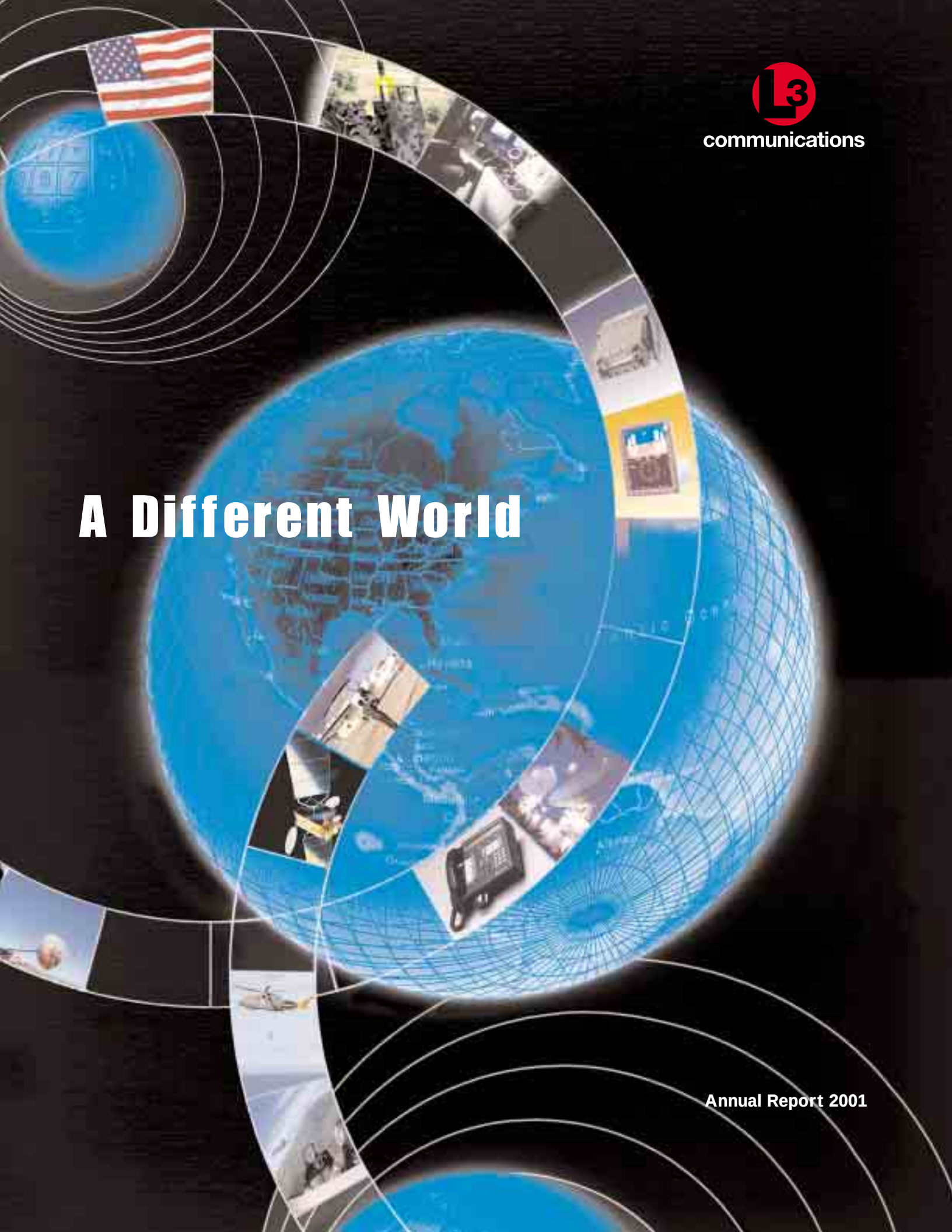


L3 communications

A Different World

Annual Report 2001

The Pentagon

"We will not tire, we will not falter, we will not fail."

- President George W. Bush

On September 11th of 2001, the world was changed irrevocably with a vicious attack on innocent and unsuspecting civilians and military personnel in New York City, Washington, DC and Pennsylvania. It was by far the worst assault on civilians in the US in its history. So many precious lives were lost, so many fire, police and rescue workers died trying to save others and two symbols of the American way of life – the World Trade Center and a wing of the Pentagon – lay in ruins.

Since then, the threat of terrorism that had once been limited to individual incidents of horror, death and destruction now threatened to destabilize the world. Terrorists renewed their threats to wage nuclear, biological and chemical war against the United States, and with roots in over 60 countries, they threatened our allies as well. With terrorist bases in Middle East countries, they funded and supported extremism in Muslim countries and brought one of their neighbors to the brink of war. After the morning of September 11th, it had become a different world.

But out of that terrible tragedy came a commitment to honor those who lost their lives with a renewed dedication to aid suffering families and rebuild New York City and the Pentagon. The nation stood squarely behind President George W. Bush, our Commander-in-Chief, as he outlined our nation's mission – to strengthen and revitalize efforts to protect our country and find and eliminate terrorist organizations and those who harbor them. There was also a recognition that this nation had to do more to increase security measures in the United States and aid military forces and intelligence agencies as they painstakingly root out an entrenched and ultra-secret terrorist infrastructure that took years to build.

The events of September 11th have been painful for all Americans and citizens of the world who witnessed its horror. It has also been terribly painful for the employees of L-3 Communications. With our headquarters in New York City and our Washington office near the Pentagon, many of us watched in horror as these events unfolded. As a defense company, we believe it is our duty to rededicate our efforts to provide our nation and its institutions with the tools to fight the enemies of freedom.

L3 communications

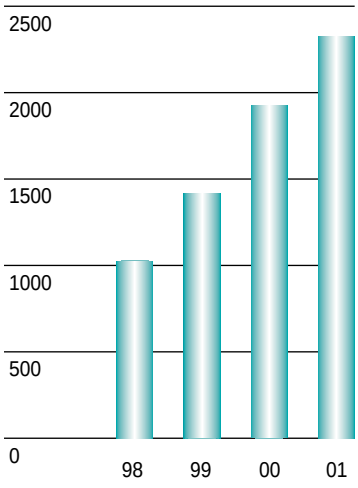
Financial Highlights

For the years ended December 31,

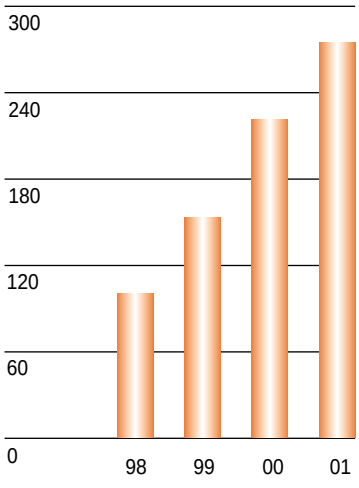
(In thousands, except per share amounts)	**2001**	2000	1999	1998
Sales	**$2,347,422**	$1,910,061	$1,405,462	$1,037,045
Operating income	**275,330**	222,718	150,486	100,349
Net income	**115,458**	82,727	58,689	32,551
Diluted earnings per share	**2.95**	2.37	1.75	1.26
Free cash flow[(a)]	**126,084**	98,285	82,275	62,623
Shareholders' equity	**1,213,892**	692,569	583,175	299,974

(a) Free cash flow is defined as net cash flow from operating activities, less capital expenditures net of dispositions.

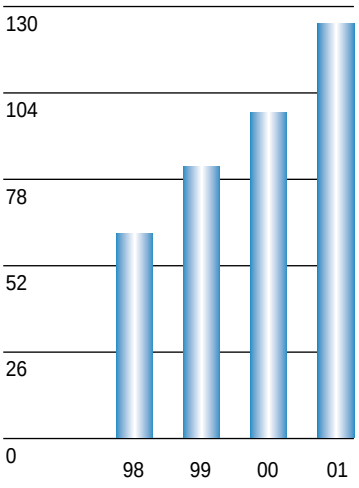
Sales
in millions



Operating Income
in millions



Free Cash Flow
in millions



MILESTONES

April 2001 L-3 announced a public offering of 4.575 million primary shares by the company. The proceeds were used to repay existing indebtedness under L-3's senior credit facility and for general corporate purposes, including acquisitions.

May 2001 KDI, a leading provider of premium fuzing products, was acquired by L-3. KDI products include proximity fuzes, Electronic Safety and Arm Devices (ESADs) and self-destruct/submunition grenade fuzes.

May 2001 L-3 added EER Systems, specializing in communication systems, training and simulation equipment and a broad range of hardware and software for the US Army, Air Force and Navy, the FAA and BMDO.

Products and Services	Applications

SECURE COMMUNICATION SYSTEMS SEGMENT

• Secure communication links, SATCOM ground terminals	• U-2, GUARDRAIL, Global Hawk, Predator, other aircraft, ships, MightySat, LADS, unmanned aerial vehicles & satellites
• Satellite communication & tracking; pointing, stabilization & command & control	• International Space Station, Earth Observing Satellite, Space Shuttle & NOAA weather satellites; Air Force Satellite Control Network, MELCO satellite ground stations, Coriolis, ICESAT, NEMO, Genesis, Delta launch vehicle guidance & ACTS
• Shipboard communications	• Aegis cruisers & destroyers, Trident & Attack (688) submarines, aircraft carriers, amphibious warfare & command ships
• Digital battlefield communications & communications software support services	• US Army IBCT, ASAS, future combat systems & UAV Risk Reduction Payload
• Secure voice, data & video; information processing (STE, OMNI™, LMD/KP & RedEagle™)	• Armed forces & government agencies
• Military training devices & worldwide training services	• Flight simulators, maintenance trainers, aircrew training systems & distance learning
• Design, development & integration of ISR systems	• US & allied armed forces & government agencies
• Aircraft modification & maintenance	• US & international military & government customers
• Comprehensive logistics support operations & maintenance	• US Special Operations Command
• Information technology seat management	• Government agencies
• Analytical & information technology support	• US intelligence community

SPECIALIZED PRODUCTS SEGMENT

• Cockpit voice & flight data recorders & Traffic and Terrain Collision Avoidance Systems; reconnaissance	• Commercial & military aircraft; SHARP
• Ultra-wide frequency antennas, rotary joints & radomes	• Military aircraft, weather radar & air traffic control
• High-performance displays and processors for airborne, shipboard and ground/vehicle applications	• AH-64, A/MH-6J, C-130J, C-130H, C-27J, C-5, E-2C, F-5B, F-16, F-14, Jaguar, JA-37, JAS-39, S-211, S-3B, SH-60J, T-38, U-2, LCAC, LOSAT & VISUAL
• Airborne dipping sonars, towed arrays; shipboard & submarine power delivery & conditioning systems	• SH-60, EH-101, NH-90, SSN, DDG-963 & FFG-7; DDG-51, NSSN & CVN-68
• Airborne, ground & space telemetry & flight testing	• JSF, F-15, F-16, F/A-18, F-22, Comanche, Nimrod (U.K.), Titan, EELV, BAE LIF, AIM-9X, JASSM, JSOW, EKV, AMRAAM, JDAM, MK-82, Patriot & THAAD missiles; commercial aircraft
• Global satellite communications & transmission; up/downconverters	• Earthwatch, IKONOS I; rural telephony, satellite news & private networks
• Rapid deployment satellite communication terminals	• Mobile military forces & disaster relief applications
• Aircraft heavy maintenance, component repair & overhaul, engineering & integrated logistics services	• C-130, B737, B727, H3, NATO E-3A
• GPS receivers, MEMS IMU, translators, simulators & ruggedized displays	• Armed forces & Department of Defense
• Fuzes; Safety and Arming Devices; proximity sensors	• Mortar, artillery, air-dropped bombs, submunition, rocket & guided missiles
• Land navigation, fire control & missile guidance	• MLRS, Dragonfire & CKEM
• Turnkey automated data acquisition systems	• Space Shuttle, Titan IV, EELV launch monitoring & US Air Force jet engine test cells
• Microwave, satellite & wireless components & RF safety products	• Emergency restoration & portable microwave communications systems, Egyptian HF family of radios; cellular & PCS, commercial & electronic systems for military aircraft

EMERGING COMMERCIAL PRODUCTS*

• Privatel™ & Integrated Key Management System (IKMS™)	• Corporations, banking & e-commerce industries
• eXaminer 3DX™ 3000 & 6000 explosive detection systems	• Domestic & international airlines & airports
• Power delivery & electrical products	• Transportation, utilities & web-based businesses
• Event recorders	• Commercial rail transportation industry
• Hardened Voyage Recorders	• Cargo vessels & passenger ships
• Cockpit display suites	• Air transport, regional & business jets
• E1/T1 trunks compression equipment	• Wireline, wireless, cellular & satellite networks
• ISAT	• Wireless system suppliers & operators
• PrimeWave™ telecommunications equipment	• Emerging competitive carriers, Internet Service Providers & developing nations
• GSM-based fixed access wireless terminal	• GSM cellular networks & GSM wireless local loop networks
• Human Patient Simulator™	• Hospitals, medical schools, emergency medical services & military organizations
• Rapidly deployable electronic remote area security systems	• Corporations & government agencies

*L-3's Emerging Commercial Products are developed within its Secure Communication Systems and Specialized Products reportable segments.

October/November 2001 L-3 sold $420 million of 4.00% Senior Subordinated Convertible Contingent Debt Securities℠ (CODES℠) due 2011. CODES are convertible under certain conditions into the company's stock at $107.625 per share, a premium equivalent to 25% over the closing price of $86.10 on Thursday, October 18, 2001.

November 2001 L-3 acquired Spar Aerospace Limited, a leading global provider of turnkey aviation life cycle management services, providing value-added engineering and upgrades for selected military and commercial aviation programs.

March 2002 L-3 added its largest acquisition to date – Aircraft Integration Systems (AIS), a division of Raytheon that is a leader in the global Intelligence, Surveillance and Reconnaissance (ISR) market.

Responding to New Challenges

Since September 11th, this nation has been engaged in a two-front war. The first is modeled after conventional wars. The second is a war against terrorism comprised of "many faces in many places," a non-conventional enemy, with agents and cells dispersed in innumerable, often unidentified locations throughout the world. These terrorists plot to cause the death and destruction of innocent civilians, disrupt international communications, commerce and travel and provoke revolution and chaos wherever there is opportunity.

Thomas Edison's Idea Factory: Edison's legacy of innovation, invention and advanced development is a part of L-3's heritage from its Communication Systems-East division.

(l. to r.)
Frank C. Lanza
chairman and chief executive officer

Robert V. LaPenta
president and chief financial officer

Dear Shareholders:

Each year since L-3's inception in 1997, the company has achieved strong growth through strategic acquisitions and demonstrated financial discipline. Our goal has been to play a crucial role in providing the Department of Defense (DoD) with the high technology products required to anticipate and overwhelm the enemy and to make acquisitions of core national assets that have defined our military's platform advantage.

In 2001, L-3 once again met and exceeded these goals – increasing its growth by over 20% top and bottom line, developing a host of new products, making key, accretive acquisitions and enhancing its relationship with its DoD customer base.

But beyond the growth that the company realized, L-3's key achievement is its contribution, along with other defense companies, in assisting US military forces in Afghanistan and in the ongoing worldwide battle against terrorism. L-3 is strategically positioned in the new world of military transformation focused on Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C^4ISR), precision-guided weapons, Unmanned Aerial Vehicles (UAVs), communications networks and homeland security. It is with great pride that L-3's advanced products have played a defining role in support of our nation in defending our way of life against those who would destroy it.

L-3's interoperable "Internet in the Sky" data links for intelligence aircraft and UAVs enable battle planners to provide situational awareness and targeting in real time to our warriors. Our signals intelligence products and services pick up unknown signals and are used to determine the enemy's intent. The company's remote sensors detect enemy movements and its secure communications provide US military and government personnel with encrypted communication and data exchange.

Also playing a major role are ISR products from L-3's largest acquisition to date, Aircraft Integration Systems, which was purchased in March 2002 from Raytheon and is now known as L-3 Communications Integrated Systems. These products provide persistent ISR – a 24-hour overview of the battlefield, enabling warfighters to take action on real-time information – one of the most important advantages in any conflict.

Photo:
A lab technician demonstrates the S/TAR™ (Strategic/Tactical Airborne Recorder) family of high-performance solid state recording systems, including models RM-3000, RM-6000F and RM-8000R: (l. to r.) Michael T. Strianese, senior vice president of finance, David T. Butler, vice president of planning, Christopher C. Cambria, senior vice president, secretary and general counsel, Ralph G. D'Ambrosio, vice president and controller, David M. Reilly, vice president, assistant general counsel and assistant secretary and Richard A. Nordstrom, vice president of operations review.

In addition to ISR products, L-3's Global Positioning System (GPS), fuzes and Electronic Safe and Arm Devices (ESADs) enable all-weather precision weapons to destroy enemy sites with minimal collateral damage and risk to our aircrews. Other key products provide situational awareness, command and control and mobile satellite communications. In addition, L-3's missile defense products and services are playing an early, crucial role in the development of a system to protect the nation against missile attack.

These products will continue to be critical as the DoD reviews its lessons learned from Afghanistan and carries out the transformation strategy outlined in the current Quadrennial Defense Review (QDR) and as the nation and its states and cities continue their work to shore up homeland security.

In the QDR, Secretary of Defense Donald H. Rumsfeld indicated that there should be a balance between upgrading existing platforms with the latest electronics and beginning to fund transformation of existing platforms and concepts. Legacy platforms are performing brilliantly in the war in Afghanistan. The success of persistent, real-time Intelligence, Surveillance, Reconnaissance and Communications (ISRC) provided by manned and unmanned aerial vehicles and other assets will lead to more refinement and greater use by our military forces. The ability of the nation's high-altitude legacy bombers to provide "close air support" out of harm's way will prompt the military to upgrade their existing platforms with even more sophisticated electronics and precise all-weather bombs.

Recapitalizing its existing platforms will allow the DoD to use its resources prudently to ensure US air, land and intelligence supremacy going forward. A key element of transformation is the use of existing platforms in the new concept of network-centric communications, as demonstrated in Afghanistan. It also allows merchant product suppliers such as L-3 to play a crucial role in providing our forces with the equipment they need to defeat our foes.

Record Sales

In 2001, our sales climbed to $2,347.4 million, versus $1,910.1 million in 2000, a 22.9% increase.

Record Earnings

Operating income for L-3 increased 23.6% in 2001 to $275.3 million from $222.7 million in 2000. Earnings before interest, taxes, depreciation and amortization (EBITDA) rose 22.0% to $362.3 million from $297.0 million in 2000. Net income in 2001 increased to $115.5 million or $2.95 per diluted share, compared to $82.7 million or $2.37 per diluted share in 2000.

Record Cash Flow and Strong Balance Sheet

In 2001, L-3 generated $126.1 million in free cash flow, compared to $98.3 million for 2000. In addition, the company also closed the year with a strong balance sheet.

Record Bookings

In 2001, we achieved a record $2,456.1 million in funded orders from each of our major business areas. Included among the contract highlights, milestones and partnerships are:

- Data link funding for the key reconnaissance and surveillance platforms, including the manned U-2 and the Global Hawk and Predator UAVs.
- Data links for the Common High Bandwidth Data Link (CHBDL) and the Navy's Tactical Common Data Link (TCDL) programs, as well as the Space Lift Range System (SLRS) program to provide technical support for Titan IV launches, the Tactical Targeting Network (TTN) system to upgrade terminals for the Army and Marines and developmental funding for the Army's Modulated Interoperable Surface Terminal (MIST-II) program.
- Record funding for Communication System-East's Secure Terminal Equipment (STE) and OMNI™ encryption devices used to provide secure voice and data exchange among the nation's military forces and government agencies.

Photo: *(l. to r.)*
Seated: Robert W. RisCassi, vice president of Washington Operations, Larry L. Henry, vice president of Air Force Programs, Jill J. Wittels, vice president of Business Development and Jimmie V. Adams, vice president of Washington Operations.

Standing: Donald A. MacDonald, vice president - International and Dennis A. Jones, vice president of Maritime Programs.

- Communication Systems-East's Strategic/Tactical Airborne Recorder (S/TAR™) was selected as the solid state recorder for the US Navy's SHARP (Shared Reconnaissance Pod) program and key international reconnaissance programs.
- Funding for communication systems on the International Space Station and various signal/data link intelligence programs.
- L-3 and Telos teamed to win a contract from the US Army Communications-Electronics Command (CECOM) for systems and software engineering to manage and support the life cycle activities associated with Mission Critical Defense Systems (MCDS).
- Communication Systems-East's MarCom™ was selected for a technology upgrade and cost reduction modification for the interior communications system aboard the Aegis class of destroyers, starting with DDG-99. This same MarCom technology was also chosen by Raytheon for the San Antonio class (LPD-17) Amphibious Warfare ships.
- Link Simulation and Training won low rate initial production of its Aviation Combined Arms Tactical Trainer-Aviation Reconfigurable Manned Simulator (AVCATT-A) program, and upgraded CH-47D and UH-60 helicopter simulators for the US Army.
- Link is providing two full mission trainers and four weapon tactics trainers for pilot training on the next-generation Lockheed Martin-built F-22 stealth fighter and delivered four F-16 unit training devices for the Egyptian Air Force.
- Link was selected to compete for military training programs valued at $3.0 billion under the US Air Force's Training Systems Acquisition (TSA) II initiative and captured the first three major awards for the T-1A Ground Based Training System, F-16 Aircrew Training Devices and the C-141 Total Training System. Link also received a contract from Textron to build a Landing Craft Air Cushion (LCAC) Full Mission Trainer (FMT) trainee station for the Japanese Maritime Self Defense Force.
- Link received a contract from Boeing to perform upgrades on six currently fielded US Navy F/A-18 simula-

tors that will make the trainers concurrent with the Super Hornet's latest aircraft and weapons systems advancements. Link will upgrade one F/A-18C dome simulator to an F/A-18E/F configuration and make modifications to five other F/A-18E/F simulators.

- Ocean Systems won initial funding for the company's Tsunami™ surface ship hull-mounted sonar product and funding from the US Navy to demonstrate its new Untethered Mine Neutralizer, which can be electronically controlled and deployed from either a ship or helicopter to search for and destroy mines.
- Bookings for the US Navy and international navies for the company's towed array Anti-Submarine Warfare (ASW) programs as well as an international award for low-frequency dipping sonar (HELRAS).
- Henschel, a business unit of SPD, will supply BAE SYSTEMS with Integrated Communications Systems (ICS) for three of the United Kingdom's Astute Class submarines.
- Display Systems received an award to provide the advanced Controls and Displays Manager and BattleView 15" tactical displays for the Army's new Line-of-Sight-Anti-Tank (LOSAT) weapon system.
- Display Systems was awarded a development contract to provide upgraded, high-resolution TADS/PNVS cockpit displays for the US Army's fleet of AH-64 Apache attack helicopters.
- Display Systems won a multi-year contract from Saab Avionics to provide the flat panel cockpit displays for the multinational JAS-39 Gripen fighter aircraft. Display Systems was also awarded a number of other cockpit display modernization contracts for aircraft including the C-130H, C-130J, F-14, T-38, F-5, F-16, S-211 and U-2.
- Aviation Recorders delivered over 4,000 recorders to American Airlines, Delta, US Airways, Qantas, ANA and Lufthansa as many of the world's major airlines embarked on fleet-wide recorder retrofit programs.
- Aviation Recorders received orders from Bombardier, Cessna, Boeing, Airbus, Raytheon and Learjet in support of new aircraft deliveries. Additionally, orders were placed for L-3's new Hardened Voyage Recorder (HVR) from various integrated bridge suppliers in the emerging maritime market.
- Northwest Airlines signed a ten-year contract with ACSS, L-3's joint venture with Thales Avionics, for Traffic Alert and Collision Avoidance Systems (TCAS), Mode S transponders and antennas and L-3 supplied about 18 ship sets of these products to Embraer monthly.
- IEC was selected to combine and miniaturize its GPS receiver with its Micro-Machined Electro-Mechanical Systems Inertial Measurement Unit (MEMS IMU) for inclusion in the Low Cost Guidance and Navigation Unit (LCGNU) program used in a NATO initiative to upgrade "dumb" to smart munitions.
- IEC was also selected by General Dynamics Land Systems (GDLS) and GM Defense for intelligent displays for the US Army's new Interim Armored Vehicle (IAV) program.
- Coleman Aerospace launched its twenty-first Hera target missile and sixth in support of the PAC-3 theater missile defense system. Coleman Federal recorded key awards for services from the National Missile Defense Joint Program Office and an information technology services contract for a classified customer.
- Microwave components continued its strong performance, driven by filter and non-ionizing safety products. Robust demand continued for filters due to system upgrades by service providers for 2.5G applications in North America. Further, the service provider marketplace continued its ongoing program to outfit technicians and maintenance personnel with protection from exposure to RF emissions in order to comply with FCC regulations.
- L-3 supplied its RIFCA (Redundant Inertial Flight Control Assembly) guidance system for its 54th consecutive successful Boeing Delta rocket launch and this system is also expected to fly on future Delta II, III and IV launches.
- L-3 was selected as the antenna subcontractor to provide the next-generation Airborne Early Warning (AEW) radar antenna for the Navy's E-2C Hawkeye surveillance aircraft. The antenna will be developed as part of the Radar Modernization Program (RMP), which introduces a new

electronically scanned UHF radar using advanced space-time adaptive processing.

- The Federal Aviation Administration (FAA) as well as Rome Airport issued explosive detection system contracts to L-3.
- L-3 received a contract to provide telecommunications services in 23 cities throughout Argentina using its PrimeWave™ fixed access system.
- Telemetry-East was awarded a contract to develop the next-generation Theater High Altitude Area Defense (THAAD) Data Acquisition System.
- ESSCO was selected by Raytheon to supply all of the radomes for the ASR-11 Digital Airport Surveillance Radar (DASR) program. DASR is the DoD/FAA's next-generation solid state terminal area air traffic control radar, providing both primary surveillance and monopulse secondary surveillance radar coverage.

Major Acquisitions

The defense industry has hundreds of small private or public companies with revenues of $50 million to $300 million that require the infrastructure and management of a larger defense firm to succeed. There are also more assets in the one-billion-dollar range that are not central to a large company's core operation and that are or will be for sale. L-3's acquisition strategy is to comb among these assets and select ones with products that are number-one or number-two in their market and have solid relationships with the DoD and prime contractors.

Management has used this formula for decades and it has worked well. Having leadership products indicates that a potential acquisition has other key strengths – excellent employees, solid engineering and good marketing. Sometimes, these small companies are under-performing, lack strong financial controls or do not have access to a large pool of funding for R&D to develop next-generation products. By becoming part of L-3, these companies can take advantage of the infrastructure to expand their market and become a greater presence in the industry.

In 2001 and in the early part of 2002, L-3 acquired a number of small niche companies and also made the largest acquisition in its history:

- **EER Systems**, a supplier of information technology and systems and engineering services, is synergistic with Coleman and Link Simulation and Training because of its cockpit simulator and Navy equipment fabrication capabilities. EER's technology-based communication systems, perimeter security systems, training and simulation equipment and a broad range of hardware and software are used by US forces, government agencies and the BMDO.
- **KDI Precision Products**, a producer of fuzing products, ESADs and self-destruct/submunition grenade fuzes that are crucial to the current war in Afghanistan. KDI's products are on systems such as the Joint Standoff Weapon (JSOW), AIM-9X Sidewinder Air-to-Air Missile and the Guided Multiple Launch Rocket System (GMLRS) among many others.
- L-3 acquired the defense business of **Bulova Technologies**, which is synergistic with KDI because of its military fuzes and ESADs for artillery systems, mortars, grenades and howitzer-fired projectiles for domestic and international customers. Its work in MEMS technology is also complementary to L-3's IEC division, which is also focused on MEMS and GPS technology. These capabilities will be essential as US military forces move toward miniaturization in precision weapon systems.
- **Spar Aerospace**, a high-end aviation product modernization and services system integrator for a number of military organizations around the world, is a solid performer. The business also offers significant opportunity for sales of L-3's high-end avionics products, including aviation recorders, displays, TCAS and transponders.
- **Emergent Government Systems Group (GSG)**, renamed L-3 Communications Analytics Corporation, is a leader in C^{4}ISR, modeling and simulation, space science data systems development and high-end Systems Engineering and Technical Assistance (SETA) support.
- **SY Technology**, specializes in air warfare simulation, C^{4}I architectures and missile defense and space systems technology for a variety of government, military and commercial customers including BMDO, the DoD and the United States Space Command.

