RAYTHEON CO/
Form 10-Q
October 22, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 27, 2009

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number 1-13699

RAYTHEON COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**95-1778500**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

870 Winter Street, Waltham, Massachusetts 02451

(Address of principal executive offices) (Zip Code)

(781) 522-3000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Number of shares of common stock outstanding as of October 14, 2009 was 383,217,000

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RAYTHEON COMPANY

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Cautionary Note Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements including information regarding our 2009 financial outlook, future plans, objectives, business prospects, the impact of certain liabilities, the impact of changes in accounting treatment, the outcome of certain litigation and audits and investigations, sufficiency of capital, and anticipated financial performance. You can identify these statements by the fact that they include words such as will, believe, anticipate, expect, estimate, intend, plan, outlook or variations of these words or similar expressions. Tl forward-looking statements are not statements of historical facts and represent only our current expectations regarding such matters. These statements inherently involve a wide range of known and unknown uncertainties. Our actual actions and results could differ materially from what is expressed or implied by these statements. Factors that could cause such a difference include, but are not limited to, those set forth under Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008 and other important factors disclosed previously and from time to time in our other filings with the Securities and Exchange Commission (SEC). Given these factors, as well as other variables that may affect our operating results, you should not rely on forward-looking statements, assume that past financial performance will be a reliable indicator of future performance nor use historical trends to anticipate results or trends in future periods. We expressly disclaim any obligation or intention to provide updates to the forward-looking statements and the estimates and assumptions associated with them.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
RAYTHEON COMPANY

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In millions, except per share amounts)	**Sept. 27, 2009**	**Dec. 31, 2008**
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,442	$ 2,259
Accounts receivable, net	105	105
Contracts in process	4,207	3,793
Inventories	317	325
Current tax asset		441
Deferred taxes	382	395
Prepaid expenses and other current assets	96	99
Total current assets	7,549	7,417
Property, plant and equipment, net	1,945	2,024
Deferred taxes	445	735
Prepaid retiree benefits	66	56
Goodwill	11,668	11,662
Other assets, net	1,207	1,240
Total assets	$ 22,880	$ 23,134
LIABILITIES AND EQUITY		
Current liabilities		
Advance payments and billings in excess of costs incurred	$ 2,002	$ 1,970
Accounts payable	1,266	1,201
Accrued employee compensation	914	913
Other accrued expenses	988	1,065
Total current liabilities	5,170	5,149
Accrued retiree benefits and other long-term liabilities	5,778	6,488
Long-term debt	2,293	2,309
Commitments and contingencies (Note 10)		
Equity		
Common stock, par value, $0.01 per share, 1,450 shares authorized, 383 shares and 400 shares outstanding at September 27, 2009 and December 31, 2008, respectively, after deducting 101 treasury shares and 81 treasury shares at September 27, 2009 and December 31, 2008, respectively	4	4
Additional paid-in capital	10,929	10,873
Accumulated other comprehensive loss	(4,967)	(5,182)
Treasury stock, at cost	(5,145)	(4,254)
Retained earnings	8,714	7,646
Total Raytheon Company stockholders equity	9,535	9,087
Noncontrolling interest in subsidiaries	104	101
Total equity	9,639	9,188

