 31, 2011, third-party guarantees totaled \$863 million and \$907 million, of which approximately 85% related to guarantees of the contractual performance of joint ventures to which we currently are or previously were a party. This amount represents our estimate of the maximum amount we would expect to incur upon the contractual non-performance of the joint venture partners. In addition, we generally have cross-indemnities in place that may enable us to recover amounts that may be paid on behalf of a joint venture partner. We believe our current and former joint venture partners will be able to perform their obligations, as they have done through June 24, 2012, and that it will not be necessary to make payments under the guarantees. In determining our exposures, we evaluate the reputation, technical capabilities, and credit quality of our current and former joint venture partners.

United Launch Alliance

In connection with our 50% ownership interest of United Launch Alliance, L.L.C. (ULA), we and The Boeing Company (Boeing) have each received distributions totaling \$404 million (since ULA's formation in December 2006) which are subject to agreements between us, Boeing, and ULA, whereby, if ULA does not have sufficient cash resources or credit capacity to make payments under the inventory supply agreement it has with Boeing, both we and Boeing would provide to ULA, in the form of an additional capital contribution, the level of funding required for ULA to make those payments. Any such capital contributions would not exceed the amount of the distributions subject to the agreements. We currently believe that ULA will have sufficient operating cash flows and credit capacity, including access to its \$400 million revolving credit agreement from third-party financial institutions, to meet its obligations such that we would not be required to make a contribution under these agreements.

In addition, both we and Boeing have cross-indemnified each other for guarantees by us and Boeing of the performance and financial obligations of ULA under certain launch service contracts. We believe ULA will be able to fully perform its obligations, as it has done through June 24, 2012, and that it will not be necessary to make payments under the cross-indemnities or guarantees.

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Consolidated Financial Statements (continued)****NOTE 7 FAIR VALUE MEASUREMENTS**

Assets and liabilities measured and recorded at fair value on a recurring basis consisted of the following (in millions):

| | June 24, 2012 | | | December 31, 2011 | | |
|----------------------------|---------------|---------|---------|-------------------|---------|---------|
| | Total | Level 1 | Level 2 | Total | Level 1 | Level 2 |
| Assets | | | | | | |
| Equity securities | \$ 74 | \$ 74 | \$ | \$ 91 | \$ 91 | \$ |
| Mutual funds | 339 | 339 | | 380 | 380 | |
| U.S. Government securities | 235 | | 235 | 211 | | 211 |
| Other securities | 150 | | 150 | 102 | | 102 |
| Derivatives | 41 | | 41 | 43 | | 43 |
| Liabilities | | | | | | |
| Derivatives | 25 | | 25 | 26 | | 26 |

Substantially all assets measured at fair value, other than derivatives, represent investments held in a separate trust to fund certain of our non-qualified deferred compensation plans. The fair values of equity securities and mutual funds were determined by reference to the quoted market price per unit in active markets multiplied by the number of units held without consideration of transaction costs. The fair values of U.S. Government and other securities were determined using model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. The fair values of derivative instruments, which consist of foreign currency exchange forward and interest rate swap contracts, primarily are determined based on the present value of future cash flows using model-derived valuations that use observable inputs such as interest rates, credit spreads, and foreign currency exchange rates. We did not have any transfers of assets or liabilities between levels of the fair value hierarchy during the six months ended June 24, 2012.

We use derivative instruments principally to reduce our exposure to market risks from changes in foreign exchange rates and interest rates. We do not enter into or hold derivative instruments for speculative trading purposes. We transact business globally and are subject to risks associated with changing foreign currency exchange rates. We enter into foreign currency hedges such as forward and option contracts that change in value as foreign currency exchange rates change. These contracts hedge forecasted foreign currency transactions in order to mitigate fluctuations in our earnings and cash flows associated with changes in foreign currency exchange rates. We designate foreign currency hedges as cash flow hedges. We also are exposed to the impact of interest rate changes primarily through our borrowing activities. We enter into interest rate swaps to manage our exposure to changes in interest rates. Currently, we use variable interest rate swaps effectively converting fixed rate borrowings to variable rate borrowings in order to reduce the amount of exposure to fixed interest rates. We designate variable interest rate swaps as fair value hedges. We may also enter into derivative instruments that are not designated as hedges and do not qualify for hedge accounting, which are intended to mitigate economic exposures.

The aggregate notional amount of our outstanding foreign currency hedges at June 24, 2012 and December 31, 2011 was \$1.4 billion and \$1.7 billion. The aggregate notional amount of our outstanding interest rate swaps at June 24, 2012 and December 31, 2011 was \$475 million and \$450 million. Derivative instruments did not have a material impact on net earnings and comprehensive income during the quarters and six months ended June 24, 2012 and June 26, 2011. Substantially all of our derivatives are designated for hedge accounting.

In addition to the financial instruments listed in the table above, we hold other financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and debt. The carrying values for cash and cash equivalents, accounts receivable, and accounts payable approximated their fair values. The estimated fair value of our outstanding debt was \$8.2 billion and \$7.8 billion at June 24, 2012 and December 31, 2011, and the carrying value was \$6.5 billion at both June 24, 2012 and December 31, 2011. The estimated fair value was determined based on quoted prices for similar instruments in active markets (Level 2).

Table of Contents**Lockheed Martin Corporation****Notes to Unaudited Consolidated Financial Statements (continued)****NOTE 8 OTHER****Stockholders Equity***Share Repurchases*

During the six months ended June 24, 2012, we repurchased 4.9 million shares of our common stock for \$428 million, of which 0.1 million shares purchased for \$5 million were settled and paid for in the third quarter of 2012. As of June 24, 2012, we had repurchased a total of 47.9 million shares of our common stock under our share repurchase program for \$3.6 billion, and had remaining authorization of \$2.9 billion for future share repurchases. As we repurchase our common shares, we reduce common stock for the \$1 of par value of the shares repurchased, with the excess purchase price over par value recorded as a reduction of additional paid-in capital. If additional paid-in capital is reduced to zero, we record the remainder of the excess purchase price over par value as a reduction of retained earnings.

Stock Option and Restricted Stock Unit Grants

In January 2012, we granted certain employees 3.4 million options to purchase our common stock with an estimated grant date fair value of \$10.57 per option, which was estimated using the Black-Scholes option pricing model. Stock options are granted with an exercise price equal to the closing market price of our common stock on the date of grant, which was \$82.01. In January 2012, we also granted certain employees 2.0 million restricted stock units (RSUs) with a grant date fair value of \$81.93 per RSU. The grant date fair value of RSUs is equal to the closing market price of our common stock on the date of grant less a discount to reflect the delay in payment of cash dividend-equivalents that are made only upon vesting. We recognize the fair value of the awards as compensation expense for substantially all awards ratably over the vesting period, which is typically three years.

Dividends

During the quarter and six months ended June 24, 2012, we declared cash dividends totaling \$331 million (\$1.00 per share) and \$659 million (\$2.00 per share). During the quarter and six months ended June 26, 2011, we declared cash dividends totaling \$520 million (\$1.50 per share) and \$786 million (\$2.25 per share). The 2011 dividend amounts also include the declaration of our 2011 third quarter dividend totaling \$258 million (\$.75 per share).

Income Taxes

Our effective income tax rates from continuing operations were 30.1% and 29.9% during the quarter and six months ended June 24, 2012, and 18.5% and 24.0% during the quarter and six months ended June 26, 2011. The rates for all periods benefited from tax deductions for U.S. manufacturing activities and dividends paid to certain defined contribution plans with an employee stock ownership plan feature. The rates for the quarter and six months ended June 26, 2011 included a reduction to income tax expense of \$89 million (\$.26 per share for the quarter and \$.25 per share for the six months ended June 26, 2011) through the elimination of liabilities for unrecognized tax benefits as a result of the U.S. Congressional Joint Committee on Taxation completing its review of the IRS Appeals Division's resolution of adjustments related to tax years 2003 through 2008. In addition, the effective income tax rate for the quarter and six months ended June 26, 2011 included the U.S. research and development tax credit that expired on December 31, 2011.

We made net federal and foreign income tax payments of \$690 million and \$229 million during the six months ended June 24, 2012 and June 26, 2011. Net federal and foreign income tax payments made during the six months ended June 26, 2011 included a refund of \$250 million from the Internal Revenue Service (IRS) related to estimated taxes paid for the 2010 calendar year.

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Lockheed Martin Corporation

Notes to Unaudited Consolidated Financial Statements (continued)

Severance Activities

During the quarter ended June 26, 2011, we recorded severance charges totaling \$97 million, net of state tax benefits, of which \$49 million and \$48 million related to our Aeronautics and Space Systems business segments. The charges reduced our net earnings by \$63 million (\$.18 per share) for the quarter and six months ending June 26, 2011. Employees received lump-sum severance payments based on years of service. During the six months ended June 24, 2012, we made severance payments of approximately \$65 million related to these severance actions, including payments related to severance actions taken in the third quarter of 2011. As of June 24, 2012, substantially all amounts related to the 2011 severance actions have been paid.

Discontinued Operations

Discontinued operations include the operating results of Savi Technology, Inc. (Savi) and also Pacific Architects and Engineers, Inc. (PAE), a business within our IS&GS business segment, through the date of its sale on April 4, 2011. In September 2011, we committed to a plan to sell Savi, a logistics business within our Electronic Systems business segment.

Amounts related to discontinued operations were not material for the quarter and six months ended June 24, 2012 and the quarter ended June 26, 2011. For the six months ended June 26, 2011, net sales and pre-tax loss from discontinued operations were \$167 million and \$56 million. Additional amounts related to the completion of certain post-closing items, such as working capital adjustments, may be recorded in discontinued operations in periods subsequent to the sale date. The assets and liabilities of Savi have not been classified as held for sale on our Balance Sheets as the amounts are not material.