- In 2002, L-3 announced the acquisition of **PerkinElmer's Detection Systems**, a provider of X-ray screening for three major security applications: aviation systems for checked and oversized baggage, break bulk cargo and air freight and port and border applications. When combined with L-3's existing checked baggage system, eXaminer 3DX™ 6000, L-3 will be able to offer complete solutions to the European and Middle East markets, be a major player in the screening of cargo and become the largest security screening provider in the United States.
- On March 8, 2002, L-3 completed its largest acquisition to date and one that substantially increased its size and significance to the DoD – Raytheon's **Aircraft Integration Services (AIS)** – a leader in ISR products as well as aircraft modernization services. AIS's signals intelligence (SIGINT), communications intelligence (COMINT) and sensors, when combined with L-3's existing secure communications, will make the company a world leader in the ISRC market.

Next-Generation Products

As the nation's military forces begin the process of transformation, they will need next-generation products and subsystems to upgrade their platforms over the next few years.

One of L-3's advantages is the substantial amount of R&D funds dedicated to developing new products. In 2001, L-3 spent $107.5 million of its own funds and $319.4 million provided by its customers in R&D.

- **Tactical Common Data Link (TCDL) Airborne Data Terminal**, a compact, lightweight system specifically for UAVs and manned, non-fighter environments and a TCDL Ground Data Terminal, accommodating tactical field situations and can be set up in just 30 minutes.
- **Dual Data Link (DDL-II)** is the latest version of evolutionary data links produced for the U-2 reconnaissance aircraft. With this link, the U-2 established two simultaneous, independent, wideband data links connecting combinations of ground stations, satellite and/or aircraft. This flexibility ensures that the U-2 meets the reconnaissance needs of both in-theater and out-of-theater users simultaneously.
- **OMNI*xi* Secure Terminal** can support data at rates up to 2.048 Mbps in synchronous mode and 115 Kbps in asynchronous mode and provide such applications as link encryption, SATCOM, network connectivity and high-speed video teleconferencing.
- **T²CAS**, a safety avionics system that integrates aircraft performance-based Terrain Avoidance Warning System (TAWS) capability from joint-venture partner Thales Avionics into L-3's TCAS 2000 without adding a line-replacement unit.
- **Recorder Independent Power Supply (RIPS)**, developed in response to newly proposed FAA regulations, provides a cockpit voice recorder with ten minutes of emergency backup power in all cases where normal aircraft power ceases.
- **Ka-band Solid State Power Amplifier (SSPA)**, a high reliability, high efficiency space-qualified solid state power amplifier for Ka-band applications, including TT&C, communication satellites, remote sensing satellites and launch vehicles.
- **Rembass-II**, a next-generation Unattended Ground Sensor (UGS) system. These sensors are covert, field deployable Measurement and Signatures Intelligence (MASINT) devices that detect and classify ground and air targets. UGS devices are used for Reconnaissance, Surveillance and Target Acquisition (RSTA) missions ahead of the forward line of troops and physical security missions.
- **Hera Targets**, high-fidelity, threat-like targets and scenarios for testing of defense systems, which can be launched either from relatively austere launch sites on the ground

Photo: *(l. to r.)*
Seated around table: Sheila M. Sheridan, director of administration, Joseph S. Paresi, vice president of product development and president of L-3 Security Systems division, Ralph DeNino, vice president of procurement and Ronald G. Sabbagh, director of software engineering.

Second row: Cynthia Swain, vice president of corporate communications and Kenneth W. Manne, vice president of human resources.

Back row: Kenneth R. Goldstein, director of taxes, Stephen M. Souza, vice president and treasurer and Vincent T. Taylor, vice president and chief information officer.

or air launched from a standard military cargo aircraft.

- **Common Ground Mobile Display (CGMD)**, an active matrix liquid display designed to operate in harsh and hostile environments. CGMD uses a modular design concept to ensure that new display technology advances can easily be incorporated to avoid obsolescence.
- **MARS Wheels**, new momentum and reaction wheels that incorporate advanced motor and space-proven bearing technology for attitude correction and pointing for communication satellites and high-performance reconnaissance and resource monitoring satellites.
- **Self-Destruct Fuzing Systems**, which substantially decrease the dud rate of grenades deployed by rocket and cannon cargo rounds with production-ready product features that include a detonate or render safe function; **Proximity Fuzing Systems**, the most advanced proximity mortar fuze; and **FMU-139 Bomb Fuze**, an electronic impact/impact delay fuzing system developed for use in the MK-80 series and M-117 low drag and high drag, guided or unguided, high explosive bombs.
- **Satellite TDMA Terminal**, second-generation technology, jointly developed with COMSAT Labs, provides low-cost access to INTELSAT's worldwide satellite network by delivering hundreds of voice and data channels to multiple destinations.
- **Model 300, Two & Three Axis Automatic Tracking Antenna System**, a new positioner capable of handling reflectors up to 15 meters in diameter in harsh environments suited for Remote Sensing Satellite (RSS) and TT&C; **Model 200-7 Meter, Dual Axis, Transportable Uplink/Downlink Telemetry Antenna System**, a transportable antenna configured for C-141, C-130 and 747 aircraft; and **System Monitor and Control Unit (SMCU)**, with the unique capability of controlling and monitoring up to seven antenna systems.
- **FTR-925**, a miniature, state-of-the-art flight termination receiver/decoder for today's missile programs that require smaller and lighter-weight components.
- **Low Cost Transmitter,** targeted for the guided munitions and Ground-based Missile Defense Segment (GMDS) initiatives.
- **Remote Asset Security Systems (RASS)**, a rapidly deployable integrated electronic security system. RASS provides increased perimeter security with less manpower and uses devices such as thermal imagers, CCTV, low light level imagers and infrared (IR) imagers.
- **Superset Displays**, a family of low-cost modular displays designed for use in commercial and military aircraft, including the interfaces for T²CAS, TAWS, weather radar, FLIR, digital maps and other airborne sensors.
- **Embedded National Tactical Receiver (ENTR)**, developed by Telemetry-West, a small, lightweight 4-channel intelligence receiver that can be deployed in a desktop or laptop computer and is currently being upgraded for deployment on military aircraft.
- **InControl-NextGeneration™ (InControl-NG)**, a highly advanced COTS automated satellite command & control software solution for all phases of a mission, including antenna control, telemetry processing/display, commanding, fleet monitoring/control and integrated data reporting for both satellites and payloads.
- **Astra™**, a new suite of hardware modules designed for satellite Telemetry, Tracking & Control (TT&C) that integrates reconfigurable satellite communications functions in a single PC to reduce the price and complexity of today's ground system equipment.

Photo: *(l. to r.)*
Standing: Gregory B. Roberts, corporate vice president and president of Communication Systems-East division, Charles J. Schafer, vice president of business operations and president of Products Group, Alan R. Dietrich, corporate vice president and president of Telemetry Group and Steven T. Schorer, president of Ocean Systems division.

Seated: James W. Dunn, president of Link Simulation and Training division, Curtis Brunson, corporate vice president and president of Communication Systems-West division, A.E. "Gene" Dotson, president of SPD Technologies and John S. Mega, corporate vice president and president of Microwave Group.

Commercial and Civil Opportunities

With the events of September 11th, homeland security has become a critical priority in many countries around the world. The protection of citizens and the national infrastructure – commerce, communications, transportation, states and cities, borders, facilities and cargo – is essential. Some of the focus areas are intrusion detection, information security, crisis management and voice responders.

L-3 has a growing business in the homeland security market.

In airport security systems, L-3 had two milestone events in 2001. First, L-3 began a ramp-up to produce a large number of systems that will be required by the Department of Transportation (DoT) to protect airports in this country. The eXaminer 3DX™ 6000, which is the only second-generation system certified by the FAA, provides continuous 3-D Computer Tomography (CT) scans and can check 500 bags an hour for explosives.

Second, by agreeing to acquire Detection Systems from PerkinElmer in 2002, L-3 was catapulted from a single product producer to the largest supplier of airport security systems worldwide. This acquisition will enable L-3 to offer turnkey airport screening to the international market and to have a strong presence in the growing cargo market.

The commercial aerospace sector is experiencing a downturn in the transportation industry, precipitated first by the recession and then by the September 11th tragedy. However, in the early part of 2001, L-3, in order to offset anticipated falloff in its aviation recorder sales, began marketing its HVRs for maritime use. International mandates are regulating the use of these recorders in cruise ships and ferry boats so that they can monitor a number of safety and performance measures. L-3 won business from Kongsberg Maritime Ship Systems for both new builds and existing vessels, as well as from Consilium Navigation.

The joint venture between Thales Avionics and L-3's ACSS division is developing T²CAS and has begun marketing the product both to domestic and international customers. L-3 is exploring other partnerships with international companies that have the infrastructure to market its products overseas as well as provide L-3 with additional product offerings that can be supplied domestically.

L-3 Communications Integrated Systems plays a key role on the defense side of homeland security by assisting the military first responders in a crisis. Currently, this organization is looking at applying these capabilities to civilian markets. L-3's MPRI operation has a well-established business working in a number of countries to assist with security issues and crisis management and is currently engaged in consulting with municipalities and states in helping to plan their response to major threats.

In its communications businesses, L-3 began 2001 with the announcement of a contract to supply its PrimeWave™ system to 23 cities in Argentina. Much of that work was completed during the year and the remainder will be completed in the first half of 2002. There is a possibility of follow-on business during 2002.

Much of the commercial satellite industry was flat during 2001 due to over-expansion and other issues. However, L-3 has strong DoD sales and expects this segment of the commercial market to begin its revival, particularly as the US government places a stronger emphasis on broadband infrastructure to support communications and data requirements.

Investor Highlights

Although L-3 has been a public company for approximately four years, the company has developed a solid reputation on Wall Street as one with responsible financial management and a clear and substantiated vision of growth. As a result, L-3 has been able to raise capital in the financial markets to continue to pursue this vision.

In April 2001, the company sold 4.575 million of primary shares. The proceeds were used to repay existing indebtedness under L-3's senior credit facility and for general corporate purposes, including acquisitions.

In the fourth quarter of 2001, L-3 sold $420 million of 4.00% Senior Subordinated Convertible Contingent Debt Securities (CODES℠) due 2011. CODES are convertible under certain conditions into the company's common stock at $107.625 per share, a premium equivalent to 25% over the closing price of $86.10 on Thursday, October 18, 2001. The funds were used for general corporate purposes, including financing of acquisitions.

L-3's senior management also presented at a number of key defense investor conferences throughout the year and attracted additional analyst coverage.

Growth in 2002 and Beyond

Clearly, the US is facing a host of new challenges in the next few years. President Bush and Secretary Rumsfeld believe that our nation's forces must be prepared

for even more devastating events. Whether the conflict involves weapons of mass destruction or acts of terrorism, the US must be prepared for every exigency.

As a result, in the QDR there was a fundamental philosophical shift in focus from a "threat-based" model to one that emphasizes capabilities. The military must identify and prepare the capabilities needed to defeat a full spectrum of adversaries – a journey that will, in time, significantly and fundamentally change the US Armed Forces.

Central to this goal will be strengthening joint operations, expanding intelligence, creating transformation capabilities and revitalizing the DoD establishment. The key technologies leading this transformation will be an increased role for UAVs, precision-guided munitions, high-technology battlefield communications, missile defense, ISRC and arsenal submarines for weapons delivery.

Since transformation will be a long-term goal, the DoD intends to strike a balance between recapitalizing existing platforms with new electronics capabilities and replacing existing platforms with new multi-sensor aircraft, tankers, weapons and adding major new roles and platforms for the US Coast Guard. The approach is to use existing capabilities in new ways, integrating new technology into old systems and developing new systems, platforms and network-centric warfare for the new battlefield.

It is very clear that this view of how the military must spend its procurement dollars has been borne out by the war in Afghanistan. Before the war, many were predicting that the US had to replace most of its legacy platforms and buy new ones. However, in Afghanistan, legacy platforms with the latest technology fought in new ways and proved to be very effective.

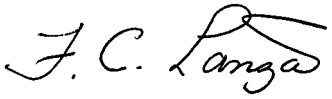
Post-Operation Enduring Freedom, the military will be focused on making greater improvements for future conflicts. Along with persistent surveillance and an expanded role and mission for UAVs, as well as a redefinition of close air support and more precise weaponry, the military will also place more emphasis on its Special Operating Forces (SOF). In addition, the focus will be on mobility, lethality, communications and force structure for first responders.

As a result of his successful efforts, President Bush's leadership has garnered great support throughout the nation for his defense policies. The US Congress has given the DoD more funding to help pay for the current war and begin to fund the transformation. In 2002, the DoD budget rose to $331 billion, of which almost $109 billion is available for procurement and R&D. In addition, President Bush has proposed a $48 billion increase that would bring the defense budget to $379 billion in 2003 with investment accounts rising to approximately $125 billion.

We believe the environment for defense companies, and in particular L-3, will be very positive in the foreseeable future. For the past decade, budget constraints have limited the funding for capabilities upgrades. However, the new emphasis on recapitalization will benefit L-3 because it has a host of defense electronics products to upgrade legacy platforms. In addition, the company has also developed next-generation defense electronics for the transformation ahead of us.

Growth will also come through acquisitions. There are a large number of acquisition candidates. Many of these companies are national assets and greatly valued by the DoD. L-3's strategy will continue to be to select those that add both vertically and horizontally to L-3's products, exercise financial discipline in acquiring them and make them accretive within a year.

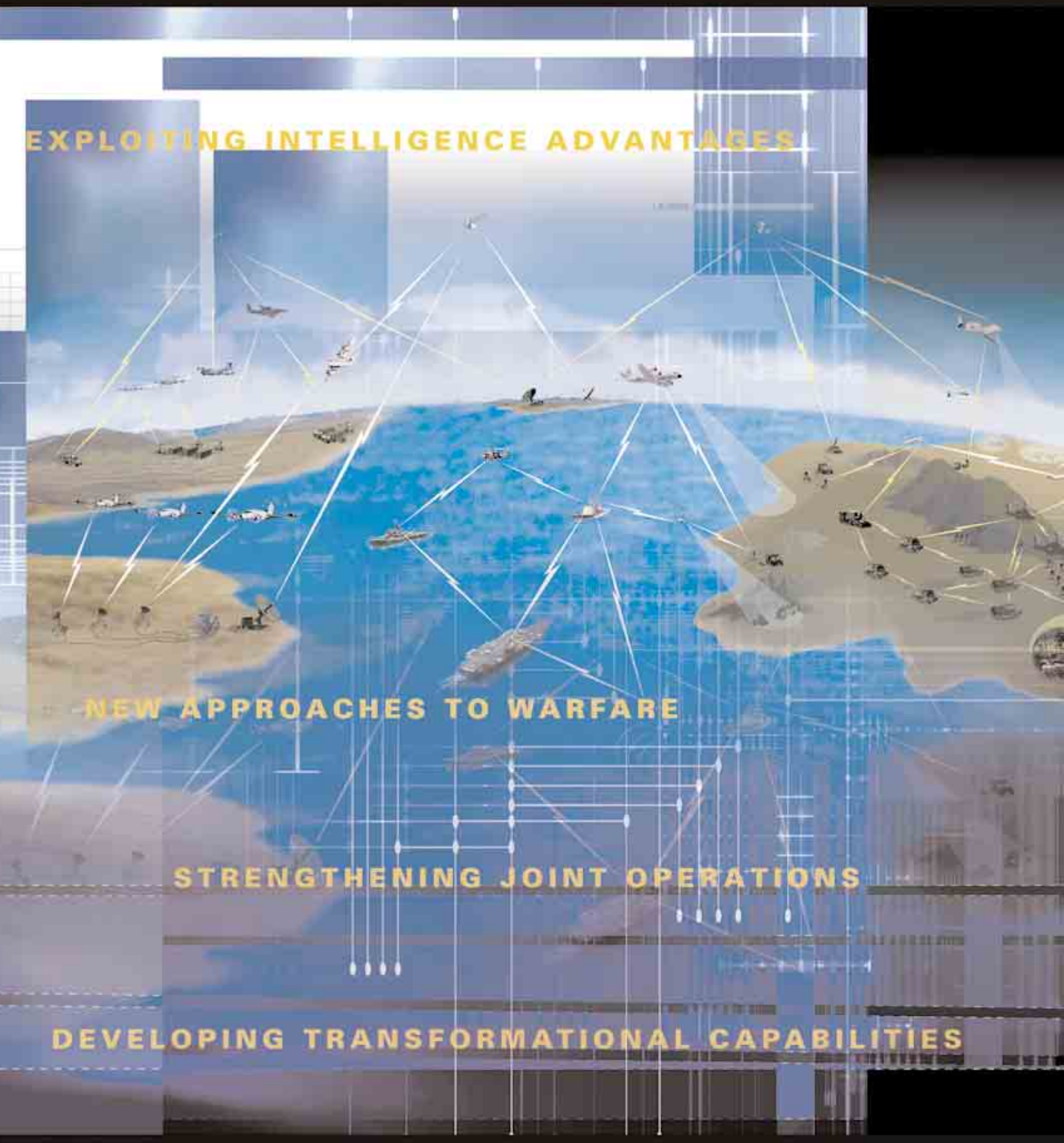
For 2002 and beyond, we believe the company's growth prospects are excellent. The defense electronics portion of the DoD budget is growing significantly. The market for consolidation of defense companies is very robust. L-3's products are number-one or number-two in their market niches because of state-of-the-art technology and quality provided by L-3's employees who develop, manufacture, market and manage them. Our continued confidence in our future results from our belief in the abilities of L-3 employees to anticipate where the technology is going and exceed our customers' expectations.



Frank C. Lanza
Chairman and Chief Executive Officer

Robert V. LaPenta
President and Chief Financial Officer

TRANSFORMING FROM PLATFORM-CENTRIC TO NETWORK-CENTRIC



INTERNET IN THE SKY

Military Recapitalization and Transformation

FROM PLATFORM-CENTRIC TO NETWORK-CENTRIC

The war in Afghanistan proved unequivocally that information dominance provides an unmatchable benefit to US forces. It resulted in real-time battlefield information, dramatically improved response time to enemy threats and, when combined with more precise and lethal weapons, proved devastating to enemy forces.

In the past decade, US military forces have focused on achieving information dominance by beginning to shift from a platform-centric to a network-centric doctrine. Network-centric warfare begins with an intelligence network, which includes information from sensors from space, air, land or sea to provide an image of the battlefield. This situational awareness is then shared

among the decision-makers and the shooters and offers increased speed of command, higher tempo of operations, greater lethality and increased survivability and self-synchronization.

Though there have been some early successes in the drive toward network-centric warfare, there is much more to do to transform the military to meet the requirements of 21st century warfare. Secretary Rumsfeld has noted that the military must begin the process of transforming itself by focusing on a number of capabilities, including information dominance, stealth, integration and interoperability as well as GPS, broadband and space.

In support of that process, Deputy Secretary Pete Aldridge has pointed out that "transformation is a journey, it is not an end-state." As a result, the DoD will focus on the recapitalization of existing legacy systems, which have performed so well in the war in Afghanistan. For instance, there were many instances where B-52s at 30,000 feet provided unprecedented "close air support" using precision bombing. By using existing platforms in new ways, the DoD can benefit from its current and previous investments.

The DoD is also focused on bringing key transformation technologies to military forces to increase interoperability. They include wideband secure communications, intelligence, Multimission Maritime Aircraft (MMA), more UAVs and commencing the Deepwater Program to replace the US Coast Guard's aging platforms. In addition, the DoD is looking to continue its work on developing a missile defense system to protect the US and to increase funding for more precision weaponry.

Photo: EP-3

The EP-3 is the Navy's only land-based signals intelligence reconnaissance aircraft. Its sensitive receivers and high-gain dish antennas enable the EP-3 to exploit a wide range of electronic emissions from within targeted territory.

NETWORK-CENTRIC SENSORS

An important goal for military commanders has always been to try to get inside the decision cycle of the enemy. The key is to compress the "sensor-to-shooter" cycle to the point where US military forces can achieve instantaneous attack. As a result, the next phase in network-centric warfare is to create an integrated, fused picture of the entire battlefield.

L-3 has a significant presence on the major platforms that play a role in the foundation of network-centric warfare. These platforms include UAVs, which can loiter over the battlefield and securely collect and transmit in real-time a continuous flow of information to air, space, sea and ground weapon systems. The Airborne Warning and Control System (AWACS) utilizes a 30-foot rotating radar dome that constructs a picture of all aircraft positions within a designated area.

In addition, there is the Joint Surveillance Target Attack Radar System (JSTARS), the most advanced targeting and battle management system in the world. From a standoff position, the RC-135 Rivet Joint detects, locates, classifies, tracks and targets hostile ground movements. Along with information from U-2s and EP-3s that are passing through the area, all this information is integrated into a fused picture.

To achieve instantaneous attack, US forces will have to use a portfolio of sensors linked together to gather all the information necessary. As a result, the plan is to develop a multi-sensor command and control system. This would tie together manned and unmanned sensors in the air, in space and on the ground, allowing the military to focus on an area with pinpoint accuracy in all-weather conditions.

In the meantime, the military plans to move beyond using the more than 40-year-old 707 platform and therefore is considering the lease of 100 Boeing 767 tankers for its refueling and ISRC requirements. European leaders who are concerned about the lack of

EP-3 Navy Maritime Surveillance

interoperability with the US and who do not have the funding to do large programs are considering shrinking this capability for use on business jets. The UK, for instance, has the Airborne Standoff Radar (ASTOR) program, a ground surveillance system that uses Synthetic Aperture Radar (SAR)/Moving Target Indicator (MTI) technology to obtain high-resolution imagery to identify and track moving vehicles. Other allies will be looking at similar approaches of intelligence gathering.

L-3 INTEGRATED SYSTEMS

By acquiring Aircraft Integration Systems, now known as L-3 Integrated Systems (L-3 IS), L-3 adds a national defense asset to its existing secure communications business to create a complete ISRC capability. L-3 is now a major player in this market and is well-positioned to take advantage of the modernization of legacy platforms as well as the transformation of military assets.

L-3 benefits greatly from the synergies of bringing together its secure communications and ISR assets. L-3 IS products collect and transmit data, providing troops on the ground and in the air with a real-time, three-dimensional view of the area in which they are fighting. This gives commanders full battlefield situational awareness as well as enemy tactics and positions. Its signals intelligence (SIGINT) systems collect, decode and analyze electronic signals from command centers, communication nodes and air defense for real-time communication and response to the warfighter.

In addition, L-3 IS brings long-term contracts for key platforms and special programs, similar to L-3's existing engine of growth – U-2. The company is a leader in integration services and modernization of key, special-purpose fixed-wing platforms and programs, including the U-2, the RC-135 Rivet Joint, EP-3, AC-130 and the UK ASTOR program. In conjunction with L-3's acquisition of Spar Aerospace, an international provider of turnkey aviation life cycle management services for military and commercial aircraft, L-3 is now a leader in the aircraft services segment of the market.

With L-3 IS, the company now will have a window into the technologies and products that will be needed in ISRC for the future. In the past, the government served as the integrator and decided which subcontractors would provide products. Today, prime contractors have largely taken on that role, utilizing most of the government-funded R&D and making the "make or buy" decisions on products and subsystems. L-3 will now have a seat at the table where the requirements are being determined, giving L-3 an enormous advantage in the development of a number of future defense electronic products.

Photo: TCDL

L-3's real-time ISR data links move important intelligence information from the air to the ground. From small UAVs to large wide-body airplanes, L-3 data links connect sensor information to the people who need it.

L-3'S SECURE COMMUNICATIONS

While L-3 IS products gather the data needed to determine a plan of action, the company's secure communications relay the data to the warfighters and the command centers so actions can be executed.

Because of the success of the U-2 during the war in Afghanistan, L-3 received a contract to upgrade the aircraft with next-generation data link technology. L-3 also produces the airborne integrated communication system for both the Predator and Global Hawk UAVs. Because these UAVs performed so well during the war, it is expected that the military will purchase more and will increase their role and mission. In another milestone for the Global Hawk, it won the 2001 Collier Trophy for the greatest achievement in aeronautics in America.

L-3 also works extensively with US government agencies as a primary supplier of signals intelligence and signal processing systems. The company developed the SkyHawk 2000, a lightweight UAV-based payload designed to detect, identify and locate communications and non-communications emitters to vastly improve situational awareness for the tactical commander.

In an era of heightened danger, it is important for military leaders and government officials to be able to communicate securely without fear of intrusion. Every year, L-3 deploys tens of thousands of its Secure Terminal Equipment (STE) to the government to ensure that its communications are encrypted and protected against espionage. STE is a multimedia unit featuring secure video and voice teleconferencing, secure fax and data transfer at ISDN speeds and is approved for communication of classified voice and/or data.

The world of banking and commerce is also vulnerable to tampering. L-3 produced the Integrated Key Management System (IKMS), using technology developed for use by the US government, including electronic management and protection of keying materials from a central location.

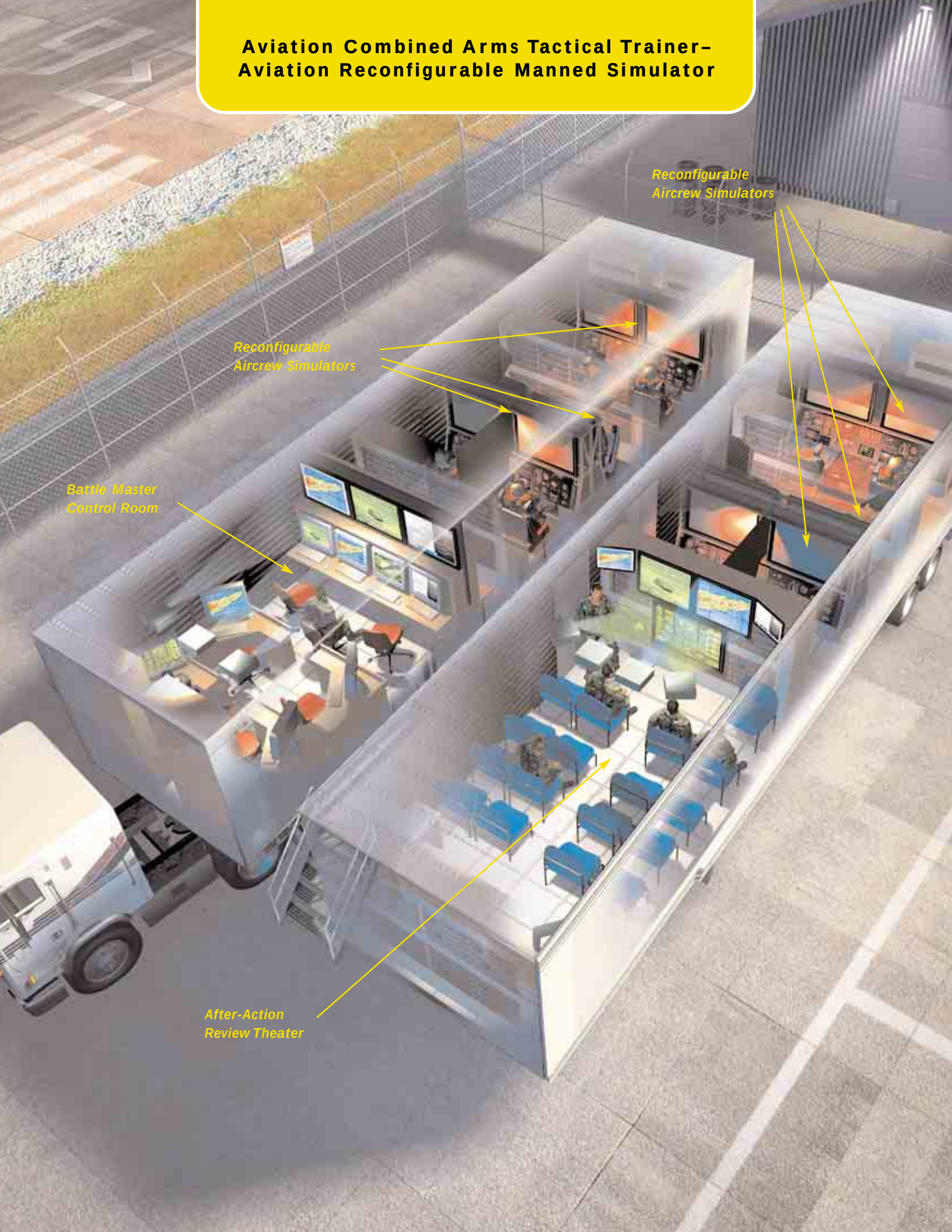
OCEAN PRODUCTS

To help meet the Navy's need for modernization of existing ships, L-3 provides state-of-the-art bridge controls, radio rooms and secure communications to help the Navy operate and communicate more efficiently. The Integrated Voice Communications System (IVCS) for Aegis cruisers and destroyers is a full-function tactical communications switching system that supports the demands of a modern combat system. MarCom is the Navy's newest commercial digital integrated voice/data switching system for affordable command and control communications and radio room automation. L-3 also provides the displays and processors for the Virtual Imaging System for Approach and Landing (VISUAL),

Photo: DDG-51

L-3's Integrated Voice Communications System (AN/STC-2) has been deployed on every Aegis cruiser and destroyer built, including the DDG-51. After delivering 75 STC-2 shipsets, L-3 will be transitioning the Aegis shipbuilding program to its newer technology MarCom™ IVCS starting with the DDG-99.

