HARBINGER GROUP INC.
Form 10-Q
May 12, 2014

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

Form 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 1-4219

Harbinger Group Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 74-1339132<br>(I.R.S. Employer<br>Identification No.) |
| 450 Park Avenue, 30th Floor<br>New York, NY | 10022 |
| (Address of principal executive offices) | (Zip Code) |

(212) 906-8555
(Registrant’s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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 or 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 (section 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 or 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 ¨ | Accelerated Filer x |
| Non-accelerated Filer ¨ (Do not check if a smaller reporting company) | 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 ¨ or No x

There were 148,466,219 shares of the registrant’s common stock outstanding as of May 9, 2014.

HARBINGER GROUP INC.
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PART I: FINANCIAL INFORMATION
Item 1. Financial Statements
HARBINGER GROUP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions)

| | March 31, 2014 (Unaudited) | September 30, 2013 |
|---|---|---|
| ASSETS | | |
| Investments: | | |
| Fixed maturities | $16,626.6 | $15,300.0 |
| Equity securities | 484.9 | 352.5 |
| Derivatives | 273.0 | 221.8 |
| Asset-based loans | 795.7 | 560.4 |
| Other invested assets | 132.6 | 31.2 |
| Total investments | 18,312.8 | 16,465.9 |
| Cash and cash equivalents | 1,319.8 | 1,899.7 |
| Receivables, net | 657.3 | 611.3 |
| Inventories, net | 725.9 | 632.9 |
| Accrued investment income | 182.0 | 161.2 |
| Reinsurance recoverable | 2,387.4 | 2,363.7 |
| Deferred tax assets | 227.1 | 293.4 |
| Properties, including oil and natural gas properties, net | 930.6 | 993.3 |
| Goodwill | 1,479.6 | 1,476.7 |
| Intangibles, including deferred acquisition costs and value of business acquired, net | 2,691.5 | 2,729.1 |
| Other assets | 408.5 | 281.6 |
| Total assets | $29,322.5 | $27,908.8 |
| LIABILITIES AND EQUITY | | |
| Insurance reserves: | | |
| Contractholder funds | $15,998.3 | $15,248.2 |
| Future policy benefits | 3,684.7 | 3,556.8 |
| Liability for policy and contract claims | 60.6 | 51.5 |
| Funds withheld from reinsurers | 39.4 | 39.4 |
| Total insurance reserves | 19,783.0 | 18,895.9 |
| Debt | 5,396.3 | 4,896.1 |
| Accounts payable and other current liabilities | 821.5 | 1,012.7 |
| Equity conversion feature of preferred stock | 364.8 | 330.8 |
| Employee benefit obligations | 92.5 | 99.6 |
| Deferred tax liabilities | 493.0 | 492.8 |
| Other liabilities | 628.7 | 718.0 |
| Total liabilities | 27,579.8 | 26,445.9 |
| Commitments and contingencies | | |
| Temporary equity: | | |
| Redeemable preferred stock | 319.3 | 329.4 |

| | | |
|---|---|---|
| Harbinger Group Inc. stockholders' equity: | | |
| Common stock | 1.5 | 1.4 |
| Additional paid-in capital | 813.2 | 828.0 |
| Accumulated deficit | (319.0 ) | (192.4 ) |
| Accumulated other comprehensive income | 197.8 | 87.7 |
| Total Harbinger Group Inc. stockholders' equity | 693.5 | 724.7 |
| Noncontrolling interest: | 729.9 | 408.8 |
| Total permanent equity | 1,423.4 | 1,133.5 |
| Total liabilities and equity | $29,322.5 | $27,908.8 |

See accompanying notes to condensed consolidated financial statements.

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HARBINGER GROUP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share data)

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | March 31, 2014 (Unaudited) | March 31, 2013 | March 31, 2014 (Unaudited) | March 31, 2013 |
| Revenues: | | | | |
| Net consumer product sales | $1,021.7 | $987.7 | $2,122.3 | $1,858.0 |
| Oil and natural gas | 39.2 | 16.7 | 74.7 | 16.7 |
| Insurance premiums | 14.8 | 14.1 | 28.7 | 27.9 |
| Net investment income | 206.4 | 171.3 | 407.6 | 349.3 |
| Net investment gains | 40.9 | 206.7 | 182.8 | 353.2 |
| Insurance and investment product fees and other | 18.2 | 14.6 | 35.1 | 28.3 |
| Total revenues | 1,341.2 | 1,411.1 | 2,851.2 | 2,633.4 |
| Operating costs and expenses: | | | | |
| Consumer products cost of goods sold | 662.1 | 664.9 | 1,381.5 | 1,247.0 |
| Oil and natural gas direct operating costs | 17.1 | 8.8 | 33.2 | 8.8 |
| Benefits and other changes in policy reserves | 196.5 | 240.9 | 431.2 | 324.5 |
| Selling, acquisition, operating and general expenses | 330.9 | 313.5 | 648.0 | 568.1 |
| Impairment of oil and natural gas properties | 81.0 | — | 81.0 | — |
| Amortization of intangibles | 37.4 | 49.0 | 80.8 | 135.6 |
| Total operating costs and expenses | 1,325.0 | 1,277.1 | 2,655.7 | 2,284.0 |
| Operating income | 16.2 | 134.0 | 195.5 | 349.4 |
| Interest expense | (77.2) | (75.7) | (161.2) | (218.8) |
| (Loss) gain from the change in the fair value of the equity conversion feature of preferred stock | (3.5) | (39.6) | (50.7) | 29.3 |
| Gain on contingent purchase price reduction | — | — | 0.5 | — |
| Other expense, net | (4.6) | (3.2) | (16.5) | (11.9) |
| (Loss) income from continuing operations before income taxes | (69.1) | 15.5 | (32.4) | 148.0 |
| Income tax (benefit) expense | (13.3) | 66.0 | 25.0 | 130.4 |
| Net (loss) income | (55.8) | (50.5) | (57.4) | 17.6 |
| Less: Net income (loss) attributable to noncontrolling interest | 19.7 | (17.2) | 44.9 | (23.2) |
| Net (loss) income attributable to controlling interest | (75.5) | (33.3) | (102.3) | 40.8 |
| Less: Preferred stock dividends and accretion | 12.1 | 12.2 | 24.3 | 24.3 |
| Net (loss) income attributable to common and participating preferred stockholders | $(87.6) | $(45.5) | $(126.6) | $16.5 |
| Net (loss) income per common share attributable to controlling interest: | | | | |
| Basic | $(0.63) | $(0.33) | $(0.91) | $0.08 |
| Diluted | $(0.63) | $(0.33) | $(0.91) | $0.06 |

See accompanying notes to condensed consolidated financial statements.

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HARBINGER GROUP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In millions)

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | March 31, 2014 (Unaudited) | March 31, 2013 | March 31, 2014 (Unaudited) | March 31, 2013 |
| Net (loss) income | $(55.8) | $(50.5) | $(57.4) | $17.6 |
| Other comprehensive income (loss) | | | | |
| Foreign currency translation losses | (2.6) | (20.4) | (2.9) | (17.6) |
| Net unrealized (loss) gain on derivative instruments | | | | |
| Changes in derivative instruments before reclassification adjustment | (1.8) | 1.5 | (0.9) | 1.4 |
| Net reclassification adjustment for (gains) losses included in net income | — | — | 0.9 | 0.4 |
| Changes in derivative instruments after reclassification adjustment | (1.8) | 1.5 | — | 1.8 |
| Changes in deferred income tax asset/liability | 0.4 | (1.1) | (0.1) | (1.1) |
| Deferred tax valuation allowance adjustments | (0.1) | 0.4 | — | 0.4 |
| Net unrealized (loss) gain on derivative instruments | (1.5) | 0.8 | (0.1) | 1.1 |
| Actuarial adjustments to pension plans | | | | |
| Changes in actuarial adjustments before reclassification adjustment | (0.2) | (0.9) | (0.6) | (1.6) |
| Net reclassification adjustment for losses included in cost of goods sold | 0.2 | 0.3 | 0.3 | 0.6 |
| Net reclassification adjustment for losses included in selling and general and administrative expenses | 0.2 | 0.2 | 0.5 | 0.4 |
| Changes in actuarial adjustments to pension plans | 0.2 | (0.4) | 0.2 | (0.6) |
| Changes in deferred income tax asset/liability | (0.1) | 0.2 | (0.1) | 0.3 |
| Net actuarial adjustments to pension plans | 0.1 | (0.2) | 0.1 | (0.3) |
| Unrealized investment gains (losses): | | | | |
| Changes in unrealized investment gains before reclassification adjustment | 386.5 | 53.9 | 376.6 | 180.2 |
| Net reclassification adjustment for gains included in net income | (10.2) | (74.5) | (18.3) | (246.5) |
| Changes in unrealized investment gains (losses) after reclassification adjustment | 376.3 | (20.6) | 358.3 | (66.3) |
| Adjustments to intangible assets | (113.0) | 22.2 | (105.1) | 50.3 |
| Changes in deferred income tax asset/liability | (91.2) | (0.6) | (87.6) | 5.5 |
| Net unrealized gain (loss) on investments | 172.1 | 1.0 | 165.6 | (10.5) |
| Net change to derive comprehensive income (loss) for the period | 168.1 | (18.8) | 162.7 | (27.3) |
| Comprehensive income (loss) | 112.3 | (69.3) | 105.3 | (9.7) |
| Less: Comprehensive income (loss) attributable to the noncontrolling interest: | | | | |
| Net income (loss) | 19.7 | (17.2) | 44.9 | (23.2) |
| Other comprehensive income (loss) | 30.8 | (8.4) | 30.0 | (7.1) |
| | 50.5 | (25.6) | 74.9 | (30.3) |

| | | | | |
|---|---|---|---|---|
| Comprehensive income (loss) attributable to the controlling interest | $61.8 | $(43.7) | $30.4 | $20.6 |

See accompanying notes to condensed consolidated financial statements.

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HARBINGER GROUP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

| | Six months ended | |
|---|---|---|
| | March 31, 2014 | March 31, 2013 |
| | (Unaudited) | |
| Cash flows from operating activities: | | |
| Net (loss) income | $(57.4) | $17.6 |
| Adjustments to reconcile net (loss) income to operating cash flows: | | |
| Depreciation of properties | 62.2 | 34.4 |
| Amortization of intangibles | 80.8 | 135.6 |
| Impairment of oil and gas properties | 81.0 | — |
| Stock-based compensation | 47.4 | 22.2 |
| Amortization of debt issuance costs | 9.5 | 5.5 |
| Amortization of debt discount | 1.3 | 0.5 |
| Write-off of debt issuance costs on retired debt | 6.4 | 15.5 |
| Write-off of debt discount on retired debt | 2.8 | 3.0 |
| Deferred income taxes | (25.4) | 150.1 |
| Gain on contingent purchase price reduction | (0.5) | — |
| Interest credited/index credits to contractholder account balances | 352.2 | 313.4 |
| Collateral received (paid) | 36.9 | — |
| Amortization of fixed maturity discounts and premiums | (19.8) | 22.2 |
| Net recognized gains on investments and derivatives | (120.5) | (374.7) |
| Charges assessed to contractholders for mortality and administration | (22.0) | (16.0) |
| Deferred policy acquisition costs | (115.8) | (71.5) |
| Non-cash increase to cost of goods sold due to the sale of HHI Business acquisition inventory | — | 31.0 |
| Non-cash restructuring and related charges | 3.4 | — |
| Changes in operating assets and liabilities: | (404.4) | (356.0) |
| Net change in cash due to operating activities | (81.9) | (67.2) |
| Cash flows from investing activities: | | |
| Proceeds from investments sold, matured or repaid | 2,863.6 | 6,016.3 |
| Cost of investments acquired | (4,032.9) | (5,916.2) |
| Acquisitions, net of cash acquired | (24.8) | (1,903.5) |
| Asset-based loans originated, net | (137.1) | (63.0) |
| Capital expenditures | (48.7) | (25.2) |
| Other investing activities, net | (0.1) | (100.0) |
| Net change in cash due to investing activities | (1,380.0) | (1,991.6) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of new debt | 745.4 | 2,945.1 |
| Repayment of debt, including tender and call premiums | (532.4) | (919.5) |
| Revolving credit facility activity | 147.4 | 355.1 |
| Debt issuance costs | (11.0) | (78.6) |
| Purchases of subsidiary stock, net | (4.5) | (16.0) |
| Contractholder account deposits | 1,344.9 | 772.8 |
| Contractholder account withdrawals | (920.3) | (950.3) |
| Dividend paid by subsidiary to noncontrolling interest | (12.1) | (5.8) |
| Dividends paid on preferred stock | (16.5) | (16.7) |

| | | |
|---|---|---|
| Share based award tax withholding payments | (32.1 ) | (20.2 ) |
| Proceeds from initial public offering of subsidiary shares, less costs of issuance | 171.9 | — |
| Other financing activities, net | 2.5 | — |
| Net change in cash due to financing activities | 883.2 | 2,065.9 |
| Effect of exchange rate changes on cash and cash equivalents | (1.2 ) | (2.8 ) |
| Net change in cash and cash equivalents | (579.9 ) | 4.3 |
| Cash and cash equivalents at beginning of period | 1,899.7 | 1,470.7 |
| Cash and cash equivalents at end of period | $1,319.8 | $1,475.0 |

See accompanying notes to condensed consolidated financial statements.

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HARBINGER GROUP INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in millions, except per share and unit figures)

(1) Description of Business

Harbinger Group Inc. ("HGI" and, collectively with its respective subsidiaries, the "Company") is a diversified holding company. HGI is focused on obtaining controlling equity stakes in companies that operate across a diversified set of industries and growing acquired businesses. In addition to acquiring controlling interests, HGI may make investments in debt instruments, acquire minority equity interests in companies and expand its operating businesses. HGI’s shares of common stock trade on the New York Stock Exchange ("NYSE") under the symbol "HRG".

In December 2013, Fidelity & Guaranty Life ("FGL"), a then wholly-owned subsidiary of HGI, announced an initial public offering of 9,750 thousand shares of common stock at a price to the public of $17.00 per share. The shares began trading on the NYSE on December 13, 2013 under the ticker symbol "FGL". FGL also granted the underwriters an option to purchase an additional 1,463 thousand shares of common stock that was subsequently exercised. HGI was not a selling shareholder in the offering. Subsequent to the offering HGI held 47,000 thousand shares of FGL's outstanding common stock, representing an 80.4% interest as of March 31, 2014.

Also in December 2013, Front Street Re (Cayman) Ltd. ("Front Street Cayman"), a wholly-owned subsidiary of HGI, closed a reinsurance treaty with Bankers Life Insurance Company. Under the terms of the treaty, Bankers Life Insurance Company ceded approximately $153.0 of its annuity business to Front Street Cayman on a funds withheld basis.

Also in December, 2013, HGI's subsidiary Spectrum Brands Holdings, Inc., a Delaware corporation ("Spectrum Brands"), amended a senior secured term loan, issuing two tranches maturing September 4, 2019 which provide for borrowings in aggregate principal amounts of $215.0 and €225.0. The proceeds from the amendment were used to refinance a portion of the term loan which was scheduled to mature December 17, 2019 and had an aggregate amount outstanding of $513.3 prior to refinancing.

In January 2014, HGI issued $200.0 aggregate principal amount of 7.75% senior unsecured notes due 2022 at par (the "7.75% Notes"). See Note 8, Debt.

Also in January 2014, Spectrum Brands completed the $35.8 acquisition of The Liquid Fence Company, Inc. ("Liquid Fence"), a producer of animal repellents. See Note 3, Acquisitions.

The Company’s reportable business segments are organized in a manner that reflects how HGI’s management views those business activities. Accordingly, the Company currently operates its business in four reporting segments: (i) Consumer Products, (ii) Insurance, (iii) Energy, and (iv) Asset Management. For the results of operations by segment, and other segment data, see Note 16, Segment Data.

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(2) Basis of Presentation, Significant Accounting Policies and Practices and Recent Accounting Pronouncements
Basis of Presentation
The accompanying unaudited Condensed Consolidated Financial Statements of the Company included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. All such adjustments are of a normal recurring nature. Although the Company believes that the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures, including a description of significant accounting policies normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"), have been condensed or omitted pursuant to such rules and regulations, except for such significant accounting policies that relate to the ceiling test on certain oil and natural gas properties, which are detailed below. Certain prior year amounts have been reclassified or combined to conform to the current year presentation. These reclassifications and combinations had no effect on previously reported results of operations or accumulated deficit. These interim financial statements should be read in conjunction with the Company’s annual consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2013, filed with the SEC on November 27, 2013 (the "Form 10-K"). The results of operations for the six months ended March 31, 2014 are not necessarily indicative of the results for any subsequent periods or the entire fiscal year ending September 30, 2014.
The Company’s fiscal year ends on September 30 and the quarters end on the last calendar day of the months of December, March and June. The Company's significant subsidiary, Spectrum Brands' fiscal year ends September 30 and its interim fiscal quarters end every thirteenth Sunday, except for its first fiscal quarter which may end on the fourteenth Sunday following September 30. The Company does not adjust for the difference in fiscal periods between Spectrum Brands and itself, as such difference would be less than 93 days, pursuant to Regulation S-X Rule 3A-02.
At March 31, 2014, the non-controlling interest component of total equity represents the 41.4% share of Spectrum Brands, the 19.6% of FGL, the 14.3% of Salus Capital Partners, LLC ("Salus"), and the 2.1% share of Zap.Com Corporation ("Zap.com") not owned by HGI.

Oil and natural gas properties
Ceiling Test
Pursuant to Rule 4-10(c)(4) of Regulation S-X, our equity investment in an oil and natural gas joint venture (the "EXCO/HGI JV") was required to compute its ceiling test using the simple average spot price for the trailing twelve month period for oil and natural gas as of March 31, 2014. The ceiling test involves comparing the net book value of the full cost pool, after taxes, to the full cost ceiling limitation defined below. In the event the full cost ceiling limitation is less than the full cost pool, the EXCO/HGI JV is required to record a ceiling test impairment of the EXCO/HGI JV's oil and natural gas properties. The full cost ceiling limitation is computed as the sum of the present value of estimated future net revenues from the EXCO/HGI JV's proved reserves by applying the average price as prescribed by the SEC Release No. 33-8995, less estimated future expenditures (based on current costs) to develop and produce the proved reserves, discounted at 10%, plus the cost of properties not being amortized and the lower of cost or estimated fair value of unproved properties included in the costs being amortized, net of income tax effects. The ceiling test is computed using the simple average spot price for the trailing 12 month period using the first day of each month. For the 12 months ended March 31, 2014, the trailing 12 month reference prices were $3.99 per Mmbtu for natural gas at Henry Hub, and $98.30 per Bbl of oil for West Texas Intermediate at Cushing, Oklahoma. The price used for natural gas liquids was $43.63 per Bbl and was based on the trailing 12 month average of realized prices. Each of the reference prices for oil, natural gas and natural gas liquids are further adjusted for quality factors and regional differentials to derive estimated future net revenues. Under full cost accounting rules, any ceiling test impairments of oil and natural gas properties may not be reversed in subsequent periods. Since the EXCO/HGI JV does not designate the EXCO/HGI JV's derivative financial instruments as hedging instruments, the EXCO/HGI JV is not allowed to use the impacts of the derivative financial instruments in the ceiling test computations.