Changes in Estimates

Accounting for contracts under the percentage-of-completion (POC) method requires judgment relative to assessing risks, estimating contract revenues and costs (including estimating award and incentive fees and penalties related to performance), and making assumptions for schedule and technical issues. Due to the scope and nature of the work required to be performed on many of our contracts, the estimation of total revenue and cost at completion is complicated and subject to many variables and, accordingly, is subject to change. When adjustments in estimated contract revenues or estimated costs at completion are required, any changes from prior estimates are recognized in the current period for the inception-to-date effect of such changes. When estimates of total costs to be incurred on a contract exceed total estimates of revenue to be earned, a provision for the entire loss on the contract is recorded in the period in which the loss is determined.

At the outset of each contract, we estimate the initial profit booking rate. The initial profit booking rate of each contract is based on the initial estimated costs at completion considering risks surrounding the ability to achieve the technical requirements (for example, a newly-developed product versus a mature product), schedule (for example, the number and type of milestone events), and costs by contract requirements. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule, and costs aspects of the contract, or may decrease if we are not successful in retiring risks and, as a result, our estimated costs at completion increase.

In any particular period, due to the nature of inception-to-date adjustments and other changes in estimates that can occur, such as the resolution of contractual matters, reserves for disputes, asset impairments and insurance recoveries, among others, the comparability of our operating profit and return on sales percentages may be affected. Our consolidated net adjustments not related to volume, including net profit rate adjustments and other matters, increased operating profit, net of state income taxes, by approximately \$595 million and \$425 million for the quarters ended June 24, 2012 and June 26, 2011, and approximately \$1.1 billion and \$750 million for the six months ended June 24, 2012 and June 26, 2011. These adjustments increased net earnings by approximately \$385 million (\$1.17 per share) and \$275 million (\$.80 per share) for the quarters ended June 24, 2012 and June 26, 2011, and approximately \$700 million (\$2.13 per share) and \$500 million (\$1.45 per share) for the six months ended June 24, 2012 and June 26, 2011.

Recent Accounting Pronouncements

Effective January 1, 2012, we retrospectively adopted new guidance issued by the Financial Accounting Standards Board by presenting total comprehensive income and the components of net income and other comprehensive income in two separate but consecutive statements. The

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adoption of this guidance resulted only in a change in how we present other comprehensive income in our consolidated financial statements and did not have any impact on our results of operations, financial position, or cash flows.

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Lockheed Martin Corporation

Report of Ernst & Young LLP,

Independent Registered Public Accounting Firm

Board of Directors

Lockheed Martin Corporation

We have reviewed the consolidated balance sheet of Lockheed Martin Corporation as of June 24, 2012, and the related consolidated statements of earnings and comprehensive income for the quarters and six months ended June 24, 2012 and June 26, 2011, and the consolidated statements of cash flows and stockholders' equity for the six months ended June 24, 2012 and June 26, 2011. These financial statements are the responsibility of the Corporation'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, 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 consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Lockheed Martin Corporation as of December 31, 2011, and the related consolidated statements of earnings, stockholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated February 23, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

McLean, Virginia

July 25, 2012

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Lockheed Martin Corporation

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

BUSINESS OVERVIEW

We are a global security and aerospace company principally engaged in the research, design, development, manufacture, integration, and sustainment of advanced technology systems and products. We also provide a broad range of management, engineering, technical, scientific, logistic, and information services. We serve both domestic and international customers with products and services that have defense, civil, and commercial applications, with our principal customers being agencies of the U.S. Government. In 2011, 82% of our \$46.5 billion in net sales were from the U.S. Government, either as a prime contractor or as a subcontractor (including 61% from the Department of Defense (DoD)), 17% were from international customers (including foreign military sales (FMS) funded, in whole or in part, by the U.S. Government), and 1% were from U.S. commercial and other customers. Our main areas of focus are in defense, space, intelligence, homeland security, and information technology, including cyber security. We operate in four business segments: Aeronautics, Electronic Systems, Information Systems & Global Solutions (IS&GS), and Space Systems. We organize our business segments based on the nature of the products and services offered.

The following discussion is a supplement to and should be read in conjunction with the accompanying unaudited financial statements and related notes and with our Annual Report on Form 10-K for the year ended December 31, 2011.

INDUSTRY CONSIDERATIONS

The U.S. Government continues to focus on discretionary spending, entitlements, tax, and other initiatives to stimulate the economy, create jobs, and reduce the deficit. The Administration and Congress are attempting to balance decisions regarding defense, homeland security, and other federal spending priorities in a constrained fiscal environment imposed by the Budget Control Act of 2011 (Budget Act), which reduces defense spending by a minimum of \$487 billion over a ten-year period starting in government fiscal year (GFY) 2012. In light of the Budget Act and deficit reduction pressures generally, it is likely that discretionary spending by the federal government will remain constrained for a number of years.

Notably, should Congress and the Administration fail to change or delay a pending sequestration of appropriations in GFY 2013 imposed by the Budget Act, our customers' budgets would be reduced immediately and significantly in January 2013, and there would be a direct and significant impact upon our customers' procurement of products and services. The investments and acquisitions we have made in recent years have sought to align our businesses with what we believe are the most critical national priorities and mission areas. The possibility remains, however, that our programs could be reduced, extended, or terminated as a result of the government's continuing assessment of priorities, changes in government priorities following the general elections in November 2012 or the implementation of sequestration.

While the specific effects of sequestration cannot yet be determined, automatic across-the-board budget cuts would approximately double the amount of the ten-year \$487 billion reduction in defense spending already required by the Budget Act and would have significant consequences to our business and industry. There would be disruption of ongoing programs, initiatives (including partial or complete terminations) and our supply chain, potential facilities closures and thousands of personnel reductions across the industry that would severely impact advanced manufacturing operations and engineering expertise, and accelerate the loss of skills and knowledge. These effects of the Budget Act and sequestration could undermine a key provision of the new DoD security strategy, which is to preserve the industrial base.

The precise nature of sequestration reductions will not be determined until the Administration issues authoritative guidance on how to interpret and execute various aspects of the law. General estimates suggest that sequestration could result in an amount in excess of \$50 billion, or approximately a 10% or more reduction in the GFY 2013 base defense budget, to approximately \$475 billion. At this point, we understand that cuts are likely to be applied across-the-board at the individual program, project and activity level, thus impacting all defense programs and contractors regardless of how they align to our country's most critical national priorities and mission areas. In addition, general estimates suggest that sequestration could result in an approximate 8% reduction to non-DoD U.S. Government programs. Consequently, we expect that sequestration will have a material effect on our results of operations, earnings, and cash flows as 82% of our \$46.5 billion in 2011 net sales were from the U.S. Government, including 61% from the DoD, and 21% from non-DoD U.S. Government programs.

Table of Contents**Lockheed Martin Corporation****Management's Discussion and Analysis of Financial Condition****and Results of Operations (continued)**

Based on our preliminary understanding of sequestration and noting that it is difficult to estimate given the lack of authoritative guidance on how sequestration would be implemented, we believe that if Congress and the Administration fail to change or delay sequestration, our 2013 net sales would be lower than expected 2012 net sales. However, subject to the uncertainty described above, we expect that the full impact of sequestration on our operating results may lag due to our production contract backlog being funded with money from the U.S. Government's GFY 2012 and prior budgets. Consequently, we expect that our 2013 net sales with the U.S. Government would not reflect the entire general estimate of percentage reductions described above and 2014 net sales with the U.S. Government would more closely reflect the entire general estimate of percentage reductions described above, subject to the uncertainty described above. Earnings and cash flow reductions, prior to restructuring activities, would generally follow a pattern similar to the net sales reductions. We are unable to reasonably estimate the cost and cash flow impact of any restructuring initiatives (potentially including but not limited to severance charges, facility closure expenses, and impairment charges) to align our cost structure to a lower sales base.

Sequestration likely would result in significant rescheduling or termination activity with our supplier base. Such activity likely would result in claims from our suppliers, which may include both the amount established in any settlement agreements, the costs of evaluating the supplier settlement proposals and the costs of negotiating settlement agreements. It would be our expectation that these costs would be recovered from the U.S. Government. Without specific guidance to the contrary from the Administration as to the implementation of sequestration, we may issue conditional notices under the Worker Adjustment and Retraining Notification (WARN) Act in 2012 to a substantial number of employees in our workforce due to potential job terminations. These notifications could occur as early as the third quarter of this year. We expect to recover the supplier and severance costs described above from our customers.

CONSOLIDATED RESULTS OF OPERATIONS

Since our operating cycle is long-term and involves many types of contracts for the design, development, and manufacturing of products and related activities with varying delivery schedules, the results of operations of a particular period, or period-to-period comparisons of recorded sales and profits, may not be indicative of future operating results. The following discussions of comparative results among periods should be viewed in this context. All per share amounts cited in this discussion are presented on a per diluted share basis. Our consolidated results of operations were as follows (in millions, except per share data):

| | Quarters Ended | | Six Months Ended | |
|--|----------------|-----------|------------------|-----------|
| | June 24, | June 26, | June 24, | June 26, |
| | 2012 | 2011 | 2012 | 2011 |
| Operating results | | | | |
| Net sales | \$ 11,921 | \$ 11,543 | \$ 23,214 | \$ 22,169 |
| Cost of sales | (10,741) | (10,637) | (21,057) | (20,449) |
| Other income, net | 20 | 87 | 55 | 137 |
| Operating profit | 1,200 | 993 | 2,212 | 1,857 |
| Interest expense | (96) | (84) | (192) | (169) |
| Other non-operating income, net | 13 | 9 | 48 | 28 |
| Income tax expense | (336) | (170) | (619) | (412) |
| Net earnings from continuing operations | 781 | 748 | 1,449 | 1,304 |
| Net loss from discontinued operations ^(a) | | (6) | | (32) |
| Net earnings | 781 | 742 | 1,449 | 1,272 |

Diluted earnings (loss) per common share

| | | | | |
|--|----------------|----------------|----------------|----------------|
| Continuing operations | \$ 2.38 | \$ 2.16 | \$ 4.41 | \$ 3.73 |
| Discontinued operations ^(a) | | (.02) | | (.09) |
| Total | \$ 2.38 | \$ 2.14 | \$ 4.41 | \$ 3.64 |

^(a) Discontinued operations for 2011 include the operating results of Savi Technology, Inc. (Savi) and also Pacific Architects and Engineers, Inc. (PAE) through the date of its sale on April 4, 2011 (Note 8, under the caption "Discontinued Operations"). Amounts related to discontinued operations during 2012 are not material and, accordingly, have been included in operating profit.