Aviation Combined Arms Tactical Trainer–Aviation Reconfigurable Manned Simulator



which will be used to upgrade US Navy carriers and amphibious assault ships to ensure safe and efficient recovery of aircraft in severe weather and nighttime conditions.

Along with its communication systems and switches, L-3 manufactures sonar sensors and systems, underwater communication systems, handheld diver sonar, mine detection and identification equipment and submarine target simulators for Anti-Submarine Warfare (ASW) training. L-3's Helicopter Long Range Active Sonar (HELRAS) is the highest performance helicopter dipping sonar in the world. The compact Low Frequency Active Towed Sonar (LFATS) system is used on ASW surface ships to detect, localize and prosecute an ever-growing number of quiet diesel/electric submarines.

Mine countermeasures are becoming increasingly important for the Navy to ensure that its fleets can carry out operations in the open oceans and littorals. L-3's Active Side Looking Sonar (ASLS) is an inexpensive, high-performance side-scan sonar for very high quality, high-resolution bottom imaging. Its Expendable Mine Destructor (EMD) is a small, self-propelled weapon for the identification and destruction of sea mines. The target is detected and classified with various minehunting sonars, then target coordinates are automatically programmed into the EMD to attack and kill the target.

L-3's naval systems have been sought after by US allies. L-3 is a member of the EUROSONAR consortium that selected HELRAS as the basis of its SONICS system NH-90 helicopter. In 2001, L-3 also signed contracts to supply HELRAS to both the Turkish and Greek navies.

For the future, the Navy will also be focused on developing a DD(X) class of vessels. Formerly known as the DD-21, the DD(X) will be the technology driver for the surface fleet of the future for sailors and marines. L-3 teamed with Lockheed Martin and General Dynamics on the Blue Team in its bid to provide communications and electric drive equipment to this proposed vessel.

SIMULATION AND TRAINING

The rise of new security threats and the movement for a leaner, more agile fighting force combined with the need to spend more money on procurement, make the cost-effectiveness and the flexibility of simulation an ideal training vehicle. In addition, the technological advances of supercomputing, advanced graphics processors, commercial-off-the-shelf software and high-speed, broadband access have dramatically improved the battlefield fidelity, interoperability and flexibility of simulation.

In the future, there will be continuing breakthroughs in raw computing power, software and broadband technology that will make the promise of distance learning a reality. Added to that will be bringing human variability into the simulation equation. Incorporating the impact of human behavior – including improvisation and mistakes – will make simulation even more realistic and effective as a training tool.

To support the military objective to "train as you fight, fight as you train," L-3 has a variety of simulation and training products from high-fidelity part task trainers to large-scale mission rehearsal domes for air platforms and artillery crews.

For the Army, L-3 has developed the Aviation Combined Arms Tactical Trainer-Aviation Reconfigurable Manned Simulator (AVCATT-A) – the first collective trainer that focuses on flying a helicopter in a totally

Photo: AVCATT-A

In 2002, Link Simulation and Training will deliver the US Army's first Aviation Combined Arms Tactical Trainer-Aviation Reconfigurable Manned Simulator suites. This reconfigurable helicopter simulation system – which houses each suite in two mobile 53-foot semitrailers – will enable commanders to mix and match helicopter platforms and enable aircrews to work as cohesive units during the conduct of complex simulated training missions. Immediately after these exercises, commanders and aircrews will be able to review what went right, what went wrong and what skills or tactics need to be refined.

integrated battlefield environment. Pilots and their crews can practice a full range of tactical scenarios over a common virtual battlefield. These trainers are also interoperable with the Service's currently fielded simulators supporting ground-based mechanized unit training.

Another key element is that these trainers are reconfigurable. In 90 minutes, they can be changed to other air platforms. The first three training suites will be delivered with four reconfigurable simulator types, including the AH-64A Apache, OH-58D Kiowa Warrior, UH-60 Black Hawk and CH-47D Chinook. The AH-64D Longbow Apache and RAH-66 Comanche will be added in the future.

L-3's F-16 Unit Training Devices (UTDs), which are used to train every Air Force and Air National Guard F-16 pilot, reached one million hours of service. In 2001, Link was awarded a contract for the F-16 Aircrew Training Devices (ATD) program, part of the US Air Force's Training Systems Acquisition II program to consolidate the operation, maintenance and support of F-16 aircrew and maintenance trainers.

In this virtual training environment, there are intelligent semi-automated forces. These can be both friendly and enemy forces in three geo-specific terrain databases. The system simulates attack, reconnaissance, cargo and utility aircraft platforms.

Link has also entered the fourth production phase for the Army's Fire Support Combined Armed Tactical Trainer (FSCATT). This program enables field artillery gunnery teams – including cannon crewmen, fire direction specialists and fire support specialists – to train individually and as a team in execution of indirect fire mission operations.

In addition, L-3 is building mission trainers and weapon tactics trainers to support pilot training on the nation's next-generation F-22 stealth fighter aircraft. These devices will be networked to support team-training exercises within a virtual simulated environment. They will support training tasks, including formation flight, air refueling, takeoff and landing, emergency procedures and weapons delivery during air-to-air and air-to-ground combat.

The military is also relying more on simulation in the training of their medical personnel. The US Army

Photo: Predator *(above)*
Predator has become a workhorse for the US government's ISR missions, providing over 24 hours on station. L-3's real-time satellite link provides global connectivity.

Photo: RC-135 *(right)*
The RC-135 Rivet Joint, a converted Boeing 707, is a reconnaissance aircraft with an on-board sensor suite, allowing the mission crew to detect, identify and geolocate signals throughout the electromagnetic spectrum. This aircraft is a silent listener with advanced signals intelligence and communications intelligence capabilities.

RC-135 Rivet Joint: Ears of the Battlefield

U-2:
The Eyes & Ears of the Battlefield

Simulation, Training and Instrumentation Command (STRICOM) has implemented the Combat Trauma Patient Simulator (CTPS) program, a DoD-sponsored initiative to provide an integrated military medical simulation system for training, test and evaluation to more realistically assess the impact of battlefield casualties. METI's Human Patient Simulator, a full-scale, fully interactive simulator used to train healthcare practitioners, is a key component of this program.

L-3's recent acquisitions have strengthened the company's position in the simulation and training market. L-3 Analytics Corporation is the premier contractor for the US Air Force Studies and Analysis Agency, developing and operating numerous air campaign modeling and simulation tools for applications such as Thunder, STORM and Brawler. For thirty years, L-3 Analytics operations have been a trusted SETA partner with the US Air Force, Army, Navy and intelligence agencies.

In May 2001, L-3 acquired EER Systems, a developer of hardware and software for aircraft and navigation/communication simulation systems. This division develops flight and avionics systems maintenance training devices for the Naval Air Systems Command (NAVAIRSYSCOM) and maintains strategic relationships with the Naval Air Warfare Center Training Systems Division (NAWCTSD) and STRICOM. EER has provided support for the Army Defense Satellite Communication System (DSCS) Training System and the Air Force F-15/F-16 Computer-Based Instruction Training System (CBITS) as well as the KC-130, CH-53E, MH-53E, E-2C/C-2A, E-6, AH-1W, UH-1N, H-46 and OH-58 platforms.

MISSILE DEFENSE

In the years since the end of the Cold War, the threat of nuclear war between the then Soviet Union and the US has substantially diminished. In its place has arisen a number of countries having or seeking weapons of mass destruction. Some of them seek to intimidate their neighbors, to threaten the US or to prohibit the US from protecting its allies. Over 20 nations possess or are developing nuclear, biological or chemical weapons. In addition, theater-class ballistic missiles have proliferated and have been used in six regional conflicts so far. There are also many strategic ballistic missiles, such as Intercontinental Ballistic Missiles (ICBMs) and Submarine-

***Photo: U-2** (left)*
Major communication systems upgrades will keep the U-2 flying for many years to come. L-3 has provided the data link systems to the U-2 program for 30 years.

***Photo: Global Hawk** (above)*
Global Hawk is a high-altitude, long-endurance unmanned aerial reconnaissance system designed to provide military field commanders with imagery of large geographic areas. L-3's integrated communications suite provides real-time connectivity both to local field commanders and outside the theater.

Launched Ballistic Missiles (SLBMs) being developed or procured by non-allies.

If there is any doubt about the potential for nuclear war between regional powers, the recent standoff between India and Pakistan is a reminder of how quickly disputes can get out of control. The possibility that each of these nations may not be subject to the same restraints and rules of deterrence as the US and Russia is very sobering. In recent years, the threat of nuclear war in the global sense has not diminished, but substantially increased.

There is some debate about how much of a threat other nations will be to the US and when enemy missile weapon systems will be viable enough to reach American borders or its allies. North Korea, the last surviving hard-line communist state, may test an ICBM capable of ranging the US. There have been reports that Russian missile experts have been providing advice to Iran on their nuclear capability. It should be noted that these ICBMs do not have to be the sophisticated, powerful and highly accurate missiles produced by the US or Russia. They could be in the form of any rocket capable of landing a warhead on US territory.

In his first State of the Union address, President Bush singled out Iraq, Iran and North Korea as pursuing weapons of mass destruction and called them "an axis of evil" that could attack US allies or America. The President, the Congress and the American people have concluded that the US must continue its efforts to build a missile defense program. An examination of technologies and strategies suitable for an effective missile defense program is currently underway.

It is too early to determine the final system configuration. While there are some promising technologies, such as sensors and interceptors, it will take a lot of work to develop a full-fledged system. In the meantime, despite some exercises that did not meet expectations in 2001, there were also some successes.

In 2001, L-3 took several steps toward becoming an important player in the early developmental work of the nation's missile defense efforts. L-3's Coleman Aerospace operation launched its 21st Hera target, which is its sixth in support of the PAC-3 program in 2001. These targets, which are high-fidelity and threat-like, can be launched from relatively primitive launch sites on the ground and can also be air launched from inside a standard military cargo aircraft.

Space & Navigation, a leader in guidance products, was awarded an AMCOM IMU development contract for the Compact Kinetic Energy Missile, which will utilize a modified version of its Silicon Fiber Optic Rotation Sensor (SiFORS) IMU.

IEC has been responsible for the design, manufacture and support of the systems that receive, process and display information to evaluate system performance on the Navy's submarine-launched Fleet Ballistic Missiles, the nation's most survivable and enduring nuclear strike capability. This division also provides Digital Global Positioning System Translators (DGTs) and GPS Translator Processors (GTPs) along with sustained engineering, logistics and field launch support for the Ground-based Midcourse Defense Segment (GMDS), which was formerly known as the National Missile Defense (NMD) program.

Telemetry-West is supplying its System 550 product to GMDS. This telemetry ground system supports

Photo: Extended Range Guided Munition (ERGM)
L-3's Interstate Electronics Corporation is developing the first gun-hardened SAASM-based GPS receiver for the US Navy's ERGM program. One of the biggest challenges of this program is the hardening of electronics to survive the massive shock of launching from the United Defense, L.P., MK-45 Mod 4 5-inch 62-caliber naval gun.

test and integration activities, develops mission capabilities and analyzes performance. When completed, GMDS will be composed of early warning sensors to detect missile attacks, sensors to track and identify the attacking missile warheads, command and control processors to develop and execute the defense engagement plans and interceptor missiles to engage and destroy the threatening warheads.

L-3 Analytics Corporation enables the company to provide a number of products and services, such as modeling and simulation targets for THAAD and missile defense, as well as program and systems support for Joint Exercises.

The acquisition of SY Technology in 2002 brings complementary missile defense and simulation and training to L-3's existing operations. SY provides engineering and analysis for missile test planning and support, strategic and theater missile defense target development, optical seeker technology and missile software engineering. SY also performs independent validation and verification and on-site testing and support for missile defense programs.

SMART PRECISION WEAPONS

One of the most impactful developments in the war in Afghanistan has been the ongoing evolution of smart to all-weather, day/night laser- and satellite-guided precision weapons. Having this capability enables the US to quickly eliminate key targets and, whenever possible, minimize collateral impact.

During the Gulf War, 10% of weapons utilized had precision-guidance capabilities. In Kosovo, the majority of US bombs were laser-guided, which had the potential of running into trouble in bad weather. In Afghanistan, most of the bombs are both all-weather and GPS-guided, which allow longer range visibility and increased effectiveness.

Another major factor in the success of the US war effort has been better targeting information. Because of persistent ISRC and the diligent efforts of the SOF and intelligence operatives, pilots have more accurate and real-time information.

As munitions continue to evolve, L-3 will play a significant role in two leadership areas. In GPS receiver and translator-based products, L-3's µSCIRAS (micro-machined Silicon Coriolis Inertial Rate and Acceleration

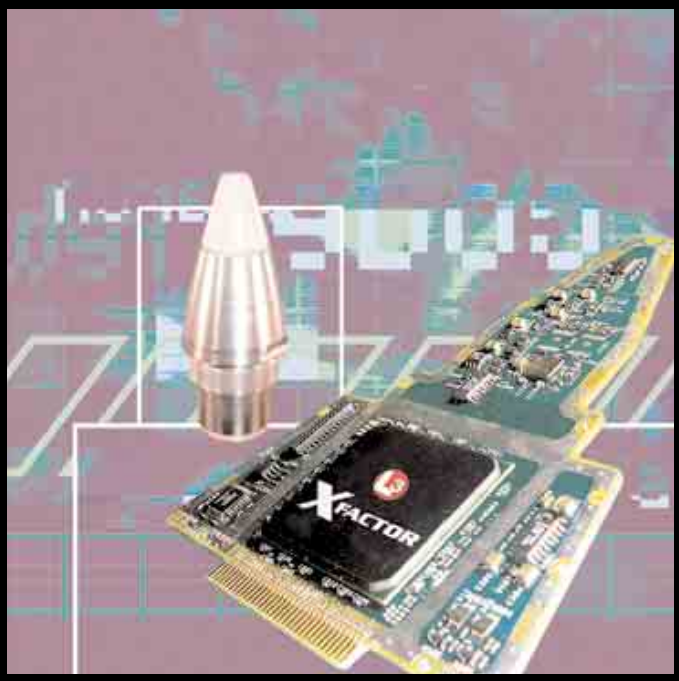


Photo: Fuze and GPS IMU
(left) L-3 KDI manufactures the Army's M782 Multi-Option Fuze for Artillery (MOFA). This multi-mode fuze, which has proximity, time, PD, and delay functions, is the Army's next-generation, NATO-standard all-purpose artillery fuze for bursting munitions. (right) This MEMS IMU is designed for use in all systems requiring tactical grade performance, including guided munitions, missiles and GPS-aided navigation systems.

Sensor) based IMU uses bulk micro-machined silicon multi-sensors and highly integrated micro-electronics to provide a small, light and highly affordable IMU. The IMU is designed for use in all systems requiring tactical-grade performance, including guided munitions, missiles and GPS-aided navigation systems. L-3's GPS products are in use on military aircraft, cruise missiles, booster rockets and precision-guided weapons.

A second area is fuzing and ESADs. By combining L-3's advanced data link and fuzing technologies, L-3 Electrodynamics played a key role in enabling the US government to advance the UAV concept a step further by adding the Hellfire II missile to the Predator UAV. Electrodynamics provides the ESAD for the Hellfire II that enables precise detonation at target impact.

In 2001, L-3 made two important acquisitions in this niche of the market. The first was KDI, a provider of ESADs that prevent the inadvertent firing and detonation of guided missiles during handling, flight operations and the initial phases of launch. The presence of ESAD technology on a number of legacy systems, such as Multiple Launch Rocket System (MLRS), Patriot Missile System and the Army Tactical Missile System (ATACMS) will put L-3 in a good position as the Army transforms into a lighter, more rapidly deployable force.

In addition, KDI provides proximity sensors or ESADs for the warheads on many precision weapons in the military inventory or under development, such as the Joint Standoff Weapon (JSOW), AIM-9X Sidewinder Air-to-Air Missile, Guided Multiple Launch Rocket System (GMLRS), ERGM and the Evolved Sea Sparrow Missile System. KDI allows L-3 to take advantage of synergies with its existing missile guidance businesses. For example, KDI developed the fuzes and IEC developed the integrated GPS/IMU for the Army's XM-982 Extended Range Projectile, the most versatile artillery projectile in the US Army inventory.

Also in 2001, L-3 acquired Bulova Technologies, now known as BT Fuze Products. This company has a catalog of fuzes for artillery systems, mortars, grenades and howitzer-fired projectiles. Because of its presence on a number of key weapon platforms, the division is well-positioned for future upgrades and enhancements on programs such as the Maverick, Minuteman, Sidewinder, Advanced Medium Range Air-to-Air Missile (AMRAAM) and Tactical Munitions Dispenser.

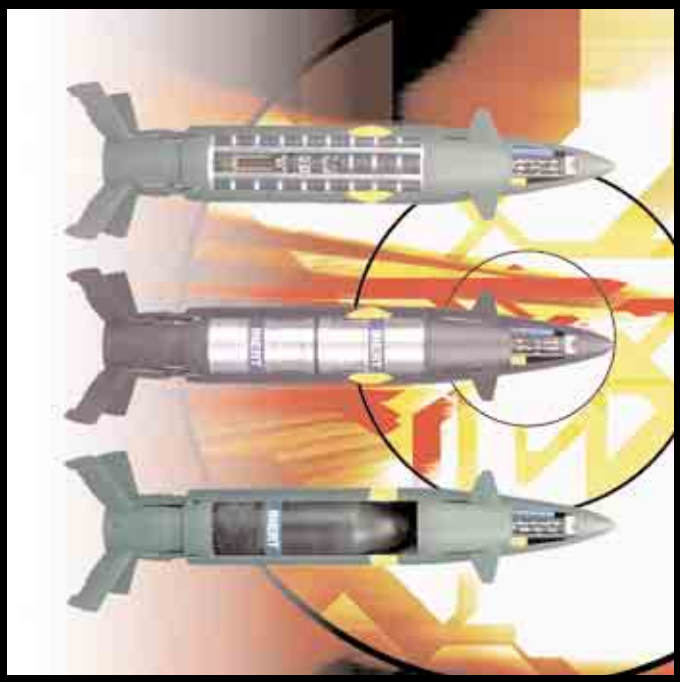
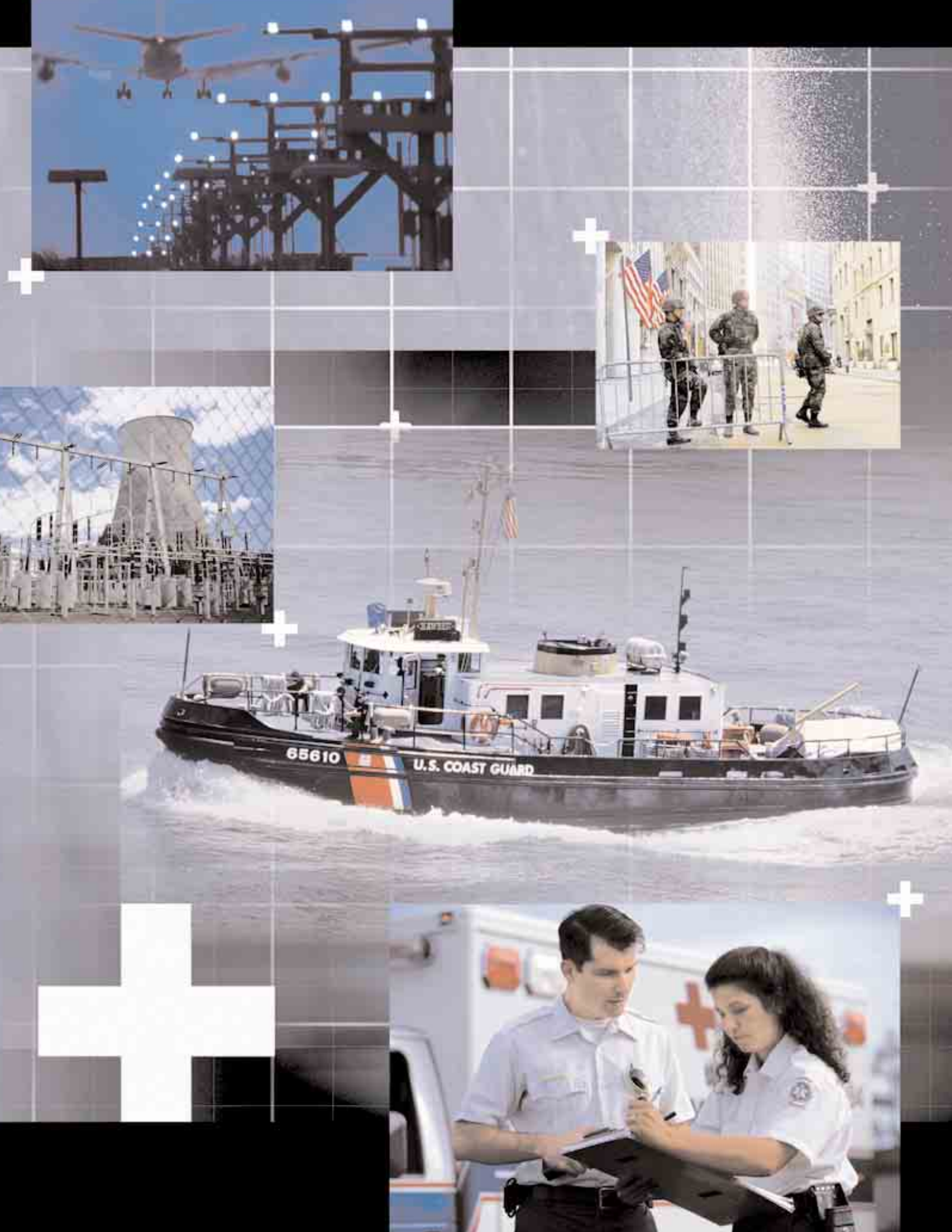


Photo: XM-982
The robust advanced capabilities of the XM-982 will ensure the dominance of the US Navy and offers interoperability with combat forces. L-3 provides GPS-based guidance and fuze products to this critical initiative.


65610
U.S. COAST GUARD

HOMELAND SECURITY

In 1979, after the fall of the Shah of Iran, a sustained terrorist campaign against the US began with the kidnapping of Americans living and traveling abroad. Subsequently, embassies in Beirut and Kuwait were bombed by the Iranian-backed Hezbollah and 200 Marines were killed in a suicide truck bombing. The terror campaign then struck US interests in Somalia in 1992 and has steadily and increasingly aimed more lethal threats at American personnel and facilities. The worst carnage of all was directed at New York City and Washington, DC on September 11th.

With these horrific attacks, the US finally began to realize how vulnerable the nation was to terrorism. All at once, Americans were wondering how safe were their borders, bridges, tunnels, railways, airplanes, food stocks, water reservoirs, nuclear power plants and computer networks. How can an open society protect itself from extremist violence and weapons of mass destruction, including nuclear, biological and chemical threats? Every day, about 1.3 million people enter the country, over 300,000 vehicles drive across borders and close to 60,000 cargo shipments are moved into American ports.

Aware... Prepared... Secure

After September 11th, President Bush asked Tom Ridge, then governor of Pennsylvania, to take charge of homeland security and coordinate the work of 46 government agencies with jurisdictions to protect Americans. In his budget, the president also called for increased funding of $38 billion for homeland security. Some of the funding will be directed to assist the first responders in dealing with crises, purchasing new equipment to protect the mail and those who deliver it, research to combat bioterrorism and money for cities and states to guard against terrorist attacks and develop crisis management capabilities. There are 36,000 local jurisdictions in the US so it will be an enormous effort to ensure that all are prepared.

Currently, federal, state and local law enforcement is focused on prevention and preparedness measures and is reevaluating its domestic security policies and procedures. Government agencies, police, fire and emergency response teams have created joint terrorism task forces to develop plans and countermeasures to protect the most vulnerable or likely terrorist targets and establish chain of command procedures to facilitate communications and cooperation in the event of an emergency.

The administration has warned that there may be more devastating attacks on the US in the future. As a result, the civilian sector is looking to the defense sector to model their plans and preparations because the military has long demonstrated its ability to quickly respond to threats domestically and internationally. Because L-3 has played a role in many of the military's security operations, it can apply those systems and products to the civilian sector.

TRANSPORTATION SAFETY

Securing air travel is a primary concern for Congress and it created the Transportation Security Administration (TSA) to implement a number of increased measures to safeguard the skies. In 2001, Congress passed the Transportation Security Act requiring the screening of all checked baggage by the end of 2002. It is estimated that over 2,000 machines and 35,000 inspectors will be required to implement this directive.

L-3 has one of the two explosive detection systems certified by the FAA for checked baggage screening. The eXaminer 3DX™ 6000 has many operational advantages over the competition, including a smaller footprint, lighter weight and higher bag processing speed. Since September 11th, there has been a rapid deployment of L-3's systems to perform this complex screening. In addition, the TSA has defined BWI airport as a model for domestic airports and four L-3 systems were installed.

Unfortunately, carry-on baggage is not currently screened for explosives. In addition, suicide terrorists who hide explosives in their clothing and shoes can pass through existing conventional X-ray systems without detection. L-3 is currently working on leading-edge, non-intrusive systems to screen passengers and systems to monitor carry-on bags as well.

Passenger aircraft as well as all-cargo aircraft are also vulnerable to explosive threats. Container ships are equally at risk. In October of 2001, Italian authorities found a suspected al Qaeda operative locked in a shipping container bound for Canada. Inside, the suspect had all he needed for a long trip, along with airport maps, security passes and an airport mechanic's certificate.

L-3's agreement to acquire PerkinElmer's Detection Systems will enable L-3 to have a substantial cargo screening business. Its Air Cargo X-ray system allows the rapid inspection of the cargo pallets and containers that are carried on both the main and lower decks of passenger and freighter aircraft. All sizes of containers and pallets carried in these aircraft can be examined in seconds, thus allowing the detection of misrepresented goods, weapons, explosives and other dangerous items.