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The EXCO/HGI JV recognized impairments of $81.0 to the EXCO/HGI JV's proved oil and natural gas properties for the three and six months ended March 31, 2014. We previously received an exemption from the SEC to exclude the acquisition of the EXCO/HGI Partnership’s unamortized oil and natural gas properties from the ceiling test for a period of one year following the acquisition date and this exemption expired during the three months ended March 31, 2014. The impairments primarily resulted from differences in the oil and natural gas prices utilized in the purchase price allocation at the acquisition date and the prices used in the ceiling test calculation. Our pricing utilized in the purchase price allocation as of the acquisition date was based on models which incorporate, among other things, market prices based on NYMEX futures. The ceiling test requires companies using the full cost accounting method to price period ending proved reserves using the simple average spot price for the trailing twelve month period, which may not be indicative of actual market values. The EXCO/HGI JV did not recognize an impairment to the EXCO/HGI JV's oil and natural gas properties for the period from inception to March 31, 2013.
The ceiling test calculation and impairment evaluation are based upon estimates of proved reserves. There are numerous uncertainties inherent in estimating quantities of proved reserves, in projecting the future rates of production and in the timing of development activities. The accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Results of drilling, testing and production subsequent to the date of the estimate may justify revision of such estimate. Accordingly, reserve estimates are often different from the quantities of oil, natural gas and natural gas liquids that are ultimately recovered.

Insurance Subsidiary Financial Information
The Company’s insurance subsidiaries file financial statements with state insurance regulatory authorities and the National Association of Insurance Commissioners ("NAIC") that are prepared in accordance with Statutory Accounting Principles ("SAP") prescribed or permitted by such authorities, which may vary materially from US GAAP. Prescribed SAP includes the Accounting Practices and Procedures Manual of the NAIC as well as state laws, regulations and administrative rules. Permitted SAP encompasses all accounting practices not so prescribed. The principal differences between statutory financial statements and financial statements prepared in accordance with US GAAP are that statutory financial statements do not reflect deferred acquisition costs ("DAC") and value of business acquired ("VOBA"), some bond portfolios may be carried at amortized cost, assets and liabilities are presented net of reinsurance, contractholder liabilities are generally valued using more conservative assumptions and certain assets are non-admitted. Accordingly, statutory operating results and statutory capital and surplus may differ substantially from amounts reported in the US GAAP basis financial statements for comparable items.
On November 1, 2013, Fidelity and Guaranty Life Insurance Company ("FGL Insurance") re-domesticated from Maryland to Iowa. After re-domestication, FGL Insurance elected to apply Iowa-prescribed accounting practices that permit Iowa-domiciled insurers to report equity call options used to economically hedge fixed indexed annuity ("FIA") index credits at amortized cost for statutory accounting purposes and to calculate FIA statutory reserves such that index credit returns will be included in the reserve only after crediting to the annuity contract. This resulted in a $11.5 increase to statutory capital and surplus at December 31, 2013. Also, the Iowa Insurance Division granted FGL Insurance a permitted statutory accounting practice to reclassify its negative unassigned surplus balance of $805.8 (unaudited) to additional paid in capital as of April 6, 2011, the date the Company acquired FGL Insurance, which will have the effect of setting FGL Insurance’s statutory unassigned surplus to zero as of this date. The prescribed and permitted statutory accounting practice has no impact on the Company’s consolidated financial statements which are prepared in accordance with US GAAP.
As of March 31, 2014, Fidelity and Guaranty Life Insurance Company of New York ("FGL NY Insurance") did not follow any prescribed or permitted statutory accounting practices that differ from the NAIC’s statutory accounting practices. However, FGL Insurance’s statutory carrying value of Raven Reinsurance Company ("Raven Re") reflects the effect of permitted practices Raven Re received from Vermont that allows Raven Re to admit the outstanding amount of a letter of credit facility as an asset. Raven Re is also permitted to follow Iowa prescribed practice statutory accounting for its statutory reserves on reinsurance assumed from FGL Insurance. Without such permitted statutory accounting practices Raven Re’s statutory capital and surplus would be negative and its risk-based capital would fall below the minimum regulatory requirements.

Change in Accounting Method
During the quarter ended June 30, 2013, the Company changed its method of presenting tax withholdings for share-based payment awards paid to a taxing authority on behalf of an employee from an operating activity to a financing

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activity within its statements of cash flows. The Company believes that the newly adopted accounting principle is preferable in the circumstances because the predominant characteristic of such transaction is a financing activity.
As a result of the change in accounting method, the Company had the following reclassifications for the six months ended March 31, 2013:

| | Six months ended March 31, 2013 |
|---|---|
| Net change in cash due to operating activities | $20.2 |
| Net change in cash due to financing activities | $(20.2 ) |

Recent Accounting Pronouncements
Offsetting Assets and Liabilities
In December 2011, the Financial Accounting Standards Board ("FASB") issued amended disclosure requirements for offsetting financial assets and financial liabilities to allow investors to better compare financial statements prepared under US GAAP with financial statements prepared under International Financial Reporting Standards. The new standards are effective for the Company beginning in the first quarter of its fiscal year ending September 30, 2014. ASU 2011-11 was adopted by the Company effective October 1, 2013. The Company does not offset any of its derivative transactions, including bifurcated embedded derivatives, in its statement of financial position. Through FGL, the Company only enters into purchased equity options and long futures contracts. The Company has not entered into any repurchase and reverse repurchase agreements or securities borrowing and lending transactions. Accordingly, no additional disclosures are required.
Investments in Qualified Affordable Housing Projects
In January 2014, the FASB issued amended guidance which allows investors in Low Income Housing Tax Credit ("LIHTC") programs that meet specified conditions to present the net tax benefits (net of the amortization of the cost of the investment) within income tax expense. The cost of the investments that meet the specified conditions will be amortized in proportion to (and over the same period as) the total expected tax benefits, including the tax credits and other tax benefits, as they are realized on the tax return. The guidance is required to be applied retrospectively, if investors elect the proportional amortization method. However, if investors have existing LIHTC investments accounted for under the effective-yield method at adoption, they may continue to apply that method for those existing investments. The new standards will become effective for the Company beginning in the first quarter of its fiscal year ending September 30, 2016. The Company is currently evaluating the impact of this new accounting guidance on its consolidated financial position and results of operations.
Joint and Several Liability Arrangements
In February 2013, the FASB issued ASU 2013-04, “Liabilities (Topic 405):Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date” ("ASU 2013-04"). ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, except for obligations addressed within existing guidance in US GAAP. The update is effective for fiscal years ending after December 15, 2014 and is required to be applied retrospectively to all prior periods presented for those obligations that existed upon adoption of ASU 2013-04. The Company is currently assessing the potential impact of ASU 2013-04.
Presentation of Unrecognized Tax Benefit
In July 2013, the FASB issued new accounting guidance which requires entities to present unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward, except to the extent the net operating loss carryforwards or tax credit carryforwards are not available to be used at the reporting date to settle additional income taxes, and the entity does not intend to use them for this

purpose. The new accounting guidance is consistent with how the Company has historically accounted for unrecognized tax benefits in its Consolidated Statements of Financial Position; therefore, the Company does not expect the adoption of this guidance to have a significant impact on its consolidated financial statements.

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(3) Acquisitions

Spectrum Brands' Acquisition of Stanley Black & Decker's Hardware and Home Improvement Business

On December 17, 2012, Spectrum Brands completed the cash acquisition (the "Hardware Acquisition") of the residential hardware and home improvement business (the "HHI Business") from Stanley Black & Decker, Inc. ("Stanley Black & Decker"). A portion of the HHI Business, consisting of the purchase of certain assets of Tong Lung Metal Industry Co. Ltd., a Taiwan Corporation ("TLM Taiwan"), closed on April 8, 2013.

EXCO/HGI JV

On February 14, 2013, EXCO Resources, Inc. ("EXCO") and a subsidiary of HGI formed the EXCO/HGI JV to own and operate conventional oil and natural gas properties. EXCO contributed to the EXCO/HGI JV its conventional assets in and above the Canyon Sand formation in the Permian Basin in West Texas as well as in the Holly, Waskom, Danville and Vernon fields in East Texas and North Louisiana. EXCO and HGI own an economic interest in the EXCO/HGI JV of 25.5% and 74.4%, respectively.

Supplemental Pro Forma Information

The following table reflects the Company's pro forma results as if the Hardware Acquisition and the acquisition of the Company's interest in the EXCO/HGI JV were completed on October 1, 2012 and the results of the HHI Business and the EXCO/HGI JV had been included in the full three and six months ended March 31, 2013.

| | March 31, 2013 | |
|---|---|---|
| | Three months ended | Six months ended |
| Revenues: | | |
| Reported revenues | $1,411.1 | $2,633.4 |
| HHI adjustment | — | 191.8 |
| EXCO/HGI JV adjustment | 17.1 | 53.7 |
| Pro forma revenues | $1,428.2 | $2,878.9 |
| | | |
| Net income: | | |
| Reported net income | $(50.5) | $17.6 |
| HHI adjustment | — | 4.9 |
| EXCO/HGI JV adjustment | (0.9) | (0.5) |
| Pro forma net income | $(51.4) | $22.0 |
| | | |
| Basic net income per common share attributable to controlling interest: | | |
| Reported net income per common share | $(0.33) | $0.08 |
| HHI adjustment | — | 0.04 |
| EXCO/HGI JV adjustment | (0.01) | — |
| Pro forma net income per common share | $(0.34) | $0.12 |
| | | |
| Diluted net income per common share attributable to controlling interest: | | |
| Reported diluted net income per common share | $(0.33) | $0.06 |
| HHI adjustment | — | 0.02 |
| EXCO/HGI JV adjustment | (0.01) | — |
| Pro forma diluted net income per common share | $(0.34) | $0.08 |

Liquid Fence

On January 2, 2014, Spectrum Brands completed the $35.8 acquisition of Liquid Fence, a producer of animal repellents. This acquisition was not considered to be significant.

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The following table summarizes the consideration paid by Spectrum Brands for Liquid Fence:

| | January 2, 2014 |
|---|---|
| Cash paid to seller at close | $24.8 |
| Promissory note due to seller | 9.5 |
| Contingent liability | 1.5 |
| Preliminary purchase price | $35.8 |

The promissory note will be paid in four semi-annual installments over 24 months from the close of the transaction.
The results of Liquid Fence's operations since January 2, 2014 are included in the Company’s Condensed Consolidated Statements of Operations.

Preliminary Valuation of Assets and Liabilities

The assets acquired and liabilities assumed in the Liquid Fence acquisition have been measured at their fair values at January 2, 2014 as set forth below. The excess of the purchase price over the fair values of the net tangible assets and identifiable intangible assets was recorded as goodwill, which includes value associated with the assembled workforce including an experienced research team, and is expected to be deductible for income tax purposes. The preliminary fair values recorded were determined based upon a valuation and the estimates and assumptions used in such valuation are subject to change, which could be significant, within the measurement period (up to one year from the acquisition date). The primary areas of acquisition accounting that are not yet finalized relate to amounts for intangible assets, contingent liabilities and residual goodwill.

The preliminary fair values recorded for the assets acquired and liabilities assumed for Liquid Fence are as follows:

| | Preliminary Valuation March 31, 2014 |
|---|---|
| Cash | $— |
| Accounts Receivable | 1.2 |
| Inventories | 2.2 |
| Other assets | 0.1 |
| Intangible assets | 26.9 |
| Total assets acquired | 30.4 |
| Total liabilities assumed | 1.6 |
| Total identifiable net assets | 28.8 |
| Goodwill | 7.0 |
| Total identifiable net assets | $35.8 |

Preliminary Pre-Acquisition Contingencies Assumed

Spectrum Brands has evaluated and continues to evaluate pre-acquisition contingencies relating to Liquid Fence that existed as of the acquisition date. Based on the evaluation to date, Spectrum Brands has preliminarily determined that certain pre-acquisition contingencies are probable in nature and estimable as of the acquisition date. Accordingly, Spectrum Brands has preliminarily recorded its best estimates for these contingencies as part of the preliminary purchase accounting for Liquid Fence. Spectrum Brands continues to gather information relating to all pre-acquisition contingencies that it has assumed from Liquid Fence. Any changes to the pre-acquisition contingency amounts recorded during the measurement period will be included in the final valuation and related amounts recognized. Subsequent to the end of the measurement period, any adjustments to pre-acquisition contingency amounts will be reflected in the Company's results of operations.

Preliminary Valuation Adjustments

Spectrum Brands performed a preliminary valuation of the acquired trade names, proprietary technology assets, customer relationships and a contingent earn-out liability at January 2, 2014. A summary of the significant key inputs is as follows:

- Spectrum Brands valued the technology assets related to formulas and processes, using the income approach, specifically the excess earnings method. Under this method, the asset value was determined by estimating the earnings attributable to the technology assets, adjusted for contributory asset charges.

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In estimating the fair value of the technology, net sales and associated earnings were forecasted and adjusted for a technical obsolescence factor to isolate the forecasted sales and earnings attributable to the acquired technology assets. The forecasted technology earnings were discounted to present value to arrive at the concluded fair value. Spectrum Brands anticipates using the technology asset over a useful life of 17 years which is generally determined by assessing the time period in which substantially all of the discounted cash flows are expected to be generated. The technology asset was valued at approximately $20.5 under this approach.

- Spectrum Brands valued an indefinite-lived trade name using the income approach, specifically the relief from royalty method. Under this method, the asset value was determined by estimating the hypothetical royalties that would have to be paid if the trade name was not owned. Royalty rates were selected based on consideration of several factors, including prior transactions of Liquid Fence, related trademarks and trade names, other similar trademark licensing and transaction agreements and the relative profitability and perceived contribution of the trademarks and trade names. Trade name and trademarks were valued at $5.1 under this approach.
- Spectrum Brands valued customer relationships using the distributor approach. Under this method, the asset value was determined by estimating the hypothetical earnings before interest and taxes ("EBIT") that a comparable distributor would earn, further adjusted for contributory asset charges. In determining the fair value of the customer relationships, the distributor approach values the intangible asset at the present value of the incremental after-tax cash flows. The customer relationships were valued at $1.3 under this approach and will be amortized over 15 years.
- Spectrum Brands valued a contingent liability related to additional payments that may be made to the selling company. This liability was calculated based on the probability weighted present value of expected payments. This contingent liability is based on the achievement of specific revenue milestones through both January 31, 2015 and January 31, 2016. The contingent liability was valued at $1.5 under this approach.

(4) Investments

The Company’s consolidated investments are summarized as follows:

| | March 31, 2014 | | | | |
|---|---|---|---|---|---|
| | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Carrying Value |
| Fixed-maturity securities, available-for sale | | | | | |
| Asset-backed securities | $1,576.6 | $19.1 | $(8.5) | $1,587.2 | $1,587.2 |
| Commercial mortgage-backed securities | 463.3 | 25.2 | (1.9) | 486.6 | 486.6 |
| Corporates | 10,177.3 | 431.4 | (86.6) | 10,522.1 | 10,522.1 |
| Hybrids | 423.6 | 28.6 | (0.6) | 451.6 | 451.6 |
| Municipals | 1,182.8 | 77.0 | (19.8) | 1,240.0 | 1,240.0 |
| Agency residential mortgage-backed securities | 96.9 | 2.5 | — | 99.4 | 99.4 |
| Non-agency residential mortgage-backed securities | 1,730.9 | 126.3 | (10.1) | 1,847.1 | 1,847.1 |
| U.S. Government | 389.1 | 6.3 | (2.8) | 392.6 | 392.6 |
| Total fixed maturities | 16,040.5 | 716.4 | (130.3) | 16,626.6 | 16,626.6 |
| Equity securities | | | | | |
| Available-for-sale | 346.6 | 14.6 | (8.1) | 353.1 | 353.1 |
| Held for trading | 140.2 | 25.5 | (33.9) | 131.8 | 131.8 |
| Total equity securities | 486.8 | 40.1 | (42.0) | 484.9 | 484.9 |
| Derivatives | 154.6 | 120.7 | (2.3) | 273.0 | 273.0 |

| | | | | | |
|---|---|---|---|---|---|
| Asset-based loans | 795.7 | — | — | 795.7 | 795.7 |
| Other invested assets | 132.5 | 0.1 | — | 132.6 | 132.6 |
| Total investments | $17,610.1 | $877.3 | $(174.6 ) | $18,312.8 | $18,312.8 |

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| | September 30, 2013 | | | | |
|---|---|---|---|---|---|
| | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Carrying Value |
| Fixed-maturity securities, available-for-sale | | | | | |
| Asset-backed securities | $1,505.7 | $22.6 | $(5.2) | $1,523.1 | $1,523.1 |
| Commercial mortgage-backed securities | 431.3 | 24.7 | (1.6) | 454.4 | 454.4 |
| Corporates | 9,314.7 | 288.7 | (185.1) | 9,418.3 | 9,418.3 |
| Hybrids | 412.6 | 19.5 | (3.3) | 428.8 | 428.8 |
| Municipals | 998.8 | 49.0 | (40.8) | 1,007.0 | 1,007.0 |
| Agency residential mortgage-backed securities | 96.5 | 2.4 | (0.3) | 98.6 | 98.6 |
| Non-agency residential mortgage-backed securities | 1,304.0 | 77.4 | (13.4) | 1,368.0 | 1,368.0 |
| U.S. Government | 998.5 | 7.2 | (3.9) | 1,001.8 | 1,001.8 |
| Total fixed-maturity securities | 15,062.1 | 491.5 | (253.6) | 15,300.0 | 15,300.0 |
| Equity securities | | | | | |
| Available-for-sale | 274.6 | 6.7 | (10.3) | 271.0 | 271.0 |
| Held for trading | 120.1 | 0.6 | (39.2) | 81.5 | 81.5 |
| Total equity securities | 394.7 | 7.3 | (49.5) | 352.5 | 352.5 |
| Derivatives | 141.7 | 88.5 | (8.4) | 221.8 | 221.8 |
| Asset-based loans | 560.4 | — | — | 560.4 | 560.4 |
| Other invested assets | 31.2 | — | — | 31.2 | 31.2 |
| Total investments | $16,190.1 | $587.3 | $(311.5) | $16,465.9 | $16,465.9 |

Included in accumulated other comprehensive income ("AOCI") were cumulative unrealized gains of $0.9 and unrealized losses of $1.9 related to the non-credit portion of other-than-temporary impairments on non-agency residential mortgage-backed securities at March 31, 2014 and September 30, 2013. The non-agency residential mortgage-backed securities unrealized gains and losses represent the difference between book value and fair value on securities that were previously impaired. There have been no impairments or write downs on any of the 2014 purchased non-agency residential mortgage-backed securities.

Securities held on deposit with various state regulatory authorities had a fair value of $14,334.4 and $19.4 at March 31, 2014 and September 30, 2013, respectively. The increase in securities held on deposits is due to the FGL Insurance re-domestication from Maryland to Iowa. Under Iowa regulations, insurance companies are required to hold securities on deposit in an amount no less than the company's legal reserve as prescribed by Iowa regulations.

In accordance with FGL Insurance's Federal Home Loan Bank of Atlanta (“FHLB”) agreements, the investments supporting the funding agreement liabilities are pledged as collateral to secure the FHLB funding agreement liabilities. The collateral investments had a fair value of $592.3 and $604.9 at March 31, 2014 and September 30, 2013, respectively.