Table of Contents**Lockheed Martin Corporation****Management's Discussion and Analysis of Financial Condition****and Results of Operations (continued)**

The following provides an overview of our consolidated results of operations by focusing on key elements. Product sales are predominantly generated in the Aeronautics, Electronic Systems, and Space Systems business segments, and most of our services sales are generated in our IS&GS and Electronic Systems business segments. Our consolidated net sales were as follows (in millions):

Net Sales

| | Quarters Ended | | Six Months Ended | |
|------------------|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | | | | |
| Products | \$ 9,543 | \$ 9,113 | \$18,691 | \$ 17,613 |
| Services | 2,378 | 2,430 | 4,523 | 4,556 |
| Total | \$11,921 | \$11,543 | \$23,214 | \$ 22,169 |

Approximately 95% of our contracts are accounted for using the percentage-of-completion (POC) method of accounting. Under the POC method, we record net sales on contracts based upon our progress towards completion on a particular contract, as well as our estimate of the profit to be earned at completion. The following discussion of material changes in our consolidated net sales should be read in tandem with the following discussion of changes in our consolidated cost of sales and our Business Segment Results of Operations, because, due to the nature of POC accounting, changes in our sales are typically accompanied by a corresponding change in our cost of sales.

Net sales for the quarter ended June 24, 2012 were \$11.9 billion, a \$378 million or 3% increase over the quarter ended June 26, 2011 net sales of \$11.5 billion. The increase was due to a \$430 million or 5% increase in product sales, partially offset by a \$52 million or 2% decrease in services sales. Net sales for the six months ended June 24, 2012 were \$23.2 billion, a \$1.0 billion or 5% increase over the six months ended June 26, 2011 net sales of \$22.2 billion. The increase was due to a \$1.1 billion or 6% increase in product sales, partially offset by a \$33 million or 1% decrease in services sales.

Product Sales

The increase of \$430 million or 5% in product sales during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011 was attributable to higher product sales at our Space Systems and Electronic Systems business segments, partially offset by lower product sales at our IS&GS business segment. Product sales at our Aeronautics business segment were comparable during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011. Product sales at Space Systems increased about \$390 million during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 primarily due to two deliveries of commercial satellites (versus no deliveries in the quarter ended June 26, 2011), increased production volume and risk retirements on the Orion Multi-Purpose Crew Vehicle (Orion) program, and increased volume on various strategic and defensive missile systems programs, partially offset by lower net sales from the NASA External Tank program, which ended in connection with the completion of the Space Shuttle program in the second quarter of 2011. Electronic Systems product sales increased approximately \$170 million during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 primarily due to higher volume and risk retirements from ship and aviation programs (such as Persistent Threat Detection System (PTDS), Littoral Combat Ship (LCS), and MH-60), and tactical missile programs (such as Multiple Launch Rocket System (MLRS) and Javelin) partially offset by decreased volume on various air defense programs (such as Patriot Advanced Capability-3 (PAC-3) and Terminal High Altitude Area Defense (THAAD)), fire control systems programs (such as Sniper and Target Acquisition Designation Sight/Pilot Night Vision Sensor (TADS/PNVS)), and integrated warfare systems and sensors programs (such as Aegis and DDG-1000). Product sales at IS&GS during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 decreased by about \$130 million primarily due to the cessation of the Airborne Maritime Fixed Station Joint Tactical Radio System (JTRS) program, the completion of the U.K. Census program in the fourth quarter of 2011, and decreased volume on various other programs, partially offset by higher net sales as a result of increased activity on numerous programs. Product sales at Aeronautics were relatively unchanged between the quarters ended June 24, 2012 and June 26, 2011. Higher net sales from increased production volume on the F-35 Low Rate Initial Production (LRIP) contracts and three additional F-16 aircraft deliveries were partially offset by lower net sales from the F-35 development contract principally due to the inception-to-date effect of reducing the profit booking rate (see Status of F-35 Program for additional information) and to a lesser extent lower volume, one less C-5M aircraft delivery, and decreased production on the F-22 program as final aircraft deliveries were completed in the second quarter of 2012, partially offset by the

resolution of a contractual matter, and lower volume on other Aeronautics sustainment programs.

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The increase of \$1.1 billion or 6% in product sales during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011 was attributable to higher product sales at our Aeronautics, Space Systems, and Electronic Systems business segments, partially offset by lower product sales at our IS&GS business segment. Product sales at Aeronautics increased about \$530 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to increased production volume on the F-35 LRIP contracts, an increase in aircraft deliveries (including 11 additional F-16's and four additional C-130J's), and F-16 sustainment activities, partially offset by decreased production volume on the F-22 program described in the preceding paragraph, lower net sales on the F-35 development contract due to the inception-to-date effect of reducing the profit booking rate (see Status of F-35 Program for additional information) and decreased volume, and lower volume on other Aeronautics sustainment programs. Product sales at Space Systems increased about \$450 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to two deliveries of commercial satellites (versus no deliveries in the six months ended June 26, 2011), increased production volume and risk retirements on the Orion program, and increased volume on various strategic and defensive missile systems programs, partially offset by lower net sales from the NASA External Tank program described in the preceding paragraph. Electronic Systems' product sales increased approximately \$340 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to higher volume and risk retirements from certain ship and aviation programs (such as PTDS, LCS, and MH-60) and tactical missiles programs (such as Javelin), partially offset by decreased volume from fire control systems programs (such as Sniper and TADS/PNVs), various air defense programs (such as PAC-3 and THAAD), and integrated warfare systems and sensors programs (such as DDG-1000 and the Medium Extended Air Defense System). Product sales at IS&GS decreased during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 by about \$240 million primarily due to the cessation of the JTRS program, the completion of the U.K. Census program in the fourth quarter of 2011, and decreased volume on various other programs partially offset by higher net sales as a result of increased activity on numerous programs.

Services Sales

Our services sales decreased \$52 million or 2% during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011, and decreased \$33 million or 1% during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. Most of our services sales are generated in our IS&GS and Electronic Systems business segments. The decline in services sales between both quarterly and year-to-date periods primarily was attributable to lower services sales at our Electronic Systems business segment, partially offset by higher services sales at our IS&GS business segment. Services sales at Electronic Systems decreased about \$80 million and \$120 million during the quarter and six months ended June 24, 2012 compared to the quarter and six months ended June 26, 2011 primarily due to decreased volume on various training and logistics programs. IS&GS' services sales increased approximately \$30 million and \$80 million during the quarter and six months ended June 24, 2012 compared to the quarter and six months ended June 26, 2011 primarily due to higher net sales as a result of increased activity on various services contracts, including net sales from an acquisition in the fourth quarter of 2011, partially offset by lower net sales from the completion of the Outsourcing Desktop Initiative for NASA (ODIN) program.

Cost of Sales

Cost of sales, for both products and services, consist of materials, labor, and subcontracting costs, as well as an allocation of indirect costs (overhead and general and administrative). For each of our contracts, we manage the nature and amount of costs at the contract level, which form the basis for estimating our total costs at completion of the contract.

Management evaluates performance on our contracts by focusing on net sales and operating profit, and not by type or amount of operating expense. Consequently, our discussion of business segment performance focuses on net sales and operating profit, consistent with our approach for managing the business. This approach is consistent with the overall life cycle of our contracts, as management assesses the bidding of each contract by focusing on net sales and operating profit, and monitors performance on our contracts in a similar manner through their completion.

We regularly provide customers with reports of our costs as the contract progresses. The cost information in the reports is accumulated in a manner specified by the requirements of each contract. For example, cost data provided to our customer for a product would typically align to the subcomponents of that product (such as a wing-box on an aircraft) or for services, the type of work being performed (such as help-desk support).

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Our contracts generally are cost-based, which allows for the recovery of costs in the pricing of our products and services. Most of our contracts generally are bid and negotiated with our customers based on the mutual awareness of our estimated costs to provide the product or service. This approach for negotiating contracts with our U.S. Government customers generally allows for the recovery of our costs. We also may enter into long-term supply contracts for certain materials or components, to coincide with the production schedule of certain products and to ensure their availability at known unit prices.

Our consolidated cost of sales were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|-------------------------|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Cost of sales | | | | |
| Cost of product sales | \$ 8,351 | \$ 8,107 | \$16,431 | \$15,694 |
| % of product sales | 87.5% | 89.0% | 87.9% | 89.1% |
| Cost of services sales | 2,115 | 2,177 | 4,032 | 4,103 |
| % of services sales | 88.9% | 89.6% | 89.1% | 90.1% |
| Severance charges | | 97 | | 97 |
| Other unallocated costs | 275 | 256 | 594 | 555 |
| Total | \$10,741 | \$10,637 | \$21,057 | \$20,449 |

Due to the nature of POC accounting, changes in our cost of product and services sales are typically accompanied by changes in our net sales. The following discussion of material changes in our consolidated cost of sales should be read in tandem with the preceding discussion of changes in our consolidated net sales and with our Business Segment Results of Operations.

Changes in our cost of sales between periods were not material, except as described below. The period-over-period change in our cost of sales was due to the volume of costs resulting from production, deliveries of products, and/or services provided on our portfolio of contracts. We have not identified any developing trends in cost of sales that would have a material impact on our future operations.