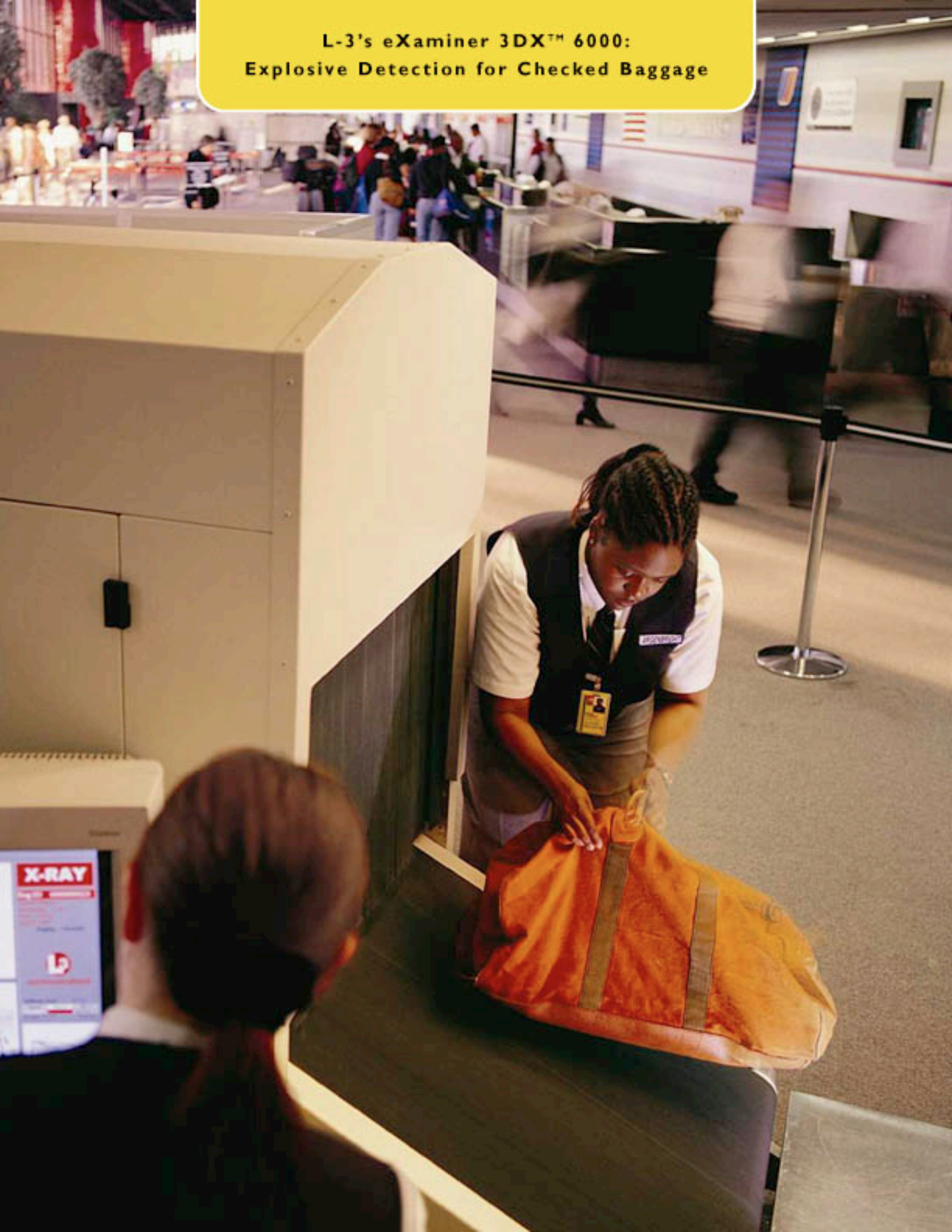
L-3's ACSS led an FAA task force charged with making recommendations that will increase safety and security for the flying public. Focusing on the Mode S transponder that transmits aircraft position information to Air Traffic Control (ATC) and other aircraft, ACSS recommended minor software changes that would allow pilots to alert ATC of an emergency situation with a simple flip of a switch. Because the ACSS Mode S transponder is the industry's most technologically advanced transponder for air transport aircraft, airlines could make these modifications in less than 10 minutes.

To increase safety in the maritime industry, L-3's Aviation Recorders division developed the Hardened Voyage Recorder (HVR). Similar to the cockpit voice and flight data recorders used in commercial airlines, L-3's HVR records voice, radar, radio and shipboard performance data

Photo: Explosive Detection System

The eXaminer 3DX™ 6000 is the only FAA-certified explosive detection system to provide a complete 2-D and 3-D view of every checked bag using computer tomography (CT). This system has a throughput of 500 bags per hour and is currently in use in many US airports including BWI (shown), as well as in the Rome Airport.

L-3's eXaminer 3DX™ 6000:
Explosive Detection for Checked Baggage



on solid state memory housed in a crash-protected capsule. Fitted with an underwater locator beacon, the capsule is designed to withstand the harsh environments of ocean-going passenger ships, ferries and large cargo ships, including those associated with an accident, such as impact, deep sea pressure and fire.

DEEPWATER

The US Coast Guard's mission is large – to protect ports, the flow of commerce and the marine transportation system from terrorism and to maintain maritime border security against contraband, firearms and weapons of mass destruction, along with a host of other major responsibilities. However, its Deepwater assets are aging and technologically obsolete. In fact, the Coast Guard Deepwater cutters are the 37th oldest of 39 similar fleets worldwide and the demands on its service are far greater than any other fleet.

With this emphasis on homeland security, the Coast Guard must replace its aging fleet with the latest technology, including advanced communications systems. The Coast Guard has initiated the Integrated Deepwater System Program. The Deepwater Program seeks to renovate, modernize and/or replace the Coast Guard's entire portfolio of Deepwater ships and planes with an integrated system of surface, air, C4ISR and logistics capabilities.

L-3 has a number of products for the Coast Guard as it revamps its fleet. There are advanced radio rooms, secure communications, power switches, hardened voyage recorders and other products for ships as well as a host of products for helicopters and fixed-wing aircraft, including displays, antennas, data recorders and data links.

Photo: TCAS

L-3's Traffic Alert and Collision Avoidance Systems (TCAS) track aircraft within certain range and altitude bands to determine whether they have the potential to become a safety hazard. T²CAS, developed with joint-venture partner Thales Avionics, integrates TCAS technology with Terrain Avoidance Warning System (TAWS). In addition to the new T²CAS traffic and terrain avoidance system, ACSS supplies TCAS 2000 and Mode S transponders to the global aviation market.

INFORMATION SECURITY

As conflicts evolve into a battle of information, there is a renewed focus on information security. L-3 developed the OMNI™ Secure Terminal, a small, portable unit designed for government communications that provides encryption for both voice and data and supports desktop, network and portable wireline user requirements.

L-3, in conjunction with Cylink Corporation, was also selected to develop and manufacture the classified government Virtual Private Network (VPN) under the brand name RedEagle™. RedEagle will incorporate a level of security available only to US military services and government agencies.

For the commercial market, L-3 introduced Privatel, an inexpensive commercial voice encryption unit. Privatel is a small, portable security module that operates in conjunction with virtually any telephone to protect conversations from wiretapping and eavesdropping. The Privatel device, the only commercial secure voice encryption unit in the world today with FIPS-140 certification, was an honoree in the telephony category at the 2002 International Consumer Electronics Show (CES).

INTRUSION DETECTION

Protecting the nation's infrastructure is an especially daunting task. How does the government ensure that no one is breaching the security of a nuclear power plant or industrial assets such as pipelines, electrical grids and water supplies with the intent to contaminate or destroy? There are products that the military uses to protect the perimeters of locations from intrusion and L-3 is preparing to offer applications of these products to the civil market.

L-3's Rembass-II is an Unattended Ground Sensor (UGS) system that can be used to detect and classify ground and air movements. It can provide unmanned situational awareness, including the number of targets, their location, speed, direction of travel and whether personnel or vehicles are trespassing.

CONSEQUENCE MANAGEMENT AND SIMULATION

One key business area for L-3 in homeland security is providing consequence management to cities and states. MPRI, with its staff of retired military, government and law enforcement personnel, has been assisting many countries in preparing their officials on what steps they need to take in the event of a threat that involves either military or police actions. MPRI is already working with US state and local government officials in applying threat and vulnerability assessment, resource planning and consequence management to their own operations.

Another major part of preparing for threats and emergencies is the use of simulation by police, fire and emergency workers. Military forces have been effectively using simulation, as well as field exercises to prepare for threats. Cities and counties will need simulation and training packages to train emergency response personnel and law enforcement officials for issues relating to crisis management, mass evacuations and the spread of contaminants from chemical and biological weapons. State and local workers need to be able to have life-like, virtual reality training to develop and refine their skills. MPRI, in conjunction with L-3's Link Simulation and Training, is developing training devices for this market.

Health workers also need training in the event that residents are subject to trauma in a catastrophic event or if weapons of mass destruction are unleashed. Hospitals, medical and nursing schools, community colleges and military bases all over the world have been using METI's Human Patient Simulator (HPS). The HPS is a computer-model-driven, full-sized mannequin that delivers true-to-life scenarios for practitioners. It blinks, speaks and breathes, has a heartbeat and a pulse and accurately mirrors human responses to such procedures as CPR, intravenous medication, intubation, ventilation and catheterization. There is also a PediaSim model that simulates the reactions of children since they have crucial differences in anatomy, drug reactions and other physical conditions. A surgical simulator will be available in the near future.

The Army has been conducting exercises to respond to weapons of mass destruction – using METI's HPS – in the US. These kinds of training exercises will increase as more and more locales train against these potential threats. Models of the HPS for first responder training as well as simulators for training of flight crews are currently in development.

Photo: Aviation Flight Recorder and Maritime Voyage Recorder
L-3 Communications Aviation Recorders, the leader in "black box" technology, provides solid state cockpit voice, flight data and hardened voyage recorders as high-capacity, low-cost solutions in both aviation and maritime markets.

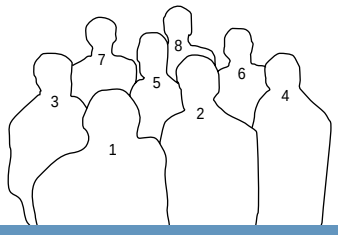
Financial Statements and Other Information

Photo:

At Glenmont, the residence of Thomas Edison

Board of Directors:

1 Frank C. Lanza
Chairman and Chief Executive Officer
2 Robert V. LaPenta
President and Chief Financial Officer
3 Alan H. Washkowitz
4 Arthur L. Simon
5 Robert B. Millard
6 General (Ret.) John M. Shalikashvili
7 John E. Montague
8 Thomas A. Corcoran



Selected Financial Data

We derived the selected financial data presented below as of December 31, 2001 and 2000 and for each of the three years in the period ended December 31, 2001 from our audited consolidated financial statements included elsewhere herein. We derived the selected financial data presented below as of December 31, 1999, 1998 and 1997 and for the nine months ended December 31, 1997 from our audited consolidated financial statements not included herein. We derived the selected financial data presented below for the three months ended March 31, 1997 from the audited combined financial statements of our predecessor company not included herein. You should read the selected financial data together with our "Management's Discussion and Analysis of Results of Operations and Financial Condition" and our audited consolidated financial statements.

	L-3					Predecessor Company
	Year Ended December 31,				Nine Months Ended December 31,	Three Months Ended March 31,
(in millions except per share data)	2001[1]	2000[1]	1999[1]	1998[1]	1997[2]	1997
Statement of Operations Data:						
Sales	$2,347.4	$1,910.1	$1,405.5	$1,037.0	$546.5	$158.9
Operating income	275.3	222.7	150.5	100.3	51.5[3]	7.9
Interest expense, net of interest and other income	84.5	88.6	55.1	46.9	28.5	8.4
Provision (benefit) for income taxes	70.8	51.4	36.7	20.9	10.7	(0.2)
Minority interest	4.5	—	—	—	—	—
Net income (loss)	115.5	82.7	58.7	32.6	12.3[3]	(0.3)
Earnings per common share:						
Basic	$ 3.08	$ 2.48	$ 1.83	$ 1.32	$ 0.62[3]	
Diluted	$ 2.95	$ 2.37	$ 1.75	$ 1.26	$ 0.61[3]	
Weighted average common shares outstanding:						
Basic	37.4	33.4	32.1	24.7	20.0	
Diluted	42.7	35.0	33.5	25.9	20.0	
Balance Sheet Data (at period end):						
Working capital	$ 714.3	$ 360.9	$ 255.5	$ 157.8	$143.2	
Total assets	3,335.4	2,463.5	1,628.7	1,285.4	697.0	
Long-term debt	1,315.3	1,095.0	605.0	605.0	392.0	
Shareholders' equity	1,213.9	692.6	583.2	300.0	113.7	

(1) The results of operations are impacted significantly by our acquisitions described elsewhere herein.
(2) Reflects the acquisition of our predecessor company and the commencement of our operations effective April 1, 1997.
(3) Includes a nonrecurring, noncash compensation charge of $4.4 million ($0.22 per share) related to our initial capitalization, which we recorded effective April 1, 1997.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Overview

We are a leading merchant supplier of sophisticated secure communication systems and specialized products. These systems and products are critical elements of virtually all major communication, command and control, intelligence gathering and space systems. Our customers include the U.S. Department of Defense ("DoD"), certain U.S. Government intelligence agencies, major aerospace and defense contractors, foreign governments, commercial customers and certain other government agencies. We have two reportable segments: Secure Communication Systems and Specialized Products.

Our Secure Communication Systems segment provides secure, high data rate communication systems for military and other U.S. Government reconnaissance and surveillance applications. The Secure Communication Systems segment also produces advanced simulation and training products, and provides a wide range of engineering development and integration support to the DoD and other U.S. federal, state and local government agencies, communication software support services and a full range of teaching, training, logistic and training device support services to domestic and international military customers, and custom ballistic targets for the DoD. Our Specialized Products segment includes three product categories: avionics and ocean products, telemetry, instrumentation and space products and microwave components.

All of our domestic government contracts and subcontracts are subject to audit and various cost controls, and include standard provisions for termination for the convenience of the U.S. Government. Multiyear U.S. Government contracts and related orders are subject to cancellation if funds for contract performance for any subsequent year become unavailable. Foreign government contracts generally include comparable provisions relating to termination for the convenience of the relevant foreign government.

Acquisitions and Divestitures

The table below summarizes the material acquisitions that we have completed during the three years ended December 31, 2001.

Acquired Company	Date Acquired	Purchase Price[1]
Microdyne Corporation	January 8, 1999	$91.1
Aydin Corporation	April 16, 1999	$70.5
Interstate Electronics Corporation	June 30, 1999	$40.0
Space and Navigation Systems	December 31, 1999	$55.2
TDTS business of Raytheon Company ("TDTS")	February 10, 2000	$158.1[2]
Trex Communications Corporation	February 14, 2000	$49.3
Traffic Alert and Collision Avoidance Systems ("TCAS")	April 28, 2000	$239.2
MPRI, Inc. ("MPRI")	June 30, 2000	$39.6[3]
Coleman Research Corporation ("Coleman")	December 29, 2000	$60.0[4]
KDI Precision Products	May 4, 2001	$78.9
EER Systems ("EER")	May 31, 2001	$119.4[5]
Spar Aerospace Limited ("Spar")	November 23, 2001	$146.8[6]
Emergent Government Services Group	November 30, 2001	$39.8[7][8]
BT Fuze Products	December 19, 2001	$49.5[7]
SY Technology ("SY")	December 31, 2001	$48.0[7][9]

(1) Purchase price represents the contractual consideration for the acquired business excluding adjustments for net cash acquired and acquisition costs.
(2) Following the acquisition we changed TDTS's name to L-3 Communications Link Simulation and Training.
(3) Includes $4.0 million of additional purchase price that was based on the financial performance of MPRI for the year ended June 30, 2001.
(4) Excludes additional purchase price, not to exceed $5.0 million, which is contingent upon the financial performance of Coleman for the year ended December 31, 2001.
(5) Excludes additional purchase price, not to exceed $10.0 million, which is contingent upon the financial performance of EER for the year ended December 31, 2001 and the year ending December 31, 2002.
(6) Includes $43.6 million for the remaining 29.7% of the outstanding common stock of Spar at December 31, 2001 that we acquired and paid for in January 2002.
(7) Purchase price is subject to adjustment based on actual closing date net assets or net working capital of the acquired business.
(8) Following the acquisition we changed Emergent Government Services Group's name to L-3 Communications Analytics.
(9) Excludes additional purchase price, not to exceed $4.8 million, which is contingent upon the financial performance of SY for the year ended December 31, 2001 and the years ended December 31, 2002 and 2003.

On January 14, 2002, we agreed to acquire Aircraft Integration Systems ("AIS"), a division of Raytheon Company, for $1.13 billion in cash. The acquisition was completed on March 8, 2002, and was financed using cash on hand, borrowings under our senior credit facilities and a $500.0 million senior subordinated bridge loan. We expect to offer and sell approximately $1.0 billion of debt and equity securities during the first half of 2002, depending on capital market conditions, and use the proceeds from those offerings to repay the $500.0 million senior subordinated bridge loan and the borrowings made under the senior credit facilities.

On January 2, 2002, we agreed to acquire the detection systems business of PerkinElmer for $100.0 million in cash. The acquisition is subject to customary closing conditions including clearance under the Hart-Scott-Rodino Antitrust Improvements Act. We expect to complete this acquisition during the second quarter of 2002.

Additionally, we purchased other businesses during 1999, 2000 and 2001 which individually and in the aggregate were not material to our consolidated results of operations, financial position or cash flows in the year acquired.

All of our acquisitions have been accounted for as purchase business combinations and are included in our consolidated results of operations from their respective effective dates.

On May 31, 2001, we sold a 30% interest in Aviation Communications and Surveillance Systems LLC ("ACSS") which comprises our TCAS business to Thales Avionics, a wholly owned subsidiary of Thales (formerly Thomson-CSF), for $75.2 million of cash. We continue to consolidate the financial statements of ACSS.

We regularly evaluate potential acquisitions and joint venture transactions, but we have not entered into any other agreements with respect to any material transactions at this time.

Critical Accounting Policies

Our significant accounting policies are described in Note 2 to the consolidated financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs and expenses during the reporting period. The most significant of these estimates and assumptions relate to contract estimates of sales and estimated costs to complete contracts in process, estimates of market values for inventories reported at lower of cost or market, estimates of pension and postretirement benefit obligations, recoverability of recorded amounts of fixed assets and goodwill, income taxes, including the valuations of deferred tax assets, litigation and environmental obligations. Actual results could differ from these estimates. We believe the following critical accounting policies contain the more significant judgements and estimates used in the preparation of our financial statements.

Revenue Recognition on Contracts and Contract Estimates. The substantial majority of our direct and indirect sales to the U.S. Government and certain of our sales to foreign governments and commercial customers are made pursuant to written contractual arrangements or "contracts" to design, develop, manufacture and or modify complex products, and to the specifications of the buyers (customers) or to provide services related to the performance of such contracts. These contracts are within the scope of the American Institute of Certified Public Accountants Statement of Position 81-1 *Accounting for Performance of Construction – Type and Certain Production-Type Contracts* ("SOP 81-1"), and sales and profits on them are recognized using percentage-of-completion methods of accounting. Sales and profits on fixed-price production contracts whose units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their selling prices (the "units-of-delivery" method). Sales and profits on other fixed-price contracts are recorded based on the ratio of total actual incurred costs to date to the total estimated costs for each contract (the "cost-to-cost method"). Sales and fees on cost-reimbursable contracts are recognized as costs are incurred. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. Under the percentage-of-completion methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance which can exceed one year. The impact of revisions in profit estimates are recognized on a cumulative catch-up basis in the period in which the revisions are made. Provisions for anticipated losses on contracts are recorded in the period in which they become

evident. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows, as well as our valuations of Contracts in Process.

Accounting for the profit on a contract requires estimates of (1) the contract value or total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's scope of work and (3) the measurement of progress towards completion. The estimated profit or loss on a contract is equal to the difference between the contract value and the estimated total cost at completion. Adjustments to original estimates are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur.

Valuation of Deferred Tax Assets and Liabilities. At December 31, 2001, we had net deferred tax assets of $160.8 million, including $32.5 million for net operating loss carryforwards and $31.9 million for tax credit carryforwards which are subject to various limitations and will expire if unused within their respective carryforward periods. Deferred taxes are determined separately for each of our tax-paying entities in each tax jurisdiction. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback and carryforward periods available under the tax law. Based on our estimates of the amounts and timing of future taxable income, we believe that we will realize our recorded deferred tax assets. A change in the ability of our operations to continue to generate future taxable income could affect our ability to realize the future tax deductions underlying our net deferred tax assets, and require us to provide a valuation allowance against our net deferred tax assets. Such changes, if significant, could have a material impact in our effective tax rate, results of operations and financial position in any given period.

Results of Operations

The following information should be read in conjunction with our consolidated financial statements. Our results of operations for the periods presented are impacted significantly by our acquisitions. (See Note 3 to the consolidated financial statements for a discussion of our acquisitions.) The tables below provide our selected income statement data for the years ended December 31, 2001, 2000 and 1999.

Segment Operating Data

(in millions)	Year ended December 31, 2001	2000	1999
Sales[1]:			
Secure Communication Systems	**$1,241.6**	$ 847.1	$ 542.9
Specialized Products	**1,105.8**	1,063.0	862.6
Total	**$2,347.4**	$1,910.1	$1,405.5
Operating income:			
Secure Communication Systems	**$ 146.2**	$ 91.3	$ 47.0
Specialized Products	**129.1**	131.4	103.5
Operating income	**$ 275.3**	$ 222.7	$ 150.5
Depreciation and amortization expenses included in operating income:			
Secure Communication Systems	**$ 33.7**	$ 26.4	$ 18.4
Specialized Products	**53.3**	47.9	35.3
Total	**$ 87.0**	$ 74.3	$ 53.7
EBITDA[2]			
Secure Communication Systems	**$ 179.9**	$ 117.7	$ 65.4
Specialized Products	**182.4**	179.3	138.8
Total	**$ 362.3**	$ 297.0	$ 204.2

(1) Sales are after intersegment eliminations. See Note 16 to the consolidated financial statements.

(2) EBITDA is defined as operating income plus depreciation expense and amortization expense (excluding the amortization of debt issuance costs). EBITDA is not a substitute for operating income, net income or cash flows from operating activities as determined in accordance with accounting principles generally accepted in the United States as a measure of profitability or liquidity. EBITDA is presented as additional information because we believe it to be a useful indicator of our ability to meet debt service and capital expenditure requirements. EBITDA as we defined it may differ from similarly named measures used by other entities.

Year Ended December 31, 2001 Compared with Year Ended December 31, 2000

Sales increased $437.3 million to $2,347.4 million in 2001 compared with 2000. Sales grew $394.5 million in the Secure Communication Systems segment and $42.8 million in the Specialized Products segment. Operating income increased $52.6 million to $275.3 million in 2001 compared with 2000. Operating income as a percentage of sales ("operating margin") remained unchanged at 11.7%. Depreciation and amortization expenses increased $12.7 million to $87.0 million in 2001, reflecting increased goodwill amortization associated with our acquisitions and additional depreciation related to our capital expenditures and acquired businesses. Our EBITDA for 2001 increased $65.3 million to $362.3 million. EBITDA as a percentage of sales ("EBITDA margin") was 15.4% in 2001 compared with 15.5% in 2000. Basic earnings per share ("EPS") grew 24.2% to $3.08 in 2001 and diluted EPS grew 24.5% to $2.95 in 2001. Diluted weighted-average common shares outstanding increased 22.2% in 2001, primarily because of the sale of our common stock in April 2001, and the dilutive effect of our Convertible Notes we sold in the fourth quarter of 2000 (see Liquidity and Capital Resources section below).

Sales within our Secure Communication Systems segment increased $394.5 million or 46.6% to $1,241.6 million in 2001 compared with 2000. Operating income increased $54.9 million to $146.2 million in 2001. Operating margin improved to 11.8% from 10.8%. The increase in sales was principally attributed to the Coleman Research, MPRI and EER acquired businesses and internal growth in our secure data links, secure telephone equipment, airport security systems, Prime Wave fixed wireless access products and training, teaching and logistic services. The increase in operating margin was principally attributable to benefits from increased volumes, cost reductions and improved operating efficiencies on sales of secure telephone equipment and airport security systems. Additionally, the operating margins for our training and simulation businesses continued to improve because of reductions in overhead costs, as well as other contract costs related to favorable performance on the AVCATT contract, arising from engineering design changes, material sourcing changes and unit price reductions on several parts in the contract bill of materials that occurred during 2001. These operating margin improvements were substantially offset by negative margins and increased expenditures associated with our Prime Wave business. EBITDA increased $62.2 million to $179.9 million in 2001 and EBITDA margin improved to 14.5% from 13.9% in 2000.

Sales within our Specialized Products segment increased $42.8 million or 4.0% to $1,105.8 million in 2001 compared with 2000. Operating income decreased $2.3 million in 2001 to $129.1 million. Operating margin decreased to 11.7% from 12.4%. The increase in sales was principally attributable to internal growth in aviation products, microwave components and acoustic undersea warfare products and to the KDI acquired business. These increases in sales were partially offset by decreases in sales of telemetry and space products, naval power equipment and displays. We expect sales of our telemetry and space products for 2002 to remain essentially unchanged as compared to 2001, due to continued softness in the space and broadband commercial communications market. The decline in operating margin was principally attributable to increased costs related to unfavorable performance on certain contracts and lower production and shipment levels for naval power equipment and lower operating margins on telemetry and space products arising from reduced sales volumes. We had higher operating margins on aviation products and microwave components related to increased sales volumes. EBITDA increased $3.1 million to $182.4 million in 2001 and EBITDA margin decreased to 16.5% from 16.9% in 2000.

Interest expense decreased $6.6 million to $86.4 million in 2001 because of lower interest rates, changes in the components and levels of our debt, and savings of $4.1 million from the interest rate swap agreements we entered into in July 2001 and November 2001. The interest rate swap agreements exchange the fixed interest rate of 8% on our $200.0 million Senior Subordinated Notes due 2008 and the fixed interest rate of 8 1/2% on our $180.0 million Senior Subordinated Notes due 2008 to variable interest rates determined using the six month LIBOR rate (see Liquidity and Capital Resources section below).

Interest and other income decreased $2.6 million to $1.8 million. Interest and other income for 2001 includes a net pre-tax gain of $0.6 million ($0.01 per diluted share), consisting of an after-tax gain of $4.3 million from the sale of a 30% interest in ACSS to Thales Avionics and an after-tax charge of $3.9 million on the write-down in the carrying amount of an investment in common stock. Also included in interest and other income for 2001 is a pre-tax charge of $0.5 million to account for the increase, in accordance with the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, in the fair value assigned to the embedded derivatives in our $420.0 million 4% Senior Subordinated Convertible Contingent Debt Securities due 2011 ("CODES") we sold in the fourth quarter of 2001 (see Liquidity and Capital Resources section below) and a pre-tax loss of $0.8 million from an equity method investment. Interest and other income for 2000 includes a net pre-tax gain of $2.5 million ($0.04 per diluted share), consisting of an after-tax gain of $9.2 million from the sale of our interests in certain businesses and an after-tax charge of $7.6 million on the write-down in the carrying value of certain investments and intangible assets. Excluding these net gains from both 2001 and 2000, diluted EPS increased 26.2% to $2.94 in 2001 from $2.33 in 2000.

The income tax provision for 2001 is based on an effective income tax rate for 2001 of 38.0% which declined slightly from the effective tax rate of 38.3% for 2000.

Year Ended December 31, 2000 Compared with Year Ended December 31, 1999

Sales increased $504.6 million to $1,910.1 million in 2000 compared with 1999. Sales grew $304.2 million in the Secure Communication Systems segment and $200.4 million in the Specialized Products segment. Operating income increased $72.2 million to $222.7 million in 2000. Operating margin improved to 11.7% from 10.7%. Depreciation and amortization expenses increased $20.6 million to $74.3 million in 2000, reflecting increased goodwill amortization associated with our acquisitions and additional depreciation related to our capital expenditures and acquired businesses. Our EBITDA for 2000 increased $92.8 million to $297.0 million. EBITDA margin increased to 15.5% in 2000 from 14.5% in 1999. EPS grew 35.5% to $2.48 in 2000 and diluted EPS grew 35.4% to $2.37 in 2000. Basic weighted-average common shares outstanding increased 3.9% in 2000, and diluted weighted-average common shares outstanding increased 4.3% in 2000, primarily because of common stock issued for exercises of employee stock options.

Sales within our Secure Communication Systems segment increased $304.2 million to $847.1 million in 2000 compared with 1999. Operating income increased $44.3 million to $91.3 million in 2000. Operating margin improved to 10.8% from 8.7%. We attribute the increase in sales principally to the acquisitions of Link Training and Simulation and MPRI and increased sales of secure telephone equipment, wideband secure data link programs, communication software support services and airport security systems. The increase in operating margin was principally attributable to improved margins on military communication systems and high data rate communication systems. These margin improvements arose from cost reductions and improved operating efficiencies. Additionally, during 2000 a larger percentage of our sales were generated from fixed-price contracts which generally have higher margins than sales generated from cost-reimbursable contracts. EBITDA increased $52.3 million to $117.7 million in 2000 and EBITDA margin improved to 13.9% from 12.0% in 1999.