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Maturities of Fixed-maturity Securities

The amortized cost and fair value of fixed maturity available-for-sale securities by contractual maturities, as applicable, are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or pre-pay obligations.

| | March 31, 2014 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Corporates, Non-structured Hybrids, Municipal and U.S. Government securities: | | |
| Due in one year or less | $353.8 | $356.8 |
| Due after one year through five years | 2,770.7 | 2,856.0 |
| Due after five years through ten years | 3,528.3 | 3,612.6 |
| Due after ten years | 5,446.5 | 5,703.8 |
| Subtotal | 12,099.3 | 12,529.2 |
| Other securities which provide for periodic payments: | | |
| Asset-backed securities | 1,576.6 | 1,587.2 |
| Commercial-mortgage-backed securities | 463.3 | 486.6 |
| Structured hybrids | 73.5 | 77.1 |
| Agency residential mortgage-backed securities | 96.9 | 99.4 |
| Non-agency residential mortgage-backed securities | 1,730.9 | 1,847.1 |
| Total fixed maturity available-for-sale securities | $16,040.5 | $16,626.6 |

Securities in an Unrealized Loss Position

FGL's available-for-sale securities with unrealized losses are reviewed by FGL for potential other-than-temporary impairments. In evaluating whether a decline in value is other-than-temporary, FGL considers several factors including, but not limited to, the following: (1) the extent and the duration of the decline; (2) the reasons for the decline in value (credit event, currency or interest-rate related, including general credit spread widening); and (3) the financial condition of and near-term prospects of the issuer. FGL also considers the ability and intent to hold the investment for a period of time to allow for a recovery of value.

FGL analyzes its ability to recover the amortized cost by comparing the net present value of cash flows expected to be collected with the amortized cost of the security. For mortgage-backed and asset-backed securities, cash flow estimates consider the payment terms of the underlying assets backing a particular security, including interest rate and prepayment assumptions, based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also include other assumptions regarding the underlying collateral including default rates and recoveries, which vary based on the asset type and geographic location, as well as the vintage year of the security. For structured securities, the payment priority within the tranche structure is also considered. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recognized.

FGL has concluded that the fair values of the securities presented in the table below were not other-than-temporarily impaired as of March 31, 2014.

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The fair value and gross unrealized losses of available-for-sale securities, aggregated by investment category, were as follows:

| | March 31, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Available-for-sale securities | | | | | | |
| Asset-backed securities | $483.4 | $(6.1) | $120.3 | $(2.4) | $603.7 | $(8.5) |
| Commercial-mortgage-backed securities | 46.8 | (0.6) | 0.2 | (1.3) | 47.0 | (1.9) |
| Corporates | 1,902.2 | (54.9) | 769.9 | (31.7) | 2,672.1 | (86.6) |
| Equities | 70.0 | (6.4) | 26.0 | (1.7) | 96.0 | (8.1) |
| Hybrids | 19.1 | (0.4) | 10.5 | (0.2) | 29.6 | (0.6) |
| Municipals | 359.8 | (13.5) | 107.5 | (6.3) | 467.3 | (19.8) |
| Agency residential mortgage-backed securities | 9.9 | — | 0.6 | — | 10.5 | — |
| Non-agency residential mortgage-backed securities | 335.9 | (7.6) | 96.7 | (2.5) | 432.6 | (10.1) |
| U.S. Government | 127.9 | (2.5) | 39.7 | (0.3) | 167.6 | (2.8) |
| Total available-for-sale securities | $3,355.0 | $(92.0) | $1,171.4 | $(46.4) | $4,526.4 | $(138.4) |
| Total number of available-for-sale securities in an unrealized loss position | | 440 | | 156 | | 596 |

| | September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Available-for-sale securities | | | | | | |
| Asset-backed securities | $329.3 | $(4.5) | $81.5 | $(0.7) | $410.8 | $(5.2) |
| Commercial mortgage-backed securities | 26.6 | (0.5) | 4.9 | (1.1) | 31.5 | (1.6) |
| Corporates | 3,457.2 | (175.0) | 186.0 | (10.1) | 3,643.2 | (185.1) |
| Equities | 118.6 | (9.1) | 32.2 | (1.2) | 150.8 | (10.3) |
| Hybrids | 52.0 | (3.3) | — | — | 52.0 | (3.3) |
| Municipals | 333.3 | (27.3) | 144.4 | (13.5) | 477.7 | (40.8) |
| Agency residential mortgage-backed securities | 9.8 | (0.1) | 1.1 | (0.2) | 10.9 | (0.3) |
| Non-agency residential mortgage-backed securities | 325.2 | (12.2) | 69.9 | (1.2) | 395.1 | (13.4) |
| U.S. Government | 753.9 | (3.9) | — | — | 753.9 | (3.9) |
| | $5,405.9 | $(235.9) | $520.0 | $(28.0) | $5,925.9 | $(263.9) |

| | | | |
|---|---|---|---|
| Total available-for-sale securities | | | |
| Total number of available-for-sale securities in an unrealized loss position | 588 | 78 | 666 |

At March 31, 2014 and September 30, 2013, securities in an unrealized loss position were primarily concentrated in investment grade corporate debt instruments. Agency residential mortgage-backed securities had positions with an unrealized loss less than $0.1 as of March 31, 2014.

At March 31, 2014 and September 30, 2013, securities with a fair value of $1.0 and $60.9, respectively, were depressed greater than 20% of amortized cost (excluding U.S. Government and U.S. Government sponsored agency securities), which represented less than 1% of the carrying values of all investments.

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Credit Loss Portion of Other-than-temporary Impairments

The following table provides a reconciliation of the beginning and ending balances of the credit loss portion of other-than-temporary impairments on fixed maturity securities held by FGL for the three and six months ended March 31, 2014, and March 31, 2013, for which a portion of the other-than-temporary impairment was recognized in AOCI:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 |
| Beginning balance | $2.7 | $2.7 | $2.7 | $2.7 |
| Increases attributable to credit losses on securities: | | | | |
| Other-than-temporary impairment was previously recognized | — | — | — | — |
| Other-than-temporary impairment was not previously recognized | — | — | — | — |
| Ending balance | $2.7 | $2.7 | $2.7 | $2.7 |

For the three and six months ended March 31, 2014, FGL recognized insignificant impairment losses in operations. For the three and six months ended March 31, 2013, FGL recognized an impairment loss in operations totaling $0.4 and $0.9, respectively, including credit impairments of $0.1 and $0.3, respectively and change-of-intent impairments of $0.3 and $0.7, respectively, and had an amortized cost of $2.7 and a fair value of $1.8 at March 31, 2013.

Asset-based Loans

Salus' portfolio of asset-based loans receivable, included in "Asset-based loans" in the Condensed Consolidated Balance Sheets as of March 31, 2014 and September 30, 2013, consisted of the following:

| | March 31, 2014 | September 30, 2013 |
|---|---|---|
| Asset-based loans, by major industry: | | |
| Apparel | $225.5 | $252.9 |
| Jewelry | 121.0 | 125.8 |
| Sporting Goods | 16.9 | 25.1 |
| Manufacturing | 53.6 | 34.3 |
| Transportation | 45.6 | 85.7 |
| Electronics | 250.0 | — |
| Other | 90.1 | 41.8 |
| Total asset-based loans | 802.7 | 565.6 |
| Less: Allowance for credit losses | 7.0 | 5.2 |
| Total asset-based loans, net | $795.7 | $560.4 |

Salus establishes its allowance for credit losses through a provision for credit losses based on its evaluation of the credit quality of its loan portfolio. The following table presents the activity in its allowance for credit losses for the three and six months ended March 31, 2014 and March 31, 2013:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 |
| Allowance for credit losses: | | | | |
| Balance at beginning of period | $7.0 | $2.6 | $5.2 | $1.4 |
| Provision for credit losses | — | 0.2 | 1.8 | 1.4 |
| Balance at end of period | $7.0 | $2.8 | $7.0 | $2.8 |

Credit Quality Indicators

Salus monitors credit quality as indicated by various factors and utilizes such information in its evaluation of the adequacy of the allowance for credit losses. As of March 31, 2014 and September 30, 2013, Salus had no outstanding loans that either were non-performing, in a non-accrual status, or had been subject to a troubled-debt restructuring.

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As of March 31, 2014 and September 30, 2013, there were no outstanding loans that had been individually considered impaired, as all loans were in current payment status.

| | Internal Risk Rating | | | | |
|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubtful | Total |
| March 31, 2014 | $221.4 | $335.6 | $245.7 | $— | $802.7 |
| September 30, 2013 | $306.9 | $36.7 | $222.0 | $— | $565.6 |

Net Investment Income

The major sources of “Net investment income” on the accompanying Condensed Consolidated Statements of Operations were as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 |
| Fixed maturity available-for-sale securities | $193.5 | $163.0 | $385.3 | $328.4 |
| Equity available-for-sale securities | 5.1 | 2.9 | 9.6 | 7.6 |
| Policy loans | 0.1 | 0.2 | 0.3 | 0.5 |
| Invested cash and short-term investments | — | 0.4 | 0.1 | 1.2 |
| Asset-based loans | 11.1 | 7.0 | 18.5 | 17.6 |
| Other investments | 0.5 | 0.6 | 1.3 | 0.9 |
| Gross investment income | 210.3 | 174.1 | 415.1 | 356.2 |
| External investment expense | (3.9) | (2.8) | (7.5) | (6.9) |
| Net investment income | $206.4 | $171.3 | $407.6 | $349.3 |

Net investment gains

“Net investment gains” reported on the accompanying Condensed Consolidated Statements of Operations were as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 |
| Net realized gains before other-than-temporary impairments | $7.9 | $73.0 | $17.7 | $245.5 |
| Gross other-than-temporary impairments | — | (0.4) | — | (0.9) |
| Net realized gains on fixed maturity available-for-sale securities | 7.9 | 72.6 | 17.7 | 244.6 |
| Realized gains on equity securities | 5.4 | 1.9 | 10.8 | 1.9 |
| Net realized gains on securities | 13.3 | 74.5 | 28.5 | 246.5 |
| Realized gains on certain derivative instruments | 50.0 | 29.7 | 110.6 | 45.3 |
| Unrealized (losses) gains on certain derivative instruments | (27.5) | 102.5 | 39.3 | 61.3 |
| Change in fair value of derivatives | 22.5 | 132.2 | 149.9 | 106.6 |
| Realized gains on other invested assets | 5.1 | — | 4.4 | 0.1 |
| Net investment gains | $40.9 | $206.7 | $182.8 | $353.2 |

For the six months ended March 31, 2014, principal repayments, calls, tenders, and proceeds from the sale of fixed maturity available-for-sale securities totaled $2,627.9, gross gains on such sales totaled $22.2 and gross losses totaled $2.5. The proceeds from the sale of fixed maturity available-for sale securities exclude maturities and repayments for the six months ended March 31, 2014.

For the six months ended March 31, 2013, principal repayments, calls, tenders, and proceeds from the sale of fixed maturity available-for-sale securities totaled $5,738.3, gross gains on such sales totaled $249.0 and gross losses totaled $0.6, respectively. The proceeds from the sale of fixed maturity available-for sale securities exclude maturities and repayments for the six months ended March 31, 2013.

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Cash flows from consolidated investing activities by security classification were as follows:

| | Six months ended | |
|---|---|---|
| | March 31, 2014 | March 31, 2013 |
| Proceeds from investments sold, matured or repaid: | | |
| Available-for-sale | $2,675.4 | $5,769.7 |
| Trading (acquired for holding) | — | 91.8 |
| Derivatives and other | 188.2 | 154.8 |
| | $2,863.6 | $6,016.3 |
| Cost of investments acquired: | | |
| Available-for-sale | $(3,815.7) | $(5,839.0) |
| Trading (acquired for holding) | (40.5) | (0.9) |
| Derivatives and other | (176.7) | (76.3) |
| | $(4,032.9) | $(5,916.2) |

Concentrations of Financial Instruments

As of March 31, 2014 and September 30, 2013, the Company’s most significant investment in one industry, excluding U.S. Government securities, was FGL’s investment securities in the banking industry with a fair value of $2,019.4 or 11.0% and $1,892.1, or 11.5%, of the Company's invested assets portfolio, respectively. FGL’s holdings in this industry includes investments in 78 different issuers with the top ten investments accounting for 37.7% of the total holdings in this industry. As of March 31, 2014 and September 30, 2013, the Company had investments in 18 and 19 issuers that exceeded 10% of the Company's stockholders’ equity with a fair value of $1,851.3 and $1,983.7, or 10.1% and 12.0% of the invested assets portfolio, respectively. Additionally, the Company’s largest concentration in any single issuer as of March 31, 2014 and September 30, 2013, had a fair value of $250.0 and $150.7, or 1.4% and 0.9% of the Company's invested assets portfolio, respectively.

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(5) Derivative Financial Instruments

The fair value of outstanding derivative contracts recorded in the accompanying Condensed Consolidated Balance Sheets were as follows:

| Asset Derivatives | Classification | March 31, 2014 | September 30, 2013 |
|---|---|---|---|
| Derivatives designated as hedging instruments: | | | |
| Commodity swap and option agreements | Receivables, net | $0.3 | $0.4 |
| Commodity swap and option agreements | Other assets | 0.1 | — |
| Foreign exchange forward agreements | Receivables, net | 2.0 | 1.7 |
| Total asset derivatives designated as hedging instruments | | 2.4 | 2.1 |
| Derivatives not designated as hedging instruments: | | | |
| Commodity contracts | Receivables, net | — | 3.7 |
| Call options | Derivatives | 271.5 | 221.8 |
| Futures contracts | Derivatives | 1.5 | — |
| Foreign exchange contracts | Receivables, net | 0.1 | 0.1 |
| Foreign exchange embedded derivative included in asset-based loans | Receivables, net | 1.2 | — |
| Total asset derivatives | | $276.7 | $227.7 |

| Liability Derivatives | Classification | March 31, 2014 | September 30, 2013 |
|---|---|---|---|
| Derivatives designated as hedging instruments: | | | |
| Commodity contracts | Accounts payable and other current liabilities | $0.2 | $0.5 |
| Foreign exchange forward agreements | Accounts payable and other current liabilities | 4.8 | 4.6 |
| Foreign exchange contracts | Other liabilities | 0.2 | 0.1 |
| Total liability derivatives designated as hedging instruments | | 5.2 | 5.2 |
| Derivatives not designated as hedging instruments: | | | |
| Commodity contracts | Other liabilities | 4.9 | 1.9 |
| FIA embedded derivative | Contractholder funds | 1,718.7 | 1,544.4 |
| Futures contracts | Other liabilities | — | 1.0 |
| Foreign exchange forward contracts | Accounts payable and other current liabilities | 2.2 | 5.3 |
| Equity conversion feature of preferred stock | Equity conversion feature of preferred stock | 364.8 | 330.8 |
| Total liability derivatives | | $2,095.8 | $1,888.6 |

Changes in AOCI from Derivative Instruments

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of AOCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative, representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness, are recognized in current earnings.

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The following table summarizes the pretax impact of derivative instruments designated as cash flow hedges on the accompanying Condensed Consolidated Statements of Operations, and within AOCI, for the three and six months ended March 31, 2014 and March 31, 2013:

| Derivatives in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) | | Amount of Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | | Amount of Gain ( Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing) | | Classification |
|---|---|---|---|---|---|---|---|
| Three months ended | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 | |
| Commodity contracts | $(1.0) | $(2.2) | $0.3 | $0.2 | $(0.2) | $(0.1) | Consumer products cost of goods sold |
| Foreign exchange contracts | (0.1) | 0.1 | — | 0.2 | — | — | Net consumer products sales |
| Foreign exchange contracts | (0.7) | 3.6 | (0.3) | (0.4) | — | — | Consumer products cost of goods sold |
| Total | $(1.8) | $1.5 | $— | $— | $(0.2) | $(0.1) | |
| Six months ended | | | | | | | |
| Commodity contracts | $0.1 | $(2.4) | $— | $0.1 | $— | $(0.1) | Consumer products cost of goods sold |
| Foreign exchange contracts | 0.1 | 0.6 | 0.1 | 0.3 | — | — | Net consumer products sales |
| Foreign exchange contracts | (1.1) | 3.2 | (1.0) | (0.9) | — | — | Consumer products cost of goods sold |
| Total | $(0.9) | $1.4 | $(0.9) | $(0.5) | $— | $(0.1) | |

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Fair Value Contracts and Other
For derivative instruments that are used to economically hedge the fair value of Spectrum Brands' third party and intercompany foreign currency payments, commodity purchases and interest rate payments, and the equity conversion feature of the Company's redeemable preferred stock, the gain (loss) associated with the derivative contract is recognized in earnings in the period of change. FGL recognizes all derivative instruments as assets or liabilities in the Condensed Consolidated Balance Sheets at fair value, including derivative instruments embedded in Fixed Indexed Annuity ("FIA") contracts, and any changes in the fair value of the derivatives are recognized immediately in the Condensed Consolidated Statements of Operations. Salus recognizes the change in the fair value of foreign exchange derivative embedded in certain of its foreign currency-denominated asset-based loans in the Condensed Consolidated Statements of Operations. During the three and six months ended March 31, 2014 and March 31, 2013, the Company recognized the following gains (losses) on these derivatives:

| Derivatives Not Designated as Hedging Instruments | Gain (Loss) Recognized in Income on Derivatives | | | | Classification |
|---|---|---|---|---|---|
| | Three months ended | | Six months ended | | |
| | March 31, 2014 | March 31, 2013 | March 31, 2014 | March 31, 2013 | |
| Equity conversion feature of preferred stock | $(3.5) | $(39.6) | $(50.7) | $29.3 | (Loss) gain from the change in the fair value of the equity conversion feature of preferred stock |
| Oil and natural gas commodity contracts | (6.8) | (8.8) | (10.2) | (8.8) | Other expense, net |
| Commodity contracts | — | — | (0.1) | — | Consumer products cost of goods sold |
| Foreign exchange contracts | (0.2) | 1.8 | 0.6 | (2.3) | Other expense, net |
| Foreign exchange embedded derivative included in asset-based loans | 1.2 | — | 1.2 | — | Other expense, net |
| Call options | 21.2 | 118.5 | 135.5 | 97.6 | Net investment gains |
| Futures contracts | 1.3 | 13.7 | 14.4 | 9.0 | Net investment gains |
| FIA embedded derivatives | 74.0 | (122.6) | 174.3 | (88.8) | Benefits and other changes in policy reserves |
| Total | $87.2 | $(37.0) | $265.0 | $36.0 | |

Additional Disclosures
Cash Flow Hedges
When it determines appropriate, Spectrum Brands uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the changes in fair value recorded in AOCI and as a derivative hedge asset or liability, as applicable. The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or receivables, respectively, and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated. At March 31, 2014 and September 30, 2013, Spectrum Brands did not have any interest rate swaps outstanding.
Spectrum Brands periodically enters into forward foreign exchange contracts to hedge the risk from forecasted foreign currency denominated third party and intercompany sales or payments. These obligations generally require Spectrum Brands to exchange foreign currencies for U.S. Dollars, Euros, Pounds Sterling, Australian Dollars, Brazilian Reals,

Mexican Pesos, Canadian Dollars or Japanese Yen. These foreign exchange contracts are cash flow hedges of fluctuating foreign exchange related to sales of product or raw material purchases. Until the sale or purchase is recognized, the fair value of the related hedge is recorded in AOCI and as a derivative hedge asset or liability, as applicable. At the time the sale or purchase is recognized, the fair value of the related hedge is reclassified as an adjustment to "Net consumer product sales" or purchase price variance in "Consumer products cost of goods sold." At March 31, 2014, Spectrum Brands had a series of foreign exchange derivative contracts outstanding through September 2014 with a contract value of $223.1. The derivative net loss on these contracts recorded in AOCI at March 31, 2014 was $1.4, net of tax benefit of $0.7 and noncontrolling interest of $1.0. At March 31, 2014, the portion of derivative net loss estimated to be reclassified from AOCI into earnings over the next twelve months is $1.3, net of tax and noncontrolling interest.