Cost of sales for the quarter ended June 24, 2012 were \$10.7 billion, a \$104 million or 1% increase over the quarter ended June 26, 2011 cost of sales of \$10.6 billion. The increase was due to a \$244 million increase in cost of product sales and a \$19 million increase in other unallocated costs, partially offset by a \$62 million decrease in cost of services sales and a reduction in severance charges of \$97 million as further discussed in the following sections. Cost of sales for the six months ended June 24, 2012 were \$21.1 billion, a \$608 million or 3% increase over the six months ended June 26, 2011 cost of sales of \$20.4 billion. The increase was due to a \$737 million increase in cost of product sales and a \$39 million increase in other unallocated costs, partially offset by a \$71 million decrease in cost of services sales and a reduction in severance charges of \$97 million as further discussed in the following sections.

Cost of Product Sales

The increase of \$244 million or 3% in cost of product sales during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011 was attributable to higher cost of product sales at our Space Systems and Electronic Systems business segments, partially offset by lower cost of product sales at our IS&GS and Aeronautics business segments. Cost of product sales increased at Space Systems by about \$300 million during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 primarily due to the delivery of two commercial satellites (versus no deliveries in the quarter ended June 26, 2011) and increased volume on various strategic and defensive missile systems programs. Cost of product sales at Electronic Systems increased by approximately \$145 million during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 primarily due to increased volume on ship and aviation programs (such as PTDS, LCS, and MH-60). Cost of product sales at IS&GS decreased by about \$160 million during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 primarily due to the cessation of the JTRS program, the completion of the U.K. Census program in the fourth quarter of 2011, and decreased

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volume on various other programs. Cost of product sales at Aeronautics decreased by approximately \$40 million during the quarter ended June 24, 2012 compared to the quarter ended June 26, 2011 primarily due to one less C-5M aircraft delivery, lower volume on the F-22 production program, risk retirements on C-130 international production contracts, and decreased volume on the F-35 development contract. The 1.5% decrease in percentage of cost of product sales relative to product sales primarily was due to risk retirements and other factors on numerous programs at IS&GS and Aeronautics.

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The increase of \$737 million or 5% in cost of product sales during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011 was attributable to higher cost of product sales at our Aeronautics, Space Systems, and Electronic Systems business segments, partially offset by lower cost of product sales at our IS&GS business segment. Cost of product sales at Aeronautics increased by about \$450 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to increased production volume on various programs, including F-35 LRIP contracts, and the impact of additional aircraft deliveries. Cost of product sales increased at Space Systems by about \$340 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to two deliveries on commercial satellites (versus no deliveries in the six months ended June 26, 2011) and increased volume on the Orion program and on various strategic and defensive missile systems programs. Cost of product sales at Electronic Systems increased by approximately \$210 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to increased volume on ship and aviation programs (such as PTDS, LCS, and MH-60). Cost of product sales at IS&GS decreased by about \$260 million during the six months ended June 24, 2012 compared to the six months ended June 26, 2011 primarily due to the cessation of the JTRS program, the completion of the U.K. Census program in the fourth quarter of 2011, and decreased volume on various other programs. The 1.2% decrease in percentage of cost of product sales relative to product sales primarily was due to risk retirements and other factors on numerous programs at IS&GS and Electronic Systems.

Cost of Services Sales

Our cost of services sales decreased \$62 million or 3% during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011, and decreased \$71 million or 2% during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. Most of our cost of services sales are in the Electronic Systems and IS&GS business segments. The decline in cost of services sales between both quarterly and year-to-date periods primarily was attributable to lower cost of services sales at our Electronic Systems business segment, partially offset by higher cost of services sales at our IS&GS business segment. Cost of services sales at Electronic Systems decreased about \$110 million and \$170 million during the quarter and six months ended June 24, 2012 compared to the quarter and six months ended June 26, 2011 primarily due to lower volume on various training and logistics services and other programs. IS&GS cost of services sales increased approximately \$60 million and \$110 million during the quarter and six months ended June 24, 2012 compared to the quarter and six months ended June 26, 2011 primarily due to increased activities on various services contracts, including cost of sales from an acquisition in the fourth quarter of 2011.

The percentage of cost of services sales relative to services sales decreased 0.7% during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011, and decreased 1.0% during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. The decreases between both quarterly and year-to-date periods primarily were due to risk retirements and other factors on numerous programs at Electronic Systems partially offset by an increase in costs as a percentage of services sales on numerous programs at IS&GS.

Severance Charges

During the quarter ended June 26, 2011, we recorded severance charges totaling \$97 million, net of state tax benefits, of which \$49 million and \$48 million related to our Aeronautics and Space Systems business segments. The charges reduced our net earnings by \$63 million (\$.18 per share) for the quarter and six months ended June 26, 2011. These severance actions related to the elimination of certain positions through either voluntary or involuntary actions. We recovered a significant amount of these charges through the pricing of our products and services to the U.S. Government and other customers. Space Systems paid and recovered most of its severance charges in the second half of 2011, while Aeronautics paid and recovered most of its severance charges during the quarter ended March 25, 2012.

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Other Unallocated Costs

Other unallocated costs principally include the non-cash FAS/CAS pension adjustment, stock-based compensation, and other corporate costs. These costs are not allocated to the business segments and, therefore, are excluded from the costs of product and services sales (see Note 3 for a description of these items). Other unallocated costs were \$275 million and \$594 million for the quarter and six months ended June 24, 2012 as compared to \$256 million and \$555 million for the quarter and six months ended June 26, 2011. In both periods, the increase primarily was due to fluctuations in expense associated with various corporate items, none of which were individually significant, partially offset by a decrease in the non-cash FAS/CAS pension adjustment of \$22 million and \$46 million for the quarter and six months ended June 24, 2012 from the comparable 2011 periods.

Other Income, Net

Other income, net for the quarter and six months ended June 24, 2012 was \$20 million and \$55 million, as compared to \$87 million and \$137 million for the quarter and six months ended June 26, 2011. The decrease in both periods primarily was due to lower equity earnings in affiliates recorded in 2012 as compared to 2011.

Operating Profit

Our operating profit for the quarter ended June 24, 2012 was \$1.2 billion, a \$207 million or 21% increase from the \$993 million for the quarter ended June 26, 2011. Our operating profit for the six months ended June 24, 2012 was \$2.2 billion, a \$355 million or 19% increase from the \$1.9 billion for the six months ended June 26, 2011. In both periods, the increase in operating profit primarily was attributable to increased operating profit at our Aeronautics, Electronic Systems, and Space Systems business segments and a reduction in severance charges and the non-cash FAS/CAS pension adjustment. These increases in operating profit partially were offset by an increase in other unallocated costs attributable to various corporate activities, a decline in other income, net, and a decline in operating profit at our IS&GS business segment.

Interest Expense

Interest expense for the quarter and six months ended June 24, 2012 was \$96 million and \$192 million, as compared to \$84 million and \$169 million for the quarter and six months ended June 26, 2011. The increase in both periods primarily was due to increased interest expense from the \$2.0 billion issuance of long-term debt in the quarter ended September 25, 2011, partially offset by the redemption of certain notes in the quarter ended December 31, 2011.

Other Non-Operating Income, Net

Other non-operating income, net was \$13 million and \$48 million for the quarter and six months ended June 24, 2012, compared to \$9 million and \$28 million for the quarter and six months ended June 26, 2011. The increase in both periods primarily was due to a gain from the sale of an investment. The increase for the quarter ended June 24, 2012 partially was offset by unrealized net losses on marketable securities held to fund certain non-qualified employee benefit obligations.

Income Tax Expense

Our effective income tax rates from continuing operations were 30.1% and 29.9% during the quarter and six months ended June 24, 2012, and 18.5% and 24.0% during the quarter and six months ended June 26, 2011. The rates for all periods benefited from tax deductions for U.S. manufacturing activities and dividends paid to certain defined contribution plans with an employee stock ownership plan feature. The rates for the quarter and six months ended June 26, 2011 included a reduction to income tax expense of \$89 million (\$.26 per share for the quarter and \$.25 per share for the six months ended June 26, 2011) through the elimination of liabilities for unrecognized tax benefits as a result of the U.S. Congressional Joint Committee on Taxation completing its review of the IRS Appeals Division's resolution of adjustments related to tax years

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2003 through 2008. In addition, the effective income tax rate for the quarter and six months ended June 26, 2011 included the U.S. research and development tax credit that expired on December 31, 2011.

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Recent proposals to lower the U.S. corporate income tax rate would require us to reduce our deferred tax assets upon enactment of the related tax legislation, with a corresponding material, one-time increase to income tax expense, but our income tax expense and payments would be materially reduced in subsequent years. Our deferred tax assets as of June 24, 2012 were \$5.5 billion, based on a 35% Federal statutory income tax rate, and primarily relate to our postretirement benefit plans. The amount of deferred tax assets will change periodically based on several factors, including the annual re-measurement of our postretirement benefit plan obligations and actual cash contributions to our postretirement benefit plans.

Net Earnings from Continuing Operations

Net earnings from continuing operations for the quarter and six months ended June 24, 2012 was \$781 million (\$2.38 per share) and \$1.4 billion (\$4.41 per share) compared to \$748 million (\$2.16 per share) and \$1.3 billion (\$3.73 per share) for the quarter and six months ended June 26, 2011. Both net earnings from continuing operations and earnings per share were affected by the factors discussed above. Earnings per share also benefited from a net decrease of 10.8 million common shares outstanding from June 26, 2011 to June 24, 2012 as a result of share repurchases, which were partially offset by share issuances under our stock-based awards and certain defined contribution plans.

Net Loss from Discontinued Operations

Discontinued operations include the operating results for Savi and also PAE through the date of its sale on April 4, 2011. There was no material net earnings (loss) from discontinued operations for the quarter and six months ended June 24, 2012. Net loss from discontinued operations for the quarter and six months ended June 26, 2011 was \$6 million (\$.02 per share) and \$32 million (\$.09 per share).