Total liabilities and equity	$ 22,880	$ 23,134

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

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RAYTHEON COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In millions, except per share amounts)	Three Months Ended Sept. 27, 2009	Three Months Ended Sept. 28, 2008	Nine Months Ended Sept. 27, 2009	Nine Months Ended Sept. 28, 2008
Net sales	$ 6,205	$ 5,864	$ 18,214	$ 17,088
Operating expenses				
Cost of sales	4,894	4,664	14,430	13,586
Administrative and selling expenses	401	380	1,135	1,156
Research and development expenses	145	130	407	379
Total operating expenses	5,440	5,174	15,972	15,121
Operating income	765	690	2,242	1,967
Interest expense	32	29	95	97
Interest income	(4)	(16)	(11)	(56)
Other (income) expense, net	(10)	18	(18)	21
Non-operating expense, net	18	31	66	62
Income from continuing operations before taxes	747	659	2,176	1,905
Federal and foreign income taxes	248	222	716	635
Income from continuing operations	499	437	1,460	1,270
(Loss) income from discontinued operations, net of tax	(1)		(1)	(2)
Net income	498	437	1,459	1,268
Less: Net income attributable to noncontrolling interests	8	10	28	17
Net income attributable to Raytheon Company	$ 490	$ 427	$ 1,431	$ 1,251
Basic earnings (loss) per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$ 1.27	$ 1.03	$ 3.64	$ 2.99
Income (loss) from discontinued operations				(0.01)
Net income	1.26	1.03	3.64	2.98
Diluted earnings (loss) per share attributable to Raytheon Company common stockholders:				
Income from continuing operations	$ 1.25	$ 1.01	$ 3.60	$ 2.92
Income (loss) from discontinued operations				(0.01)
Net income	1.25	1.00	3.59	2.91
Amounts attributable to Raytheon Company common stockholders:				
Income from continuing operations	$ 491	$ 427	$ 1,432	$ 1,253
(Loss) income from discontinued operations	(1)		(1)	(2)
Net income	$ 490	$ 427	$ 1,431	$ 1,251

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

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RAYTHEON COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)	Nine Months Ended Sept. 27, 2009	Nine Months Ended Sept. 28, 2008
Cash flows from operating activities		
Net income	$ 1,459	$ 1,268
Loss from discontinued operations, net of tax	1	2
Income from continuing operations	1,460	1,270
Adjustments to reconcile to net cash provided by operating activities from continuing operations, net of the effect of acquisitions and divestitures		
Depreciation and amortization	295	288
Stock-based compensation	92	89
Deferred income taxes	231	52
Collection of financing receivables	28	46
Tax benefit from stock-based awards	(6)	(50)
Changes in assets and liabilities		
Accounts receivable, net		(3)
Contracts in process and advance payments and billings in excess of costs incurred	(280)	(487)
Inventories	13	34
Prepaid expenses and other current assets	(19)	76
Accounts payable	71	53
Income taxes receivable / payable	487	264
Accrued employee compensation	5	(67)
Other accrued expenses	(15)	12
Pension and other, net	(690)	15
Net cash provided by operating activities from continuing operations	1,672	1,592
Net cash used in operating activities from discontinued operations	(16)	(21)
Net cash provided by operating activities	1,656	1,571
Cash flows from investing activities		
Additions to property, plant and equipment	(138)	(167)
Proceeds from sales of property, plant and equipment	1	7
Additions to capitalized expenditures for internal use software	(49)	(58)
Proceeds from sale of discontinued operation, net		9
Payments for purchases of acquired companies, net of cash received		(54)
Change in other assets	(10)	
Net cash used in investing activities	(196)	(263)
Cash flows from financing activities		
Dividends paid	(355)	(344)
Repurchases of common stock	(900)	(1,020)
Activity under common stock plans	(20)	112
Tax benefit from stock-based awards	6	50
Other	(8)	
Net cash used in financing activities	(1,277)	(1,202)
Net increase in cash and cash equivalents	183	106

Cash and cash equivalents at beginning of the year	2,259	2,655
Cash and cash equivalents at end of period	$ 2,442	$ 2,761

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

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RAYTHEON COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

We prepared the accompanying unaudited consolidated financial statements (Financial Statements) of Raytheon Company on the same basis as our annual audited Financial Statements, except for the adoption of new accounting standards in the first nine months of 2009 related to the following:

Noncontrolling interests as discussed in Note 7;

Fair value measurements as discussed in Note 8;

Disclosure of derivative instruments and hedging activities as discussed in Note 9;

The earnings per share (EPS) impact of instruments granted in share-based payment transactions as discussed in Note 11; and

Business combinations, which we will apply prospectively to business combinations with acquisition dates after January 1, 2009.