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Spectrum Brands is exposed to risk from fluctuating prices for raw materials, specifically zinc and brass used in its manufacturing processes. Spectrum Brands hedges a portion of the risk associated with the purchase of these materials through the use of commodity swaps. The hedge contracts are designated as cash flow hedges with the fair value changes recorded in AOCI and as a hedge asset or liability, as applicable. The unrecognized changes in fair value of the hedge contracts are reclassified from AOCI into earnings when the hedged purchase of raw materials also affects earnings. The swaps effectively fix the floating price on a specified quantity of raw materials through a specified date. At March 31, 2014, Spectrum Brands had a series of zinc swap contracts outstanding through September 2014 for 7 tons with a contract value of $13.7. At March 31, 2014, Spectrum Brands had a series of brass swap contracts outstanding through September 2014 for one ton with a contract value of $5.7. The derivative net gain on these contracts recorded in AOCI at March 31, 2014 was insignificant. At March 31, 2014, the portion of derivative net gain estimated to be reclassified from AOCI into earnings over the next twelve months is insignificant.

Fair Value Contracts

Spectrum Brands

Spectrum Brands periodically enters into forward and swap foreign exchange contracts to economically hedge the risk from third party and intercompany payments resulting from existing obligations. These obligations generally require Spectrum Brands to exchange foreign currencies for U.S. Dollars, Canadian Dollars, Euros or Australian Dollars. These foreign exchange contracts are fair value hedges of a related liability or asset recorded in the accompanying Condensed Consolidated Balance Sheets. The gain or loss on the derivative hedge contracts is recorded in earnings as an offset to the change in value of the related liability or asset at each period end. At March 31, 2014 and September 30, 2013, Spectrum Brands had $120.5 and $108.5, respectively, of notional value for such foreign exchange derivative contracts outstanding.

Spectrum Brands periodically enters into commodity swap contracts to economically hedge the risk from fluctuating prices for raw materials, specifically the pass-through of market prices for silver used in manufacturing purchased watch batteries. Spectrum Brands hedges a portion of the risk associated with these materials through the use of commodity swaps. The swap contracts are designated as economic hedges with the unrealized gain or loss recorded in earnings and as an asset or liability at each period end. The unrealized changes in fair value of the hedge contracts are adjusted through earnings when the realized gains or losses affect earnings upon settlement of the hedges. The swaps effectively fix the floating price on a specified quantity of silver through a specified date. At March 31, 2014, Spectrum Brands had a series of such swap contracts outstanding through April 2014 for 15 troy ounces with a contract value of $0.3. At September 30, 2013, Spectrum Brands had a series of such swap contracts outstanding through April 2014 for 45 troy ounces with a contract value of $1.0.

Oil and natural gas commodity contracts

The EXCO/HGI JV’s primary objective in entering into derivative financial instruments is to manage its exposure to commodity price fluctuations, protect its returns on investments and achieve a more predictable cash flow in connection with its operations. These transactions limit exposure to declines in commodity prices, but also limit the benefits the EXCO/HGI JV would realize if commodity prices increase. When prices for oil and natural gas are volatile, changes in the fair value of the derivative financial instrument contracts underlying the EXCO/HGI JV’s derivative financial instrument management activities may result in significant non-cash income or expense activity. Cash losses or gains only arise from payments made or received on monthly settlements of contracts or if the EXCO/HGI JV terminates a contract prior to its expiration. The EXCO/HGI JV does not designate its derivative financial instruments as hedging instruments for financial reporting purposes and, as a result, the EXCO/HGI JV recognizes the change in the respective instruments’ fair value in earnings.

Settlements in the normal course of maturities of derivative financial instrument contracts result in cash receipts from, or cash disbursements to, the EXCO/HGI JV's derivative contract counterparties. Changes in the fair value of the EXCO/HGI JV's derivative financial instrument contracts, which includes both cash settlements and non-cash changes in fair value, are included in income with a corresponding increase or decrease in the Condensed Consolidated Balance Sheets fair value amounts.

The EXCO/HGI JV's natural gas and oil commodity contract derivative instruments are comprised of swap contracts. Swap contracts allow the EXCO/HGI JV to receive a fixed price and pay a floating market price to the counterparty for the hedged commodity.

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The following table presents our proportionate share of the EXCO/HGI JV’s volumes and fair value of the oil and natural gas derivative financial instruments as of March 31, 2014 (presented on a calendar-year basis) :

| (in millions, except volumes and prices) | Volume Mmmbtus/Mbbls | Weighted average strike price per Mmbtu/Bbl | March 31, 2014 |
|---|---|---|---|
| Natural gas: | | | |
| Swaps: | | | |
| Remainder of 2014 | 12,272.0 | $4.15 | $(3.8) |
| Total natural gas | 12,272.0 | | $(3.8) |
| Oil: | | | |
| Swaps: | | | |
| Remainder of 2014 | 205.0 | $91.87 | $(1.2) |
| Total oil | 205.0 | | $(1.2) |
| Total oil and natural gas derivatives | | | $(5.0) |

At September 30, 2013, the EXCO/HGI JV had outstanding derivative contracts to mitigate price volatility covering 16,018 Billion British Thermal Units ("Mmmbtus") of natural gas and 375 Thousand Barrels ("Mbbls") of oil. At March 31, 2014, the average forward NYMEX oil prices per Bbl for the calendar year 2014 was $98.47, and the average forward NYMEX natural gas prices per Mmbtu for the remainder of 2014 was $4.45.

The EXCO/HGI JV's derivative financial instruments covered approximately 69.0% and 77.0% of production volumes for the three and six months ended March 31, 2014, respectively, and 54.0% or production volumes for the period from inception to March 31, 2013.

Credit Risk

Spectrum Brands is exposed to the risk of default by the counterparties with which Spectrum Brands transacts and generally does not require collateral or other security to support financial instruments subject to credit risk. Spectrum Brands monitors counterparty credit risk on an individual basis by periodically assessing each such counterparty’s credit rating exposure. The maximum loss due to credit risk equals the fair value of the gross asset derivatives that are concentrated with certain domestic and foreign financial institution counterparties. Spectrum Brands considers these exposures when measuring its credit reserve on its derivative assets, which was insignificant at March 31, 2014 and September 30, 2013.

Spectrum Brands’ standard contracts do not contain credit risk related contingent features whereby Spectrum Brands would be required to post additional cash collateral as a result of a credit event. However, Spectrum Brands is typically required to post collateral in the normal course of business to offset its liability positions. At March 31, 2014, Spectrum Brands did not post any cash collateral related to such liability positions. At September 30, 2013, Spectrum Brands had posted cash collateral of $0.5 related to such liability positions. In addition, at March 31, 2014 and September 30, 2013, Spectrum Brands had no posted standby letters of credit related to such liability positions. The cash collateral is included in "Receivables, net" within the accompanying Condensed Consolidated Balance Sheets.

The EXCO/HGI JV places derivative financial instruments with the financial institutions that are lenders under the EXCO/HGI JV Credit Agreement that it believes have high quality credit ratings. To mitigate risk of loss due to default, the EXCO/HGI JV has entered into master netting agreements with its counterparties on its derivative financial instruments that allow it to offset its asset position with its liability position in the event of a default by the counterparty.

FGL is exposed to credit loss in the event of nonperformance by its counterparties on the call options and reflects assumptions regarding this nonperformance risk in the fair value of the call options. The nonperformance risk is the net counterparty exposure based on the fair value of the open contracts less collateral held. FGL maintains a policy of requiring all derivative contracts to be governed by an International Swaps and Derivatives Association ("ISDA") Master Agreement.

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Information regarding FGL’s exposure to credit loss on the call options it holds is presented in the following table:

| | | March 31, 2014 | | | | September 30, 2013 | | | |
|---|---|---|---|---|---|---|---|---|---|
| Counterparty | Credit Rating (Moody's/S&P) (a) | Notional Amount | Fair Value | Collateral | Net Credit Risk | Notional Amount | Fair Value | Collateral | Net Credit Risk |
| Merrill Lynch | A/A | $2,018.2 | $83.0 | $41.1 | $41.9 | $2,037.8 | $70.7 | $— | $70.7 |
| Deutsche Bank | A2/A | 2,265.3 | 81.9 | 45.7 | 36.2 | 1,620.4 | 51.7 | 23.0 | 28.7 |
| Morgan Stanley | A3/A | 2,143.3 | 89.9 | 63.2 | 26.7 | 2,264.1 | 75.7 | 49.0 | 26.7 |
| Royal Bank of Scotland | BBB+/Baa2 | 114.7 | 8.1 | — | 8.1 | 364.3 | 20.3 | — | 20.3 |
| Barclay's Bank | A2/A | 260.4 | 8.6 | — | 8.6 | 120.8 | 3.4 | — | 3.4 |
| | | $6,801.9 | $271.5 | $150.0 | $121.5 | $6,407.4 | $221.8 | $72.0 | $149.8 |

(a) Credit rating as of March 31, 2014.

Collateral Agreements

FGL is required to maintain minimum ratings as a matter of routine practice under its ISDA agreements. Under some ISDA agreements, FGL has agreed to maintain certain financial strength ratings. A downgrade below these levels provides the counterparty under the agreement the right to terminate the open derivative contracts between the parties, at which time any amounts payable by FGL or the counterparty would be dependent on the market value of the underlying derivative contracts. FGL’s current rating allows multiple counterparties the right to terminate ISDA agreements. No ISDA agreements have been terminated, although the counterparties have reserved the right to terminate the ISDA agreements at any time. In certain transactions, FGL and the counterparty have entered into a collateral support agreement requiring either party to post collateral when the net exposures exceed pre-determined thresholds. These thresholds vary by counterparty and credit rating. As of March 31, 2014 and September 30, 2013, counterparties posted $150.0 and $72.0 of collateral, of which $108.9 and $72.0, respectively, is included in "Cash and cash equivalents," with an associated payable for this collateral included in "Other liabilities" in the Condensed Consolidated Balance Sheets. The remaining $41.1 of non-cash collateral was held by a third-party custodian at March 31, 2014. Accordingly, the maximum amount of loss due to credit risk that FGL would incur if parties to the call options failed completely to perform according to the terms of the contracts was $121.5 and $149.8 at March 31, 2014 and September 30, 2013, respectively.

FGL held 1,990 and 1,693 futures contracts at March 31, 2014 and September 30, 2013, respectively. The fair value of the futures contracts represents the cumulative unsettled variation margin (open trade equity, net of cash settlements). FGL provides cash collateral to the counterparties for the initial and variation margin on the futures contracts which is included in "Cash and cash equivalents" in the Condensed Consolidated Balance Sheets. The amount of collateral held by the counterparties for such contracts was $8.6 and $5.9 at March 31, 2014 and September 30, 2013, respectively.

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(6) Fair Value of Financial Instruments

The Company's consolidated assets and liabilities measured at fair value are summarized according to the hierarchy previously described as follows:

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Fair Value |
| Assets (a) | | | | |
| Cash and cash equivalents (b) | $1,319.8 | $— | $— | $1,319.8 |
| Contingent purchase price reduction receivable | — | — | 41.5 | 41.5 |
| Derivatives: | | | | |
| Foreign exchange forward agreements | — | 2.1 | — | 2.1 |
| Commodity swap and option agreements | — | 0.4 | — | 0.4 |
| Foreign exchange embedded derivative included in asset-based loans | — | 1.2 | — | 1.2 |
| Call options and futures contracts | — | 273.0 | — | 273.0 |
| Fixed maturity securities, available-for-sale: | | | | |
| Asset-backed securities | — | 1,576.5 | 10.7 | 1,587.2 |
| Commercial mortgage-backed securities | — | 486.6 | — | 486.6 |
| Corporates | — | 9,865.1 | 657.0 | 10,522.1 |
| Hybrids | — | 451.6 | — | 451.6 |
| Municipals | — | 1,204.4 | 35.6 | 1,240.0 |
| Agency residential mortgage-backed securities | — | 99.4 | — | 99.4 |
| Non-agency residential mortgage-backed securities | — | 1,847.1 | — | 1,847.1 |
| U.S. Government | 181.5 | 211.1 | — | 392.6 |
| Equity securities: | | | | |
| Available-for-sale | — | 353.1 | — | 353.1 |
| Trading | 121.0 | — | 10.8 | 131.8 |
| Other invested assets | — | 2.1 | — | 2.1 |
| Funds withheld receivable | 19.0 | 135.5 | — | 154.5 |
| Total financial assets | $1,641.3 | $16,509.2 | $755.6 | $18,906.1 |
| | | | | |
| Liabilities (a) | | | | |
| Derivatives: | | | | |
| FIA embedded derivatives, included in contractholder funds | $— | $— | $1,718.7 | $1,718.7 |
| Front Street future policyholder benefit liability | — | — | 151.0 | 151.0 |
| Foreign exchange forward agreements | — | 7.2 | — | 7.2 |
| Commodity swap and option agreements | — | 5.1 | — | 5.1 |
| Equity conversion feature of preferred stock | — | — | 364.8 | 364.8 |
| Total financial liabilities | $— | $12.3 | $2,234.5 | $2,246.8 |

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| | September 30, 2013 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Fair Value |
| Assets (a) | | | | |
| Cash and cash equivalents (b) | $1,899.7 | $— | $— | $1,899.7 |
| Contingent purchase price reduction receivable | — | — | 41.0 | 41.0 |
| Derivatives: | | | | |
| Foreign exchange forward agreements | — | 1.8 | — | 1.8 |
| Commodity swap and option agreements | — | 4.1 | — | 4.1 |
| Call options and futures contracts | — | 221.8 | — | 221.8 |
| Fixed maturity securities, available-for-sale: | | | | |
| Asset-backed securities | — | 1,518.1 | 5.0 | 1,523.1 |
| Commercial mortgage-backed securities | — | 448.7 | 5.7 | 454.4 |
| Corporates | — | 8,957.2 | 461.1 | 9,418.3 |
| Hybrids | — | 428.8 | | 428.8 |
| Municipals | — | 1,007.0 | — | 1,007.0 |
| Agency residential mortgage-backed securities | — | 98.6 | — | 98.6 |
| Non-agency residential mortgage-backed securities | — | 1,368.0 | — | 1,368.0 |
| U.S. Government | 790.9 | 210.9 | — | 1,001.8 |
| Equity securities: | | | | |
| Available-for-sale | — | 271.0 | — | 271.0 |
| Trading | 70.8 | — | 10.7 | 81.5 |
| Total financial assets | $2,761.4 | $14,536.0 | $523.5 | $17,820.9 |
| | | | | |
| Liabilities (a) | | | | |
| Derivatives: | | | | |
| FIA embedded derivatives, included in contractholder funds | $— | $— | $1,544.4 | $1,544.4 |
| Futures contracts | — | 1.0 | — | 1.0 |
| Foreign exchange forward agreements | — | 10.0 | — | 10.0 |
| Commodity swap and option agreements | — | 2.4 | — | 2.4 |
| Equity conversion feature of preferred stock | — | — | 330.8 | 330.8 |
| Total financial liabilities | $— | $13.4 | $1,875.2 | $1,888.6 |

(a) The carrying amounts of trade receivables, accounts payable, accrued investment income and portions of other insurance liabilities approximate fair value due to their short duration and, accordingly, they are not presented in the tables above.

(b) The fair values of cash equivalents and equity investments set forth above are generally based on quoted or observed market prices.

Valuation Methodologies

Fixed Maturity Securities & Equity Securities

FGL measures the fair value of its securities based on assumptions used by market participants in pricing the security. The most appropriate valuation methodology is selected based on the specific characteristics of the fixed maturity or equity security, and FGL will then consistently apply the valuation methodology to measure the security’s fair value. FGL’s fair value measurement is based on a market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable securities. Sources of inputs to the market approach include a third-party pricing service, independent broker quotations or pricing matrices. FGL uses observable and unobservable inputs in its valuation methodologies. Observable inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. In addition, market indicators and industry and economic events are monitored and further market data will be acquired when certain thresholds are met. For certain security types, additional inputs may be used, or some of

the inputs described above may not be applicable. For broker-quoted only securities, quotes from market makers or broker-dealers are obtained from sources recognized to be market participants.

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Management believes the broker quotes are prices at which trades could be executed based on historical trades executed at broker-quoted or slightly higher prices.
FGL did not adjust prices received from third parties as of March 31, 2014 and September 30, 2013. However, FGL does analyze the third-party valuation methodologies and its related inputs to perform assessments to determine the appropriate level within the fair value hierarchy.
Front Street Re (Delaware) Ltd. and its subsidiaries ("Front Street") elected to apply the Fair Value Option to account for its Funds Withheld Receivables and Future Policy Holder Benefits Reserve related to its assumed reinsurance. Front Street measures fair value of the Funds Withheld Receivables based on the fair values of the securities in the underlying funds withheld portfolio held in trust by the cedant. Front Street uses a discounted cash flows approach to measure the fair value of the Future Policy Holder Benefits Reserve. The cash flows associated with future policy benefits are generated using best estimate assumptions (plus a risk margin, where applicable) and are consistent with market prices, where available. Risk margins are typically applied to non-observable, non-hedgeable market inputs such as long term volatility, mortality, morbidity, lapse, etc.
Derivative Financial Instruments
The fair value of derivative assets and liabilities is based upon valuation pricing models, which represents what FGL would expect to receive or pay at the balance sheet date if it canceled the options, entered into offsetting positions, or exercised the options. The fair value of futures contracts represents the cumulative unsettled variation margin (open trade equity net of cash settlements). Fair values for these instruments are determined externally by an independent actuarial firm using market-observable inputs, including interest rates, yield curve volatilities, and other factors. Credit risk related to the counterparty is considered when estimating the fair values of these derivatives. The fair value of the embedded derivatives in FGL’s FIA products are derived using market indices, pricing assumptions and historical data.
The EXCO/HGI JV evaluates derivative assets and liabilities in accordance with master netting agreements with the derivative counterparties, but reports them on a gross basis on the Condensed Consolidated Balance Sheets. Net derivative asset values are determined primarily by quoted futures prices and utilization of the counterparties’ credit-adjusted risk-free rate curves and net derivative liabilities are determined by utilization of a credit-adjusted risk-free rate curve. The credit-adjusted risk-free rates of the EXCO/HGI JV’s counterparties are based on an independent market-quoted credit default swap rate curve for the counterparties’ debt plus the London Interbank Offered Rate (“LIBOR”) curve as of the end of the reporting period. The EXCO/HGI JV’s credit-adjusted risk-free rate is based on its cost of debt plus the LIBOR curve as of the end of the reporting period.
The EXCO/HGI JV’s oil derivatives are swap contracts for notional Bbls of oil at fixed NYMEX West Texas Intermediate (“WTI”) oil prices. The asset and liability values attributable to oil derivatives as of the end of the reporting period are based on (i) the contracted notional volumes, (ii) independent active NYMEX futures price quotes for WTI oil, and (iii) the applicable estimated credit-adjusted risk-free rate curve, as described above.
The EXCO/HGI JV’s natural gas derivatives are swap contracts for notional Mmbtus of natural gas at posted price indexes, including NYMEX Henry Hub (“HH”) swap contracts. The asset and liability values attributable to natural gas derivatives as of the end of the reporting period are based on (i) the contracted notional volumes, (ii) independent active NYMEX futures price quotes for HH for natural gas swaps, and (iii) the applicable credit-adjusted risk-free rate curve, as described above.