BUSINESS SEGMENT RESULTS OF OPERATIONS

Net sales of our business segments exclude intersegment sales, as these activities are eliminated in consolidation. Intercompany transactions are generally negotiated under terms and conditions similar to our third-party contracts.

Operating profit of our business segments includes the equity earnings or losses from investees in which certain of our business segments hold equity interests, because the activities of the investees are closely aligned with the operations of those business segments. Operating profit of our business segments excludes the non-cash FAS/CAS pension adjustment described below; expense for stock-based compensation programs; the effects of items not considered part of management's evaluation of segment operating performance, such as charges related to material severance actions in 2011 (Note 8, under the caption "Severance Activities"); gains or losses from divestitures; the effects of legal settlements; corporate costs not allocated to our business segments; and other miscellaneous corporate activities. These items are included in the reconciling item "Unallocated expense, net" between operating profit from our business segments and our consolidated operating profit.

The results of operations of our business segments include pension expense only as determined and funded in accordance with U.S. Government Cost Accounting Standards (CAS). The non-cash FAS/CAS pension adjustment represents the difference between pension expense or income calculated in accordance with GAAP and pension costs calculated and funded in accordance with CAS. CAS is a major factor in determining our pension funding requirements, and governs the extent to which pension costs can be allocated to and recovered on U.S. Government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts and, therefore, is recognized in each of our business segments' net sales and cost of sales.

The operating results in the following tables exclude businesses included in discontinued operations (Note 8, under the caption "Discontinued Operations") for all periods presented. During the quarter ended December 31, 2011, we realigned an immaterial supply chain services business from our Aeronautics business segment to our Electronic Systems business segment. The realignment had no effect on our consolidated results of operations, financial position, or cash flows. The financial information in the following tables has been reclassified to reflect this realignment.

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

| | Quarters Ended | | Six Months Ended | |
|---|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | | | | |
| Aeronautics | \$ 3,408 | \$ 3,390 | \$ 7,114 | \$ 6,542 |
| Electronic Systems | 3,866 | 3,780 | 7,475 | 7,262 |
| Information Systems & Global Solutions | 2,263 | 2,361 | 4,353 | 4,510 |
| Space Systems | 2,384 | 2,012 | 4,272 | 3,855 |
| Total net sales | \$11,921 | \$11,543 | \$23,214 | \$22,169 |
| Operating profit | | | | |
| Aeronautics | \$ 454 | \$ 397 | \$ 839 | \$ 725 |
| Electronic Systems | 526 | 478 | 1,067 | 910 |
| Information Systems & Global Solutions | 208 | 213 | 396 | 407 |
| Space Systems | 282 | 263 | 508 | 480 |
| Total business segment operating profit | 1,470 | 1,351 | 2,810 | 2,522 |
| Unallocated expense, net | | | | |
| Non-cash FAS/CAS pension adjustment | | | | |
| FAS pension expense | (486) | (456) | (971) | (911) |
| Less: CAS expense | (278) | (226) | (556) | (450) |
| Non-cash FAS/CAS pension adjustment | (208) | (230) | (415) | (461) |
| Severance charges ^(a) | | (97) | | (97) |
| Stock-based compensation | (45) | (40) | (87) | (79) |
| Other, net ^(b) | (17) | 9 | (96) | (28) |
| Total unallocated expense, net | (270) | (358) | (598) | (665) |
| Total consolidated operating profit | \$ 1,200 | \$ 993 | \$ 2,212 | \$ 1,857 |

^(a) The severance charges for 2011 consist of amounts, net of state taxes, related to actions taken at our Aeronautics and Space Systems business segments (Note 8, under the caption "Severance Activities"). Severance charges for initiatives that are not material are included in segment operating profit.

^(b) The change between the periods was attributable to changes in the market value of securities underlying certain deferred compensation liabilities and changes in other corporate items, none of which were individually significant.

Many of our contracts are multi-billion dollar contracts that span several years and include highly complex technical requirements. At the outset of a contract, we identify and monitor risks to the achievement of the technical, schedule, and costs aspects of the contract, and assess the effects of those risks on our estimates of total costs to complete the contract. The estimates consider the technical requirements (for example, a newly-developed product versus a mature product), the schedule and associated tasks (for example, the number and type of milestone events), and costs (for example, material, labor, subcontractor and overhead). The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements, schedule, and costs in the initial estimated costs at completion. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule and costs aspects of the contract. Alternatively, our profit booking rates may decrease if the estimated costs to complete the contract increase. All of the estimates are subject to change during the performance of the contract and may affect the profit booking rate.

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We have a number of programs that are designated as classified by the U.S. Government and cannot be specifically described. The operating results of these classified programs are included in our consolidated and business segment results, and are subjected to the same oversight and internal controls as our other programs.

Our net sales are derived from long-term contracts for products and services provided to the U.S. Government as well as FMS conducted through the U.S. Government. We account for these contracts, as well as product contracts for non-U.S. Government customers, under the POC method of accounting which represent approximately 95% of our net sales. We derive our remaining net sales from contracts to provide services to non-U.S. Government customers, which we account for under the services method of accounting.

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Under the POC method of accounting, we record sales on contracts based upon our progress towards completion on a particular contract as well as our estimate of the profit to be earned at completion. Cost-reimbursable contracts, which account for the majority of our net sales, provide for the payment of allowable costs plus a fee. For fixed-priced contracts, net sales and cost of sales are recognized as products are delivered or as costs are incurred. Due to the nature of the POC method of accounting, changes in our cost of sales are typically accompanied by a related change in our net sales.

In the discussion of comparative segment results, changes in net sales and segment operating profit generally are expressed in terms of volume. Changes in volume refer to increases or decreases in sales resulting from varying production activity levels, deliveries, or service levels on individual contracts. Volume changes typically include a corresponding change in segment operating profit based on the current profit booking rate for a particular contract.

In addition, comparability of our segment operating profit may be impacted by changes in estimated profit booking rates. Increases in the estimated profit booking rates on our contracts accounted for using the POC method of accounting, typically referred to as risk retirements, usually relate to revisions in the total estimated costs at completion that reflect improved conditions on a particular contract. Conversely, conditions on a particular contract may deteriorate resulting in an increase in the total estimated costs at completion and a reduction of the estimated profit booking rate. Increases or decreases in estimated profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes. Segment operating profit may also be impacted, favorably or unfavorably, by matters that are not accounted for using the POC method of accounting, such as the resolution of contractual matters, reserves for disputes, asset impairments and insurance recoveries, among others. Segment operating profit and items such as risk retirements, reductions of profit booking rates, or other matters are presented net of state income taxes.

Our consolidated net adjustments not related to volume, including net profit rate adjustments and the resolution of contractual matters, increased segment operating profit by approximately \$595 million and \$425 million for the quarters ended June 24, 2012 and June 26, 2011, and approximately \$1.1 billion and \$750 million for the six months ended June 24, 2012 and June 26, 2011. The 2012 net amounts include significant profit reductions for both our Aeronautics business segment (as described on pages 30 and 36) and our Electronic Systems business segment (as described on page 31).

Aeronautics

Summary operating results for our Aeronautics business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|-------------------|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | \$3,408 | \$3,390 | \$7,114 | \$6,542 |
| Operating profit | 454 | 397 | 839 | 725 |
| Operating margins | 13.3% | 11.7% | 11.8% | 11.1% |

Net sales in the Aeronautics business segment increased \$18 million, or 1%, during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011. The increase was attributable to higher net sales of approximately \$200 million from increased production volume on F-35 LRIP contracts after considering the effect of the International Association of Machinists and Aerospace Workers strike which was settled on June 28, 2012; and about \$130 million from F-16 programs primarily as a result of increased aircraft deliveries (10 F-16 aircraft delivered in the quarter ended June 24, 2012 compared to seven in the quarter ended June 26, 2011); while sales from C-130 programs remained comparable. Partially offsetting the increases were lower net sales of approximately \$140 million from the F-35 development contract principally due to the inception-to-date effect of reducing the profit booking rate and to a lesser extent lower volume; about \$115 million primarily due to a decrease in C-5M aircraft deliveries (no C-5M aircraft delivered in the quarter ended June 24, 2012 compared to one in the quarter ended June 26, 2011); approximately \$40 million from the F-22 program due principally to decreased production as final aircraft deliveries were completed in the

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quarter ended June 24, 2012, partially offset by the resolution of a contractual matter; and about \$20 million principally due to lower volume on other sustainment activities.

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Net sales in the Aeronautics business segment increased \$572 million, or 9%, during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. The increase was attributable to higher net sales of approximately \$460 million from increased production volume on F-35 LRIP contracts after considering the effect of the strike; about \$345 million from F-16 programs primarily as a result of increased aircraft deliveries (23 F-16 aircraft delivered in the six months ended June 24, 2012 compared to 12 in the six months ended June 26, 2011) and to a lesser extent F-16 sustainment activities; and approximately \$240 million principally due to increased C-130J aircraft deliveries (17 C-130J aircraft delivered in the six months ended June 24, 2012 compared to 13 in the six months ended June 26, 2011); while sales from C-5 programs remained comparable. Partially offsetting these increases were lower net sales of about \$215 million from the F-22 production program described in the preceding paragraph; approximately \$170 million from the F-35 development contract due to the inception-to-date effect of reducing the profit booking rate and decreased volume; and about \$85 million principally due to lower volume on other sustainment activities.