Sales within our Specialized Products segment increased $200.4 million to $1,063.0 million in 2000 compared with 1999. Operating income increased $27.9 million to $131.4 million in 2000. Operating margin improved to 12.4% from 12.0%. We attribute this increase in sales principally to the acquisitions of TCAS and Space and Navigation Systems and volume increases on acoustic undersea warfare products, aviation recorders and display products. These increases in sales were partially offset by decreased shipments of naval power equipment in 2000 compared with 1999 principally due to the slippage of certain sales into 2001 which were previously anticipated to occur in 2000. Sales of our telemetry products were essentially unchanged in 2000 compared with 1999 due to continued softness in the space and broadband commercial communications markets. We attribute our increase in operating margin principally to improved margins on avionics and ocean products. These margin improvements arose from sales volume increases, cost reductions and the higher margins from the TCAS business. Lower margins on our naval power equipment due to less shipments and on our telemetry products and microwave components due to changes in product sales mix partially offset these operating margin improvements. EBITDA increased $40.5 million to $179.3 million in 2000 and EBITDA margin improved to 16.9% from 16.1% in 1999.

Interest expense increased $32.4 million to $93.0 million in 2000 principally because of the higher average outstanding debt during 2000. Interest and other income decreased $1.1 million to $4.4 million. Interest and other income for 2000 includes a net pre-tax gain of $2.5 million ($0.04 per diluted share), consisting of an after-tax gain of $9.2 million from the sale of our interests in certain businesses and an after-tax charge of $7.6 million on the write-down in the carrying value of certain investments and intangible assets. Excluding the net gain, diluted EPS was $2.33, an increase of 33.1% in 2000 compared with 1999.

The income tax provision for 2000 is based on an effective income tax rate for 2000 of 38.3% which declined slightly from the effective tax rate of 38.5% for 1999.

Liquidity and Capital Resources

Balance Sheet

During 2001, contracts in process increased $101.7 million to $801.8 million at December 31, 2001. The increase included $61.0 million related to acquired businesses and $40.7 million principally from:

- increases of $56.2 million in unbilled contract receivables principally arising from an increase in programs in production phases, during which unbilled costs and profits generally exceed progress payments and advances received from the customers until contract shipments are completed;
- increases of $31.9 million in inventories, including inventories of our Prime Wave business, naval power equipment products and on certain other programs and products; and
- decreases of $47.4 million in billed receivables due to improved collections on certain programs, partially offset by increases at our Prime Wave business.

Included in contracts in process at December 31, 2001, are billed receivables of $15.8 million and inventories of $30.2 million related to our Prime Wave business. At December 31, 2000, we had $6.4 million of billed receivables and $17.4 million of inventories related to our Prime Wave business.

The increases in property, plant and equipment, intangibles and accrued employment costs during 2001 were principally related to acquired businesses. The decreases in accounts payable and accrued expenses were principally related to the timing of payments to vendors partially offset by balances of acquired businesses. The increase in other current liabilities is primarily attributable to balances of acquired businesses and an accrual of $43.6 million related to the remaining outstanding common stock of Spar at December 31, 2001 that we acquired and paid for in January 2002, and was partially offset by a decline in estimated contract costs in excess of billings to complete contracts in process. The decrease in other liabilities is in part related to the issuance of common stock in April 2001 to satisfy our $17.7 million obligation for the additional purchase price for the ILEX acquisition completed in 1998. The decrease is also related to a reclassification of the current portion of estimated costs in excess of billings to complete contracts in process to other current liabilities.

The decrease in accrued interest was due to the effect of lower interest rates, as well as interest savings of $4.1 million from the interest rate swap agreements we entered into in July 2001 and November 2001, partially offset by an increase in accrued interest due to higher outstanding debt balances at December 31, 2001, attributable to our sale of the CODES in the fourth quarter of 2001. The quarterly cash interest payments on our Senior Subordinated Notes and Convertible Notes in 2001 were $8.0 million in the first quarter and third quarter, $27.6 million in the second quarter and $27.2 million in the fourth quarter. Our cash interest payments may be adjusted in future years due to the interest rate swap agreements we entered into on our $200.0 million 8% Senior Subordinated Notes due 2008 and our $180.0 million 8 1/2% Senior Subordinated Notes due 2008 and changes in the amount of our outstanding debt.

Statement of Cash Flows

The table below provides our cash flow statement data for the years presented.

(in millions)	Year ended December 31, **2001**	2000	1999
Net cash from operating activities	**$ 173.0**	$ 113.8	$ 99.0
Net cash (used in) investing activities	**$(424.9)**	$(608.2)	$(284.8)
Net cash from financing activities	**$ 580.3**	$ 484.3	$ 202.4

Operating Activities

During 2001, we generated $173.0 million of cash from our operating activities, an increase of $59.2 million from the $113.8 million generated during 2000. Earnings adjusted for non-cash items and deferred income taxes increased $83.2 million to $283.5 million in 2001 from $200.3 million in 2000. During 2001, our working capital and operating assets and liabilities increased $110.5 million compared with an increase of $86.5 million in 2000.

In 2001, we used cash for increases in inventories, receivables and negative operating margins related to our Prime Wave business and naval power equipment products, as well as for incurred contract costs in excess of billings for the continued effort on the AVCATT contract. These uses of cash were partially offset by a settlement of certain items related to a services agreement and lower income

tax payments related to an increase in tax deductions for temporary differences between the tax basis and financial reporting amounts for inventoried costs, income recognition on contracts in process, and long-lived assets including goodwill and other intangibles. We expect the amount of our deferred income tax provision for 2002, excluding any additional income tax benefits arising from the acquisition of AIS, to be consistent with that for 2001.

During 2000, we generated $113.8 million of cash from our operating activities, an increase of $14.8 million from the $99.0 million generated during 1999. Earnings adjusted for non-cash items and deferred taxes increased $48.5 million to $200.3 million in 2000 from $151.8 million in 1999. During 2000, our working capital and operating assets and liabilities increased $86.5 million compared with an increase of $52.8 million in 1999. Our cash flows from operating activities during 2000 include uses of cash relating to performance on certain contracts in process including the AVCATT contract that were assumed in the TDTS acquisition for which the estimated costs exceed the estimated billings to complete these contracts.

Investing Activities

In 2001, we invested $446.9 million to acquire businesses, compared with $599.6 million in 2000 and $272.2 million in 1999.

We make capital expenditures for the improvement of manufacturing facilities and equipment. We expect that our capital expenditures for the year ending December 31, 2002 will be between $75 million and $80 million, including Aircraft Integration Systems, compared with $48.1 million for the year ended December 31, 2001. The anticipated increase is principally due to capital expenditures for our acquired businesses. Dispositions of property, plant and equipment for 2000 includes net proceeds of $13.3 million related to a facility located in Hauppauge, NY which we sold and leased back in December 2000.

On May 31, 2001, we sold a 30% interest in ACSS to Thales Avionics for $75.2 million in cash. In 2000, we sold our interests in two businesses for net cash proceeds of $19.6 million, which are included in other investing activities.

On January 14, 2002, we agreed to acquire AIS for $1.13 billion in cash plus acquisition costs. The acquisition was completed on March 8, 2002. The acquisition was financed using cash on hand, borrowings under our senior credit facilities and a $500.0 million senior subordinated bridge loan. We expect to offer and sell approximately $1.0 billion of debt and equity securities during the first half of 2002, depending on capital market conditions, and use the proceeds from those offerings to repay the $500.0 million senior subordinated bridge loan and the borrowings made under the senior credit facilities.

Financing Activities

Debt. In May 2001, we restructured our senior credit facilities. At December 31, 2001, the senior credit facilities were comprised of a $400.0 million five year revolving credit facility maturing on May 15, 2006 and a $200.0 million 364-day revolving facility maturing on May 15, 2002 under which at the maturity date we may, (1) at our request and subject to approval of the lenders, extend the maturity date, in whole or in part, for an additional 364-day period, or (2) at our election, convert the outstanding principal amount thereunder into a term loan which would be repayable in a single payment two years from the conversion date. Additionally, the senior credit facilities provided us the ability to increase, on an uncommitted basis, the amount of either the five year revolving credit facility or the 364-day revolving credit facility up to an additional $150.0 million in the aggregate.

At December 31, 2001, available borrowings under our senior credit facilities were $497.6 million, after reductions for outstanding letters of credit of $102.4 million. There were no outstanding borrowings under our senior credit facilities at December 31, 2001.

On February 26, 2002, the lenders approved a $150.0 million increase in the amount of our senior credit facilities. The five-year revolving credit facility increased by $100.0 million to $500.0 million. The 364-day revolving credit facility increased by $50.0 million to $250.0 million. Additionally, the maturity date of the $200.0 million 364-day revolving credit facility was extended to February 26, 2003.

On March 8, 2002, we borrowed $500.0 million under a senior subordinated bridge loan facility ("Bridge Loan Facility") to finance a portion of the purchase price of AIS and related expenses as discussed above. The Bridge

Loan Facility is subordinated in right of payment to all of L-3 Communications' existing and future senior debt and ranks pari passu with our other senior subordinated indebtedness and related guarantees discussed below. Borrowings under the Bridge Loan Facility bear interest through March 8, 2003, at our option, at either the one-month or three-month LIBOR rate plus a spread equal to 350 basis points. The Bridge Loan Facility matures on May 15, 2009, but if the loans under the facility are not repaid by March 8, 2003, each lender's loan will be automatically converted into an exchange note with terms substantially similar to those of our other senior subordinated indebtedness discussed below, and will bear interest at a fixed rate equal to the yield to maturity on our highest yielding existing subordinated indebtedness at the time of exchange plus 100 basis points. Subject to the exceptions set forth in the Bridge Loan Facility, we are required to prepay the Bridge Loan Facility with the net cash proceeds from:

- any debt offerings by L-3 Holdings or its subsidiaries, including L-3 Communications;
- issuance of any equity interests in L-3 Holdings or L-3 Communications;
- incurrence of any other indebtedness of L-3 Holdings or any of its subsidiaries, including L-3 Communications (other than under the senior credit facilities and certain permitted indebtedness); and
- any sale of assets or stock of any subsidiaries of L-3 Communications.

In the fourth quarter of 2001, L-3 Holdings sold $420.0 million of 4% Senior Subordinated Convertible Contingent Debt Securities due 2011 ("CODES"). The net proceeds from this offering amounted to approximately $407.5 million after underwriting discounts and commissions and other offering expenses. Interest is payable semi-annually on March 15 and September 15 of each year commencing March 15, 2002. The CODES are convertible into L-3 Holdings' common stock at a conversion price of $107.625 per share (3,902,439 shares) under any of the following circumstances: (1) during any Conversion Period (defined below) if the closing sales price of the common stock of L-3 Holdings is more than 120% of the conversion price ($129.15) for at least 20 trading days in the 30 consecutive trading-day period ending on the first day of the respective Conversion Period, (2) during the five business day period following any 10 consecutive trading-day period in which the average of the trading prices for the CODES was less than 105% of the conversion value, (3) if the credit ratings assigned to the CODES by either Moody's or Standard & Poor's are below certain specified ratings, (4) if they have been called for redemption by us, or (5) upon the occurrence of certain specified corporate transactions. A Conversion Period is the period from and including the thirtieth trading day in a fiscal quarter to, but not including, the thirtieth trading day of the immediately following fiscal quarter. There are four Conversion Periods in each fiscal year. Additionally, holders of the CODES have a right to receive contingent interest payments, not to exceed a per annum rate of 0.5% of the outstanding principal amount of the CODES, which will be paid on the CODES during any six-month period following a six-month period in which the average trading price of the CODES is above 120% of the principal amount of the CODES. The contingent interest payment provision as well as the ability of the holders of the CODES to exercise the conversion features as a result of changes in the credit ratings assigned to the CODES have been accounted for as embedded derivatives.

In the fourth quarter of 2000, L-3 Holdings sold $300.0 million of 5 1/4% Convertible Senior Subordinated Notes due 2009 (the "Convertible Notes"). The net proceeds from this offering amounted to $290.5 million after underwriting discounts and commissions and other offering expenses, and were used to repay revolver borrowings outstanding under our senior credit facilities. The Convertible Notes may be converted at any time into L-3 Holdings common stock at a conversion price of $81.50 per share (3,680,982 shares).

In April 1997, May 1998 and December 1998, L-3 Communications sold $225.0 million of 10 3/8% Senior Subordinated Notes due 2007, $180.0 million of 8 1/2% Senior Subordinated Notes due 2008, and $200.0 million of 8% Senior Subordinated Notes due 2008 (collectively, the "Senior Subordinated Notes"), whose aggregate net proceeds amounted to $576.0 million after underwriting discounts and commissions and other offering expenses.

In November 2001, we entered into interest rate swap agreements on our $180.0 million of 8 1/2% Senior Subordinated Notes due 2008. These swap agreements exchange our fixed interest rate for a variable interest rate on the entire principal amount. Under these swap agreements, we will pay or receive the difference between the fixed interest rate of 8 1/2% on the senior subordinated notes and a variable interest rate, set in arrears, determined two business days prior to the interest payment date of the related senior subordinated notes equal to (1) the six month LIBOR rate plus (2) an average of 350.8 basis points. In July 2001, we entered into interest rate swap agreements on our $200.0 million of 8% Senior Subordinated Notes due 2008. These swap agreements exchange our fixed interest rate for a variable interest rate on the entire principal amount. Under these swap agreements, we will pay or receive the difference between the fixed interest rate of 8% on the senior subordinated notes and a variable interest rate, set in arrears, determined two business days prior to the interest payment date of the related senior subordinated notes equal to (1) the six month LIBOR rate plus (2) an average of 192 basis points. The difference to be paid or received on these swap agreements is recorded as an adjustment to interest expense. The swap agreements are accounted for as fair value hedges.

The senior credit facilities, Bridge Loan Facility, Senior Subordinated Notes, Convertible Notes and CODES agreements contain financial covenants and other restrictive covenants which remain in effect so long as we owe any amount or any commitment to lend exists thereunder. As of December 31, 2001, we were in compliance with those covenants at all times. The borrowings under the senior credit facilities are guaranteed by L-3 Holdings and by substantially all of the domestic subsidiaries of L-3 Communications on a senior basis. The payments of principal and premium, if any, and interest on the Senior Subordinated Notes and Bridge Loan Facility are unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by all of L-3 Communications' restricted subsidiaries other than its foreign subsidiaries. The guarantees of the Senior Subordinated Notes and Bridge Loan Facility are junior to the guarantees of the senior credit facilities and rank pari passu with each other and the guarantees of the Convertible Notes and the CODES. The Convertible Notes and CODES are unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by L-3 Communications and substantially all of its direct and indirect domestic subsidiaries. These guarantees rank junior to the guarantees of the senior credit facilities and rank pari passu with each other and the guarantees of the Senior Subordinated Notes and Bridge Loan Facility. See Note 7 to our consolidated financial statements for a description of our debt and related financial covenants at December 31, 2001.

The tables below present our contractual obligations and contingent commitments as of December 31, 2001.

Contractual Obligations:

(in millions)	Total	Year Ending December 31, 2002	2003	2004	2005 and thereafter
Principal amount of long-term debt	$1,325.0	$ —	$ —	$ —	$1,325.0
Non-cancelable operating leases	350.5	61.9	49.3	33.1	206.2
Capital leases	4.7	1.7	1.4	0.9	0.7
Total	$1,680.2	$ 63.6	$ 50.7	$ 34.0	$1,531.9

Contingent Commitments:

(in millions)	Total	Year Ending December 31, 2002	2003	2004	2005 and thereafter
Outstanding letters of credit under our senior credit facilities	$102.4	$ 86.5	$10.6	$3.6	$ 1.7
Other outstanding letters of credit	20.0	12.5	7.3	—	0.2
Construction agency agreement	43.5	43.5	—	—	—
Simulator systems operating leases	89.2	—	4.2	5.2	79.8
Guarantees of affiliate debt	1.0	1.0	—	—	—
Capital contributions for limited partnership investments	5.0	5.0	—	—	—
Total	$261.1	$148.5	$22.1	$8.8	$81.7

Equity. On May 2, 2001, we sold 4.6 million shares of L-3 Holdings common stock in a public offering for $80.00 per share. In addition, as part of the transaction, other selling stockholders including affiliates of Lehman Brothers Inc. sold 2.3 million secondary shares. Upon closing, we received net proceeds of $353.6 million, which we used to repay borrowings outstanding under our senior credit facilities, pay for the KDI and EER acquisitions and to increase cash and cash equivalents.

On February 4, 1999, we sold 5.0 million shares of L-3 Holdings common stock in a public offering for $42.00 per share which generated net proceeds of $201.6 million. In addition, as part of the same transaction, 6.5 million shares of L-3 Holdings common stock were sold by Lehman Brothers Capital Partners III, L.P. and its affiliates ("the Lehman Partnership") and Lockheed Martin in a secondary public offering. In October 1999, Lockheed Martin sold its remaining L-3 Holdings common stock. In December 1999, the Lehman Partnership distributed approximately 3.8 million shares of its shares of common stock of L-3 Holdings to its partners. On December 31, 2001, the Lehman Partnership owned approximately 4.4% of the outstanding common stock of L-3 Holdings.

Based upon our current level of operations, we believe that our cash from operating activities, together with available borrowings under the senior credit facilities, will be adequate to meet our anticipated requirements for working capital, capital expenditures, commitments, research and development expenditures, contingent purchase prices, program and other discretionary investments, and interest payments for the foreseeable future. There can be no assurance, however, that our business will continue to generate cash flow at current levels, or that currently anticipated improvements will be achieved. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to sell assets, reduce capital expenditures, refinance

all or a portion of our existing debt or obtain additional financing. Our ability to make scheduled principal payments or to pay interest on or to refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control. There can be no assurance that sufficient funds will be available to enable us to service our indebtedness, to make necessary capital expenditures and to make discretionary investments.

Derivative Financial Instruments

Included in our derivative financial instruments are interest rate swap agreements, caps, floors, foreign currency forward contracts and the embedded derivatives related to the issuance of our CODES. All of our derivative financial instruments that are sensitive to market risk are entered into for purposes other than trading.

Embedded Derivatives. The contingent interest payment and contingent conversion features of the CODES are embedded derivatives which were bifurcated from the CODES, and a portion of the net proceeds received from the CODES equal to their aggregate fair value of $2.5 million was ascribed to the embedded derivatives as required by SFAS No. 133. The subsequent changes in the fair values of the embedded derivatives are recorded in the statement of operations. Their fair values at December 31, 2001 were $3.1 million.

Interest Rate Risk. Our financial instruments that are sensitive to changes in interest rates include borrowings under the senior credit facilities and our purchased interest rate cap contracts, written interest rate floor contracts and interest rate swap agreements, all of which are denominated in U.S. dollars. The interest rates on the Senior Subordinated Notes, Convertible Notes and CODES are fixed-rate and are not affected by changes in interest rates.

To mitigate risks associated with changing interest rates on borrowings under the senior credit facilities that bear interest at variable rates we entered into interest rate cap and floor contracts. The interest rate cap contract provides protection against increases in interest rates on borrowings to the extent:

- those borrowings are less than or equal to the notional amount of the cap contract; and
- the interest rate paid on the borrowings rises above the sum of the cap reference rate plus our applicable borrowing spread.

However, the written interest rate floor limits our ability to enjoy decreases in interest rates on our borrowings to the extent:

- those borrowings are less than or equal to the notional amount of the floor contract; and
- the interest rate paid on those borrowings falls below the sum of the floor reference rate plus our applicable borrowing spread.

In 2001, we entered into interest rate swap agreements on $380.0 million of our senior subordinated notes to convert their fixed interest rates to variable rates and to take advantage of the current low interest rate environment. These swap agreements are described above. For every basis point (0.01%) that the six month LIBOR interest rate is greater than 4.99%, we will incur an additional $18,000 of interest expense above the fixed interest rate on $180.0 million of senior subordinated notes calculated on a per annum basis until maturity. For every basis point that the six month LIBOR interest rate is greater than 6.08%, we will incur an additional $20,000 of interest expense above the fixed interest rate on $200.0 million of senior subordinated notes calculated on a per annum basis until maturity. Conversely, for every basis point that the six month LIBOR interest rate is less than 4.99%, we will recognize $18,000 of interest income on $180.0 million of senior subordinated notes calculated on a per annum basis until maturity. For every basis point that the six month LIBOR interest rate is less than 6.08%, we will recognize $20,000 of interest income on $200.0 million of senior subordinated notes calculated on a per annum basis until maturity. The six month LIBOR rate at December 31, 2001 was 1.96%.

We attempt to manage exposure to counterparty credit risk by entering into interest rate agreements only with major financial institutions that are expected to perform fully under the terms of such agreements. Cash payments between us and the counterparties are made at the end of each quarter on the caps and floors and on the interest payment dates of the senior subordinated notes on the interest rate swap agreements. Such payments are recorded as adjustments to interest expense. Additional data on our debt obligations, our applicable borrowing spreads included in the interest rates we pay on borrowings under the senior

credit facilities and interest rate agreements are provided in Notes 7 and 8 to our consolidated financial statements.

The table below presents significant contract terms and fair values as of December 31, 2001 for our interest rate agreements.

(in millions)	Caps	Floors	Interest rate swap agreements	
Notional amount	$ 100.0	$ 50.0	$ 200.0	$ 180.0
Interest rate	7.5%	5.5%	8.0%	8.5%
Reference rate	3 month LIBOR	3 month LIBOR	6 month LIBOR	6 month LIBOR
Designated maturity	Quarterly	Quarterly	Semi-Annual	Semi-Annual
Expiration date	Mar 28, 2002	Mar 28, 2002	Aug 1, 2008	May 15, 2008
Fair value	$ —	$ (0.4)	$ 2.4	$ (9.6)

Foreign Currency Exchange Risk. We conduct some of our operations outside the U.S. in functional currencies other than the U.S. dollar. Additionally, some of our U.S. operations have contracts with foreign customers denominated in foreign currencies. To mitigate the risk associated with certain of these contracts denominated in foreign currency we have entered into foreign currency forward contracts. At December 31, 2001, the notional value of foreign currency forward contracts was $7.1 million and the fair value of these contracts was $0.3 million. We account for these contracts as cash flow hedges.

Equity Price Risk. Our investments in common equities are subject to equity price risk. The fair values of the Company's investments are based on quoted market prices, as available, and on historical cost for investments which it is not practicable to estimate fair value. Both the carrying values and estimated fair values of such instruments amounted to $16.5 million at the end of 2001.

Backlog and Orders

We define funded backlog as the value of contract awards received from the U.S. Government, which the U.S. Government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. Government which have yet to be recognized as sales. Our funded backlog as of December 31, 2001 was $1,719.3 million and as of December 31, 2000 was $1,354.0 million. We expect to record as sales approximately 69.7% of our December 31, 2001 funded backlog during 2002. However, there can be no assurance that our funded backlog will become sales in any particular period, if at all. Our funded orders were $2,456.1 million for 2001, $2,013.7 million for 2000 and $1,423.1 million for 1999.

Our funded backlog does not include the full value of our contract awards including those pertaining to multi-year, cost-plus reimbursable contracts, which are generally funded on an annual basis. Funded backlog also excludes the sales value of unexercised contract options that may be exercised by customers under existing contracts and the sales value of purchase orders that may be issued under indefinite quantity contracts or basic ordering agreements.

Research and Development

Company-sponsored research and development costs including bid and proposal costs were $107.5 million for 2001, $101.9 million for 2000 and $76.1 million for 1999. Customer-funded research and development costs were $319.4 million for 2001, $299.3 million for 2000 and $226.3 million for 1999.

Contingencies

We are engaged in providing products and services under contracts with the U.S. Government and to a lesser degree, under foreign government contracts, some of which are funded by the U.S. Government. All such contracts are subject to extensive legal and regulatory requirements, and, periodically, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. Under government procurement regulations, an indictment by a federal grand jury could result in the suspension for a period of time from eligibility for awards of new government contracts. A conviction could result in debarment from contracting with the federal government for a specified term. Additionally, in the event that U.S. Government expenditures for products and services of the type we manufacture and provide are reduced, and not offset by greater commercial sales or other new programs or products, or acquisitions, there may be a reduction in the volume of contracts or subcontracts awarded to us.

We continually assess our obligations with respect to applicable environmental protection laws. While it is difficult to determine the timing and ultimate cost to be incurred in order to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which we are aware, we

believe that even without considering potential insurance recoveries, if any, there are no environmental loss contingencies that, individually or in the aggregate, would be material to our consolidated financial position, results of operations or cash flows. Also, we have been periodically subject to litigation, claims or assessments and various contingent liabilities incidental to our business. We accrue for these contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

With respect to those investigative actions, items of litigation, claims or assessments of which we are aware, we are of the opinion that the probability is remote that, after taking into account certain provisions that have been made with respect to these matters, the ultimate resolution of any such investigative actions, items of litigation, claims or assessments will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Recently Issued and Proposed Accounting Standards

In July 2001, the FASB issued SFAS No. 141, *Business Combinations*, which supersedes Accounting Principles Board Opinion ("APB") No. 16, *Business Combinations*. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and establishes specific criteria for the recognition of intangible assets separately from goodwill. In July 2001, the FASB also issued SFAS No. 142, *Goodwill and Other Intangible Assets*, which supersedes APB No. 17, *Intangible Assets*. SFAS No. 142 revises the standards for accounting for goodwill and intangible assets. SFAS No. 142 requires that goodwill and indefinite lived identifiable intangible assets shall no longer be amortized, but be tested for impairment at least annually. SFAS No. 142 also requires that the amortization period of identifiable intangible assets with finite lives be no longer limited to forty years. The provisions of SFAS No. 142 are effective beginning January 1, 2002, with full implementation of the impairment measurement provisions completed by December 31, 2002. Under SFAS No.142, we will not amortize goodwill, but will be required to amortize identifiable intangibles with finite lives. Our goodwill amortization expense for the year ended December 31, 2001 was $42.6 million. Based on a preliminary internal assessment, we do not believe that the cumulative effect of the accounting change resulting from the adoption of the transitional impairment provisions of SFAS No. 142 will be material.

In August of 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 applies to legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset, except for certain obligations of lessees. This statement does not apply to obligations that arise solely from a plan to dispose of a long-lived asset. SFAS No. 143 requires that estimated asset retirement costs be measured at their fair values and recognized as assets and depreciated over the useful life of the related asset. Similarly, liabilities for the present value of asset retirement obligations are to be recognized and accreted as interest expense each year to their estimated future value until the asset is retired. These provisions will be applied to existing asset retirement obligations as of the adoption date as a cumulative-effect of a change in accounting policy. SFAS No. 143 is effective for our fiscal years beginning January 1, 2003. SFAS No. 143 will not have a material effect on our consolidated results of operations and financial position.

In October of 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB No. 30), for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 expands the scope of accounting for disposals to include all components of an entity, including reportable segments and operating segments, reporting units, subsidiaries and certain asset groups. It requires the gain or loss on disposal to be measured as the difference between (1) the fair value less the costs to sell and (2) the carrying value of the component, and such gain or loss cannot include the estimated future operating losses of the component, which were included in the gain or loss determination under APB No. 30. SFAS No. 144 also amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to eliminate the exception to consolidation for a subsidiary for which control is likely to be tempo-

rary. The provisions of SFAS No. 144 are effective for our fiscal years beginning January 1, 2002, and interim periods within those fiscal years. SFAS No. 144 will not have a material effect on our consolidated results of operations and financial position.

Inflation

The effect of inflation on our sales and earnings has not been significant. Although a majority of our sales are made under long-term contracts, the selling prices of such contracts, established for deliveries in the future, generally reflect estimated costs to be incurred in these future periods. In addition, some contracts provide for price adjustments through escalation clauses.

Forward-Looking Statements

Certain of the matters discussed concerning our operations, cash flows, financial position, economic performance, and financial condition, including in particular, the likelihood of our success in developing and expanding our business and the realization of sales from backlog, include forward-looking statements within the meaning of section 27A of the Securities Act and Section 21E of the Exchange Act.

Statements that are predictive in nature, that depend upon or refer to events or conditions or that include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions are forward-looking statements. Although we believe that these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital, capital expenditures and other projections, they are subject to several risks and uncertainties, and therefore, we can give no assurance that these statements will be achieved.