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Quantitative information regarding significant unobservable inputs used for recurring Level 3 fair value measurements of financial instruments carried at fair value as of March 31, 2014 and September 30, 2013 are as follows:

| Assets | Valuation Technique | Unobservable Input(s) | Fair Value at March 31, 2014 | September 30, 2013 | Range (Weighted average) March 31, 2014 | September 30, 2013 |
|---|---|---|---|---|---|---|
| Contingent purchase price reduction receivable | Discounted cash flow | Probability of collection | $41.5 | $41.0 | 88% - 96% (92%) | 88% - 96% (92%) |
| | | Expected term | | | 6 months | 9 months |
| | | Discount rate | | | 1% | 1% |
| | | Credit insurance risk premium | | | 12% | 11% |
| Asset-backed securities | Broker-quoted | Offered quotes | 10.7 | 5.0 | 96% - 101% (99%) | 100% - 107% (101%) |
| Commercial mortgage-backed securities | Broker-quoted | Offered quotes | — | 5.7 | —% | 96% |
| Corporates | Broker-quoted | Quoted prices | 591.2 | 404.5 | 0% - 120% (94%) | 0% - 113% (90%) |
| Corporates | Market Pricing | Offered quotes | 65.8 | 56.6 | 94% - 138% (99%) | 90% - 131% (97%) |
| Municipal | Broker-quoted | Offered quotes | 35.6 | — | 102% | —% |
| Equity | Market Pricing | Revenue multiple | 10.8 | | 0.3x - 0.4x | |
| | | Probably of transaction closing | | | 90% | |
| | Option Pricing | Risk-adjusted rate | | 10.7 | | 25.0% |
| | | Risk-free discount factor | | | | 0.999 |
| | | Risk-adjusted discount factor | | | | 0.995 |
| | | Upward movement factor (Mu) | | | | 1.1 |
| | | Downward movement factor (Md) | | | | 0.9 |
| | | Probability of upward movement (Pu) | | | | 48.6% |
| | | Probability of downward movement (Pd) | | | | 51.4% |
| Total | | | $755.6 | $523.5 | | |
| Liabilities | | | | | | |
| | | | $1,718.7 | $1,544.4 | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| FIA embedded derivatives, included in contractholder funds | Discounted cash flow | Market value of option | | | 0% - 44% (4%) | 0% - 38% (4%) |
| | | SWAP rates | | | 2% - 3% (2%) | 2% - 3% (2%) |
| | | Mortality multiplier | | | 80% | 80% |
| | | Surrender rates | | | 0.50% - 75% (7%) | 0.50% - 75% (7%) |
| | | Non-performance spread | | | 0.25% | 0.25% - 0.25% (0.25%) |
| Front Street future policyholder benefit liability | Discounted cash flow | Non-performance risk spread | 151.0 | — | 0.6% - 1.5% | —% |
| | | Risk margin to reflect uncertainty | | | 0.25-0.50% | —% |

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| Assets | Valuation Technique | Unobservable Input(s) | Fair Value at March 31, 2014 | September 30, 2013 | Range (Weighted average) March 31, 2014 | September 30, 2013 |
|---|---|---|---|---|---|---|
| Equity conversion feature of preferred stock | Monte Carlo simulation / Option model | Annualized volatility of equity | 364.8 | 330.8 | 41% | 42% |
| | | Discount yield | | | 10.5% | 11.0% |
| | | Non-cash accretion rate | | | 0% | 0% |
| | | Calibration adjustment | | | 0% | 0% - 1.0% (0.3%) |
| Total | | | $2,234.5 | $1,875.2 | | |

The significant unobservable inputs used in the fair value measurement of the contingent purchase price reduction receivable are the probability of collection depending on the outcomes of litigation and regulatory action, the expected term until payment, discount rate and the credit insurance risk premium. Generally, an increase in the assumptions for the expected term, discount rate and credit insurance risk premium would decrease the fair value of the contingent purchase price receivable. An increase in the probability of collection would increase the fair value of the contingent purchase price reduction receivable.

The significant unobservable inputs used in the fair value measurement of the equity investment are revenue multiple and probability of the transaction closing. Significant increases (decreases) in the revenue multiple and the probability of transaction closing would result in a higher (lower) fair value measurement. Generally, a change in any one unobservable input would not result in a change in any other unobservable input.

The significant unobservable inputs used in the fair value measurement of FIA embedded derivatives included in contractholder funds are market value of option, interest swap rates, mortality multiplier, surrender rates, and non-performance spread. The mortality multiplier at March 31, 2014 and September 30, 2013, is based on the 2000 and 1983 annuity tables, respectively and assumes the contractholder population is 50% female and 50% male. Significant increases (decreases) in the market value of option in isolation would result in a higher (lower) fair value measurement. Significant increases (decreases) in interest swap rates, mortality multiplier, surrender rates, or non-performance spread in isolation would result in a lower (higher) fair value measurement. Generally, a change in any one unobservable input would not result in a change in any other unobservable input.

The significant unobservable inputs used in the fair value measurement of the equity conversion feature of the Company’s Preferred Stock are annualized volatility of the market value of the Company’s listed shares of common stock, the discount yield as of the valuation date, a calibration factor to the issued date fair value of the Preferred Stock and the forecasted non-cash accretion rate. Significant increases (decreases) in any of the inputs in isolation would result in a significantly higher (lower) fair value measurement. Generally, an increase in the assumptions used for the volatility and discount yield assumptions would increase the fair value of the equity conversion feature of Preferred Stock, and maintaining a higher forecasted non-cash accretion rate, would also increase the fair value of the equity conversion feature of Preferred Stock. A decrease in the calibration factor would result in an increase in the fair value of the equity conversion feature of Preferred Stock.

The significant unobservable inputs used in the fair value measurement of the Front Street future policyholder benefit liability are non-performance risk spread and risk spread to reflect uncertainty. Significant increases (decreases) in non-performance risk spread and risk margin to reflect uncertainty would result in a lower (higher) fair value measurement.

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The following tables summarize changes to the Company’s financial instruments carried at fair value and classified within Level 3 of the fair value hierarchy for the three and six months ended March 31, 2014 and March 31, 2013. This summary excludes any impact of amortization of VOBA and DAC. The gains and losses below may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.

| | Three months ended March 31, 2014 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Total Gains (Losses) | | | | | | |
| | Balance at Beginning of Period | Included in Earnings | Included in AOCI | Purchases | Sales | Settlements | Net transfer In (Out) of Level 3 (a) | Balance at End of Period |
| Assets | | | | | | | | |
| Contingent purchase price reduction receivable | $41.5 | $ — | $— | $— | $— | $— | $— | $41.5 |
| Fixed maturity securities available-for-sale: | | | | | | | | |
| Asset-backed securities | 9.8 | — | (0.1 ) | — | — | — | 1.0 | 10.7 |
| Commercial mortgage-backed securities | 6.0 | — | — | — | — | — | (6.0 ) | — |
| Corporates | 607.1 | — | 10.1 | 41.7 | — | (1.9 ) | — | 657.0 |
| Municipals | 34.3 | — | 1.3 | — | — | — | — | 35.6 |
| Equity securities - trading | 10.8 | — | — | — | — | — | — | 10.8 |
| Total assets at fair value | $709.5 | $ — | $11.3 | $41.7 | $— | $(1.9 ) | $(5.0 ) | $755.6 |

| | | Total (Gains) Losses | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Balance at Beginning of Period | Included in Earnings | Included in AOCI | Purchases | Sales | Settlements | Net transfer In (Out) of Level 3 | Balance at End of Period | |
| Liabilities | | | | | | | | | |
| FIA embedded derivatives, included in contractholder funds | $1,644.7 | $ 74.0 | $— | $— | $— | $— | $— | $1,718.7 | |
| Front Street future policyholder benefit liability | 149.9 | 3.7 | — | — | — | (2.6 ) | — | 151.0 | 1.6 |
| Share repurchases | (2.3 ) | (3.2 ) | (5.5 ) | (5.5 ) | | | | | |
| Ending balance | 303.6 | 310.6 | 303.6 | 310.6 | | | | | |

Diluted Earnings (Loss) per Share from Discontinued Operations Attributable to Raytheon Company Common Stockholders

Diluted earnings per share from discontinued operations attributable to Raytheon Company common stockholders was less than $0.01 and $0.17 for the second quarters of 2015 and 2014, respectively and less than $0.01 and $0.19 for the first six months of 2015 and 2014, respectively. The decreases of $0.16 in the second quarter of 2015 and $0.18 in the first six months of 2015, respectively, compared to the second quarter and first six months of 2014 was primarily due to the resolution of a dispute and related litigation with the U.S. Government in the second quarter of 2014 describe above in Income (loss) from Discontinued Operations.

Diluted EPS Attributable to Raytheon Company Common Stockholders

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In millions, except per share amounts) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| Net income attributable to Raytheon Company | $505 | $551 | $1,056 | $1,147 |
| Diluted weighted-average shares outstanding | 305.7 | 313.5 | 307.2 | 314.6 |
| Diluted EPS attributable to Raytheon Company | $1.65 | $1.76 | $3.44 | $3.65 |

The decrease in diluted EPS attributable to Raytheon Company common stockholders of $0.11 in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to the $0.16 decrease in diluted EPS from discontinued operations described above, partially offset by the $0.06 increase in diluted EPS from continuing operations attributable to Raytheon Company common stockholders described above.

The decrease in diluted EPS attributable to Raytheon Company common stockholders of $0.21 in the first six months of 2015 compared to the first six months of 2014 was primarily due to the $0.18 decrease in diluted EPS from discontinued operations described above and the $0.02 decrease in diluted EPS from continuing operations attributable to Raytheon Company common stockholders described above.

SEGMENT RESULTS

On May 29, 2015, we completed a series of transactions with Vista Equity Partners by which we acquired Websense from Vista Equity Partners and combined it with RCP, formerly part of our IIS segment, to create Raytheon|Websense, a new cybersecurity joint venture company (with Vista Equity Partners). In connection with these transactions, we reorganized our operating and reporting structure with Raytheon|Websense as our fifth reporting segment. We report our results in the following segments: Integrated Defense Systems (IDS); Intelligence, Information and Services (IIS); Missile Systems (MS); Space and Airborne Systems (SAS); and Raytheon|Websense.

The amounts, discussion and presentation of our business segments, including eliminations for intersegment activity, as set forth in this Form 10-Q, reflect our new structure. The Raytheon|Websense results reflect RCP results for all periods and Websense results after the acquisition date of May 29, 2015. None of the changes impact our previously reported consolidated balance sheets, statements of operations, or statements of cash flows. See "Note 13: Business Segment Reporting" for additional information including revised historical segment results under our new structure.

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Revised segment financial results were as follows:

| Total Net Sales (in millions) | Three Months Ended Mar 29, 2015 | Dec 31, 2014 | Sep 28, 2014 | Jun 29, 2014 | Mar 30, 2014 | Twelve Months Ended Dec 31, 2014 | Dec 31, 2013 |
|---|---|---|---|---|---|---|---|
| Integrated Defense Systems | $1,433 | $1,627 | $1,428 | $1,549 | $1,481 | $6,085 | $6,489 |
| Intelligence, Information and Services | 1,372 | 1,517 | 1,450 | 1,493 | 1,429 | 5,889 | 5,970 |
| Missile Systems | 1,473 | 1,719 | 1,477 | 1,539 | 1,574 | 6,309 | 6,599 |
| Space and Airborne Systems | 1,358 | 1,660 | 1,509 | 1,505 | 1,398 | 6,072 | 6,371 |
| Raytheon\|Websense[1] | 24 | 23 | 30 | 28 | 23 | 104 | 87 |
| Eliminations | (372) | (403) | (420) | (413) | (397) | (1,633) | (1,810) |
| Total business segment sales | 5,288 | 6,143 | 5,474 | 5,701 | 5,508 | 22,826 | 23,706 |
| Raytheon\|Websense Acquisition Accounting Adjustments[2] | — | — | — | — | — | — | — |
| Total | $5,288 | $6,143 | $5,474 | $5,701 | $5,508 | $22,826 | $23,706 |

(1) Excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value related to Raytheon|Websense, including historical RCP acquisitions. These amounts are included in Raytheon|Websense Acquisition Accounting Adjustments.

(2) Adjustments were less than $(1) million for the year ended 2013, fiscal quarters and year ended 2014 and the first quarter of 2015.

| Operating Income (in millions) | Three Months Ended Mar 29, 2015 | Dec 31, 2014 | Sep 28, 2014 | Jun 29, 2014 | Mar 30, 2014 | Twelve Months Ended Dec 31, 2014 | Dec 31, 2013 |
|---|---|---|---|---|---|---|---|
| Integrated Defense Systems | $195 | $299 | $230 | $219 | $226 | $974 | $1,115 |
| Intelligence, Information and Services | 284 | 131 | 118 | 123 | 123 | 495 | 507 |
| Missile Systems | 207 | 212 | 190 | 190 | 208 | 800 | 830 |
| Space and Airborne Systems | 173 | 217 | 237 | 202 | 190 | 846 | 920 |
| Raytheon\|Websense[1] | — | (1) | 5 | 3 | 4 | 11 | 13 |
| Eliminations | (37) | (41) | (43) | (42) | (40) | (166) | (170) |
| Total business segment operating income | 822 | 817 | 737 | 695 | 711 | 2,960 | 3,215 |
| Raytheon\|Websense Acquisition Accounting Adjustments | (2) | (2) | (1) | (1) | (2) | (6) | (9) |
| FAS/CAS Adjustment | 49 | 70 | 42 | 87 | 87 | 286 | (249) |
| Corporate | (29) | (16) | (15) | (22) | (8) | (61) | (19) |
| Total | $840 | $869 | $763 | $759 | $788 | $3,179 | $2,938 |

(1) Excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value and the amortization of acquired intangible assets related to Raytheon|Websense, including historical RCP acquisitions. These amounts are included in Raytheon|Websense Acquisition Accounting Adjustments.

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| | Three Months Ended | | | | | Twelve Months Ended | |
|---|---|---|---|---|---|---|---|
| Bookings (in millions) | Mar 29, 2015 | Dec 31, 2014 | Sep 28, 2014 | Jun 29, 2014 | Mar 30, 2014 | Dec 31, 2014 | Dec 31, 2013 |
| Integrated Defense Systems | $1,483 | $3,352 | $1,764 | $657 | $1,180 | $6,953 | $5,869 |
| Intelligence, Information and Services | 933 | 993 | 1,185 | 2,030 | 997 | 5,205 | 4,964 |
| Missile Systems | 1,405 | 1,388 | 1,430 | 2,482 | 1,083 | 6,383 | 5,221 |
| Space and Airborne Systems | 631 | 1,356 | 1,454 | 1,581 | 1,019 | 5,410 | 5,996 |
| Raytheon\|Websense | 19 | 20 | 45 | 22 | 14 | 101 | 82 |
| Total | $4,471 | $7,109 | $5,878 | $6,772 | $4,293 | $24,052 | $22,132 |

| Funded Backlog (in millions) | Dec 31, 2014 | Dec 31, 2013 |
|---|---|---|
| Integrated Defense Systems | $8,939 | $9,397 |
| Intelligence, Information and Services | 2,854 | 2,550 |
| Missile Systems | 6,992 | 6,859 |
| Space and Airborne Systems | 4,259 | 4,166 |
| Raytheon\|Websense[(1)] | 48 | 42 |
| Total | $23,092 | $23,014 |

(1) Raytheon|Websense funded backlog excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value.

| Total Backlog (in millions) | Dec 31, 2014 | Dec 31, 2013 |
|---|---|---|
| Integrated Defense Systems | $11,495 | $10,916 |
| Intelligence, Information and Services | 5,825 | 5,811 |
| Missile Systems | 9,269 | 9,162 |
| Space and Airborne Systems | 6,930 | 7,751 |
| Raytheon\|Websense[(1)] | 52 | 45 |
| Total | $33,571 | $33,685 |

(1) Raytheon|Websense total backlog excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value.

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

Given the nature of our business, bookings, total net sales, and operating income (and the related operating margin percentage), which we disclose and discuss at the segment level, are most relevant to an understanding of management's view of our segment performance, and often these measures have significant interrelated effects, as described below. In addition, we disclose and discuss backlog, which represents future sales that we expect to recognize over the remaining contract period, which is generally several years. We also disclose total operating expenses and the components of total operating expenses within our segment disclosures.

Bookings—We disclose the amount of bookings and notable contract awards for each segment. Bookings generally represent the dollar value of new contracts awarded to us during the reporting period and include firm orders for which funding has not been appropriated. We believe bookings are an important measure of future performance and are an indicator of potential future changes in total net sales, because we cannot record revenues under a new contract

without first having a booking in the current or a preceding period.

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

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| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| Bookings (in millions) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| Integrated Defense Systems | $2,801 | $657 | $4,284 | $1,837 |
| Intelligence, Information and Services | 1,274 | 2,030 | 2,207 | 3,027 |
| Missile Systems | 2,216 | 2,482 | 3,621 | 3,565 |
| Space and Airborne Systems | 1,240 | 1,581 | 1,871 | 2,600 |
| Raytheon\|Websense | 49 | 22 | 68 | 36 |
| Total | $7,580 | $6,772 | $12,051 | $11,065 |

Included in bookings were international bookings of $3,494 million and $1,658 million in the second quarters of 2015 and 2014, respectively, and $4,999 million and $3,341 million in the first six months of 2015 and 2014, respectively, which included foreign military bookings through the U.S. Government. International bookings amounted to 46% and 24% of total bookings in the second quarters of 2015 and 2014, respectively, and 41% and 30% of total bookings in the first six months of 2015 and 2014, respectively.

We record bookings for not-to-exceed contract awards (e.g. undefinitized contract awards, binding letter agreements) based on reasonable estimates of expected contract definitization, which will generally not be less than 75% of the award. We subsequently adjust bookings to reflect the actual amounts definitized, or, when prior to definitization, when facts and circumstances indicate that our previously estimated amounts are no longer reasonable. The timing of awards that may cover multiple fiscal years influences the size of bookings in each year. Bookings exclude unexercised contract options and potential orders under ordering-type contracts (e.g., indefinite delivery/indefinite quantity (IDIQ) type contracts), and are reduced for contract cancellations and terminations of bookings recognized in the current year. We reflect contract cancellations and terminations from prior year bookings, as well as the impact of changes in foreign exchange rates, directly as an adjustment to backlog in the period in which the cancellation or termination occurs and the impact is determinable.

Backlog—We disclose period-ending backlog for each segment. Backlog represents the dollar value of firm orders for which work has not been performed. Backlog generally increases with bookings and generally converts into sales as we incur costs under the related contractual commitments. Therefore, we discuss changes in backlog, including any significant cancellations, for each of our segments, as we believe such discussion provides an understanding of the awarded but not executed portions of our contracts.

| | Funded Backlog | | Total Backlog | |
|---|---|---|---|---|
| Backlog (in millions) | Jun 28, 2015 | Dec 31, 2014 | Jun 28, 2015 | Dec 31, 2014 |
| Integrated Defense Systems | $10,398 | $8,939 | $12,544 | $11,495 |
| Intelligence, Information and Services | 2,739 | 2,854 | 5,423 | 5,825 |
| Missile Systems | 7,316 | 6,992 | 9,880 | 9,269 |
| Space and Airborne Systems | 4,456 | 4,259 | 6,221 | 6,930 |
| Raytheon\|Websense[(1)] | 423 | 48 | 426 | 52 |
| Total | $25,332 | $23,092 | $34,494 | $33,571 |

(1) Raytheon|Websense total backlog excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value.

Total backlog includes both funded backlog (firm orders for which funding is authorized, appropriated and contractually obligated by the customer for which work has not been performed) and unfunded backlog (firm orders for which funding has not been appropriated and/or contractually obligated by the customer for which work has not been performed). Revenue is generally not recognized on backlog until funded. Backlog excludes unexercised contract options and potential orders under ordering-type contracts (e.g., IDIQ). Both funded and unfunded backlog are

affected by changes in foreign exchange rates.

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



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result, in any reporting period, the changes in volume on numerous contracts are likely to be due to normal fluctuations in our engineering, production or service activities.