Operating profit in the Aeronautics business segment increased \$57 million, or 14%, during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011. The increase was attributable to higher operating profit of approximately \$80 million from C-130 programs principally due to risk retirements on international production contracts; about \$50 million from the resolution of a contractual matter on the F-22 production program; approximately \$20 million due to risk retirements on F-35 LRIP contracts; and about \$20 million from F-16 programs driven by increased aircraft deliveries. Operating profit from C-5 programs was comparable as the decline in profit from aircraft deliveries was largely offset by risk retirements on C-5 sustainment activities. Partially offsetting the increases were lower operating profit of approximately \$85 million from the F-35 development contract principally due to the inception-to-date effect of reducing the profit booking rate to reflect lower estimated incentive fees on the contract (see Status of F-35 Program for additional information), and about \$25 million principally from lower profit booking rate adjustments on other sustainment activities. Adjustments not related to volume, including net profit rate adjustments and the resolution of the contractual matter described above, were approximately \$35 million higher in the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011.

Operating profit in the Aeronautics business segment increased \$114 million, or 16%, during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. The increase was attributable to higher operating profit of approximately \$100 million from C-130 programs due to risk retirements on international production contracts, increased aircraft deliveries, and higher volume on sustainment activities; about \$50 million from F-16 programs driven by increased aircraft deliveries; approximately \$35 million from F-35 LRIP contracts due to increased risk retirements and production; about \$20 million from C-5 programs due to increased risk retirements; and approximately \$15 million from the F-22 production program principally including the \$50 million resolution of the contractual matter partially offset by lower volume and risk retirements. Partially offsetting these increases were lower operating profit of about \$85 million from the F-35 development contract principally due to the inception-to-date effect of reducing the profit booking rate; and about \$20 million principally from lower profit booking rate adjustments on other sustainment activities. Adjustments not related to volume, including net profit rate adjustments and the resolution of the contractual matter described above, were approximately the same in the six months ended June 24, 2012 as compared to the six months ended June 26, 2011.

We expect our Aeronautics business segment will experience a low single digit percentage decrease in net sales for 2012 as compared to 2011, operating profit will increase at a low single digit percentage range from 2011 levels, and operating margins will accordingly increase between the years.

Table of Contents**Lockheed Martin Corporation****Management's Discussion and Analysis of Financial Condition****and Results of Operations (continued)****Electronic Systems**

Summary operating results for our Electronic Systems business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|-------------------|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | \$3,866 | \$3,780 | \$7,475 | \$7,262 |
| Operating profit | 526 | 478 | 1,067 | 910 |
| Operating margins | 13.6% | 12.6% | 14.3% | 12.5% |

Net sales in the Electronic Systems business segment increased \$86 million, or 2%, during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011. The increase was attributable to higher volume and risk retirements of approximately \$245 million from ship and aviation programs (PTDS, LCS, MH-60) and about \$65 million from tactical missile programs (MLRS, Javelin). Partially offsetting these increases were lower net sales due to decreased volume on various programs including approximately \$100 million from air defense programs (PAC-3, THAAD); about \$45 million from numerous programs, primarily training and logistics programs; approximately \$40 million from fire control systems programs (Sniper, TADS/PNVs); and about \$40 million from integrated warfare systems and sensors programs (Aegis, DDG-1000).

Net sales in the Electronic Systems business segment increased \$213 million, or 3%, during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. The increase was attributable to higher volume and risk retirements of approximately \$425 million from ship and aviation programs (PTDS, LCS, MH-60); and about \$95 million from tactical missiles programs (Javelin). Partially offsetting the increase were lower net sales due to decreased volume of approximately \$85 million from fire control systems programs (Sniper, TADS/PNVs); about \$50 million from air defense programs (PAC-3, THAAD); approximately \$60 million from integrated warfare systems and sensors programs (DDG-1000, Medium Extended Air Defense System); and about \$110 million from various other programs, primarily training and logistics programs.

Operating profit in the Electronic Systems business segment increased \$48 million, or 10%, during the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011. The increase was attributable to higher operating profit of approximately \$60 million from ship and aviation programs (PTDS, Vertical Launching System (VLS)) as a result of increased risk retirements; approximately \$20 million from tactical missile programs (MLRS) as a result of increased risk retirements; and about \$50 million from the resolution of contractual matters. Partially offsetting these increases was lower operating profit of about \$15 million from air defense programs (PAC-3, THAAD) due to decreased volume; and over \$50 million from reducing profit booking rates on certain programs, including training and logistics programs, and a net increase in various costs, including severance. Adjustments not related to volume, including net profit rate adjustments and the resolution of contractual matters described above, were approximately \$90 million higher in the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011.

Operating profit in the Electronic Systems business segment increased \$157 million, or 17%, during the six months ended June 24, 2012 as compared to the six months ended June 26, 2011. The increase was attributable to higher operating profit of approximately \$135 million from ship and aviation programs (PTDS, VLS) as a result of increased risk retirements; about \$70 million from tactical missiles programs (MLRS) due to increased risk retirements and volume; approximately \$25 million from fire control systems programs as a result of increased risk retirements and volume; and about \$50 million from the resolution of contractual matters. Partially offsetting these increases was lower operating profit of about \$20 million for reserves on certain integrated warfare systems and sensors programs; and approximately \$105 million from reducing profit booking rates on certain programs, including training and logistics programs, and a net increase in various costs, including severance. Adjustments not related to volume, including net profit rate adjustments and the resolution of contractual matters described above, were approximately \$235 million higher in the six months ended June 24, 2012 as compared to the six months ended June 26, 2011.

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We expect our Electronic Systems business segment's net sales for 2012 will be comparable with 2011. We expect Electronic Systems' operating profit to increase in the mid single digit percentage range for 2012 as compared to 2011, resulting in an increase in operating margins between the years.

Table of Contents**Lockheed Martin Corporation****Management's Discussion and Analysis of Financial Condition****and Results of Operations (continued)****Information Systems & Global Solutions**

Summary operating results for our IS&GS business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|-------------------|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | \$2,263 | \$2,361 | \$4,353 | \$4,510 |
| Operating profit | 208 | 213 | 396 | 407 |
| Operating margins | 9.2% | 9.0% | 9.1% | 9.0% |

Net sales in the IS&GS business segment decreased \$98 million, or 4%, during the quarter ended June 24, 2012 and \$157 million, or 3%, during the six months ended June 24, 2012 as compared to the quarter and six months ended June 26, 2011. The decreases in both periods were attributable to lower net sales of approximately \$55 million during the quarter ended June 24, 2012 and \$120 million during the six months ended June 24, 2012 due to cessation of the JTRS program; about \$40 million during quarter ended June 24, 2012 and \$55 million during the six months ended June 24, 2012 from the completion of the U.K. Census program in the fourth quarter of 2011; and approximately \$35 million during the quarter ended June 24, 2012 and \$60 million during the six months ended June 24, 2012 from the completion of the ODIN program. Partially offsetting the decreases were higher net sales as a result of increased activity on numerous programs, including net sales from an acquisition in the fourth quarter of 2011.

The declines in operating profit in the IS&GS business segment during the quarter and six months ended June 24, 2012 as compared to the quarter and six months ended June 26, 2011 were attributable to lower net sales. Adjustments not related to volume, including net profit rate adjustments, were about the same in the quarter ended June 24, 2012 as compared to the quarter ended June 26, 2011, and approximately \$40 million higher in the six months ended June 24, 2012 as compared to the six months ended June 26, 2011.

We expect our IS&GS business segment will experience a mid to upper single digit percentage decrease in net sales for 2012 as compared to 2011. The decline is primarily due to the completion of various programs including ODIN, the U.K. Census, and JTRS, and we do not expect that this work will be replaced by other contracts due to the fiscal pressures constraining government purchases of information technology and other products and services. We expect IS&GS operating profit to decrease in the upper single digit percentage range for 2012 as compared to 2011 as a result of the lower sales volume, resulting in a slight decline in operating margins between the years.

Space Systems

Summary operating results for our Space Systems business segment were as follows (in millions):

| | Quarters Ended | | Six Months Ended | |
|-------------------|------------------|------------------|------------------|------------------|
| | June 24, 2012 | June 26, 2011 | June 24, 2012 | June 26, 2011 |
| Net sales | \$2,384 | \$2,012 | \$4,272 | \$3,855 |
| Operating profit | 282 | 263 | 508 | 480 |
| Operating margins | 11.8% | 13.1% | 11.9% | 12.5% |

Net sales in the Space Systems business segment increased \$372 million, or 18%, during the quarter ended June 24, 2012 and \$417 million, or 11%, during the six months ended June 24, 2012 as compared to the quarter and six months ended June 26, 2011. The increases in both periods were attributable to higher net sales as a result of increased commercial satellite deliveries of approximately \$285 million during both the quarter

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and six months ended June 24, 2012 (two deliveries in the quarter and six months ended June 24, 2012 compared to none in the quarter and six months ended June 26, 2011); about \$70 million during the quarter ended June 24, 2012 and \$130 million during the six months ended June 24, 2012 due to increased production volume and risk retirements on the Orion program; and approximately \$45 million during the quarter ended June 24, 2012 and \$50 million during the six months ended June 24, 2012 due to increased volume on various strategic and defensive missile systems programs. Partially offsetting these increases were lower net sales of about \$15 million during the quarter ended June 24, 2012 and \$35 million during the six months ended June 24, 2012 from the NASA External Tank program, which ended in connection with the completion of the Space Shuttle program in the second quarter of 2011.

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Management's Discussion and Analysis of Financial Condition

and Results of Operations (continued)

Operating profit in the Space Systems business segment increased \$19 million, or 7%, during the quarter ended June 24, 2012 and \$28 million, or 6%, during the six months ended June 24, 2012 as compared to the quarter and six months ended June 26, 2011. The increases in both periods were attributable to higher operating profit of approximately \$45 million during the quarter ended June 24, 2012 and \$55 million during the six months ended June 24, 2012 due to increased commercial satellite deliveries and risk retirements; and about \$35 million during the quarter ended June 24, 2012 and \$40 million during the six months ended June 24, 2012 primarily due to increased risk retirements on the Orion program. Partially offsetting these increases were lower equity earnings of \$70 million during the quarter ended June 24, 2012 and \$80 million during the six months ended June 24, 2012. Adjustments not related to volume, including net profit rate adjustments described above, were approximately \$35 million higher in the quarter ended June 24, 2012 and \$40 million higher in the six months ended June 24, 2012 as compared to the corresponding periods in 2011.