Such statements will also be influenced by factors such as:

- our dependence on the defense industry and the business risks peculiar to that industry including changing priorities or reductions in the U.S. Government defense budget;
- our reliance on contracts with a limited number of agencies of, or contractors to, the U.S. Government and the possibility of termination of government contracts by unilateral government action or for failure to perform;
- our ability to obtain future government contracts on a timely basis;
- the availability of government funding and changes in customer requirements for our products and services;
- our significant amount of debt and the restrictions contained in our debt agreements;
- collective bargaining agreements and labor disputes;
- economic conditions, competitive environment, international business and political conditions, timing of international awards and contracts;
- our extensive use of fixed-price contracts as compared to cost-reimbursable contracts;
- our ability to identify future acquisition candidates or to integrate acquired operations;
- the rapid change of technology and high level of competition in the communication equipment industry;
- our introduction of new products into commercial markets or our investments in commercial products or companies;
- pension, environmental or legal matters or proceedings and various other market, competition and industry factors, many of which are beyond our control; and
- the fair values of the assets including goodwill and other intangibles of our businesses which can be impaired or reduced by the other factors discussed above.

Readers of this document are cautioned that our forward-looking statements are not guarantees of future performance and the actual results or developments may differ materially from the expectations expressed in the forward-looking statements.

As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainties of estimates, forecasts and projections and may be better or worse than projected. Given these uncertainties, you should not place any reliance on these forward-looking statements. These forward-looking statements also represent our estimates and assumptions only as of the date that they were made. We expressly disclaim a duty to provide updates to these forward-looking statements, and the estimates and assumptions associated with them, after the date of this filing to reflect events or changes or circumstances or changes in expectations or the occurrence of anticipated events.

Consolidated Balance Sheets

(in thousands, except per share data)	December 31, 2001	2000
Assets		
Current assets:		
Cash and cash equivalents	**$ 361,022**	$ 32,680
Contracts in process	**801,824**	700,133
Deferred income taxes	**62,965**	89,732
Other current assets	**12,774**	7,025
Total current assets	**1,238,585**	829,570
Property, plant and equipment, net	**203,374**	156,128
Intangibles, primarily goodwill	**1,711,551**	1,371,368
Deferred income taxes	**97,883**	57,111
Deferred debt issue costs	**40,190**	29,907
Other assets	**43,850**	19,460
Total assets	**$3,335,433**	$2,463,544
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable, trade	**$ 129,538**	$ 159,901
Accrued employment costs	**126,981**	102,606
Accrued expenses	**38,823**	55,576
Customer advances	**74,060**	55,203
Accrued interest	**13,288**	16,335
Income taxes	**16,768**	7,251
Other current liabilities	**124,819**	71,797
Total current liabilities	**524,277**	468,669
Pension and postretirement benefits	**155,052**	105,523
Other liabilities	**57,063**	101,783
Long-term debt	**1,315,252**	1,095,000
Total liabilities	**2,051,644**	1,770,975
Minority interest	**69,897**	—
Commitments and contingencies		
Shareholders' equity:		
Common stock; $.01 par value; authorized 100,000,000 shares, issued and outstanding 39,248,313 and 33,606,645 shares	**939,037**	515,926
Retained earnings	**301,730**	186,272
Unearned compensation	**(3,205)**	(2,457)
Accumulated other comprehensive loss	**(23,670)**	(7,172)
Total shareholders' equity	**1,213,892**	692,569
Total liabilities and shareholders' equity	**$3,335,433**	$2,463,544

See notes to consolidated financial statements.

Consolidated Statements of Operations

(in thousands, except per share data)	Year Ended December 31, 2001	2000	1999
Sales	**$2,347,422**	$1,910,061	$1,405,462
Costs and expenses	**2,072,092**	1,687,343	1,254,976
Operating income	**275,330**	222,718	150,486
Interest and other income	**1,739**	4,393	5,534
Interest expense	**86,390**	93,032	60,590
Minority interest	**4,457**	—	—
Income before income taxes	**186,222**	134,079	95,430
Provision for income taxes	**70,764**	51,352	36,741
Net income	**$ 115,458**	$ 82,727	$ 58,689
Earnings per common share:			
Basic	**$ 3.08**	$ 2.48	$ 1.83
Diluted	**$ 2.95**	$ 2.37	$ 1.75
Weighted average common shares outstanding:			
Basic	**37,440**	33,355	32,107
Diluted	**42,719**	34,953	33,516

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

For the Years Ended December 31, 2001, 2000 and 1999 (in thousands)

	Common Stock Shares Issued	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Total
Balance December 31, 1998	27,402	$274	$264,495	$44,856	$ —	$(9,651)	$ 299,974
Comprehensive income:							
Net income				58,689			58,689
Minimum pension liability adjustment						9,443	9,443
Unrealized loss on securities						(970)	(970)
Foreign currency translation adjustment						(1,225)	(1,225)
							65,937
Shares issued:							
Sale of common stock	5,000	50	201,763				201,813
Employee benefit plans	163	2	6,991				6,993
Acquisition consideration	151	2	6,432				6,434
Exercise of stock options	79	—	1,764				1,764
Grant of restricted stock			1,921		(1,921)		—
Amortization of unearned compensation					260		260
Balance December 31, 1999	32,795	328	483,366	103,545	(1,661)	(2,403)	583,175
Comprehensive income:							
Net income				82,727			82,727
Minimum pension liability adjustment, net of ($553) tax benefit						(819)	(819)
Foreign currency translation adjustment						(1,222)	(1,222)
Unrealized loss on securities, net of ($2,316) tax benefit						(2,728)	(2,728)
							77,958
Shares issued:							
Employee benefit plans	235	2	12,640				12,642
Exercise of stock options	577	6	18,056				18,062
Grant of restricted stock			1,512		(1,512)		—
Amortization of unearned compensation					716		716
Other			16				16
Balance December 31, 2000	33,607	336	515,590	186,272	(2,457)	(7,172)	692,569
Comprehensive income:							
Net income				115,458			115,458
Minimum pension liability adjustment, net of ($11,955) tax benefit						(19,519)	(19,519)
Foreign currency translation adjustment, net of ($164) tax benefit						(268)	(268)
Unrealized loss on securities, net of ($111) tax benefit						(180)	(180)
Unrealized loss on securities reclassified into net income, net of $2,274 tax expense						3,632	3,632
Unrealized losses on hedging instruments, net of ($100) tax benefit						(163)	(163)
							98,960
Shares issued:							
Sale of common stock	4,575	46	353,576				353,622
Employee benefit plans	208	2	16,866				16,868
Acquisition consideration	294	3	17,354				17,357
Exercise of stock options	564	6	28,258				28,264
Employee stock purchase plan contributions			4,861				4,861
Grant of restricted stock			2,118		(2,118)		—
Amortization of unearned compensation					1,370		1,370
Other			21				21
Balance December 31, 2001	**39,248**	**$393**	**$938,644**	**$301,730**	**$(3,205)**	**$(23,670)**	**$1,213,892**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in thousands)	Year Ended December 31, 2001	2000	1999
Operating activities:			
Net income	**$ 115,458**	$ 82,727	$ 58,689
Goodwill amortization	**42,606**	35,327	20,970
Depreciation and other amortization	**44,345**	38,927	32,748
Amortization of deferred debt issue costs	**6,388**	5,724	3,904
Minority interest	**4,457**	—	—
Deferred income tax provision	**52,638**	25,103	28,831
Other noncash items	**17,576**	12,517	6,617
Changes in operating assets and liabilities, net of amounts acquired:			
Contracts in process	**(40,652)**	(66,402)	(61,670)
Other current assets	**1,643**	(2,599)	(70)
Other assets	**(12,033)**	(416)	552
Accounts payable	**(43,165)**	38,065	2,896
Accrued employment costs	**11,931**	6,239	2,052
Accrued expenses	**(20,300)**	2,274	(6,280)
Customer advances	**12,627**	(17,087)	5,766
Accrued interest	**(3,047)**	3,637	5,985
Income taxes	**14,431**	13,161	3,917
Other current liabilities	**(37,555)**	(59,286)	(13,554)
Pension and postretirement benefits	**4,550**	(7,214)	1,788
Other liabilities	**1,423**	1,959	7,102
All other operating activities	**(353)**	1,149	(1,225)
Net cash from operating activities	**172,968**	113,805	99,018
Investing activities:			
Acquisition of businesses, net of cash acquired	**(446,911)**	(599,608)	(272,195)
Proceeds from sale of interest in subsidiary	**75,206**	—	—
Capital expenditures	**(48,121)**	(33,580)	(23,456)
Disposition of property, plant and equipment	**1,237**	18,060	6,713
Other investing activities	**(6,301)**	6,905	4,136
Net cash (used in) investing activities	**(424,890)**	(608,223)	(284,802)
Financing activities:			
Borrowings under revolving credit facility	**316,400**	858,500	74,700
Repayment of borrowings under revolving credit facility	**(506,400)**	(668,500)	(74,700)
Proceeds from sale of convertible senior subordinated notes	**420,000**	300,000	—
Proceeds from sale of common stock, net	**353,622**	—	201,582
Debt issuance costs	**(16,671)**	(12,916)	(323)
Proceeds from exercise of stock options	**16,325**	8,954	658
Employee stock purchase plan contributions	**4,861**	—	—
Distributions to minority interest	**(2,530)**	—	—
Other financing activities	**(5,343)**	(1,728)	525
Net cash from financing activities	**580,264**	484,310	202,442
Net increase (decrease) in cash	**328,342**	(10,108)	16,658
Cash and cash equivalents, beginning of period	**32,680**	42,788	26,130
Cash and cash equivalents, end of period	**$ 361,022**	$ 32,680	$ 42,788

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share data)

1. Description of Business

L-3 Communications Holdings, Inc. derives all its operating income and cash flow from its wholly-owned subsidiary L-3 Communications Corporation ("L-3 Communications"). L-3 Holdings' only asset is its investment in L-3 Communications. L-3 Communications Holdings, Inc. ("L-3 Holdings", and together with its subsidiaries, "L-3" or "the Company") is a merchant supplier of sophisticated secure communication systems and specialized products. The Company produces secure, high data rate communication systems, training and simulation systems, engineering development and integration support, avionics and ocean products, fuzing products, telemetry, instrumentation, space and guidance products and microwave components. These systems and products are critical elements of virtually all major communication, command and control, intelligence gathering and space systems. The Company's systems and specialized products are used to connect a variety of airborne, space, ground-and sea-based communication systems and are used in the transmission, processing, recording, monitoring and dissemination functions of these communication systems. The Company's customers include the U.S. Department of Defense ("DoD"), certain U.S. Government intelligence agencies, major aerospace and defense contractors, foreign governments, commercial customers and certain other U.S. federal, state and local government agencies. The Company has two reportable segments, Secure Communication Systems and Specialized Products.

Secure Communication Systems. This segment provides secure, high data rate communication systems for military and other U.S. Government reconnaissance and surveillance applications. The major secure communication programs and systems include:

- secure data links for airborne, satellite, ground-and sea-based remote platforms for real time information collection and dissemination to users;
- strategic and tactical signal intelligence systems that detect, collect, identify, analyze and disseminate information;
- secure telephone and network equipment and encryption management;
- communication software support services;
- communication systems for surface and undersea vessels and manned space flights; and
- wide-area security systems.

The Secure Communication Systems segment includes the training and simulation business, which produces advanced simulation and training products, with high-fidelity representations of cockpits and operator stations for aircraft and vehicle system simulation. This segment also provides a wide range of engineering development and integration support to the DoD and other government agencies, a full range of teaching, training, logistic and training device support services to domestic and international military customers, and custom ballistic targets for the DoD.

Specialized Products. This segment supplies products to military and commercial customers, and focuses on niche markets in which the Company believes it can achieve a market leadership position. This reportable segment includes three product categories:

- avionics and ocean products including aviation and maritime recorders, airborne collision avoidance products, displays, antennas, acoustic undersea warfare products, naval power distribution, conditioning, switching and protection equipment, premium fuzing products and aircraft modernization;
- telemetry, instrumentation and space products including commercial off-the-shelf, real-time data collection and transmission products and components for missile, aircraft and space-based electronic systems; and
- microwave components including commercial off-the-shelf, high-performance microwave components and frequency monitoring equipment.

2. Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements of the Company include all wholly-owned and significant majority-owned subsidiaries. All significant intercompany transactions are eliminated in consolidation. Investments over which the Company has significant influence but does not have voting control are accounted for by the equity method.

Cash and Cash Equivalents: Cash equivalents consist of highly liquid investments with a maturity of three months or less at time of purchase.

Revenue Recognition: The substantial majority of the Company's direct and indirect sales to the U.S. Government and certain of the Company's sales to foreign governments and commercial customers are made pursuant to written contractual arrangements or "contracts" to design, develop, manufacture and or modify complex products, and to the specifications of the buyers (customers) or to provide services related to the performance of such contracts. These contracts are within the scope of the American Institute of Certified Public Accountants Statement of Position 81-1 *Accounting for Performance of Construction — Type and Certain Production-Type Contracts* ("SOP 81-1"), and sales and profits on them are recognized using percentage-of-completion methods of accounting. Sales and profits on fixed-price production contracts whose units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their selling prices (the "units-of-delivery" method). Sales and profits on other fixed-price contracts are recorded based on the ratio of total actual incurred costs to date to the total estimated costs for each contract (the "cost-to-cost method"). Sales and fees on cost-reimbursable contracts are recognized as costs are incurred. Amounts representing contract change orders or claims are included in sales only when they can be reliably estimated and their realization is reasonably assured. Losses on contracts are recognized in the period in which they are determined. The impact of revisions of contract estimates, which may result from contract modifications, performance or other reasons, are recognized on a cumulative catch-up basis in the period in which the revisions are made.

Sales on arrangements that are not within the scope of SOP 81-1 are recognized in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 101. Sales are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectibility is reasonably assured.

Contracts in Process: For the Company's contracts that are within the scope of SOP 81-1, accumulated costs incurred that are allowable under the terms of the contract and profits earned on contract sales are reported in Contracts in Process. Billed Receivables represent the uncollected portion of amounts recorded as sales and billed to customers, including those amounts for sales arrangements that are not within the scope of SOP 81-1. Unbilled Contract Receivables represent accumulated recoverable costs and earned profits or losses on contracts in process that have been recorded as sales, but have not yet been billed to customers. Inventoried Contract Costs represent recoverable incurred costs on contracts in process. Incurred contract costs include direct costs and overhead costs, and for U.S. Government contracts and contracts with prime contractors or subcontractors of the U.S. Government, general and administrative costs, independent research and development costs and bid and proposal costs. Contracts in Process also contain amounts relating to contracts and programs with long performance cycles, a portion of which may not be realized within one year. Provisions for contracts in a loss position in excess of the amounts included in Contracts in Process represent the unrecoverable costs on the loss contracts that will be incurred in future periods and are reported in Estimated Costs in Excess of Billings to Complete Contracts in Process, which is a component of Other Current Liabilities and Other Liabilities. Under the contractual arrangements on certain contracts with the U.S. Government, the Company receives progress payments as it incurs costs. The U.S. Government has a security interest in the Unbilled Contract Receivables and Inventoried Contract Costs to which progress payments have been applied, and such progress payments are reflected as a reduction of the related Unbilled Contract Receivables and Inventoried Contract Costs. Customer Advances are classified as current liabilities.

Inventories other than Inventoried Contract Costs are stated at the lower of cost or market primarily using the average cost method.

Derivative Financial Instruments: In connection with its risk management and financial derivatives, the Company has entered into interest rate swap agreements, interest rate cap and floor contracts and foreign currency forward contracts. The interest rate swap agreements are accounted for as fair value hedges. The foreign currency forward contracts are accounted for as cash flow hedges. The embedded derivatives related to the issuance of the Company's debt is recorded at fair value with changes reflected in the statement of operations. The differential to

be paid or received as interest rates change on the interest rate swap agreements is recorded as an adjustment to interest expense.

Property, Plant and Equipment: Property, plant and equipment are stated at cost. Depreciation is computed by applying principally the straight-line method to the estimated useful lives of the related assets. Useful lives range substantially from 10 to 40 years for buildings and improvements and 3 to 10 years for machinery, equipment, furniture and fixtures. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the improvements.

Debt Issuance Costs: Costs incurred to issue debt are deferred and amortized as interest expense over the term of the related debt using a method that approximates the effective interest method.

Intangibles: Intangibles consist primarily of the excess of the purchase cost of acquired businesses over the fair value of identifiable net assets acquired ("goodwill"). Goodwill related to acquisitions consummated after June 30, 2001 is not amortized. Other intangibles are amortized on a straight-line basis over periods ranging from 5 to 15 years. Accumulated goodwill amortization was $117,975 at December 31, 2001 and $76,001 at December 31, 2000. The carrying amount of goodwill is evaluated on a recurring basis. Current and estimated future profitability and undiscounted cash flows excluding financing costs of the acquired businesses are the primary indicators used to assess the recoverability of goodwill. For the years ended December 31, 2001 and 2000, there were no material adjustments to the carrying amounts of goodwill resulting from these evaluations (see Recently Issued Accounting Standards below for a description of changes in accounting for goodwill).

Income Taxes: The Company provides for income taxes using the liability method. Deferred income tax assets and liabilities reflect tax carryforwards and the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes, as determined under enacted tax laws and rates. The effect of changes in tax laws or rates is accounted for in the period of enactment.

Research and Development: Research and development costs sponsored by the Company include bid and proposal costs related to government products and services. These costs generally are allocated among all contracts in progress under U.S. Government contractual arrangements. Customer-funded research and development costs, including software development costs, incurred pursuant to contracts are accounted for as direct contract costs. Other software development costs incurred after establishing technological feasibility are capitalized and are amortized on a product by product basis using the amount that is the greater of the straight line method over the useful life or the ratio of current revenues to total estimated revenues.

Stock Options: Compensation expense for stock options is recognized in income based on the excess, if any, of L-3 Holdings' fair value of the stock at the grant date of the award or other measurement date over the amount an employee must pay to acquire the stock. When the exercise price for stock options granted to employees equals or exceeds the fair value of the L-3 Holdings common stock at the date of grant, the Company does not recognize compensation expense. See Note 12 for the fair value pro forma disclosure of stock-based compensation.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs and expenses during the reporting period. The most significant of these estimates and assumptions relate to contract estimates of sales and estimated costs to complete contracts in process, estimates of market values for inventories reported at lower of cost or market, estimates of pension and postretirement benefit obligations, recoverability of recorded amounts of fixed assets and goodwill, income taxes, litigation and environmental obligations. Actual results could differ from these estimates.

Recently Issued Accounting Standards: In July 2001, the FASB issued SFAS No. 141, *Business Combinations*, which supersedes Accounting Principles Board Opinion ("APB") No. 16, *Business Combinations*. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and establishes specific criteria for the recognition of intangible assets separately from goodwill. In July 2001, the FASB also issued SFAS No. 142, *Goodwill and Other Intangible*

Assets, which supersedes APB No. 17, *Intangible Assets.* SFAS No. 142 revises the standards for accounting for goodwill and intangible assets. SFAS No. 142 requires that goodwill and indefinite lived identifiable intangible assets shall no longer be amortized, but be tested for impairment at least annually. SFAS No. 142 also requires that the amortization period of identifiable intangible assets with finite lives be no longer limited to forty years. The provisions of SFAS No. 142 are effective beginning January 1, 2002, with full implementation of the impairment measurement provisions completed by December 31, 2002. Effective January 1, 2002, the Company will not record goodwill amortization expense, but will be required to amortize identifiable intangibles with finite lives. Goodwill amortization expense for the year ended December 31, 2001 was $42,606.

In August of 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations.* SFAS No. 143 applies to legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset, except for certain obligations of lessees. This statement does not apply to obligations that arise solely from a plan to dispose of a long-lived asset. SFAS No. 143 requires that estimated asset retirement costs be measured at their fair values and recognized as assets and depreciated over the useful life of the related asset. Similarly, liabilities for the present value of asset retirement obligations are to be recognized and accreted as interest expense each year to their estimated future value until the asset is retired. These provisions will be applied to existing asset retirement obligations as of the adoption date as a cumulative-effect of a change in accounting policy. SFAS No. 143 is effective for the Company's fiscal years beginning January 1, 2003. SFAS No. 143 will not have a material effect on the Company's consolidated results of operations and financial position.

In October of 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121, *Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed Of*, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB No. 30), for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 expands the scope of accounting for disposals to include all components of an entity, including reportable segments and operating segments, reporting units, subsidiaries and certain asset groups. It requires the gain or loss on disposal to be measured as the difference between (1) the fair value less the costs to sell and (2) the carrying value of the component, and such gain or loss cannot include the estimated future operating losses of the component, which were included in the gain or loss determination under APB No. 30. SFAS No. 144 also amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. The provisions of SFAS No. 144 are effective for the Company's fiscal years beginning January 1, 2002, and interim periods within those fiscal years. SFAS No. 144 will not have a material effect on the Company's consolidated results of operations and financial position.

Reclassifications: Certain reclassifications have been made to conform prior-year amounts to the current-year presentation.

3. Acquisitions, Divestitures and Other Transactions

On October 3, 2001, the Company announced that it had signed a definitive agreement with Spar Aerospace Limited ("Spar"), a leading provider of high-end aviation product modernization, pursuant to which L-3 offered to acquire all of the outstanding common stock of Spar for Cdn$15.50 per share or approximately Cdn$182,000, net of cash to be acquired of approximately Cdn$47,500. The acquisition of Spar provides the Company significant opportunity for pull-through sales of its avionics products. The acquisition also opens up the Canadian and worldwide high-end aviation product modernization marketplace to the Company.

On November 23, 2001, the Company acquired 65.8% of the outstanding common stock of Spar for $97,223 in cash and acquired control of Spar and the ability to require the remaining stockholders to tender their shares. The Company acquired an additional 4.5% of the outstanding common stock of Spar for $7,855 in cash, during the remainder of

2001. Additional consideration of $43,641 for the remaining outstanding common stock of Spar at December 31, 2001, that the Company acquired and paid for in January 2002, has been recorded in other current liabilities in the consolidated balance sheet at December 31, 2001. During January 2002, the Company completed the acquisition and paid for the remaining outstanding common stock of Spar. The table below presents a summary of the preliminary estimates of fair values of the assets acquired and liabilities assumed on the date the Company obtained a majority ownership interest in Spar.

Cash	$ 29,460
Other current assets	33,108
Property, plant and equipment	12,565
Goodwill	104,289
Other non-current assets	229
Total assets acquired	179,651
Current liabilities	23,816
Long-term liabilities	7,116
Total liabilities assumed	30,932
Net assets acquired	$148,719

The goodwill was assigned to the Specialized Products segment and is not deductible for tax purposes.

During the fourth quarter of 2001, the Company acquired three other businesses for an aggregate purchase price of $137,290 in cash plus acquisition costs, subject to adjustment based on the closing date net assets or net working capital of the acquired business and, in one case, additional purchase price contingent upon the post-acquisition performance of the acquired company. The Company acquired:

(1) the net assets of SY Technology, Inc. ("SY"), a provider of air warfare simulation services, on December 31, 2001. This acquisition is subject to additional purchase price not to exceed $4,800 which is contingent upon the financial performance of SY for the year ended December 31, 2001, and the years ending December 31, 2002 and 2003;

(2) the net assets of Bulova Technologies, a producer of military fuzes that prevent the inadvertent firing and detonation of weapons during handling, on December 19, 2001. Bulova Technology was later renamed BT Fuze Products ("BT Fuze"); and,

(3) the common stock of Emergent Government Services Group ("Emergent"), a provider of engineering and information services to the U.S. Air Force, Army, Navy and intelligence agencies, on November 30, 2001. Following the acquisition, the Company changed Emergent Government Services Group's name to L-3 Communications Analytics.

Based on the preliminary purchase price allocations, the goodwill recognized in the acquisitions of SY, BT Fuze and Emergent was $102,145, of which approximately $74,000 is expected to be fully deductible for tax purposes. Goodwill of $60,525 was assigned to the Secure Communication Systems segment and $41,620 was assigned to the Specialized Products segment.

On May 4, 2001, the Company acquired all of the outstanding common stock of KDI Precision Products ("KDI") for $79,432 in cash including acquisition costs. On May 31, 2001, the Company acquired all of the outstanding common stock of EER Systems ("EER") for $119,533 in cash including acquisition costs, and additional purchase price not to exceed $10,000 which is contingent upon the financial performance of EER for the year ended December 31, 2001 and the year ending December 31, 2002.

On February 10, 2000, the Company acquired the assets of the Training Devices and Training Services ("TDTS") business of Raytheon Company for $159,203 in cash including acquisition costs. Following the acquisition, the Company changed TDTS's name to L-3 Communications Link Simulation and Training ("Link Simulation and Training"). On February 14, 2000, the Company acquired the assets of Trex Communications Corporation ("TrexCom") for $50,069 in cash including acquisition costs. On April 28, 2000, the Company acquired the Traffic Alert and Collision Avoidance System ("TCAS") product line from Honeywell Inc. for a purchase price of $239,988 in cash including acquisition costs. On June 30, 2000, the Company acquired all the outstanding common stock of MPRI Inc. ("MPRI") for $39,725 in cash including acquisition costs and $4,000 of additional purchase price that was based on the financial performance of MPRI for the year ended June 30, 2001. On December 29, 2000, the Company acquired all of the outstanding common stock of Coleman Research Corporation ("Coleman"), a subsidiary of Thermo Electron Corporation, for $60,565 in cash including acquisition costs, and additional

purchase price not to exceed $5,000 which is contingent upon the financial performance of Coleman for the year ended December 31, 2001.

Additionally, during the years ended December 31, 2001, 2000 and 1999, the Company purchased other businesses, which individually and in the aggregate were not material to its consolidated results of operations, financial position or cash flows in the year acquired.

All of the acquisitions were financed with cash on hand or borrowings on bank credit facilities.

All of the Company's acquisitions have been accounted for as purchase business combinations and are included in the Company's results of operations from their respective effective dates. The assets and liabilities recorded in connection with the purchase price allocations for the acquisitions of KDI, EER, Spar, Emergent, BT Fuze and SY are based upon preliminary estimates of fair values for contracts in process, estimated costs in excess of billings to complete contracts in process, inventories, identifiable intangibles and deferred taxes. Actual adjustments will be based on the final purchase prices and final appraisals and other analyses of fair values which are in process. The Company has valued acquired contracts in process at contract price, less the estimated costs to complete and an allowance for the Company's normal profit on its effort to complete such contracts. The preliminary assets and liabilities recorded in connection with the acquisitions of KDI, EER, Emergent, BT Fuze and SY were $367,570 and $31,214. The Company does not expect the differences between the preliminary and final purchase price allocations for the acquisitions to be material. Goodwill is amortized on a straight-line basis over periods of 40 years for KDI and EER. In accordance with SFAS No. 142, goodwill is not amortized for Spar, Emergent, BT Fuze and SY.

Had the acquisitions of KDI, EER, SY, BT Fuze, Emergent and Spar and the related financing transactions occurred on January 1, 2001, the unaudited pro forma sales, net income and diluted earnings per share for the year ended December 31, 2001 would have been $2,638,700, $121,300 and $2.98. Had the acquisitions of TDTS, TrexCom, TCAS, MPRI, Coleman, KDI, EER, SY, BT Fuze, Emergent and Spar and the related financing transactions occurred on January 1, 2000 the unaudited pro forma sales, net income and diluted earnings per share for the year ended December 31, 2000 would have been $2,554,600, $103,700 and $2.62. The pro forma results are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the acquisitions and the related financing transactions occurred on January 1, 2000 and 2001.

On January 14, 2002, the Company agreed to acquire Aircraft Integration Systems ("AIS"), a division of Raytheon Company, for $1,130,000 in cash plus acquisition costs. The acquisition is expected to close in March 2002. The acquisition is expected to be financed using cash on hand, borrowings under the Company's senior credit facilities and a $500,000 senior subordinated bridge loan. The Company expects to offer and sell approximately $1,000,000 of debt and equity securities during the first half of 2002, depending on capital market conditions, and use the proceeds from those offerings to repay the $500,000 senior subordinated bridge loan and the borrowings made under the senior credit facilities.