Total net sales by segment were as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| Total Net Sales (in millions) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| Integrated Defense Systems | $1,698 | $1,549 | $3,131 | $3,030 |
| Intelligence, Information and Services | 1,496 | 1,493 | 2,868 | 2,922 |
| Missile Systems | 1,559 | 1,539 | 3,032 | 3,113 |
| Space and Airborne Systems | 1,416 | 1,505 | 2,774 | 2,903 |
| Raytheon\|Websense[(1)] | 57 | 28 | 81 | 51 |
| Eliminations | (368) | (413) | (740) | (810) |
| Total business segment sales | 5,858 | 5,701 | 11,146 | 11,209 |
| Raytheon\|Websense Acquisition Accounting Adjustments[(2)] | (10) | — | (10) | — |
| Total | $5,848 | $5,701 | $11,136 | $11,209 |

(1) Excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value related to Raytheon|Websense, including historical RCP acquisitions. These amounts are included in Raytheon|Websense Acquisition Accounting Adjustments.
(2) Adjustments were less than $(1) million for the second quarter and first six months of 2014.

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

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

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

Changes in net EAC adjustments typically relate to the current period impact of revisions to total estimated revenues and costs at completion. These changes reflect improved or deteriorated operating performance or award fee rates. We have a Company-wide standard and disciplined quarterly EAC process in which management reviews the progress and performance of our contracts. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities, and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (e.g., the number and type of milestone events), technical requirements (e.g., a newly-developed product versus a mature product), and other contract

requirements. Management must make assumptions and estimates regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (e.g., to estimate increases in wages and prices for materials and related support cost allocations), performance by our subcontractors, the availability and timing of funding from our customer, and overhead cost rates, among other variables. These estimates also include the estimated cost of satisfying our industrial cooperation agreements, sometimes referred to as offset obligations, required under certain contracts. Based on this analysis, any quarterly adjustments to net sales, cost of sales, and the related impact to operating income are recognized as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating income during the performance of individual contracts, if we determine we will be successful in mitigating risks surrounding the technical, schedule, and cost aspects of those contracts or in realizing related opportunities. Likewise, these adjustments may result in a decrease in operating income if we determine we will not be successful in mitigating these risks or in realizing

related opportunities. Changes in estimates of net sales, cost of sales, and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a contract's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our contracts. Given that we have over 15,000 individual contracts and the types and complexity of the assumptions and estimates we must make on an on-going basis, as discussed above, we have both favorable and unfavorable EAC adjustments. We had the following aggregate EAC adjustments for the periods presented:

| EAC Adjustments (in millions) | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| Gross favorable | $150 | $269 | $331 | $520 |
| Gross unfavorable | (110) | (181) | (170) | (310) |
| Total net EAC adjustments | $40 | $88 | $161 | $210 |

Included in net EAC adjustments in the second quarter and first six months of 2015 was a $33 million unfavorable adjustment to eliminate all remaining estimated incentive fees related to the Air Warfare Destroyer (AWD) program at IDS due to the shipbuilder extending the planned schedule and related increase in costs to complete its portion of the program. Also included in net EAC adjustments in the first six months of 2015 was a $25 million favorable resolution of a contractual issue at MS. Included in net EAC adjustments in the second quarter and first six months of 2014 was a $38 million unfavorable adjustment from a decrease in estimated incentive fees on the AWD program at IDS due to an increase in expected costs by the shipbuilder to complete its portion of the program.

The decrease in net EAC adjustments in the second quarter and first six months of 2015 compared to the second quarter and first six months of 2014 was primarily due to the decrease in net EAC adjustment at MS and SAS. Refer to the individual segment results for further information.

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

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

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Operating income by segment was as follows:

| Operating Income (in millions) | Three Months Ended Jun 28, 2015 | Three Months Ended Jun 29, 2014 | Six Months Ended Jun 28, 2015 | Six Months Ended Jun 29, 2014 |
|---|---|---|---|---|
| Integrated Defense Systems | $215 | $219 | $410 | $445 |
| Intelligence, Information and Services | 108 | 123 | 392 | 246 |
| Missile Systems | 183 | 190 | 390 | 398 |
| Space and Airborne Systems | 186 | 202 | 359 | 392 |
| Raytheon\|Websense[1] | (1) | 3 | (1) | 7 |
| Eliminations | (39) | (42) | (76) | (82) |
| Total business segment operating income | 652 | 695 | 1,474 | 1,406 |
| Raytheon\|Websense Acquisition Accounting Adjustments | (18) | (1) | (20) | (3) |
| FAS/CAS Adjustment | 49 | 87 | 98 | 174 |
| Corporate | (35) | (22) | (64) | (30) |
| Total | $648 | $759 | $1,488 | $1,547 |

(1) Excludes the unfavorable impact of the acquisition accounting adjustments to record acquired deferred revenue at fair value of $(10) million and less than $(1) million for the second quarters of 2015 and 2014, respectively, and $(10) million and less than $(1) million for the first six months of 2015 and 2014, respectively and amortization of acquired intangible assets of $(8) million and $(1) million for the second quarters of 2015 and 2014, respectively, and $(10) million and $(3) million for the first six months of 2015 and 2014, respectively related to Raytheon|Websense, including historical RCP acquisitions. These amounts are included in Raytheon|Websense Acquisition Accounting Adjustments.

Integrated Defense Systems

| (In millions, except percentages) | Three Months Ended Jun 28, 2015 | Three Months Ended Jun 29, 2014 | % Change | Six Months Ended Jun 28, 2015 | Six Months Ended Jun 29, 2014 | % Change |
|---|---|---|---|---|---|---|
| Total net sales | $1,698 | $1,549 | 9.6 % | $3,131 | $3,030 | 3.3 % |
| Total operating expenses | | | | | | |
| Cost of sales—labor | 526 | 543 | (3.1)% | 1,018 | 1,091 | (6.7)% |
| Cost of sales—materials and subcontractors | 621 | 574 | 8.2 % | 1,157 | 1,040 | 11.3 % |
| Other cost of sales and other operating expenses | 336 | 213 | 57.7 % | 546 | 454 | 20.3 % |
| Total operating expenses | 1,483 | 1,330 | 11.5 % | 2,721 | 2,585 | 5.3 % |
| Operating income | $215 | $219 | (1.8)% | $410 | $445 | (7.9)% |
| Operating margin | 12.7 % | 14.1 % | | 13.1 % | 14.7 % | |

| Change in Operating Income (in millions) | Three Months Ended Jun 28, 2015 Versus Three Months Ended Jun 29, 2014 | Six Months Ended Jun 28, 2015 Versus Six Months Ended Jun 29, 2014 |
|---|---|---|
| Volume | $26 | $23 |
| Net change in EAC adjustments | (5) | 9 |
| Mix and other performance | (25) | (67) |
| Total change in operating income | $(4) | $(35) |

| (In millions, except percentages) | Three Months Ended Jun 28, 2015 | Three Months Ended Jun 29, 2014 | % Change | Six Months Ended Jun 28, 2015 | Six Months Ended Jun 29, 2014 | % Change |
|---|---|---|---|---|---|---|
| Bookings | $2,801 | $657 | 326.3 % | $4,284 | $1,837 | 133.2 % |

Total Net Sales—The increase in total net sales of $149 million in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to $212 million of higher net sales on an international Patriot program awarded in the second quarter of 2015, driven by the recognition of previously deferred precontract costs and program activity in the quarter, and $90 million of higher net sales from an international Patriot program awarded in the fourth quarter of 2014, partially offset by lower net sales of $147 million from the scheduled completion of certain production phases on various Patriot programs for international customers.

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The increase in total net sales of $101 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to higher net sales of $212 million from the international Patriot program awarded in the second quarter of 2015, $161 million of higher net sales from the international Patriot program awarded in the fourth quarter of 2014, and $90 million of higher net sales from an international air and missile defense system program awarded in the fourth quarter of 2013. The higher net sales were partially offset by lower net sales of $276 million from the scheduled completion of certain production phases on various Patriot programs for international customers and $107 million from the scheduled completion of certain production phases on our missile defense radar programs.

Total Operating Expenses—The increase in total operating expenses of $153 million in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to an increase in other cost of sales and other operating expenses of $123 million, and an increase in materials and subcontractors costs of $47 million. The increase in other cost of sales and other operating expenses was primarily due to a change in previously deferred precontract costs of $101 million related to the international Patriot program awarded in the second quarter of 2015. The increase in materials and subcontractors costs was primarily due to the activity on the international Patriot program awarded in the fourth quarter of 2014 described above in Total Net Sales.

The increase in total operating expenses of $136 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to an increase in materials and subcontractors costs of $117 million and an increase in other cost of sales and other operating expenses of $92 million, partially offset by a decrease in labor costs of $73 million. The increase in materials and subcontractors costs was primarily due to the activity on an international air and missile defense system program awarded in the fourth quarter of 2013 and the international Patriot program awarded in the fourth quarter of 2014 described above in Total Net Sales. The increase in other cost of sales and other operating expenses was primarily due to a change in previously deferred precontract costs of $101 million related to the international Patriot program awarded in the second quarter of 2015. The decrease in labor costs was primarily driven by program requirements on certain Patriot programs for domestic and international customers, partially offset by increased labor on the international Patriot program awarded in the fourth quarter of 2014.

Operating Income and Margin—Operating income in the second quarter of 2015 was relatively consistent with the second quarter of 2014. Included in operating income in the second quarter of 2015 was an EAC adjustment of $33 million to eliminate all remaining estimated incentive fees related to the AWD program due to the shipbuilder extending the planned schedule and related increase in costs to complete its portion of the program. Included in operating income in the second quarter of 2014 was an EAC adjustment of $38 million from a decrease in estimated incentive fees on the AWD program driven by an increase in expected costs by the shipbuilder to complete its portion of the program. The decrease in operating margin in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to the change in mix and other performance driven by lower volume on the various Patriot programs for international customers described above in Total Net Sales, partially offset by higher volume on an international Patriot program awarded in the second quarter of 2015 with the remaining change spread across numerous programs with no individual or common significant driver.

The decrease in operating income of $35 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to a change in mix and other performance of $67 million. The change in mix and other performance was principally driven by lower volume on the various Patriot programs for international customers described above in Total Net Sales, partially offset by higher volume on an international Patriot program awarded in the second quarter of 2015. Included in the net change in EAC adjustments in the first six months of 2015 was an EAC adjustment of $33 million to eliminate all remaining estimated incentive fees related to the AWD program due to the shipbuilder extending the planned schedule and related increase in costs to complete its portion of the program. Included in operating income in the first six months of 2014 was an EAC adjustment of $38 million from a decrease in estimated incentive fees on the AWD program driven by an increase in expected costs by the shipbuilder to complete its portion of the program. The decrease in operating margin in the first six months of 2015 compared to the first six

months of 2014 was primarily due to the change in mix and other performance.

Backlog and Bookings—Backlog was $12,544 million at June 28, 2015 compared to $11,495 million at December 31, 2014. The increase in backlog of $1,049 million or 9% at June 28, 2015 compared to December 31, 2014 was primarily due to the international Patriot bookings in 2015 described below. Bookings increased by $2,144 million in the second quarter of 2015 compared to the second quarter of 2014. In the second quarter of 2015, IDS booked $2.0 billion to provide advanced Patriot air and missile defense capability for the Kingdom of Saudi Arabia. IDS also booked $132 million to provide satellite communication ground terminals for an international customer and $77 million on the NextGen Weather Processor (NWP) program for the Federal Aviation Administration (FAA).

Bookings increased by $2,447 million in the first six months of 2015 compared to the first six months of 2014. In addition to the bookings noted above, in the first six months of 2015, IDS booked $769 million to provide advanced Patriot air and missile defense capability for the Republic of Korea. IDS also booked $213 million to provide Patriot engineering services support for

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U.S. and international customers and $103 million on the Wide Area Augmentation System (WAAS) program for the FAA. In the first six months of 2014, IDS booked $587 million to provide advanced Patriot air and missile defense capability for Kuwait. IDS also booked $131 million to provide Patriot engineering services support for U.S. and international customers.

Intelligence, Information and Services

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Total net sales | $1,496 | $1,493 | 0.2 % | $2,868 | $2,922 | (1.8 )% |
| Total operating expenses | | | | | | |
| Cost of sales—labor | 611 | 565 | 8.1 % | 1,177 | 1,116 | 5.5 % |
| Cost of sales—materials and subcontractors | 594 | 637 | (6.8 )% | 1,129 | 1,219 | (7.4 )% |
| Other cost of sales and other operating expenses | 183 | 168 | 8.9 % | 170 | 341 | (50.1 )% |
| Total operating expenses | 1,388 | 1,370 | 1.3 % | 2,476 | 2,676 | (7.5 )% |
| Operating income | $108 | $123 | (12.2 )% | $392 | $246 | 59.3 % |
| Operating margin | 7.2 % | 8.2 % | | 13.7 % | 8.4 % | |

| Change in Operating Income (in millions) | Three Months Ended Jun 28, 2015 Versus Three Months Ended Jun 29, 2014 | Six Months Ended Jun 28, 2015 Versus Six Months Ended Jun 29, 2014 |
|---|---|---|
| Volume | $— | $(1 ) |
| Net change in EAC adjustments | — | (1 ) |
| Mix and other performance | (15 ) | 148 |
| Total change in operating income | $(15 ) | $146 |

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Bookings | $1,274 | $2,030 | (37.2 )% | $2,207 | $3,027 | (27.1 )% |

Total Net Sales—Total net sales in the second quarter of 2015 were relatively consistent with the second quarter of 2014. Included in the change in total net sales was lower net sales of $41 million on training programs supporting the U.S. Army's Warfighter FOCUS activities due to a decrease in customer-determined activity levels and higher net sales of $26 million on cybersecurity and special missions programs, primarily driven by the fourth quarter of 2014 acquisition of Raytheon Blackbird Technologies (RBT). The remaining change in total net sales was spread across numerous programs with no individual or common significant driver.

Total net sales in the first six months of 2015 were relatively consistent with the first six months of 2014. Included in the change in total net sales was lower net sales of $91 million on training programs supporting the U.S. Army's Warfighter FOCUS activities due to a decrease in customer-determined activity levels and higher net sales of $55 million on cybersecurity and special missions programs, primarily driven by the fourth quarter of 2014 acquisition of RBT. The remaining change in total net sales was spread across numerous programs with no individual or common significant driver.

Total Operating Expenses—Total operating expenses in the second quarter of 2015 were relatively consistent with the second quarter of 2014. The increase in labor costs of $46 million was primarily due to the activity associated with RBT described above in Total Net Sales with the remaining change spread across numerous programs with no individual or common significant driver. The increase in other cost of sales and other operating expenses of $15

million was primarily due to increased general and administrative expenses, driven principally by an increase in independent research and development and activity related to RBT. The decrease in materials and subcontractors costs of $43 million was driven principally by the activity on the training programs supporting the U.S. Army's Warfighter FOCUS activities described above in Total Net Sales.

The decrease in total operating expenses of $200 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to a decrease in other cost of sales and other operating expenses of $171 million driven principally by the $181 million impact from the eBorders settlement as described in Consolidated Results of Operations beginning on page 25, and a decrease in materials and subcontractors costs of $90 million driven principally by the activity on the training

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programs supporting the U.S. Army's Warfighter FOCUS activities described above in Total Net Sales. The decreases were partially offset by an increase in labor costs of $61 million, driven principally by the activity associated with RBT described above in Total Net Sales.

Operating Income and Margin—The decrease in operating income of $15 million and the related decrease in operating margin in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to a change in mix and other performance of $15 million spread across numerous programs with no individual or common significant driver. Operating income was reduced by approximately $4 million and $2 million for certain cybersecurity-related acquisition costs and investments in the second quarters of 2015 and 2014, respectively.

The increase in operating income of $146 million and the related increase in operating margin in the first six months of 2015 compared to the first six months of 2014 was primarily due to a change in mix and other performance of $148 million, principally driven by the $181 million impact from the eBorders settlement. The remaining change in mix and other performance in the first six months of 2015 compared to the first six months of 2014 was primarily due to the U.S. Army’s Warfighter FOCUS program, which had an impact of $10 million, driven principally by an award fee received in the first six months of 2014, and $6 million of acquisition-related costs for RBT in the first six months of 2015. Operating income was reduced by approximately $8 million (which includes the $6 million of acquisition-related costs for RBT) and $3 million for certain cybersecurity-related acquisition costs and investments in the first six months of 2015 and 2014, respectively.

Backlog and Bookings—Backlog was $5,423 million at June 28, 2015 compared to $5,825 million at December 31, 2014. The decrease in backlog of $402 million or 7% at June 28, 2015 compared to December 31, 2014 was primarily due to sales in excess of bookings in the first six months of 2015, driven principally by the Global Positioning System Next Generation Operational Control System (GPS-OCX) program and the Joint Polar Satellite System (JPSS) program for NASA. Bookings decreased by $756 million in the second quarter of 2015 compared to the second quarter of 2014. In the second quarter of 2015, IIS booked $387 million on domestic training programs and $151 million on foreign training programs in support of Warfighter FOCUS activities. IIS also booked $376 million on a number of classified contracts. In the second quarter of 2014, IIS booked $521 million for a U.S. Air Force program. IIS also booked $515 million on domestic training programs and $160 million on foreign training programs in support of Warfighter FOCUS activities, approximately $160 million on a program to provide operations and maintenance services on an international radar system and $369 million on a number of classified contracts.

Bookings decreased by $820 million in the first six months of 2015 compared to the first six months of 2014. In addition to the bookings above, in the first six months of 2015, IIS booked $547 million on a number of classified contracts. In addition to the bookings above, in the first six months of 2014, IIS booked $111 million on the JPSS program for NASA. IIS also booked $59 million on domestic training programs and $45 million on foreign training programs in support of Warfighter FOCUS activities, and $529 million on a number of classified contracts, including a $195 million award for international cyber.

Missile Systems

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Total net sales | $1,559 | $1,539 | 1.3 % | $3,032 | $3,113 | (2.6 )% |
| Total operating expenses | | | | | | |
| Cost of sales—labor | 505 | 486 | 3.9 % | 985 | 983 | 0.2 % |
| Cost of sales—materials and subcontractors | 649 | 646 | 0.5 % | 1,276 | 1,302 | (2.0 )% |
| Other cost of sales and other operating expenses | 222 | 217 | 2.3 % | 381 | 430 | (11.4 )% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total operating expenses | 1,376 | 1,349 | 2.0 % | 2,642 | 2,715 | (2.7 )% |
| Operating income | $183 | $190 | (3.7 )% | $390 | $398 | (2.0 )% |
| Operating margin | 11.7 % | 12.3 % | | 12.9 % | 12.8 % | |

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| Change in Operating Income (in millions) | Three Months Ended Jun 28, 2015 Versus Three Months Ended Jun 29, 2014 | Six Months Ended Jun 28, 2015 Versus Six Months Ended Jun 29, 2014 |
|---|---|---|
| Volume | $4 | $(9) |
| Net change in EAC adjustments | (28) | (24) |
| Mix and other performance | 17 | 25 |
| Total change in operating income | $(7) | $(8) |

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Bookings | $2,216 | $2,482 | (10.7)% | $3,621 | $3,565 | 1.6% |

Total Net Sales—Total net sales in the second quarter of 2015 were relatively consistent with the second quarter of 2014. Included in total net sales was $50 million of lower net sales on the SM-3® program primarily due to the planned transition from development to production and $31 million of higher net sales on the Phalanx program principally driven by increased program requirements.

The decrease in total net sales of $81 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to $78 million of lower net sales on the SM-3® program primarily due to the planned transition from development to production.

Total Operating Expenses—Total operating expenses in the second quarter of 2015 were relatively consistent with the second quarter of 2014.

The decrease in total operating expenses of $73 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to a decrease in other cost of sales and other operating expenses of $49 million, driven principally by the timing of costs applied to contracts through rates, which had an impact of $46 million. Included in other cost of sales and other operating expenses was a $25 million favorable resolution of a contractual issue.