Total equity earnings recognized by the Space Systems business segment from United Launch Alliance (ULA) and United Space Alliance (USA) represented about \$10 million, or 4%, and approximately \$50 million, or 10%, of this segment's operating profit during the quarter and six months ended June 24, 2012. The level of equity earnings are expected to trend higher during the second half of 2012 as compared to the first half of 2012. During the quarter and six months ended June 26, 2011, total equity earnings recognized by the Space Systems business segment from ULA and USA represented about \$80 million, or 30%, and approximately \$130 million, or 27%, of this segment's operating profit.

We expect our Space Systems business segment will experience a slight decrease in operating profit for 2012 as compared to 2011 due to slightly lower sales volume as well as lower equity earnings from ULA, resulting in a slight decline in operating margins between the years.

FINANCIAL CONDITION

Liquidity and Cash Flows

Our access to capital resources that provide liquidity has not been materially affected by the changing economic and market conditions over the past few years. We continually monitor changes in such conditions so that we can timely respond to any related developments. We have generated strong operating cash flows which have been the primary source of funding for our operations, debt service and repayments, capital expenditures, share repurchases, dividends, acquisitions, and postretirement benefit plan funding. We have accessed the capital markets on limited occasions, as needed or when opportunistic.

We expect our cash from operations to continue to be sufficient to support our operations and anticipated capital expenditures for the foreseeable future. We have financing resources available to fund potential cash outflows that are less predictable or more discretionary, as discussed under Capital Resources. We have access to the credit markets, if needed, for liquidity or general corporate purposes, including letters of credit to support customer advance payments and for other trade finance purposes such as guaranteeing our performance on particular contracts.

Table of Contents**Lockheed Martin Corporation****Management's Discussion and Analysis of Financial Condition****and Results of Operations (continued)**

We have a balanced cash deployment strategy to enhance stockholder value and position ourselves to take advantage of new business opportunities when they arise. Consistent with that strategy, we have invested in our business, including capital expenditures and independent research and development, repurchased shares, increased our dividends, made selective acquisitions of businesses, and managed our debt levels. The following table provides a summary of our cash flow information (in millions) and the subsequent discussion provides an overview of our execution of this strategy.

| | Six Months Ended | |
|--|-------------------------|-------------|
| | June 26, | |
| | June 24, | 2011 |
| | 2012 | 2011 |
| Cash and cash equivalents at beginning of period | \$3,582 | \$2,261 |
| Net cash provided by operating activities | 1,303 | 2,613 |
| Net cash (used for) provided by investing activities | (298) | 168 |
| Net cash used for financing activities | (785) | (1,774) |
| Net change in cash and cash equivalents | 220 | 1,007 |
| Cash and cash equivalents at end of period | \$3,802 | \$3,268 |
| <i>Operating Activities</i> | | |

Net cash provided by operating activities was \$1.3 billion in the six months ended June 24, 2012, a decrease of \$1.3 billion from \$2.6 billion in the six months ended June 26, 2011. The decrease between periods was driven by net cash outflows of \$681 million due to an increase in contributions paid to the pension trust (as discussed below), inclusive of an increase in the recovery of CAS costs on our contracts, a \$593 million reduction in cash provided by operating working capital as discussed below, and a reduction in cash caused by an increase of \$461 million in net federal and foreign income tax payments made during the six months ended June 24, 2012 compared to the corresponding period in 2011. These decreases partially were offset by improvements in operating results of \$177 million, a net decrease of \$95 million in payments related to certain severance and other charges (as discussed below), and timing of other corporate items.

The decrease in cash provided by operating working capital changes primarily was due to the timing of payment of accounts payable, a reduction in customer advance payments, and an increase in inventories, which partially were offset by the timing of collections of accounts receivable. The decrease in cash flows from customer advances and amounts in excess of costs incurred was attributable to a reduction on various programs (largely Javelin) at our Electronic Systems business segment. The change in accounts receivable primarily reflects the timing of contract negotiations and related billing activities on various programs (largely F-35) at our Aeronautics business segment which partially were offset by various programs at our Electronic Systems business segment. The decrease in cash flows from inventories was attributable to various programs (largely C-130 and C-5) at our Aeronautics business segment.

During the six months ended June 24, 2012, we made \$1.1 billion in required contributions to our qualified defined benefit pension plans compared to \$325 million during the six months ended June 26, 2011. During the six months ended June 24, 2012, we made approximately \$65 million in payments related to certain 2011 severance actions (Note 8, under the caption "Severance Activities"), and during the six months ended June 26, 2011, we made \$160 million in payments related to the Voluntary Executive Separation Program announced in 2010.

Investing Activities

The majority of our capital expenditures relate to facilities infrastructure and equipment that generally are incurred to support new and existing programs across all of our business segments. We also incur capital expenditures for information technology to support programs and general enterprise information technology infrastructure, inclusive of costs for development or purchase of internal-use software. Capital expenditures amounted to \$306 million and \$328 million for the six months ended June 24, 2012 and June 26, 2011. We expect that our operating cash flows

will continue to be sufficient to fund our planned annual capital expenditures over the next few years.

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Management's Discussion and Analysis of Financial Condition

and Results of Operations (continued)

During the six months ended June 26, 2011, we received proceeds related to the sale of PAE (Note 8) and decreased our short-term investments by \$260 million. There were no material divestiture or investment activities during the six months ended June 24, 2012.

Financing Activities

We paid cash totaling \$423 million and \$1.3 billion for share repurchases during the six months ended June 24, 2012 and June 26, 2011. The amount paid during the six months ended June 26, 2011 included \$63 million for shares we repurchased in December 2010 but that were not paid for until January 2011.

Pursuant to our share repurchase program, we are authorized to repurchase up to \$6.5 billion of our common stock. Under the program, we have discretion to determine the dollar amount of shares to be repurchased and the timing of any repurchases in compliance with applicable law and regulation. As of June 24, 2012, we had repurchased a total of 47.9 million shares of our common stock under the program for \$3.6 billion, and there remained \$2.9 billion authorized for additional share repurchases. See Part II, Item 2 of this Form 10-Q for additional information regarding the repurchase of shares during the quarter ended June 24, 2012.

Cash received from the issuance of our common stock in connection with employee stock option exercises during the six months ended June 24, 2012 and June 26, 2011 totaled \$235 million and \$60 million. Those exercises resulted in the issuance of 3.6 million shares and 1.0 million shares during the respective periods.

During the six months ended June 24, 2012 and June 26, 2011, we paid dividends totaling \$653 million (\$2.00 per share) and \$524 million (\$1.50 per share).

Capital Resources

At June 24, 2012, we held cash and cash equivalents of \$3.8 billion. Our long-term debt, net of unamortized discounts, amounted to \$6.3 billion, and mainly is in the form of publicly-issued notes that bear interest at fixed rates. As of June 24, 2012, we were in compliance with all covenants contained in our debt and credit agreements.

At June 24, 2012, we had in place with a group of banks a \$1.5 billion revolving credit facility which expires in August 2016. We may request and the banks may grant, at their discretion, an increase to the credit facility by an additional amount up to \$500 million. There were no borrowings outstanding under the credit facility through June 24, 2012. We have agreements in place with banking institutions to provide for the issuance of commercial paper. There were no commercial paper borrowings outstanding through June 24, 2012. If we were to issue commercial paper, the borrowings would be supported by the credit facility. We also have an effective shelf registration statement on Form S-3 on file with the U.S. Securities and Exchange Commission through August 2014 to provide for the issuance of an indeterminate amount of debt securities.

Our stockholders' equity was \$2.2 billion at June 24, 2012, an increase of \$1.2 billion from December 31, 2011. The increase primarily was due to net earnings of \$1.4 billion, reclassification adjustments related to our postretirement benefit plans of \$406 million included within other comprehensive income, and employee stock activity of \$448 million. These increases partially were offset by dividends declared of \$659 million and the repurchase of 4.9 million common shares for \$428 million during the six months ended June 24, 2012. As we repurchase our common shares, we reduce common stock for the \$1 of par value of the shares repurchased, with the excess purchase price over par value recorded as a reduction of additional paid-in capital. If additional paid-in capital is reduced to zero, we record the remainder of the excess purchase price over par value as a reduction of retained earnings.

OTHER MATTERS

Status of F-35 Program

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The F-35 program consists of multiple contracts. Under our customer's acquisition strategy, the development contract is being performed concurrently with the LRIP contracts. Concurrent performance of development and production contracts is advantageous in complex programs to test airplanes, shorten the time to field systems, and achieve overall cost savings.

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Management's Discussion and Analysis of Financial Condition

and Results of Operations (continued)

The development portion of the F-35 program is expected to continue into 2017 and currently has approximately \$530 million of incentive fees remaining. After updating our estimates at completion on the contract during the second quarter, we reduced the profit booking rate to reflect lower expected estimated fees at completion. This reduced profit by approximately \$85 million during the quarter to reflect the inception to date impact of the revised booking rate. In addition to other key factors, our revised estimates recognize that we have made little progress in negotiating with our customer to restructure the development contract incentive fees to tie the fees to specific milestones. For example, only \$13 million of the remaining fee has recently been tied to specific milestones even though there has been significant flight and test point activity scheduled this year. In addition, when fee has been tied to milestones, the U.S. government fee determinations have been less than our self-assessment of the significant progress accomplished during the evaluation periods. We will continue to record profit at the revised booking rate for the duration of the contract unless further adjustments are necessary.