On January 2, 2002, the Company agreed to acquire the detection system business of PerkinElmer for $100,000 in cash plus acquisition costs. The acquisition is subject to customary closing conditions, including clearance under the Hart-Scott-Rodino Antitrust Improvements Act and is expected to close by the end of the second quarter of 2002.

On May 31, 2001, the Company sold a 30% interest in Aviation Communications and Surveillance Systems LLC ("ACSS") which comprised the Company's TCAS business to Thales Avionics, a wholly owned subsidiary of Thales (formerly Thomson-CSF), for $75,206 of cash. L-3 continues to consolidate the financial statements of ACSS.

Interest and other income for the year ended December 31, 2001 includes a gain of $6,966 from the sale of a 30% interest in ACSS which was largely offset by a $6,341 write-down in the carrying amount of an investment in common stock. Also included in interest and other income for 2001 is a charge of $515 to account for the increase, in accordance with SFAS No. 133, in the fair value assigned to the embedded derivatives in L-3 Holdings'

$420,000 4% Senior Subordinated Contingent Debt Securities due 2011 sold in the fourth quarter of 2001, and a loss of $751 from an equity method investment. Interest and other income for the year ended December 31, 2000 includes gains of $14,940 from the sales of the Company's interests in certain businesses. These gains were largely offset by losses of $12,456 on the write-down in the carrying value of certain investments and intangible assets. The net proceeds from the sales were $19,638, and are included in Other Investing Activities on the Statement of Cash Flows.

In March 2001, the Company settled certain items with a third party provider related to an existing services agreement. In connection with the settlement, L-3 received a net cash payment of $14,200. The payment represents a credit for fees being paid over the term of the services agreement and incremental costs incurred by the Company over the same period arising from performance deficiencies under the services agreement. These incremental costs include additional operating costs for material management, vendor replacement, rework, warranty, manufacturing and engineering support, and administrative activities. The $14,200 cash receipt was recorded as a reduction of costs and expenses in 2001.

4. Contracts in Process

The components of contracts in process are presented in the table below. The unbilled contract receivables, inventoried contract costs and unliquidated progress payments are principally related to contracts with the U.S. Government and prime contractors or subcontractors of the U.S. Government.

	December 31, **2001**	2000
Billed receivables, less allowances of $11,649 and $6,430	**$ 330,795**	$310,185
Unbilled contract receivables	**353,262**	277,026
Less: unliquidated progress payments	**(102,739)**	(69,529)
Unbilled contract receivables, net	**250,523**	207,497
Inventoried contract costs, gross	**110,244**	83,808
Less: unliquidated progress payments	**(6,575)**	(5,685)
Inventoried contract costs, net	**103,669**	78,123
Inventories at lower of cost or market	**116,837**	104,328
Total contracts in process	**$ 801,824**	$700,133

The Company believes that approximately $289,396 of the unbilled contract receivables at December 31, 2001 will be billed and collected within one year.

The selling, general and administrative ("SG&A") cost data presented in the table below have been used in the determination of the costs and expenses presented on the statements of operations.

	Year Ended December 31, **2001**	2000	1999
SG&A costs included in inventoried contract costs	**$ 19,970**	$ 24,396	$ 23,637
SG&A incurred costs	**418,002**	350,561	265,136
Independent research and development, including bid and proposal costs included in SG&A incurred costs	**107,466**	101,883	76,134

5. Other Current Liabilities and Other Liabilities

At December 31, 2001, other current liabilities include an accrual of $43,641 for the remaining Spar common shares outstanding at December 31, 2001 which the Company acquired in January 2002, and $19,236 of estimated costs in excess of billings to complete contracts in process. At December 31, 2001, other liabilities include $18,814 for the non-current portion of estimated costs in excess of billings to complete contracts in process.

At December 31, 2000, other current liabilities include $31,737 of estimated costs in excess of billings to complete contracts in process principally related to contracts assumed as part of the TDTS business that was acquired from Raytheon in February 2000, including the U.S. Army Aviation Combined Arms Tactical Trainer ("AVCATT") contract. At December 31, 2000, other liabilities include $59,641 for the non-current portion of estimated costs in excess of billings to complete contracts in process, principally for the AVCATT contract.

At December 31, 2001, current and non-current estimated costs in excess of billings to complete contracts in process reflect contract costs incurred during 2001 that were charged against the estimated costs in excess of billings and favorable performance on the AVCATT contract related to cost reductions arising from engineering design changes, material sourcing changes, unit price reductions on several parts in the contract bill of materials and lower overhead costs that occurred during 2001.

6. Property, Plant and Equipment

	December 31, 2001	2000
Land	**$ 12,947**	$11,242
Buildings and improvements	**38,544**	25,942
Machinery, equipment, furniture and fixtures	**260,338**	192,679
Leasehold improvements	**29,232**	24,514
Gross property, plant and equipment	**341,061**	254,377
Less: accumulated depreciation and amortization	**137,687**	98,249
Property, plant and equipment, net	**$203,374**	$156,128

Depreciation and amortization expense for property, plant and equipment was $40,362 for 2001, $36,158 for 2000, and $29,554 for 1999.

7. Debt

The components of long-term debt and a reconciliation to the carrying amount of long-term debt are presented in the table below.

	December 31, 2001	2000
Borrowings under Senior Credit Facilities	**$ —**	$ 190,000
10 3/8% Senior Subordinated Notes due 2007	**225,000**	225,000
8 1/2% Senior Subordinated Notes due 2008	**180,000**	180,000
8% Senior Subordinated Notes due 2008	**200,000**	200,000
5 1/4% Convertible Senior Subordinated Notes due 2009	**300,000**	300,000
4% Senior Subordinated Convertible Contingent Debt Securities due 2011	**420,000**	—
Principal amount of long-term debt	**1,325,000**	1,095,000
Less: Unamortized discount	**2,502**	—
Fair value of interest rate swap agreements	**7,246**	—
Carrying amount of long-term debt	**$1,315,252**	$1,095,000

The borrowings under the Senior Credit Facilities, 10 3/8% Senior Subordinated Notes due 2007, 8 1/2% Senior Subordinated Notes due 2008 and 8% Senior Subordinated Notes due 2008 are the indebtedness of L-3 Communications. The 5 1/4% Convertible Senior Subordinated Notes due 2009 and the 4% Senior Subordinated Convertible Contingent Debt Securities due 2011 are the indebtedness of L-3 Holdings. Details on all of the outstanding debt are discussed below.

In May 2001, L-3 Communications restructured its Senior Credit Facilities. At December 31, 2001, the Senior Credit Facilities were comprised of a $400,000 five year revolving credit facility maturing on May 15, 2006 and a $200,000 364-day revolving facility maturing on May 15, 2002 under which at the maturity date L-3 Communications may, (1) at its request and subject to approval of the lenders, extend the maturity date, in whole or in part, for an additional 364-day period, or (2) at its election, convert the outstanding principal amount thereunder into a term loan which would be repayable in a single payment two years from the conversion date. Additionally, the Senior Credit Facilities provided L-3 Communications the ability to increase, on an uncommitted basis, the amount of either the five year revolving credit facility or the 364-day revolving credit facility up to an additional $150,000 in the aggregate.

At December 31, 2001, available borrowings under the Company's Senior Credit Facilities were $497,594, after reductions for outstanding letters of credit of $102,406. There were no outstanding borrowings under the Senior Credit Facilities at December 31, 2001.

Borrowings under the Senior Credit Facilities bear interest, at L-3 Communications' option, at either: (i) a "base rate" equal to the higher of 0.50% per annum above the latest federal funds rate and the Bank of America "reference rate" (as defined) plus a spread ranging from 2.00% to 0.50% per annum depending on L-3 Communications' Debt Ratio at the time of determination or (ii) a "LIBOR rate" (as defined) plus a spread ranging from 3.00% to 1.50% per annum depending on L-3 Communications' Debt ratio at the time of determination. The Debt Ratio is defined as the ratio of Consolidated Total Debt to Consolidated EBITDA. Consolidated Total Debt is equal to outstanding debt plus capitalized lease obligations minus the lesser of actual unrestricted cash or $50,000. Consolidated EBITDA is equal to consolidated net income (excluding extraordinary gains and losses, and gains and losses in connection with asset dispositions and discontinued operations) for the most recent four quarters, plus consolidated interest expense, income taxes, deprecation and amortization minus depreciation and amortization related to minority interest. At December 31, 2001, there were no borrowings outstanding under the Senior Credit Facilities. L-3 Communications pays commitment fees calculated on the daily amounts of the available unused commitments under the Senior Credit Facilities at a rate ranging from 0.50% to 0.35% per annum, depending on L-3 Communications' Debt Ratio in effect at the time of determination. L-3 Communications pays letter of credit fees cal-

culated at a rate ranging from 1.50% to 0.75% per annum for performance letters of credit and 3.00% to 1.50% for all other letters of credit, in each case depending on L-3 Communications' Debt Ratio at the time of determination.

Additionally, in February 2002, the Company expects the lenders to approve a $150,000 increase in the amount of the Senior Credit Facilities. The five year revolving credit facility will increase by $100,000 to $500,000 and the 364-day revolving credit facility will increase by $50,000 to $250,000. Additionally, the maturity date of the $200,000 364-day revolving credit facility is expected to be extended to February 2003.

In March 2002, L-3 Communications expects to borrow $500,000 under a senior subordinated Bridge Loan Facility to finance a portion of the purchase price of AIS and related expenses. The Bridge Loan Facility will be subordinated in right of payment to all of L-3 Communications' existing and future senior debt. Borrowings under the Bridge Loan Facility will bear interest through March 2003, at L-3 Communications' option, at either the one-month or three-month LIBOR rate plus a spread equal to 350 basis points. The Bridge Loan Facility will mature in May 2009, but if the loans under the facility are not repaid by March 2003, each lender's loan will be automatically converted into an exchange note with terms substantially similar to those of the senior subordinated notes discussed below, and will bear interest at a fixed rate equal to the yield to maturity on the Company's highest yielding existing subordinated indebtedness at the time of exchange plus 100 basis points. Subject to the exceptions that will be set forth in the Bridge Loan Facility, L-3 Communications will be required to prepay the Bridge Loan Facility with the net cash proceeds from:

- any debt offerings by L-3 Holdings or its subsidiaries, including L-3 Communications;
- issuance of any equity interests in L-3 Holdings or L-3 Communications;
- incurrence of any other indebtedness of L-3 Holdings or any of its subsidiaries, including L-3 Communications (other than under the Senior Credit Facilities and certain permitted indebtedness); and
- any sale of assets or stock of any subsidiaries of L-3 Communications.

In the fourth quarter of 2001, L-3 Holdings sold $420,000 of 4% Senior Subordinated Convertible Contingent Debt Securities ("CODES") due September 15, 2011. The net proceeds from this offering amounted to approximately $407,450 after underwriting discounts and commissions and other offering expenses. Interest is payable semi-annually on March 15 and September 15 of each year commencing March 15, 2002. The CODES are convertible into L-3 Holdings' common stock at a conversion price of $107.625 per share (3,902,439 shares) under any of the following circumstances: (1) during any Conversion Period (defined below) if the closing sales price of the common stock of L-3 Holdings is more than 120% of the conversion price ($129.15) for at least 20 trading days in the 30 consecutive trading-day period ending on the first day of the respective Conversion Period; (2) during the five business day period following any 10 consecutive trading-day period in which the average of the trading prices for the CODES was less than 105% of the conversion value, (3) if the credit ratings assigned to the CODES by either Moody's or Standard & Poor's are below certain specified ratings, (4) if they have been called for redemption by the Company or (5) upon the occurrence of certain specified corporate transactions. A Conversion Period is the period from and including the thirtieth trading day in a fiscal quarter to, but not including, the thirtieth trading day of the immediately following fiscal quarter. There are four Conversion Periods in each fiscal year. Additionally, holders of the CODES have a right to receive contingent interest payments, not to exceed a per annum rate of 0.5% of the outstanding principal amount of the CODES, which will be paid on the CODES during any six-month period following a six-month period in which the average trading price of the CODES is above 120% of the principal amount of the CODES. The contingent interest payment provision as well as the ability of the holders of the CODES to exercise the conversion features as a result of changes in the credit ratings assigned to the CODES have been accounted for as embedded derivatives. The initial aggregate fair values assigned to the embedded derivatives was $2,502, which was also recorded as a discount to the CODES. The carrying values assigned to the embedded derivatives were recorded in other liabilities and will be adjusted periodically through other income (expense) for changes in their fair values. The CODES are subject to

redemption at any time at the option of L-3 Holdings, in whole or in part, on or after October 24, 2004 at redemption prices (plus accrued and unpaid interest — including contingent interest) starting at 102% of principal (plus accrued and unpaid interest — including contingent interest) during the 12-month period beginning October 24, 2004 and declining annually to 100% of principal (plus accrued and unpaid interest — including contingent interest) on September 15, 2006. The CODES are general unsecured obligations of L-3 Holdings and are subordinated in right of payment to all existing and future senior debt of L-3.

In the fourth quarter of 2000, L-3 Holdings sold $300,000 of 5 1/4% Convertible Senior Subordinated Notes (the "Convertible Notes") due June 1, 2009. The net proceeds from this offering amounted to approximately $290,500 after underwriting discounts and other offering expenses, and were used to repay revolver borrowings outstanding under the Company's Senior Credit Facilities. Interest is payable semi-annually on June 1 and December 1 of each year commencing June 1, 2001. The Convertible Notes may be converted at any time into L-3 Holdings common stock at a conversion price of $81.50 per share. If all the Convertible Notes were converted, an additional 3,680,982 shares of L-3 Holdings common stock would have been outstanding at December 31, 2001. The Convertible Notes are general unsecured obligations of L-3 Holdings and are subordinated in right of payment to all existing and future senior debt of L-3 Holdings and L-3 Communications. The Convertible Notes are subject to redemption at any time, at the option of L-3 Holdings, in whole or in part, on or after December 1, 2003 at redemption prices (plus accrued and unpaid interest) starting at 102.625% of principal (plus accrued and unpaid interest) during the 12-month period beginning December 1, 2003 and declining annually to 100% of principal (plus accrued and unpaid interest) on December 1, 2005 and thereafter.

In December 1998, L-3 Communications sold $200,000 of 8% Senior Subordinated Notes due August 1, 2008 (the "December 1998 Notes") with interest payable semi-annually on February 1 and August 1 of each year commencing February 1, 1999. The December 1998 Notes are general unsecured obligations of L-3 Communications and are subordinated in right of payment to all existing and future senior debt of L-3 Communications. The December 1998 Notes are subject to redemption at any time, at the option of L-3 Communications, in whole or in part, on or after August 1, 2003 at redemption prices (plus accrued and unpaid interest) starting at 104% of principal (plus accrued and unpaid interest) during the 12-month period beginning August 1, 2003 and declining annually to 100% of principal (plus accrued and unpaid interest) on August 1, 2006 and thereafter.

In May 1998, L-3 Communications sold $180,000 of 8 1/2% Senior Subordinated Notes due May 15, 2008 (the "May 1998 Notes") with interest payable semi-annually on May 15 and November 15 of each year commencing November 15, 1998. The May 1998 Notes are general unsecured obligations of L-3 Communications and are subordinated in right of payment to all existing and future senior debt of L-3 Communications. The May 1998 Notes are subject to redemption at any time, at the option of L-3 Communications, in whole or in part, on or after May 15, 2003 at redemption prices (plus accrued and unpaid interest) starting at 104.250% of principal (plus accrued and unpaid interest) during the 12-month period beginning May 15, 2003 and declining annually to 100% of principal (plus accrued and unpaid interest) on May 15, 2006 and thereafter.

In April 1997, L-3 Communications sold $225,000 of 10 3/8% Senior Subordinated Notes due May 1, 2007 (the "1997 Notes") with interest payable semi-annually on May 1 and November 1 of each year commencing November 1, 1997. The 1997 Notes are general unsecured obligations of L-3 Communications and are subordinated in right of payment to all existing and future senior debt of L-3 Communications. The 1997 Notes are subject to redemption at any time, at the option of L-3 Communications, in whole or in part, on or after May 1, 2002 at redemption prices (plus accrued and unpaid interest) starting at 105.188% of principal (plus accrued and unpaid interest) during the 12-month period beginning May 1, 2002 and declining annually to 100% of principal (plus accrued and unpaid interest) on May 1, 2005 and thereafter.

Collectively the 1997 Notes, May 1998 Notes and December 1998 Notes comprise the "Senior Subordinated Notes". The maturities on the Senior Subordinated Notes, Convertible Notes and CODES are $225,000 in 2007, $380,000 in 2008, $300,000 in 2009 and $420,000 in 2011.

In November 2001, L-3 Communications entered into interest rate swap agreements on its $180,000 of 8 1/2% Senior Subordinated Notes due 2008. These swap agreements

exchange the fixed interest rate for a variable interest rate on the entire principal amount. Under these swap agreements, L-3 Communications will pay or receive the difference between the fixed interest rate of 8 1/2% on the senior subordinated notes and a variable interest rate determined two business days prior to the interest payment date of the senior subordinated notes equal to (1) the six month LIBOR rate, set in arrears, plus (2) an average of 350.8 basis points. In July 2001, L-3 Communications entered into interest rate swap agreements on its $200,000 of 8% Senior Subordinated Notes due 2008. These swap agreements exchange the fixed interest rate for a variable interest rate on the entire principal amount. Under these swap agreements, L-3 Communications will pay or receive the difference between the fixed interest rate of 8% on the senior subordinated notes and a variable interest rate determined two business days prior to the interest payment date of the senior subordinated notes equal to (1) the six-month LIBOR rate, set in arrears, plus (2) an average of 192 basis points. The difference to be paid or received on these swap agreements as interest rates change is recorded as an adjustment to interest expense. The swap agreements are accounted for as fair value hedges.

The Senior Credit Facilities, Senior Subordinated Notes, Convertible Notes and CODES agreements contain (and the Bridge Loan Facility will contain) financial and other restrictive covenants that limit, among other things, the ability of the Company to borrow additional funds, dispose of assets, or pay cash dividends. The Company's most restrictive covenants are contained in the Senior Credit Facilities, as amended. The covenants require that (1) the Company's Debt Ratio be less than or equal to 4.50 for the quarter ended December 31, 2001, and that the maximum allowable Debt Ratio be 4.85 for the quarters ending March 31, 2002 and June 30, 2002, thereafter declining over time to less than or equal to 3.50 for the quarters ending December 31, 2004 and thereafter, and (2) the Company's Interest Coverage Ratio be greater than or equal to 2.50 for the quarter ended December 31, 2001, and that the minimum allowable Interest Coverage Ratio, thereafter increase over time to greater than or equal to at least 3.00 for the quarters ending December 31, 2003 and thereafter. The Interest Coverage Ratio is equal to the ratio of Consolidated EBITDA to Consolidated Cash Interest Expense. Consolidated Cash Interest Expense is equal to interest expense less the amortization of deferred debt issue costs included in interest expense. For purposes of calculating the financial covenants under the Senior Credit Facilities, the Convertible Notes and CODES are considered debt of L-3 Communications. The Senior Credit Facilities also limit the payment of dividends by L-3 Communications to L-3 Holdings except for payment of franchise taxes, fees to maintain L-3 Holdings' legal existence, income taxes up to certain amounts, interest accrued on the Convertible Notes and CODES or to provide for operating costs of up to $1,000 annually. Under the covenant, L-3 Communications may also pay permitted dividends to L-3 Holdings from its excess cash flow, as defined, a cumulative amount of $5,000, provided that the Debt Ratio is no greater than 3.5 to 1 as of the most recent fiscal quarter. As a result, at December 31, 2001, $5,000 of L-3 Communications net assets were available for payment of dividends to L-3 Holdings. Through December 31, 2001, the Company was in compliance with these covenants at all times.

In connection with the Senior Credit Facilities, the Company has granted the lenders a first priority lien on the stock of L-3 Communications and substantially all of its domestic subsidiaries. The borrowings under the Senior Credit Facilities are guaranteed by L-3 Holdings and by substantially all of the domestic subsidiaries of L-3 Communications on a senior basis. The payment of principal and premium, if any, and interest on the Senior Subordinated Notes are (and the Bridge Loan Facility will be) unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by all of L-3 Communications' restricted subsidiaries other than its foreign subsidiaries. The guarantees of the Senior Subordinated Notes are (and the Bridge Loan Facility will be) junior to the guarantees of the Senior Credit Facilities and rank pari passu with each other and the guarantees of the Convertible Notes and the CODES. Additionally, the Convertible Notes and CODES are unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by L-3 Communications and substantially all of its direct and indirect domestic subsidiaries. These guarantees rank junior to the guarantees of the Senior Credit Facilities and rank pari passu with each other and the guarantees of the Senior Subordinated Notes and will rank pari passu with the guarantees of the Bridge Loan Facility.

8. Financial Instruments

Fair Value of Financial Instruments. The Company's financial instruments consist primarily of cash and cash equivalents, billed receivables, investments, trade accounts payable, customer advances, Senior Credit Facilities, Senior Subordinated Notes, Convertible Notes, CODES, foreign currency forward contracts, interest rate cap and floor contracts, interest rate swap agreements and embedded derivatives related to the issuance of the CODES. The carrying amounts of cash and cash equivalents, billed receivables, trade accounts payable, Senior Credit Facilities, and customer advances are representative of their respective fair values because of the short-term maturities or expected settlement dates of these instruments. The fair values of the Company's investments are based on quoted market prices, as available, and on historical cost for investments which it is not practicable to estimate fair value. The Senior Subordinated Notes are registered, unlisted public debt which are traded in the over-the-counter market and their fair values are based on quoted trading activity. The fair values of the Convertible Notes and CODES are based on quoted prices for the same or similar issues. The fair value of foreign currency forward contracts were estimated based on exchange rates at December 31, 2001 and 2000. The fair values of the interest rate cap and floor contracts, interest rate swap agreements and the embedded derivatives were estimated by discounting expected cash flows using quoted market interest rates. The carrying amounts and estimated fair values of the Company's financial instruments are presented in the table below.

	December 31,			
	2001		2000	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Investments	**$ 16,532**	**$ 16,532**	$ 8,985	$ 8,985
Senior Subordinated Notes	**597,754**	**630,925**	605,000	586,300
Convertible Notes	**300,000**	**387,000**	300,000	331,350
CODES	**417,498**	**432,600**	—	—
Borrowings under Senior Credit Facilities	**—**	**—**	190,000	190,000
Interest rate caps	**—**	**—**	431	2
Interest rate floor	**(432)**	**(432)**	(74)	(104)
Foreign currency forward contracts	**258**	**258**	—	392
Interest rate swaps	**(7,246)**	**(7,246)**	—	—
Embedded derivatives	**(3,060)**	**(3,060)**	—	—

Interest Rate Risk Management. To mitigate risks associated with changing interest rates on borrowings under the Senior Credit Facilities, the Company entered into interest rate cap and interest rate floor contracts. The interest rate caps and floors are denominated in U.S. dollars and have designated maturities which occur every three months until the interest rate cap and floor contracts expire in March 2002. In 2001, the Company entered into interest rate swap agreements on $380,000 of its Senior Subordinated Notes to take advantage of the current low interest rate environment. These swap agreements exchanged the fixed interest rate for a variable interest rate on the entire notional amount, are denominated in U.S. dollars and have designated maturities which occur on the interest payment dates of the related Senior Subordinated Notes. Collectively the interest rate cap and floor contracts and interest rate swap agreements are herein referred to as the ("interest rate agreements"). Cash payments received from or paid to the counterparties on the interest rate agreements are the difference between the amount that the reference interest rates are greater than or less than the contract rates on the designated maturity dates, multiplied by the notional amounts underlying the respective interest rate agreements. Cash payments or receipts between the Company and counterparties are recorded as a component of interest expense. The initial cost or receipt of these arrangements, if any, are deferred and amortized as a component of interest expense over the term of the interest rate agreement. The Company manages exposure to counterparty credit risk by entering into the interest rate agreements only with major financial institutions that are expected to fully perform under the terms of such agreements. The notional amounts are used to measure the volume of these agreements and do not represent exposure to credit loss.

Foreign Currency Exchange Risk Management. Some of the Company's U.S. operations have contracts with foreign customers which are denominated in foreign currencies. To mitigate the risk associated with certain of these contracts denominated in foreign currency, the Company has entered into foreign currency forward contracts. The Company's activities involving foreign currency forward con-

tracts are designed to hedge the foreign denominated cash paid or received, primarily Euro, British Pound and Italian Lira. The Company manages exposure to counterparty credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. The notional amounts are used to measure the volume of these contracts and do not represent exposure to foreign currency losses.

Information with respect to the interest rate agreements and foreign currency forward contracts is presented in the table below.

	December 31, 2001		2000	
	Notional Amount	Unrealized Gains (Losses)	Notional Amount	Unrealized Gains (Losses)
Interest rate swaps	**$380,000**	**—**	—	—
Interest rate caps	**100,000**	**$(107)**	$100,000	$(429)
Interest rate floor	**50,000**	**(414)**	50,000	(30)
Foreign currency forward contracts	**7,138**	**258**	6,863	392

9. Common Stock

On June 29, 2001, the Company established the L-3 Communications Corporation Employee Stock Purchase Plan ("ESPP") and registered 1,500,000 shares of L-3 Holdings common stock, which may be purchased by employees of L-3 Communications Corporation and its U.S. subsidiaries through payroll deductions. In general, an eligible employee who participates in the ESPP may purchase L-3 Holdings' common stock at a fifteen percent discount. The ESPP is not subject to the Employment Retirement Income Security Act of 1974, as amended. As of December 31, 2001, $4,861 of employee contributions to the employee stock purchase plan were received by the Company and recorded as a component of shareholders' equity in the consolidated balance sheet. On January 7, 2002, the Company transferred 74,285 shares of L-3 Holdings' common stock to the trustee of the ESPP on behalf of those employees who made contributions to the ESPP in 2001.

On May 2, 2001, L-3 Holdings sold 6,900,000 shares of its common stock in a public offering for $80.00 per share. L-3 Holdings sold 4,575,000 shares and other selling stockholders, including affiliates of Lehman Brothers Inc., sold 2,325,000 secondary shares. Upon closing, L-3 Holdings received net proceeds after underwriting discounts and commissions and other offering expenses of $353,622. The net proceeds were contributed to L-3 Communications and were used to repay borrowings under the Senior Credit Facilities, pay for the KDI and EER acquisitions and to increase cash and cash equivalents.

As additional consideration for the ILEX acquisition, L-3 Holdings issued 294,124 shares of its common stock valued at $17,357 in April 2001 based on the financial performance of ILEX in 1999 and 2000, and in August 1999, L-3 Holdings issued 150,955 shares of its common stock valued at $6,434 based on the financial performance of ILEX in 1998. There is no remaining contingent consideration for the ILEX acquisition.

On February 4, 1999, L-3 Holdings sold 5,000,000 shares of common stock in a public offering for $42.00 per share (the "February 1999 Common Stock Offering"); the net proceeds amounted to $201,582 and were contributed by L-3 Holdings to L-3 Communications. In addition, 6,500,000 shares were also sold in the February 1999 Common Stock Offering by the Lehman Partnership and Lockheed Martin. In October 1999, Lockheed Martin sold its remaining interest in L-3 Holdings' common stock. In December 1999, the Lehman Partnership distributed to its partners approximately 3,800,000 shares of L-3 Holdings' common stock. As of December 31, 2001, the Lehman Partnership owned approximately 4.4% of the outstanding common stock of L-3 Holdings.

On May 19, 1998, L-3 Holdings sold 6,900,000 shares of its common stock in an initial public offering ("IPO"). The net proceeds of the IPO amounted to $139,500 and were contributed by L-3 Holdings to L-3 Communications. Prior to the IPO, the common stock of L-3 Holdings consisted of three classes Class A, Class B, and Class C common stock. Immediately prior to the IPO, each authorized share of L-3 Holdings Class A common stock, Class B common stock and Class C common stock was converted into one class of common stock and the authorized L-3 Holdings common stock was increased to 100,000,000 shares.

10. Earnings Per Share

A reconciliation of basic and diluted earnings per share ("EPS") is presented in the table below.