Operating Income and Margin—The decrease in operating income of $7 million in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to a net change in EAC adjustments of $28 million, partially offset by a change in mix and other performance of $17 million. The net change in EAC adjustments was primarily due to a reduction in estimated labor and materials costs to fulfill requirements on a land warfare systems program in the second quarter of 2014. The change in mix and other performance was driven principally by activity on an air warfare systems contract awarded in the second quarter of 2015. The decrease in operating margin in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to the net change in EAC adjustments and the change in mix and other performance.

Operating income in the first six months of 2015 was relatively consistent with the first six months of 2014. The net change in EAC adjustments of $24 million was principally driven by a reduction in estimated labor and materials costs to fulfill requirements on a land warfare systems program in the first six months of 2014, partially offset by a $25 million favorable resolution of a contractual issue in the first six months of 2015. Operating margin in the first six months of 2015 was relatively consistent with the first six months of 2014.

Backlog and Bookings—Backlog was $9,880 million at June 28, 2015 compared to $9,269 million at December 31, 2014. The increase in backlog of $611 million or 7% was at June 28, 2015 compared to December 31, 2014 was primarily due to bookings in excess of sales in the first six months of 2015, principally within our Air Warfare Systems product line. Bookings decreased by $266 million in the second quarter of 2015 compared to the second

quarter of 2014. In the second quarter of 2015, MS booked $529 million for SM-3® for the Missile Defense Agency (MDA), $511 million on Evolved SeaSparrow Missile (ESSM) for the U.S. Navy and international customers, $363 million for Paveway™ for international customers, and $143 million for Standard Missile-6 (SM-6™) for the U.S. Navy. MS also booked $99 million on a classified program. In the second quarter of 2014, MS booked $764 million for Tube-launched, Optically-tracked, Wireless-guided (TOW) missiles for the U.S. Army, U.S. Marines and international customers, $289 million for SM-6™ for the U.S. Navy, $259 million for AIM-9X Sidewinder short range air-to-air missiles for the U.S. Navy, U.S. Air Force and international customers, $179 million for Advanced Medium-Range Air-to-Air Missiles (AMRAAM®) for the U.S. Air Force, U.S. Navy and international customers, $130 million for Phalanx weapon systems for the U.S. Navy and U.S. Army, $81 million on Miniature Air-Launch Decoy (MALD®) for the U.S. Air Force, $79 million for Rolling Airframe Missile (RAM™) programs for the U.S. Navy and international customers, and $75 million for SM-3® for the MDA. MS also booked $140 million on a classified program.

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Bookings increased by $56 million in the first six months of 2015 compared to the first six months of 2014. In addition to the bookings above, in the first six months of 2015, MS booked $539 million for AMRAAM® for the U.S. Air Force, U.S. Navy and international customers, $231 million for Tomahawk for the U.S. Navy, $110 million for SM-6™ for the U.S. Navy, and $92 million for MALD® for the U.S. Air Force. In addition to the bookings above, in the first six months of 2014, MS booked $479 million for SM-3® for the MDA, $164 million for Paveway™ for international customers, and $86 million for Maverick missiles for international customers.

Space and Airborne Systems

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Total net sales | $1,416 | $1,505 | (5.9)% | $2,774 | $2,903 | (4.4)% |
| Total operating expenses | | | | | | |
| Cost of sales—labor | 561 | 572 | (1.9)% | 1,106 | 1,120 | (1.3)% |
| Cost of sales—materials and subcontractors | 429 | 485 | (11.5)% | 856 | 948 | (9.7)% |
| Other cost of sales and other operating expenses | 240 | 246 | (2.4)% | 453 | 443 | 2.3% |
| Total operating expenses | 1,230 | 1,303 | (5.6)% | 2,415 | 2,511 | (3.8)% |
| Operating income | $186 | $202 | (7.9)% | $359 | $392 | (8.4)% |
| Operating margin | 13.1% | 13.4% | | 12.9% | 13.5% | |

| Change in Operating Income (in millions) | Three Months Ended Jun 28, 2015 Versus Three Months Ended Jun 29, 2014 | Six Months Ended Jun 28, 2015 Versus Six Months Ended Jun 29, 2014 |
|---|---|---|
| Volume | $(11) | $(15) |
| Net change in EAC adjustments | (15) | (33) |
| Mix and other performance | 10 | 15 |
| Total change in operating income | $(16) | $(33) |

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Bookings | $1,240 | $1,581 | (21.6)% | $1,871 | $2,600 | (28.0)% |

Total Net Sales—Total net sales decreased $89 million in the second quarter of 2015 compared to the second quarter of 2014. Included in the change in total net sales was lower net sales of $41 million primarily due to reduced schedule requirements on international tactical radar systems programs and higher net sales of $80 million on classified programs. The remaining change in total net sales was spread across numerous programs with no individual or common significant driver.

Total net sales decreased $129 million in the first six months of 2015 compared to the first six months of 2014. Included in the change in total net sales was lower net sales of $61 million primarily due to reduced schedule requirements on international tactical radar systems programs and higher net sales of $125 million on classified programs. The remaining change in total net sales was spread across numerous programs with no individual or common significant driver.

Total Operating Expenses—The decrease in total operating expenses of $73 million in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to a decrease in materials and subcontractors costs of $56 million driven principally by intersegment contracts supporting U.S. Army ground sensor systems programs and activity on the programs described above in Total Net Sales.

The decrease in total operating expenses of $96 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to a decrease in materials and subcontractors costs of $92 million driven principally by intersegment contracts supporting U.S. Army ground sensor systems programs and activity on the programs described above in Total Net Sales.

Operating Income and Margin—The decrease in operating income of $16 million and the related decrease in operating margin in the second quarter of 2015 compared to the second quarter of 2014 were primarily due to a net change in EAC adjustments



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of $15 million principally driven by an increase in expected costs in the design phase of a protected communications development program for the U.S. Air Force. Included in mix and other performance in the second quarter of 2015 was an $11 million gain on a real estate transaction. Also included in mix and other performance in the second quarters of 2015 and 2014 were $9 million and $10 million, respectively, of acquisition-related costs.

The decrease in operating income of $33 million and the related decrease in operating margin in the first six months of 2015 compared to the first six months of 2014 was primarily due to a net change in EAC adjustments of $33 million principally driven by labor and material production efficiencies on two international tactical radar systems programs in the first six months of 2014 and efficiencies on certain classified programs in the first six months of 2014. Included in mix and other performance in the first six months of 2015 was an $11 million gain on a real estate transaction. Also included in mix and other performance in the first six months of 2015 and 2014 were $18 million and $20 million, respectively, of acquisition-related costs.

Backlog and Bookings—Backlog was $6,221 million at June 28, 2015 compared to $6,930 million at December 31, 2014. The decrease in backlog of $709 million or 10% at June 28, 2015 compared to December 31, 2014 was primarily due to sales in excess of bookings in the first six months of 2015, principally within our Intelligence, Surveillance, and Reconnaissance Systems and the Tactical Airborne Systems product lines. Bookings decreased by $341 million in the second quarter of 2015 compared to the second quarter of 2014. In the second quarter of 2015, SAS booked $153 million on a multimission radar program for the U.S. Navy and an international customer, $99 million on an Active Electronically Scanned Array (AESA) radar Performance Based Logistics (PBL) contract for an international customer, and $82 million to provide communication subsystems for the U.S. Navy and an international customer. SAS also booked $250 million on a number of classified contracts. In the second quarter of 2014, SAS booked $129 million to provide radar subsystems for the U.S. Navy. SAS also booked $431 million on a number of classified contracts.

Bookings decreased by $729 million in the first six months of 2015 compared to the first six months of 2014. In addition to the bookings noted above, in the first six months of 2015, SAS booked $210 million on a number of classified contracts. In addition to the bookings noted above, in the first six months of 2014, SAS booked $116 million to provide radar components for an international customer and $81 million for software enhancements for the AESA radars for the U.S. Air Force. SAS also booked $216 million on a number of classified contracts.

Raytheon|Websense

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Total net sales | $57 | $28 | 103.6 % | $81 | $51 | 58.8 % |
| Total operating expenses | | | | | | |
| Cost of sales | 11 | 5 | 120.0 % | 17 | 11 | 54.5 % |
| Selling and marketing | 19 | 5 | 280.0 % | 24 | 8 | 200.0 % |
| Research and development | 21 | 9 | 133.3 % | 31 | 16 | 93.8 % |
| General and administrative | 7 | 6 | 16.7 % | 10 | 9 | 11.1 % |
| Total operating expenses | 58 | 25 | 132.0 % | 82 | 44 | 86.4 % |
| Operating income (loss) | $(1) | $3 | (133.3)% | $(1) | $7 | (114.3)% |
| Operating margin | (1.8)% | 10.7 % | | (1.2)% | 13.7 % | |

| | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|
| (In millions, except percentages) | Jun 28, 2015 | Jun 29, 2014 | % Change | Jun 28, 2015 | Jun 29, 2014 | % Change |
| Bookings | $49 | $22 | 122.7 % | $68 | $36 | 88.9 % |

Total Net Sales—Total net sales for the segment are net sales before any reduction for the acquisition accounting adjustments to record deferred revenue at fair value. The increase in total net sales of $29 million and $30 million in the second quarter of 2015 and the first six months of 2015, respectively, compared to the second quarter of 2014 and first six months of 2014 was primarily due to $29 million of higher sales resulting from our acquisition of Websense. Total net sales in the second quarter of 2015 and the first six months of 2015 excluded the unfavorable impact of $10 million related to the deferred revenue acquisition accounting adjustments described below in Raytheon|Websense Acquisition Accounting Adjustments.

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

- Cost of sales—costs associated with Web content analysis and technical support, infrastructure costs associated with maintaining our databases, costs associated with providing our Cloud offerings, and costs associated with the sale of our appliance products.
- Selling and marketing—salaries, commissions and benefits related to personnel engaged in selling and marketing and customer support functions; costs related to public relations, advertising, promotions and travel; and other allocated costs.
- Research and development—salaries and benefits for software developers that support the development of new products and continued enhancement of existing products, and allocated costs.
- General and administrative expenses—salaries, benefits and related expenses for our executive, finance, and administrative personnel; third party professional service fees; and allocated costs.

Total operating expenses in the second quarter of 2015 increased $33 million compared to the second quarter of 2014. The increase in all of the categories of total operating expenses was primarily due to the acquisition of Websense. In addition, the increase in total operating expenses included $5 million of additional research and development and selling and marketing expenses for the development and launch of new commercial products. Research and development expense in the second quarter of 2015 also included $5 million related to severance and retention associated with the restructuring of Websense. Total operating expenses in the second quarter of 2015 and the second quarter of 2014 excluded $8 million and $1 million, respectively, of amortization of acquired intangible assets as described below in Raytheon|Websense Acquisition Accounting Adjustments, as well as certain other acquisition and acquisition related costs described below in Corporate.

Total operating expenses in the first six months of 2015 increased $38 million compared to the first six months of 2014. The increase in all of the categories of total operating expenses was primarily due to the acquisition of Websense. In addition, the increase in total operating expenses included $10 million of additional research and development and selling and marketing expenses for the development and launch of new commercial products. Research and development expense in the first six months of 2015 also included $5 million related to severance and retention associated with the restructuring of Websense. Total operating expenses in the first six months of 2015 and the first six months of 2014 excluded $10 million and $3 million, respectively, of amortization of acquired intangible assets as described below in Raytheon|Websense Acquisition Accounting Adjustments, as well as certain other acquisition and acquisition related costs described below in Corporate.

Operating Income and Margin—The decrease in operating income of $4 million in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to the increase in the research and development and sales and marketing expenses described above. Operating income in the second quarter of 2015 and the second quarter of 2014 excludes $18 million and $1 million, respectively, related to the acquisition accounting adjustments described below in Raytheon|Websense Acquisition Accounting Adjustments, as well as certain other acquisition and acquisition related costs described below in Corporate. The decrease in operating margin in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to the research and development and sales and marketing expenses and the severance, relocation and other expenses required to integrate Websense described above.

The decrease in operating income of $8 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to the increase in the research and development and sales and marketing expenses described above. Operating income in the first six months of 2015 and first six months of 2014 excludes $20 million and $3 million, respectively, related to the acquisition accounting adjustments described below in Raytheon|Websense Acquisition Accounting Adjustments, as well as certain other acquisition and acquisition related costs described below in Corporate. The decrease in operating margin in the first six months of 2015 compared to the first six months of 2014 was primarily due to the research and development and sales and marketing expenses and the severance,

relocation and other expenses required to integrate Websense described above.

Backlog and Bookings—Backlog was $426 million at June 28, 2015 compared to $52 million at December 31, 2014. The increase in backlog of $374 million at June 28, 2015 compared to December 31, 2014 was primarily due to the acquisition of Websense. Bookings increased by $27 million in the second quarter of 2015 compared to the second quarter of 2014 primarily due to the acquisition of Websense.

Bookings increased by $32 million in the first six months of 2015 compared to the first six months of 2014 primarily due to the acquisition of Websense.

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Raytheon|Websense Acquisition Accounting Adjustments

Raytheon|Websense Acquisition Accounting Adjustments include the adjustments to record acquired deferred revenue at fair value ("deferred revenue adjustment") and the amortization of acquired intangible assets related to the Websense acquisition and historical RCP acquisitions. These adjustments are not considered part of management's evaluation of Raytheon|Websense segment results.

The components of Raytheon|Websense Acquisition Accounting Adjustments were as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (in millions) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| Deferred revenue adjustment[(1)] | $(10 ) | $— | $(10 ) | $— |
| Amortization of acquired intangibles | (8 ) | (1 ) | (10 ) | (3 ) |
| Total Raytheon|Websense Acquisition Accounting Adjustments | $(18 ) | $(1 ) | $(20 ) | $(3 ) |

(1) The deferred revenue adjustment to operating income was less than $1 million for the second quarter and first six months of 2014.

The change in our Raytheon|Websense Acquisition Accounting Adjustments of $17 million in both the second quarter and first six months of 2015 compared to second quarter and first six months of 2014, respectively, was primarily due to a $10 million increase in the deferred revenue adjustment and a $7 million increase in the intangibles amortization adjustment, both driven by the acquisition of Websense.

FAS/CAS Adjustment

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

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In millions) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| FAS/CAS Pension Adjustment | $48 | $86 | $96 | $172 |
| FAS/CAS PRB Adjustment | 1 | 1 | 2 | 2 |
| FAS/CAS Adjustment | $49 | $87 | $98 | $174 |

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In millions) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| FAS (expense) | $(292 ) | $(220 ) | $(583 ) | $(441 ) |
| CAS expense | 340 | 306 | 679 | 613 |
| FAS/CAS Pension Adjustment | $48 | $86 | $96 | $172 |

The change in our FAS/CAS Pension Adjustment of $38 million in the second quarter of 2015 compared to the second quarter of 2014 was driven by a $72 million increase in our FAS expense offset by a $34 million increase in our CAS expense. The change in our FAS/CAS Pension Adjustment of $76 million in the first six months of 2015 compared to the first six months of 2014 was driven by a $142 million increase in our FAS expense offset by a $66 million increase in our CAS expense. The increase in our FAS expense in the second quarter of 2015 and in first six months of 2015 was primarily due to the lower discount rate at December 31, 2014 compared to the discount rate as of December 31, 2013 and the decrease in our long-term return on assets (ROA) assumptions as described in our Annual Report on Form 10-K for the year ended December 31, 2014. The increase in our CAS expense in the second quarter

of 2015 and in first six months of 2015 was primarily due to the CAS Harmonization phased transition to the use of a discount rate based on high quality corporate bonds, consistent with the Pension Protection Act of 2006, to measure liabilities in determining the CAS pension expense. This was partially offset by a decrease in CAS expense as a result of the passage of the Highway and Transportation Funding Act of 2014. The change in the discount rate used to measure liabilities for purposes of determining CAS pension expense has been included in our contracts through our overhead forward pricing rates.

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Our FAS/CAS PRB Adjustment was $1 million of income in the second quarters of 2015 and 2014 and in $2 million of income in the first six months of 2015 and 2014.

Corporate

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

Operating income related to Corporate was as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In millions) | Jun 28, 2015 | Jun 29, 2014 | Jun 28, 2015 | Jun 29, 2014 |
| Corporate | $(35) | $(22) | $(64) | $(30) |

The decrease in operating income related to Corporate of $13 million in the second quarter of 2015 compared to the second quarter of 2014 was primarily due to $23 million of Websense acquisition and integration related expenses in the second quarter of 2015, partially offset by $17 million of Corporate stock compensation expense associated with the RSUs awarded in the second quarter of 2014 as part of our annual Restricted Stock Program. We awarded 0.2 million RSUs in the second quarter of 2014 to retiree-eligible employees. These awards vest over a specified period of time as determined by the Management Development and Compensation Committee of our Board of Directors and are compensatory in nature. The RSUs continue to vest, but do not accelerate, on the scheduled vesting dates into retirement subject to the employee's compliance with certain post-employment covenants. Due to the continued vesting provisions of the RSUs into retirement, the Company recognized all of the stock compensation expense associated with the RSUs in the in the second quarter of 2014 rather than over the vesting period of the awards.

The decrease in operating income related to Corporate of $34 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to $25 million of Websense acquisition and integration related expenses in the second quarter of 2015. Included in operating income related to Corporate in the first six months of 2015 and 2014 was $16 million and $17 million, respectively, of Corporate stock compensation expense associated with the issuance of RSU awards as described above. We awarded 0.2 million RSUs in the first six months of 2015 and 2014 to retiree-eligible employees.

FINANCIAL CONDITION AND LIQUIDITY

Overview

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

In addition, the following table highlights selected measures of our liquidity and capital resources at June 28, 2015 and December 31, 2014:

| (In millions) | Jun 28, 2015 | Dec 31, 2014 |
|---|---|---|
| Cash and cash equivalents | $1,828 | $3,222 |
| Short-term investments | 666 | 1,497 |
| Working capital | 3,063 | 4,362 |

| | | |
|---|---|---|
| Amount available under credit facilities | 1,398 | 1,398 |

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Operating Activities

| (In millions) | Six Months Ended Jun 28, 2015 | Jun 29, 2014 |
|---|---|---|
| Net cash provided by (used in) operating activities from continuing operations | $431 | $812 |
| Net cash provided by (used in) operating activities | 432 | 846 |

The decrease in net cash provided by operating activities from continuing operations of $381 million in the first six months of 2015 compared to the first six months of 2014, was primarily due to customer advances received in the first six months of 2014, an increase in tax payments as discussed below, and the timing of collections in the first six months of 2015 related to an international Patriot program awarded in the second quarter of 2015, partially offset by the eBorders settlement payment received in the first six months of 2015 and a decrease in pension contributions as discussed below.

Pension Plan Contributions—We made the following contributions to our pension and other postretirement benefit plans during the first six months of 2015 and 2014:

| (In millions) | Six Months Ended Jun 28, 2015 | Jun 29, 2014 |
|---|---|---|
| Required pension contributions | $170 | $464 |
| Other postretirement benefit contributions | 10 | 9 |

Tax Payments and Refunds—We made (received) the following net tax payments (refunds) during the first six months of 2015 and 2014:

| (In millions) | Six Months Ended Jun 28, 2015 | Jun 29, 2014 |
|---|---|---|
| Federal | $488 | $190 |
| Foreign | 12 | 13 |
| State | 32 | 23 |

We expect full-year net federal, foreign and state tax payments to be approximately $1,241 million in 2015.

Interest Payments—We made interest payments on our outstanding debt of $116 million and $105 million in the first six months of 2015 and 2014, respectively.