Given the size and complexity of the F-35 program, we anticipate that there will be continual reviews related to aircraft quantities, program schedule, cost, and requirements as part of the DoD, Congressional, and international partners' oversight and budgeting processes. Current program challenges include, but are not limited to, executing flight tests, supplier and partner performance, software development, and receiving funding for current LRIP contracts on a timely basis. Our customer is currently delaying funding for LRIP Lot 6 until the LRIP Lot 5 contract is negotiated. This could result in material termination liability exposure in future periods if funding is not received.

Although not exclusively related to the F-35 program, on October 4, 2010, the Defense Contracting Management Agency (DCMA) withdrew its prior validation and determination of compliance of the earned value management system (EVMS) at our Fort Worth, Texas location. EVMS is a tool for managing cost and schedule performance on complex programs. The DCMA recently conducted a compliance review and concluded that although we have made notable progress toward compliance, additional corrective actions are needed to achieve full compliance. We are working on resolving the remaining corrective actions as soon as possible. The withdrawal of the prior validation and determination of compliance of the EVMS had no impact on our internal controls over financial reporting.

In January 2012, the Secretary of Defense removed the short takeoff and vertical landing (STOVL) fighter variant from probation as the STOVL variant completed highly successful initial sea trials aboard the USS Wasp and is demonstrating the kind of performance and maturity that is in line with the other two variants of the F-35. In the quarter ended June 24, 2012, the final three LRIP lot 2 aircraft were delivered to the U.S. Government. We have received orders for 93 production aircraft, of which 14 have been delivered through the quarter ended June 24, 2012.

We have two U.S. Government FMS customers to go along with our eight partner countries. International interest in the F-35 continues to strengthen. In 2011, the Israeli government signed a letter of offer and acceptance with the U.S. Government for the procurement of F-35 aircraft and the Japanese Ministry of Defense selected the F-35 to be its next generation fighter. Israel and Japan are expected to be the first two countries to receive the F-35 aircraft through the U.S. Government FMS process. We recently submitted a proposal to provide approximately 60 F-35 aircraft to South Korea.

Contingencies

For information regarding our contingent obligations, including off-balance sheet arrangements, see Note 6 Legal Proceedings and Contingencies in this Form 10-Q.

Critical Accounting Policies

During the quarter ended June 24, 2012, there were no significant changes to the critical accounting policies we disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2011 Form 10-K.

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ITEM 3. Quantitative and Qualitative Disclosure About Market Risk.

For quantitative and qualitative disclosures about market risk, refer to the following sections of our Annual Report on Form 10-K for the year ended December 31, 2011: Management's Discussion and Analysis of Financial Condition and Results of Operations under the caption Quantitative and Qualitative Disclosures About Market Risk, Note 1 Significant Accounting Policies, under the caption Derivative financial instruments, and Note 9 - Debt. Our exposures to market risk have not changed materially since December 31, 2011.

ITEM 4. Controls and Procedures.

We performed an evaluation of the effectiveness of our disclosure controls and procedures as of June 24, 2012. The evaluation was performed with the participation of senior management of each business segment and key Corporate functions, under the supervision of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Based on this evaluation, the CEO and CFO concluded that our disclosure controls and procedures were operating and effective as of June 24, 2012.

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

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Forward-Looking Statements

This Form 10-Q contains statements which, to the extent that they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws, and are based on our current expectations and assumptions. The words believe, estimate, anticipate, project, intend, expect, plan, outlook, forecast and similar expressions are intended to identify forward-looking statements. statements are not guarantees of future performance and are subject to risks and uncertainties. Actual results could differ materially due to factors such as:

the availability of government funding for the Corporation's products and services both domestically and internationally due to budgetary constraints, sequestration under the Budget Control Act of 2011, performance, cost, or other factors;

changes in government and customer priorities, requirements or contracting practices (including the potential for deferral, reduction or termination of programs);

quantity revisions to the F-35 program, including in the U.S. or internationally;

actual returns (or losses) on pension plan assets, movements in interest rates, and other changes that may affect pension plan assumptions;

the effect of capitalization changes (such as share repurchase activity, accelerated pension funding, stock option exercises, or debt levels);

difficulties in developing and producing operationally advanced technology systems;

the timing and customer acceptance of product deliveries;

materials availability and performance by key suppliers, subcontractors, and customers;

charges from any future impairment reviews that may result in the recognition of losses and a reduction in the book value of goodwill or other long-term assets;

the effect of future legislation, rulemaking, and changes in accounting, tax, defense, and procurement policy or interpretations, or challenges to the allowability of costs incurred under government cost accounting standards (including potential corporate tax reform);

the impact of future acquisitions or divestitures, joint ventures, or teaming arrangements;

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the outcome of legal proceedings and other contingencies (including lawsuits, government investigations or audits, and the cost of completing environmental remediation efforts);

the competitive environment for the Corporation's products and services, export policies, and potential for delays in procurement due to bid protests;

the ability to attract and retain key personnel and suppliers (including the potential for disruption associated with sequestration and related employee severance or supplier termination costs); and

economic, business, and political conditions domestically and internationally.

These are only some of the factors that may affect the forward-looking statements contained in this Form 10-Q. For a discussion identifying additional important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see our filings with the SEC including, but not limited to, the discussions of "Government Contracts and Regulation" and "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2011; "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-Q; and "Note 5 Postretirement Benefit Plans" and "Note 6 Legal Proceedings and Contingencies" of the Notes to Unaudited Consolidated Financial Statements included in this Form 10-Q.

Our actual financial results likely will be different from those projected due to the inherent nature of projections. Given these uncertainties, you should not rely on forward-looking statements in making investment decisions. The forward-looking statements contained in this Form 10-Q speak only as of the date of its filing. We expressly disclaim a duty to

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provide updates to forward-looking statements after the date of this Form 10-Q to reflect subsequent events that have occurred, changed circumstances, changes in expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Form 10-Q are intended to be subject to the safe harbor protection provided by the federal securities laws.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

We are a party to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment, as described in Note 6 Legal Proceedings and Contingencies in this Form 10-Q, and in our 2011 Annual Report on Form 10-K filed with the Securities Exchange Commission (2011 Form 10-K). In the opinion of management and in-house counsel, the probability is remote that the outcome of each of those matters will have a material adverse effect on the Corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our net earnings in any particular quarter. The results of legal proceedings, however, cannot be predicted with certainty.

We primarily are engaged 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 are funded by the U.S. Government. These contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Government investigate whether our operations are being conducted in accordance with these requirements. U.S. Government investigations of us, whether relating to these contracts or conducted for other reasons, could result in administrative, civil, or criminal liabilities, including repayments, fines, or penalties being imposed on us, or could lead to our 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.

We are subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites. As a result, we are a party to or have our property subject to various lawsuits or proceedings involving environmental protection matters. Due in part to their complexity and pervasiveness, such requirements have resulted in us being involved with related legal proceedings, claims, and remediation obligations. The extent of our financial exposure cannot in all cases be reasonably estimated at this time. For information regarding these matters, including current estimates of the amounts that we believe are required for remediation or clean-up to the extent estimable, see Note 6 Legal Proceedings and Contingencies under the caption Environmental Matters in this Form 10-Q.

In addition, see the Legal Proceedings section of the 2011 Form 10-K for a description of previously reported matters.

ITEM 1A. Risk Factors.

While we attempt to identify, manage, and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our 2011 Form 10-K describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results, and future prospects. We do not believe that there have been any material changes to the risk factors previously disclosed in our 2011 Form 10-K.

Table of Contents**Lockheed Martin Corporation****ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

There were no sales of unregistered equity securities during the quarter ended June 24, 2012.

The following table provides information about our repurchases during the quarter ended June 24, 2012 of our common stock that is registered pursuant to Section 12 of the Exchange Act.

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ^(a) | Amount Available for Future Share Repurchases Under the Program ^(b) (in millions) |
|---------------------------------|---|---------------------------------------|---|--|
| March 26, 2012 - April 29, 2012 | | N/A | | \$3,081 |
| April 30, 2012 - May 27, 2012 | 1,121,354 | \$84.09 | 1,121,354 | \$2,987 |
| May 28, 2012 - June 24, 2012 | <u>1,109,529</u> | \$82.69 | <u>1,109,529</u> | \$2,895 |
| Total | 2,230,883 | \$83.40 | 2,230,883 | \$2,895 |

^(a) We repurchased a total of 2.2 million shares of our common stock for \$186 million during the quarter ended June 24, 2012 under a share repurchase program that we announced in October 2010.

^(b) Our Board of Directors has approved a share repurchase program for the repurchase of our common stock from time-to-time, authorizing an amount available for share repurchases of \$6.5 billion. Under the program, management has discretion to determine the dollar amount of shares to be repurchased and the timing of any repurchases in compliance with applicable law and regulation. The program does not have an expiration date. As of June 24, 2012, we had repurchased a total of 47.9 million shares under the program for \$3.6 billion.

ITEM 6. Exhibits.

| <u>Exhibit No.</u> | Description |
|--------------------|--|
| 3.1 | Bylaws of Lockheed Martin Corporation, as amended and restated effective June 28, 2012 (incorporated by reference to Exhibit 3.1 to Lockheed Martin Corporation's Current Report on Form 8-K filed with the SEC on July 3, 2012) |
| 10.1 | Lockheed Martin Corporation Severance Benefit Plan For Certain Management Employees, as amended |
| 15 | Acknowledgment of Ernst & Young LLP, Independent Registered Public Accounting Firm |
| 31.1 | Rule 13a-14(a) Certification of Robert J. Stevens |
| 31.2 | Rule 13a-14(a) Certification of Bruce L. Tanner |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350 of Robert J. Stevens |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350 of Bruce L. Tanner |
| 101.INS | XBRL Instance Document |

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| | |
|---------|--|
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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Lockheed Martin Corporation

SIGNATURE

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.

Lockheed Martin Corporation
(Registrant)

Date: July 25, 2012

by: /s/ Christopher J. Gregoire
Christopher J. Gregoire
Vice President and Controller

(Chief Accounting Officer)