	Year Ended December 31, 2001	2000	1999
Basic:			
Net income	**$115,458**	$82,727	$58,689
Weighted average common shares outstanding	**37,440**	33,355	32,107
Basic earnings per share	**$ 3.08**	$ 2.48	$ 1.83
Diluted:			
Net income	**$115,458**	$82,727	$58,689
After-tax interest expense savings on the assumed conversion of Convertible Notes	**10,502**	—	—
Net income including assumed conversion	**$125,960**	$82,727	$58,689
Common and potential common shares:			
Weighted average common shares outstanding	**37,440**	33,355	32,107
Assumed exercise of stock options	**3,846**	3,940	3,376
Assumed purchase of common shares for treasury	**(2,248)**	(2,342)	(1,967)
Assumed conversion of Convertible Notes	**3,681**	—	—
Common and potential common shares	**42,719**	34,953	33,516
Diluted earnings per share	**$ 2.95**	$ 2.37	$ 1.75

The 3,902,439 shares of L-3 Holdings' common stock that are issuable upon conversion of the CODES were not included in the computation of diluted EPS for the year ended December 31, 2001 because the conditions required for the CODES to become convertible have not been met.

11. Income Taxes

Pretax income of the Company was $186,222 for 2001, $134,079 for 2000, and $95,430 for 1999, substantially all of which was derived from domestic operations. The components of the Company's provision for income taxes are presented in the table below.

	Year Ended December 31, 2001	2000	1999
Current income tax provision, primarily federal	**$18,126**	$26,249	$7,910
Deferred income tax provision:			
Federal	**43,965**	23,130	27,881
State and local	**8,673**	1,973	950
Subtotal	**52,638**	25,103	28,831
Total provision for income taxes	**$70,764**	$51,352	$36,741

A reconciliation of the statutory federal income tax rate to the effective income tax rate of the Company is presented in the table below.

	Year Ended December 31, 2001	2000	1999
Statutory federal income tax rate	**35.0%**	35.0%	35.0%
State and local income taxes, net of federal income tax benefit	**5.3**	4.4	4.6
Foreign sales corporation and extra territorial income benefits	**(3.6)**	(2.6)	—
Nondeductible goodwill amortization and other expenses	**4.8**	6.8	5.2
Research and experimentation and other tax credits	**(5.0)**	(6.1)	(7.1)
Other, net	**1.5**	0.8	0.8
Effective income tax rate	**38.0%**	38.3%	38.5%

The provision for income taxes excludes current tax benefits related to compensation expense deductions for the exercise of stock options that were credited directly to shareholders' equity of $11,939 for 2001, $9,108 for 2000 and $1,011 for 1999.

The significant components of the Company's net deferred tax assets and liabilities are presented in the table below.

	December 31, 2001	2000
Deferred tax assets:		
Inventoried costs	**$ 8,520**	$14,868
Compensation and benefits	**11,460**	10,461
Pension and postretirement benefits	**59,397**	39,486
Property, plant and equipment	**16,579**	9,081
Income recognition on contracts in process	**16,670**	55,942
Net operating loss carryforwards	**32,480**	9,660
Tax credit carryforwards	**31,943**	18,444
Other, net	**21,555**	14,430
Total deferred tax assets	**198,604**	172,372
Deferred tax liabilities:		
Goodwill	**(26,493)**	(18,903)
Other, net	**(11,263)**	(6,626)
Total deferred tax liabilities	**(37,756)**	(25,529)
Net deferred tax assets	**$160,848**	$146,843

The following table presents the classification of the Company's net deferred tax assets.

Current deferred tax assets	$ 62,965	$89,732
Long-term deferred tax assets	97,883	57,111
Total net deferred tax assets	$160,848	$146,843

At December 31, 2001, the Company had $82,340 of U.S. net operating losses and $31,943 of tax credit carryforwards primarily related to U.S. and state research and experimentation credits and state investment tax credits. The net operating losses, some of which are subject to limitation, expire, if unused, between 2011 and 2021. The tax credits primarily expire, if unused, beginning in 2012. The Company believes that it will generate sufficient taxable income to utilize these net operating losses and tax credit carryforwards before they expire.

12. Stock Options

The Company adopted the 1999 Long Term Performance Plan in April 1999, and adopted the 1997 Option Plan in April 1997. As of December 31, 2001, the number of shares of L-3 Holdings' common stock authorized for grant of options or awards under these plans was 8,305,815. On April 26, 2001, an additional 3,000,000 shares of L-3 Holdings' common stock were authorized for grant of options or awards under the 1999 Long Term Performance Plan. The grants may be awarded to employees of the Company in the form of non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock or other incentive awards. The price at which options may be granted shall not be less than 100% of the fair market value of L-3 Holdings' common stock on the date of grant. In general, options expire after 10 years and are exercisable ratably over a three-year period. As of December 31, 2001, the Company had 2,502,919 shares of L-3 Holdings' common stock available for awards under these plans.

On January 1, 2001, January 1, 2000 and May 19, 1999, the Company awarded 30,464, 42,896 and 40,339 shares of restricted stock of L-3 Holdings to employees. The 2001 and 1999 awards vest January 1, 2004 and the 2000 award vests January 1, 2005.

On April 5, 1999, the Company amended the terms of the stock options granted to Frank C. Lanza, Chairman and Chief Executive Officer and Robert V. LaPenta, President and Chief Financial Officer on April 30, 1997 for the purchase of 1,142,857 shares each of L-3 Holdings' common stock at an option price of $6.47. Such amendments eliminated the performance target acceleration provisions on the unvested performance options so that 457,143 options for each of Mr. Lanza and Mr. LaPenta vested on April 5, 1999. These performance options would have originally vested nine years after the grant date, but would have become exercisable with respect to 25% of the shares subject to such performance options on each of April 30, 1999, 2000, 2001 and 2002, to the extent certain targets for the Company's EBITDA were achieved.

The table below presents the Company's stock option activity.

(in thousands)	Number of Options	Weighted Average Exercise Price
Balance at December 31, 1998	2,878	$ 9.27
Options granted	1,009	39.09
Options exercised	(79)	8.37
Options cancelled	(43)	29.99
Balance at December 31, 1999	3,765	17.02
Options granted	661	47.73
Options exercised	(577)	15.52
Options cancelled	(221)	39.82
Balance at December 31, 2000	3,628	21.42
Options granted	1,107	71.61
Options exercised	(564)	29.14
Options cancelled	(181)	42.46
Balance at December 31, 2001	**3,990**	**$33.36**

The following table summarizes information about stock options outstanding at December 31, 2001.

	Outstanding			Exercisable		
Range of Exercise Prices	Number of Options	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Options	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
$ 6.47	1,859	5.5	$ 6.47	1,630	5.5	$ 6.47
$22.00	85	6.3	$22.00	85	6.3	$22.00
$32.75 – $39.99	370	7.7	$37.53	215	7.7	$37.23
$40.00 – $47.00	410	7.6	$41.59	128	7.3	$41.10
$58.00	184	8.6	$58.00	50	8.6	$58.00
$65.00 – $70.00	642	9.3	$66.50	—	—	—
$79.39	440	9.9	$79.39	—	—	—
Total	3,990	7.2	$33.36	2,108	5.9	$13.55

The weighted average fair values of stock options at their grant date during 2001, 2000 and 1999, where the exercise price equaled the market price (estimated fair value) on the grant date were $29.73, $20.19 and $14.60, respectively. In accordance with APB 25, no compensation expense was recognized. The following table reflects pro forma net income and L-3 Holdings EPS had the Company elected to adopt the fair value approach of SFAS 123.

	Year Ended December 31, 2001	2000	1999
Net income:			
As reported	**$115,458**	$82,727	$58,689
Pro forma	**107,573**	75,064	54,625
Basic EPS:			
As reported	**$ 3.08**	$ 2.48	$ 1.83
Pro forma	**2.87**	2.25	1.70
Diluted EPS:			
As reported	**$ 2.95**	$ 2.37	$ 1.75
Pro forma	**2.76**	2.15	1.63

The estimated fair value of options granted was calculated using the Black-Scholes option-pricing valuation model. The weighted average assumptions used in the valuation models are presented in the table below.

	Year Ended December 31, 2001	2000	1999
Expected option term	**5.0**	5.0	4.8
Expected volatility	**39.5%**	35.8%	31.0%
Expected dividend yield	**—**	—	—
Risk-free interest rate	**4.5%**	6.4%	4.7%

13. Commitments and Contingencies

The Company leases certain facilities and equipment under agreements expiring at various dates through 2028. The following table presents future minimum payments under noncancelable operating leases with initial or remaining terms in excess of one year as of December 31, 2001.

	Operating Leases		
	Real Estate	Equipment	Total
2002	$ 60,163	$1,735	$ 61,898
2003	48,302	996	49,298
2004	32,693	379	33,072
2005	28,788	104	28,892
2006	25,722	12	25,734
Thereafter	151,561	—	151,561
Total	$347,229	$3,226	$350,455

Real estate lease commitments have been reduced by minimum sublease rental income of $5,127 due in the future under noncancellable subleases. Leases covering major items of real estate and equipment contain renewal and or purchase options. Rent expense, net of sublease income was $41,370 for 2001, $34,123 for 2000 and $22,452 for 1999.

On March 30, 1998, the Company entered into a real estate lease agreement, as lessee, with an unrelated lessor which expired on March 30, 2001, which is accounted for as an operating lease. On March 29, 2001, the Company exercised its option to renew the lease through March 30, 2003. On or before the lease expiration date, the Company can exercise options under the lease agreement to either renew the lease, purchase the property for $12,500, or sell the property on behalf of the lessor (the "Sale Option"). If the Company elects the Sale Option, the Company must pay the lessor a residual guarantee amount of $10,894, on or before the lease expiration date, and at the time the property is sold, the Company must pay the lessor a supplemental rent equal to the gross sales proceeds in excess of the residual guarantee amount not to exceed $1,606.

On June 30, 1999, the Company entered into a real estate lease agreement, as lessee, with an unrelated lessor which expires on June 30, 2002, which is accounted for as an operating lease. On or before the lease expiration date, the Company can exercise options under the lease agreement to either renew the lease, purchase the property for $15,500, or sell the property on behalf of the lessor. If the Company elects the Sale Option, the Company must pay the lessor a residual guarantee amount of $13,524, on or before the lease expiration date, and at the time the property is sold, the Company must pay the lessor a supplemental rent equal to the gross sales proceeds in excess of the residual guarantee amount not to exceed $1,976.

For both real estate lease agreements discussed above, if the gross sales proceeds are less than the sum of the residual guarantee amount and the supplemental rent, the Company is required to pay a supplemental rent to the extent the reduction in the fair value of the property is demonstrated by an independent appraisal to have been caused by the Company's failure to properly maintain the property. Accordingly, the aggregate residual guarantee amounts of $24,418 have been included in the noncancellable real estate operating lease payments relating to the expiration of such leases.

On December 28, 2000, the Company entered into a sale-leaseback transaction on its facility located in Hauppauge, NY. The facility was sold for $13,650. The lease agreement which is accounted for as an operating lease, has an initial term of 14 years with a fixed annual rent that increases 2.5% annually. The Company has the option to extend the lease term for an additional 3 terms of 5 years each. The gain of

$4,110 on the sale of the facility has been deferred and will be recognized ratably over the term of the lease.

The Company has a contract to provide and operate for the U.S. Air Force ("USAF") a full-service training facility including simulator systems near a USAF base. The Company expects to lease the simulator systems from unrelated third parties, and has entered into agreements with the owner-lessors of the simulator systems, under which the Company is acting as the construction agent on behalf of the owner-lessors for procurement and construction for the simulator systems. The estimated project costs to construct the simulator systems is approximately $48,360. During the construction period, if certain events occur that are caused by the Company's actions or failures to act, these agreements may obligate the Company to make payments to the owner-lessors which may be equal to 89.9% of the incurred project costs for the simulator systems at the time of such defaults. At December 30, 2002, the estimated completion date of the construction, pursuant to these agreements, the Company, as lessee, will enter into leases each with a term of 15 years with the owner-lessors for the use of the simulator systems. These leases are expected to be accounted for as operating leases and the aggregate noncancellable rental payments under such leases are estimated to be $89,241.

The Company is engaged in providing products and services under contracts with the U.S. Government and to a lesser degree, under foreign government contracts, some of which are funded by the U.S. Government. All such contracts are subject to extensive legal and regulatory requirements, and, from time to time, agencies of the U.S. Government investigate whether such contracts were and are being conducted in accordance with these requirements. Under U.S. Government procurement regulations, an indictment of the Company by a federal grand jury could result in the Company being suspended for a period of time from eligibility for awards of new government contracts. A conviction could result in debarment from contracting with the federal government for a specified term. Additionally, in the event that U.S. Government expenditures for products and services of the type manufactured and provided by the Company are reduced, and not offset by greater commercial sales or other new programs or products, or acquisitions, there may be a reduction in the volume of contracts or subcontracts awarded to the Company.

The Company has been periodically subject to litigation, claims or assessments and various contingent liabilities incidental to its business. Management continually assesses the Company's obligations with respect to applicable environmental protection laws. While it is difficult to determine the timing and ultimate cost to be incurred by the Company in order to comply with these laws, based upon available internal and external assessments, with respect to those environmental loss contingencies of which management is aware, the Company believes that even without considering potential insurance recoveries, if any, there are no environmental loss contingencies that, individually or in the aggregate, would be material to the Company's consolidated results of operations. The Company accrues for these contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

With respect to those investigative actions, items of litigation, claims or assessments of which it is aware, management of the Company is of the opinion that the probability is remote that, after taking into account certain provisions that have been made with respect to these matters, the ultimate resolution of any such investigative actions, items of litigation, claims or assessments will have a material adverse effect on the consolidated financial position, results of operations or cash flows of the Company.

14. Pensions and Other Employee Benefits

The Company maintains a number of pension plans, both contributory and noncontributory, covering employees at certain locations. Eligibility for participation in these plans varies and benefits are generally based on the participant's compensation and/or years of service. The Company's funding policy is generally to contribute in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations thereon. Plan assets are invested primarily in U.S. government and agency obligations and listed stocks and bonds.

The Company also provides postretirement medical and life insurance benefits for retired employees and dependents at certain locations. Participants are eligible for these benefits when they retire from active service and meet the eligibility requirements for the Company's pension plans. These benefits are funded primarily on a pay-as-you-go basis with the

retiree generally paying a portion of the cost through contributions, deductibles and coinsurance provisions.

The following table summarizes the balance sheet impact, as well as the benefit obligations, assets, funded status and rate assumptions associated with the pension and postretirement benefit plans.

	Pensions Plans		Postretirement Benefit Plans	
	2001	2000	**2001**	2000
Change in benefit obligation:				
Benefit obligation at beginning of year	**$ 415,483**	$328,541	**$ 68,538**	$ 65,554
Service cost	**18,516**	16,343	**1,709**	1,670
Interest cost	**31,428**	28,029	**4,746**	4,754
Participants' contributions	**62**	36	**607**	—
Amendments	**—**	853	**—**	—
Actuarial loss (gain)	**22,277**	8,867	**4,043**	(1,271)
Acquisitions	**63,793**	48,187	**12,369**	1,879
Benefits paid	**(18,108)**	(15,373)	**(4,869)**	(4,048)
Benefit obligation at end of year	**$ 533,451**	$415,483	**$ 87,143**	$ 68,538
Change in plan assets:				
Fair value of plan assets at beginning of year	**$ 391,263**	$367,451	**$ —**	$ —
Actual return on plan assets	**(13,754)**	(21,905)	**—**	—
Acquisitions	**63,344**	49,709	**—**	—
Employer contributions	**8,108**	11,345	**4,262**	4,048
Participants' contributions	**62**	36	**607**	—
Benefits paid	**(18,108)**	(15,373)	**(4,869)**	(4,048)
Fair value of plan assets at end of year	**$ 430,915**	$391,263	**$ —**	$ —
Funded status of the plans	**$(102,536)**	$(24,220)	**$(87,143)**	$(68,538)
Unrecognized actuarial loss (gain)	**69,697**	(5,044)	**(5,032)**	(9,401)
Unrecognized prior service cost	**3,426**	3,777	**(547)**	(1,207)
Net amount recognized	**$ (29,413)**	$(25,487)	**$(92,722)**	$(79,146)
Amounts recognized in the balance sheets consist of:				
Accrued benefit liability	**$ (62,330)**	$(26,377)	**$(92,722)**	$(79,146)
Accumulated other comprehensive income	**32,917**	890	**—**	—
Net amount recognized	**$ (29,413)**	$(25,487)	**$(92,722)**	$(79,146)
Rate Assumptions:				
Discount rate	**7.25%**	7.50%	**7.25%**	7.50%
Rate of return on plan assets	**9.50%**	9.50%	**n.a.**	n.a.
Salary increases	**4.50%**	4.50%	**4.50%**	4.50%

The annual increase in cost of benefits ("health care cost trend rate") is assumed to be an average of 10.00% in 2001 and is assumed to gradually decrease to a rate of 4.5% thereafter. Assumed health care cost trend rates have a significant effect on amounts reported for postretirement medical benefit plans. A one percentage point decrease in the assumed health care cost trend rates would have the effect of decreasing the aggregate service and interest cost by $540 and the postretirement medical obligations by $6,139. A one percentage point increase in the assumed health care cost trend rate would have the effect of increasing the aggregate service and interest cost by $658 and the postretirement medical obligations by $6,651.

The following table summarizes the components of net periodic pension and postretirement medical costs.

	Pensions Plans		Postretirement Benefit Plans	
	2001	2000	**2001**	2000
Components of net periodic benefit cost:				
Service cost	**$ 18,516**	$ 16,343	**$1,709**	$1,670
Interest cost	**31,428**	28,029	**4,746**	4,754
Amortization of prior service cost	**351**	351	**(99)**	(99)
Expected return on plan assets	**(37,716)**	(39,109)	**—**	—
Recognized actuarial (gain) loss	**(424)**	(3,981)	**(887)**	(865)
Recognition due to settlement	**—**	307	**—**	—
Net periodic benefit cost	**$ 12,155**	$ 1,940	**$5,469**	$5,460

The accumulated benefit obligation, projected benefit obligation, and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were $300,072, $324,840, and $247,383, respectively, as of December 31, 2001 and $86,426, $92,180 and $78,773, respectively, as of December 31, 2000.

In connection with the Company's assumption of certain plan obligations pursuant to the Company's acquisition of the predecessor company, Lockheed Martin has provided the Pension Benefit Guaranty Corporation ("PBGC") with commitments to assume sponsorship or other forms of financial support under certain circumstances with respect to the Company's pension plans for Communication Systems - West and Aviation Recorders (the "Subject Plans"). Upon the occurrence of certain events, Lockheed Martin, at its option, has the right to decide whether to cause the Company to transfer sponsorship of any or all of the Subject Plans to Lockheed Martin, even if the PBGC has not sought to terminate the Subject Plans. Such a triggering event occurred in 1998, but reversed in 1999, relating to a decrease in the PBGC-mandated discount rate in 1998 that had resulted in an increase in the underlying liability. The Company notified Lockheed Martin of the 1998 triggering event, and in February 1999, Lockheed Martin informed the

Company that it had no present intention to exercise its right to cause the Company to transfer sponsorship of the Subject Plans. If Lockheed Martin did assume sponsorship of these plans, it would be primarily liable for the costs associated with funding the Subject Plans or any costs associated with the termination of the Subject Plans but L-3 Communications would be required to reimburse Lockheed Martin for these costs. To date, the impact on pension expense and funding requirements resulting from this arrangement has not been significant. However, should Lockheed Martin assume sponsorship of the Subject Plans or if these plans were terminated, the impact of any increased pension expenses or funding requirements could be material to the Company. The Company has performed its obligations under the letter agreement with Lockheed Martin and the Lockheed Martin Commitment and has not received any communications from the PBGC concerning actions which the PBGC contemplates taking in respect of the Subject Plans.

Employee Savings Plans. Under its various employee savings plans, the Company matches the contributions of participating employees up to a designated level. The extent of the match, vesting terms and the form of the matching contributions vary among the plans. Under these plans, the Company's matching contributions in L-3 Holdings common stock and cash were $21,462 for 2001, $15,201 for 2000 and $8,798 for 1999.

15. Supplemental Cash Flow Information

	Year Ended December 31,		
	2001	2000	1999
Interest paid	**$81,552**	$81,390	$50,532
Income taxes paid	**4,904**	10,052	6,317
Noncash transactions:			
Common stock issued related to acquisition	**17,357**	—	6,432
Contribution in common stock to savings plans	**16,868**	12,642	6,993

16. Segment Information

The Company has two reportable segments, Secure Communication Systems and Specialized Products, which are described in Note 1. The Company evaluates the performance of its operating divisions and reportable segments based on sales and operating income. All corporate expenses are allocated to the Company's divisions using an allocation methodology prescribed by U.S. Government regulations for government contractors. Accordingly, all costs and expenses are included in the Company's measure of segment profitability.

	Secure Communication Systems	Specialized Products	Corporate	Elimination of Intersegment Sales	Consolidated Total
2001					
Sales	**$1,241,981**	**$1,109,641**		**$ (4,200)**	**$2,347,422**
Operating income	**146,270**	**129,060**			**275,330**
Total assets	**1,021,924**	**1,769,453**	**$544,056**		**3,335,433**
Capital expenditures	**16,115**	**31,727**	**279**		**48,121**
Depreciation and amortization	**33,723**	**53,228**			**86,951**
2000					
Sales	$ 856,970	$ 1,065,136		$(12,045)	$ 1,910,061
Operating income	91,310	131,408			222,718
Total assets	792,949	1,480,790	$ 189,805		2,463,544
Capital expenditures	10,750	22,830			33,580
Depreciation and amortization	26,417	47,837			74,254
1999					
Sales	$ 544,418	$ 867,495		$ (6,451)	$ 1,405,462
Operating income	46,955	103,531			150,486
Total assets	370,918	1,065,236	$ 192,587		1,628,741
Capital expenditures	6,980	16,476			23,456
Depreciation and amortization	18,451	35,267			53,718

Corporate assets not allocated to the reportable segments primarily include cash and cash equivalents, corporate office fixed assets, deferred income tax assets and deferred debt issuance costs.

Substantially all of the Company's operations are domestic. The Company's foreign operations are not material to the Company's results of operations, cash flows or financial position. Sales to principal customers are summarized in the table below.

	Year Ended December 31,		
	2001	2000	1999
U.S. Government agencies	**$1,614,858**	$1,284,379	$ 924,006
Foreign governments	**200,913**	144,274	127,637
Commercial export	**218,971**	172,101	144,274
Other (principally U.S. commercial)	**312,680**	309,307	209,545
Consolidated Sales	**$2,347,422**	$1,910,061	$1,405,462

17. Unaudited Quarterly Financial Data

Unaudited summarized financial data by quarter for the years ended December 31, 2001 and 2000 is presented in the table below.

	March 31	June 30	September 30	December 31
2001				
Sales	**$461,901**	**$561,560**	**$618,164**	**$705,797**
Operating income	**46,869**	**60,467**	**75,208**	**92,786**
Net income	**14,158**	**23,336**	**33,435**	**44,529**
Basic EPS	**$0.42**	**$0.62**	**$0.86**	**$1.14**
Diluted EPS	**$0.40**	**$0.60**	**$0.82**	**$1.06**
2000				
Sales	$ 377,052	$ 460,976	$ 514,415	$ 557,618
Operating income	34,669	49,653	62,815	75,581
Net income	10,929	16,459	24,116	31,223
Basic EPS	$0.33	$0.49	$0.72	$0.93
Diluted EPS	$0.32	$0.47	$0.69	$0.89

Report of Independent Auditors

To the Board of Directors and Shareholders of L-3 Communications Holdings, Inc.

We have audited the accompanying consolidated balance sheets of L-3 Communications Holdings, Inc. and subsidiaries (the "Company") as of December 31, 2001 and 2000, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2001 and 2000 and their consolidated results of operations and cash flows for each of the three years ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

1177 Avenue of the Americas
New York, New York
February 4, 2002

Report of Management

The consolidated financial statements and other financial data contained in this annual report have been prepared in conformity with generally accepted accounting principles in the United States of America. The integrity and objectivity of this financial information is the responsibility of management. To this end, management maintains an adequate system of internal controls and supports an extensive program of internal reviews and audits to provide reasonable assurance that the Company's assets are protected and that transactions and events are recorded properly.

The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, Independent Auditors. The Report of Independent Auditors, above, expresses an informed judgment as to whether management's financial statements, considered in their entirety, present fairly, in conformity with generally accepted accounting principles in the United States of America, the Company's financial position, results of operations and cash flows. This judgment is based on procedures described in the second paragraph of their report. These procedures include an assessment of the Company's internal control structure, and performing tests and other auditing procedures sufficient to provide reasonable assurance that the financial statements are free of material misstatements.

To further assure objectivity, the financial information contained in this annual report is subject to review by the Audit Committee of the Board of Directors. The Audit Committee, composed of outside directors who are not employees, meets periodically with management, the internal auditors and the independent auditors to discuss auditing, internal control and financial reporting matters. The internal auditors and independent auditors periodically meet alone with the Audit Committee and have unlimited access to the Audit Committee at any time.

We believe that our policies and procedures provide reasonable assurance that operations are conducted in conformity with applicable laws and with our commitment to a high standard of business conduct.

Robert V. LaPenta
President and
Chief Financial Officer

Michael T. Strianese
Senior Vice President–
Finance

L-3 Communications Officers

Frank C. Lanza Chairman and Chief Executive Officer

Robert V. LaPenta President and Chief Financial Officer

Christopher C. Cambria Senior Vice President, Secretary and General Counsel

Michael T. Strianese Senior Vice President of Finance

General Jimmie V. Adams (USAF – Retired) Vice President of Washington Operations

David T. Butler III Vice President of Planning

Ralph G. D'Ambrosio Vice President and Controller

Kenneth W. Manne Vice President of Human Resources

Joseph S. Paresi Vice President of Product Development and President of Security Systems Division

David M. Reilly Vice President, Assistant General Counsel and Assistant Secretary

General Robert W. RisCassi (US Army – Retired) Vice President of Washington Operations

Charles J. Schafer Vice President of Business Operations and President of Products Group

Stephen M. Souza Vice President and Treasurer

Cynthia A. Swain Vice President of Corporate Communications

Jill J. Wittels, Ph.D. Vice President of Business Development

Curtis Brunson Corporate Vice President and President of Communication Systems-West Division

Alan R. Dietrich Corporate Vice President and President of Telemetry Group

John S. Mega Corporate Vice President and President of Microwave Group

Gregory B. Roberts Corporate Vice President and President of Communication Systems-East Division

Shareholder Information

Corporate Headquarters

You can contact the corporate headquarters by writing to: L-3 Communications, 600 Third Avenue, New York, NY 10016, or by calling 212-697-1111. To send a fax, dial 212-805-5353.

Corporate Information

News media, analysts, shareholders and others seeking corporate information about L-3 Communications should contact Cynthia Swain, vice president of corporate communications at 212-697-1111.

Printed Materials

Printed financial materials, including the 2001 Annual Report, may be obtained without charge from L-3's Investor Relations firm, Morgen-Walke Associates by calling 212-850-5600.

Internet

You can access quarterly and annual financial information, news releases and an overview of the company's products and services through the L-3 web site at http://www.L-3com.com on the Internet.

Auditors

PricewaterhouseCoopers LLP, New York, NY.

Shareholder Assistance

If you have questions concerning your shareholder account, please contact the stock transfer agent, EquiServe Trust Company N.A., P.O. Box 2500, Jersey City, New Jersey 07303, or call 800-446-2617. For the hearing impaired, the phone number is TDD: 201-222-4955.

You can also contact the stock transfer agent at their web site at http://www.equiserve.com on the Internet.

Stock Exchange Listing

The common stock of L-3 Communications is traded on the New York Stock Exchange under the symbol LLL.

Annual Meeting

The annual meeting of shareholders will be held at 2:30 p.m. on Tuesday, April 23, 2002 at the Rihga Royal New York Hotel, 151 West 54th Street, New York, NY.

Equal Opportunity Employer

L-3 Communications Corporation is an equal opportunity employer. All matters regarding recruiting, hiring, training, compensation, benefits, promotions, transfers and all other personnel policies will continue to be free from discriminatory practices.

600 Third Avenue
New York, NY 10016