Investing Activities

| (In millions) | Six Months Ended Jun 28, 2015 | Jun 29, 2014 |
|---|---|---|
| Net cash provided by (used in) investing activities | $(1,222) | $(21) |

The change in net cash provided by (used in) investing activities of $1,201 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to the acquisition of Websense as described below.

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

| (In millions) | Six Months Ended Jun 28, 2015 | Jun 29, 2014 |
|---|---|---|
| Additions to property, plant and equipment | $143 | $101 |
| Additions to capitalized internal use software | 26 | 26 |

We expect our property, plant and equipment and internal use software expenditures to be between approximately $410–$470 million and $50–$70 million, respectively, in 2015, consistent with the anticipated needs of our business and for specific investments including capital assets and facility improvements.

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

| | Six Months Ended | |
|---|---|---|
| (In millions) | Jun 28, 2015 | Jun 29, 2014 |
| Purchases of short-term investments | $(148 ) | $(1,371 ) |
| Sales of short-term investments | 209 | 882 |
| Maturities of short-term investments | 774 | 595 |

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

| | Six Months Ended | |
|---|---|---|
| (In millions) | Jun 28, 2015 | Jun 29, 2014 |
| Payments for purchases of acquired companies, net of cash acquired | $(1,892 ) | $— |

On May 29, 2015, we acquired Websense from Vista Equity Partners for approximately $1.9 billion, net of cash received, and exclusive of retention payments.

Financing Activities

| | Six Months Ended | |
|---|---|---|
| (In millions) | Jun 28, 2015 | Jun 29, 2014 |
| Net cash provided by (used in) financing activities | $(604 ) | $(860 ) |

We have used cash provided by operating activities, and proceeds from the issuance of new debt as our primary sources for the repayment of debt, payment of dividends, pension contributions and the repurchase of our common stock. The change in net cash used in financing activities of $256 million in the first six months of 2015 compared to the first six months of 2014 was primarily due to our sales of noncontrolling interest described below.

Share Repurchases—In November 2013, our Board of Directors authorized the repurchase of up to $2.0 billion of our outstanding common stock. At June 28, 2015, we had approximately $1 billion available under this repurchase program. Share repurchases will take place from time to time at management's discretion depending on market conditions.

Share repurchases also include shares surrendered by employees to satisfy tax withholding obligations in connection with restricted stock, restricted stock units and stock option awards issued to employees.

Our share repurchases were as follows:

| | Six Months Ended | | | |
|---|---|---|---|---|
| (In millions) | Jun 28, 2015 | | Jun 29, 2014 | |
| | $ | Shares | $ | Shares |
| Shares repurchased under our share repurchase programs | $500 | 4.6 | $450 | 4.6 |
| Shares repurchased to satisfy tax withholding obligations | 96 | 0.9 | 83 | 0.9 |
| Total share repurchases | $596 | 5.5 | $533 | 5.5 |

In May 2010, our shareholders approved the Raytheon 2010 Stock Plan. Under the plan, we may grant restricted stock awards, restricted stock units, stock grants, stock options and stock appreciation rights.

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

| | Six Months Ended | |
|---|---|---|
| (In millions, except per share amounts) | Jun 28, 2015 | Jun 29, 2014 |
| Cash dividends declared per share | $1.34 | $1.21 |
| Total dividends paid | 391 | 363 |

In March 2015, our Board of Directors authorized an 11% increase to our annual dividend payout rate from $2.42 to $2.68 per share. Dividends are subject to quarterly approval by our Board of Directors.

Sale of noncontrolling interest in Raytheon|Websense—In connection with the Websense acquisition, we combined Websense with RCP to form Raytheon|Websense, and then sold 19.7% of the equity interest in Raytheon|Websense to Vista Equity Partners for $343 million.

CAPITAL RESOURCES

Total debt was $5.3 billion at June 28, 2015 and December 31, 2014. Our outstanding debt bears contractual interest at fixed interest rates ranging from 2.5% to 7.2% and matures at various dates from 2018 through 2044.

Cash and Cash Equivalents and Short-term Investments—Cash and cash equivalents and short-term investments were $2.5 billion and $4.7 billion at June 28, 2015 and December 31, 2014, respectively. We may invest in U.S. Treasuries; AAA/Aaa rated money market funds; certificates of deposit, time deposits and commercial paper of banks with a minimum long-term debt rating of A or A2 and minimum short-term debt rating of A-1 and P-1; and commercial paper of corporations with a minimum long-term debt rating of A- or A3 and minimum short-term debt rating of A-2 and P-2. Cash and cash equivalents and short-term investments balances held at our foreign subsidiaries were approximately $982 million and $715 million at June 28, 2015 and December 31, 2014, respectively. Earnings from our foreign subsidiaries are currently deemed to be indefinitely reinvested. We do not expect such reinvestment to affect our liquidity and capital resources, and we continuously evaluate our liquidity needs and ability to meet global cash requirements as a part of our overall capital deployment strategy. Factors that affect our global capital deployment strategy include anticipated cash flows, the ability to repatriate cash in a tax efficient manner, funding requirements for operations and investment activities, acquisitions and divestitures, and capital market conditions.

Credit Facilities—In December 2011, we entered into a $1.4 billion revolving credit facility maturing in 2016. Under the $1.4 billion credit facility, we can borrow, issue letters of credit, and backstop commercial paper. Borrowings under this facility bear interest at various rate options, including LIBOR plus a margin based on our credit ratings. Based on our credit ratings at June 28, 2015, borrowings would generally bear interest at LIBOR plus 79.5 basis points. The credit facility is comprised of commitments from approximately 25 separate highly rated lenders, each committing no more than 10% of the facility. As of June 28, 2015 and December 31, 2014, there were no borrowings outstanding under this credit facility. However, we had $2 million of outstanding letters of credit at June 28, 2015 and December 31, 2014, which effectively reduced our borrowing capacity under this credit facility by that amount.

Under the $1.4 billion credit facility we must comply with certain covenants, including a ratio of total debt to total capitalization of no more than 60%. We were in compliance with the credit facility covenants during the six months ended June 28, 2015 and full-year 2014. Our ratio of total debt to total capitalization, as those terms are defined in the credit facility, was 34.7% at June 28, 2015. We are providing this ratio as this metric is used by our lenders to monitor our leverage and is also a threshold that limits our ability to utilize this facility.

Credit Ratings—Three major corporate debt rating organizations, Fitch Ratings (Fitch), Moody's Investors Service (Moody's) and Standard & Poor's (S&P), assign ratings to our short-term and long-term debt. The following chart reflects the current ratings assigned by each of these agencies as of June 28, 2015 to our short and long-term senior unsecured debt:

| | Short-Term | Long-Term Senior Debt |
|---|---|---|

| Rating Agency | Debt Rating | Rating | Outlook | Date of Last Action |
|---|---|---|---|---|
| Fitch | F2 | A - | Stable | September 2008 |
| Moody’s | P-2 | A3 | Stable | October 2011 |
| S&P | A-1 | A | Stable | May 2014 |

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Shelf Registrations—We have an effective shelf registration with the SEC, filed in January 2013, which covers the registration of debt securities, common stock, preferred stock and warrants.

COMMITMENTS AND CONTINGENCIES

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

| (In millions, except percentages) | Jun 28, 2015 | Dec 31, 2014 |
|---|---|---|
| Total remediation costs—undiscounted | $214 | $202 |
| Weighted average discount rate | 5.4 % | 5.5 % |
| Total remediation costs—discounted | $144 | $131 |
| Recoverable portion | 90 | 80 |

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

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

Financing Arrangements and Other—We issue guarantees and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. These instruments expire on various dates through 2023. Additional guarantees of project performance for which there is no stated value also remain outstanding. The stated values outstanding consisted of the following:

| (In millions) | Jun 28, 2015 | Dec 31, 2014 |
|---|---|---|
| Guarantees | $215 | $266 |
| Letters of credit | 2,268 | 1,938 |
| Surety bonds | 265 | 298 |

Included in guarantees and letters of credit described above were $205 million and $194 million, respectively, at June 28, 2015, and $196 million and $244 million, respectively, at December 31, 2014, related to our joint venture in Thales-Raytheon Systems Co. Ltd. (TRS). We provide these guarantees and letters of credit to TRS and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. While we expect these entities to satisfy their loans, and meet their project performance and other contractual obligations, their failure to do so may result in a future obligation to us. We periodically evaluate the risk of TRS and other affiliates failing to meet their obligations described above. At June 28, 2015, we believe the risk that TRS and other affiliates will not be able to meet their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at June 28, 2015. At June 28, 2015 and December 31, 2014, we had an estimated liability of $10 million and $9 million, respectively, related to these guarantees and letters of credit.

The TRS joint venture agreement was amended on June 10, 2014 to allow for termination of the joint venture by either party every three years based on the scheduled date for the designation of a successor Chief Executive Officer for the joint venture which would next occur in 2016. Termination terms and related payments are subject to negotiation between Thales S.A. and Raytheon, but generally would include a net payment due for undistributed earnings of the joint venture companies since inception and a net payment based on the relative fair value of those companies excluding Air Command Systems International S.A.S. As a result, any final future termination amounts cannot be determined precisely at this time and could be different from those amounts recorded to date. However, if the joint venture were terminated as of June 28, 2015, we believe the termination payment we would be required to make based on a standard valuation approach would not be material. If a termination liability exceeds $50 million, the agreement allows the paying side to elect to make payments, inclusive of interest, in equal installments over five years to settle the liability.

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The joint venture (JV) agreement between Raytheon and Vista Equity Partners provides Vista Equity Partners with certain rights to require Raytheon|Websense to pursue an initial public offering at any time after four years and three months following the closing date of May 29, 2015, or pursue a sale of the company at any time after five years following the closing date. In either of these events, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Raytheon|Websense for cash at a price equal to fair value as determined under the JV agreement. Additionally, Vista Equity Partners has the ability to liquidate its ownership through a put option any time after two years following the closing date. In the event of a put option, Vista Equity Partners could require Raytheon to purchase all (but not less than all) of Vista Equity Partners' interest in Raytheon|Websense for cash at a price equal to fair value as determined under the JV agreement. Lastly, at any time after three years following the closing date, Raytheon has the option to purchase all (but not less than all) of Vista Equity Partners' interest in Raytheon|Websense at a price equal to fair value as determined under the JV agreement.
We have entered into industrial cooperation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. At June 28, 2015, the aggregate amount of our offset agreements had an outstanding notional value of approximately $5 billion. These agreements are designed to return economic value to the foreign country by requiring us to engage in activities supporting local defense or commercial industries, promoting a balance of trade, developing in-country technology capabilities, or addressing other local development priorities. Offset agreements may be satisfied through activities that do not require a direct cash payment, including transferring technology, providing manufacturing, training and other consulting support to in-country projects, and the purchase by third parties (e.g., our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for activities such as subcontracting with local partners, purchasing supplies from in-country vendors, providing financial support for in-country projects, and making investments in local ventures. Such activities may also vary by country depending upon requirements as dictated by their governments. We typically do not commit to offset agreements until orders for our products or services are definitive. The amounts ultimately applied against our offset agreements are based on negotiations with the customers and typically require cash outlays that represent only a fraction of the notional value in the offset agreements. Offset programs usually extend over several or more years and may provide for penalties in the event we fail to perform in accordance with offset requirements. We have historically not been required to pay any such penalties.

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

On June 29, 2012 and July 13, 2012, we received a contracting officer’s final decision (COFD) for 2004 and 2005 incurred costs at our Space and Airborne Systems (SAS) segment. The COFDs demand a total payment of $241 million for costs, interest and penalties associated with several issues, the largest of which relates to specific research and development and capital projects undertaken by SAS between 2000 and 2005. To date, no COFDs have been provided for 2000 to 2003 periods at SAS on these issues. The Government alleges that the costs incurred on the projects should have been charged directly to U.S. Government contracts rather than through indirect rates and that these costs should not be recoverable. We strongly disagree with the Government's position. We have requested a deferment of the payment and in February and May 2013, we filed complaints in the U.S. COFC challenging the 2004 and 2005 COFDs, respectively. Due to the inherent uncertainties of litigation, we cannot estimate a range of potential loss. We believe that we appropriately charged the disputed costs based on government accounting standards and applicable precedent and properly disclosed our approach to the Government. We also believe that in many cases, the statute of limitations has run on the issues. Based upon the foregoing, we do not expect the results of the COFDs to have a material impact on our financial position, results of operations or liquidity.

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We do not currently expect the Greek financial crisis to have a material impact on our financial position, results of operations or liquidity. We have less than 1% of our sales in Greece and less than $100 million in U.S. dollar denominated contracts in process. We currently believe all of these amounts to be collectible; however, if circumstances change, we could be required to write off some or all of the contracts in process balance.

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

Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2014-09 Revenue from Contracts with Customers (Topic 606) which will replace numerous requirements in U.S. GAAP, including industry-specific requirements, and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. Under the new standard, we expect to continue using the cost-to-cost percentage of completion method to recognize revenue for most of our long-term contracts. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. We have not yet selected a transition method. We are currently evaluating the potential changes from this ASU to our future financial reporting and disclosures. On July 9, 2015, the FASB approved the deferral of the new standard's effective date by one year. The new standard now would be effective for annual reporting periods beginning after December 15, 2017. The FASB will permit companies to adopt the new standard early, but not before the original effective date of December 15, 2016.

Other new pronouncements issued but not effective until after June 28, 2015 are not expected to have a material impact on our financial position, results of operations or liquidity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

The following tables provide information as of June 28, 2015 and December 31, 2014 about our market risk exposure associated with changing interest rates. For long-term debt obligations, the table presents principal cash flows by maturity date and average interest rates related to outstanding obligations. There were no interest rate swaps outstanding at June 28, 2015 or December 31, 2014.

As of June 28, 2015
Principal Payments and Interest Rate Detail by Contractual Maturity Dates
(In millions, except percentages)

| Long-Term Debt | 2015 | 2016 | 2017 | 2018 | 2019 | Thereafter | Total | Fair Value |
|---|---|---|---|---|---|---|---|---|
| Fixed-rate debt | $— | $— | $— | $591 | $— | $4,792 | $5,383 | $5,759 |
| Average interest rate | — | — | — | 6.549 % | — | 4.017 % | 4.295 % | |

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As of December 31, 2014
Principal Payments and Interest Rate Detail by Contractual Maturity Dates
(In millions, except percentages)

| Long-Term Debt | 2015 | 2016 | 2017 | 2018 | 2019 | Thereafter | Total | Fair Value |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Fixed-rate debt | $— | $— | $— | $591 | $— | $4,792 | $5,383 | $5,936 |
| Average interest rate | — | — | — | 6.549 % | — | 4.017 % | 4.295 % | |

In addition, the aggregate notional amount of the outstanding foreign currency forward contracts was $826 million and $926 million at June 28, 2015 and December 31, 2014, respectively. The net notional exposure of these contracts was approximately $79 million and $57 million at June 28, 2015 and December 31, 2014, respectively.
For foreign currency forward contracts designated and qualifying for hedge accounting, we record the effective portion of the gain or loss on the derivative in accumulated other comprehensive loss, net of tax, and reclassify it into earnings in the same period or periods during which the hedged revenue or cost of sales transaction affects earnings. Unrealized gains of $10 million and $7 million were included in other assets, net, and unrealized losses of $25 million and $24 million were included in other accrued expenses at June 28, 2015 and December 31, 2014, respectively. Realized gains and losses resulting from these cash flow hedges offset the foreign currency exchange gains and losses on the underlying assets or liabilities being hedged. We believe our exposure due to changes in foreign currency rates is not material due to our hedging policy.

At June 28, 2015, we had short-term investments with a fair value of $666 million, which are classified as available-for-sale and consist of highly rated bank certificates of deposit with a minimum long-term debt rating of A or A2 and a minimum short-term debt rating of A-1 and P-1. Our exposure due to changes in interest rates is not material due to the nature and amount of our short-term investments (i.e., high quality certificates of deposit which had an average maturity of three months).

## ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures
Management conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a–15(e) and 15d–15(e) of the Securities Exchange Act of 1934) as of June 28, 2015.
Conclusion of Evaluation—Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of June 28, 2015 were effective.
Inherent Limitations on Effectiveness of Controls—In designing and evaluating our disclosure controls and procedures, management recognizes that any controls, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.
Changes in Internal Control Over Financial Reporting—There were no changes in our internal control over financial reporting during the second quarter of 2015 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

# PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

We primarily engage in providing products and services under contracts with the U.S. Government and, to a lesser degree, under direct foreign sales contracts, some of which the U.S. Government funds. As a U.S. Government contractor, we are subject to many levels of audit and investigation by the U.S. Government relating to our contract performance and compliance with applicable rules and regulations. Agencies that oversee contract performance include: the Defense Contract Audit Agency, the Defense Contract Management Agency, the Inspector General of the Department of Defense and other departments and agencies, the Government Accountability Office, the Department

of Justice and Congressional Committees. From time to time, these and other agencies investigate or conduct audits to determine whether our operations are being conducted in accordance with applicable requirements. Such investigations and audits could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, the suspension of government export licenses or the suspension or debarment from future U.S. Government contracting. U.S. Government investigations often take years to

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complete and many result in no adverse action against us. Our final allowable incurred costs for each year are also subject to audit and have from time to time resulted in disputes between us and the U.S. Government with litigation resulting at the Court of Federal Claims (COFC) or the Armed Services Board of Contract Appeals (ASBCA) or their related courts of appeals. In addition, the Department of Justice has, from time to time, convened grand juries to investigate possible irregularities by us. We also provide products and services to customers outside of the U.S. and those sales are subject to local government laws, regulations, and procurement policies and practices. Our compliance with such local government regulations or any applicable U.S. Government regulations (e.g., the Foreign Corrupt Practices Act and the International Traffic in Arms Regulations) may also be investigated or audited. Other than as specifically disclosed in this Form 10-Q, we do not expect these audits, investigations or disputes to have a material effect on our financial position, results of operations or liquidity, either individually or in the aggregate.

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

ITEM 1A. RISK FACTORS

You should carefully review and consider the information regarding certain factors which could materially affect our business, financial condition or future results set forth under Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no material changes from the factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014, although we may disclose changes to such factors or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

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

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Approximate Dollar Value (in billions) of Shares that May Yet Be Purchased Under the Plan (2) |
|---|---|---|---|---|
| April (March 30, 2015 - April 26, 2015) | 930,948 | $ 109.20 | 916,031 | $ 1.1 |
| May (April 27, 2015 - May 24, 2015) | 938,429 | 106.56 | 938,399 | 1.0 |
| June (May 25, 2015 - June 28, 2015) | 499,877 | 104.11 | — | 1.0 |
| Total | 2,369,254 | $ 107.08 | 1,854,430 | |

(1) Includes shares purchased related to activity under our stock plans. Such activity during the second quarter of 2015 includes the surrender by employees of 514,824 shares to satisfy income tax withholding obligations in connection with the vesting of restricted stock issued to employees.

(2) In November 2013, our Board of Directors authorized the repurchase of up to $2.0 billion of our outstanding common stock. Share repurchases will take place from time to time at management’s discretion depending on market conditions.

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ITEM 6. EXHIBITS

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

| | |
|---|---|
| 15 | PricewaterhouseCoopers LLP Awareness Letter.* |
| 31.1 | Certification of Thomas A. Kennedy pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.* |
| 31.2 | Certification of Anthony F. O'Brien pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.* |
| 32.1 | Certification of Thomas A. Kennedy pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.** |
| 32.2 | Certification of Anthony F. O'Brien pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.** |
| 101 | The following materials from Raytheon Company’s Quarterly Report on Form 10-Q for the quarter ended June 28, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements.* |

* filed electronically herewith
** furnished and not filed herewith

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SIGNATURES

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

RAYTHEON COMPANY

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

July 23, 2015