Our 2008 annual audited financial statements included the January 1, 2008 adoption of accounting standards related to the accounting for deferred compensation and postretirement aspects of endorsement split-dollar life insurance agreements and the accounting for collateral assignment split-dollar life insurance arrangements.

In the opinion of management, our Financial Statements reflect all adjustments, which are of a normal recurring nature, necessary for presentation of Financial Statements for interim periods in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and with the instructions to Form 10-Q in Article 10 of SEC Regulation S-X. The preparation of Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of our Financial Statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. In addition, we reclassified certain prior year amounts to conform with our current year presentation. As used in this report, the terms we, us, our, Raytheon and the Company mean Raytheon Company and its subsidiaries, unless the context indicates otherwise.

We condensed or omitted certain information and footnote disclosures normally included in our annual audited Financial Statements, which we prepared in accordance with GAAP. Our quarterly Financial Statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2008.

We have evaluated subsequent events through the time of filing this Form 10-Q with the SEC on October 22, 2009.

2. Inventories

Inventories consisted of the following at:

(In millions)	Sept. 27, 2009	Dec. 31, 2008
Materials and purchased parts	$ 57	$ 56
Work in process	226	224

Finished goods		34		45
Total	$	317	$	325

We capitalize costs incurred in advance of contract award or funding in Inventories if we determine the contract award or funding is probable. These precontract costs exclude any start-up costs. We included capitalized precontract and other deferred costs of $61 million and $85 million in Inventories as work in process at September 27, 2009 and December 31, 2008, respectively.

3. Product Warranty

We provide product warranties in conjunction with certain product sales where revenue is recognized upon delivery.

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Activity related to warranty accruals was as follows:

(In millions)	Three Months Ended Sept. 27, 2009	Three Months Ended Sept. 28, 2008	Nine Months Ended Sept. 27, 2009	Nine Months Ended Sept. 28, 2008
Balance at beginning of period	$ 38	$ 44	$ 39	$ 47
Provisions for warranties	4	1	10	5
Warranty services provided	(3)	(4)	(10)	(11)
Balance at end of period	$ 39	$ 41	$ 39	$ 41

We account for costs incurred under warranty provisions performed under long-term contracts as contract costs using the cost-to-cost measure of progress, as the estimation of these costs is an integral part of the pricing determination on these long-term contracts, and exclude these costs from the table above.

4. Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued an accounting standard amending the accounting and disclosure requirements for transfers of financial assets. This accounting standard requires greater transparency and additional disclosures for transfers of financial assets and the entity s continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, it eliminates the concept of a qualifying special-purpose entity (QSPE). This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2009, and will not have a material effect on our financial position, results of operations or liquidity.

In June 2009, the FASB also issued an accounting standard amending the accounting and disclosure requirements for the consolidation of variable interest entities (VIEs). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this accounting standard. Further, this accounting standard requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. It also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, it requires enhanced disclosures about an enterprise s involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise s financial statements. Finally, an enterprise will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2009, and will not have a material effect on our financial position, results of operations or liquidity.

5. Acquisitions

In the three months ended September 27, 2009, we entered into an agreement to acquire BBN Technologies, which will be part of our Network Centric Systems segment, for a total purchase price of approximately $350 million, subject to purchase price adjustments. The amount is also exclusive of retention and management incentive payments. The acquisition is expected to be completed in the three months ended December 31, 2009.

In the nine months ended September 28, 2008, we acquired Telemus Solutions, Inc. and SI Government Solutions at our Intelligence and Information Systems segment, for $52 million in cash. We recorded $9 million of intangible assets primarily related to intellectual property, and $39 million of goodwill in connection with these acquisitions.

6. Discontinued Operations

Results from discontinued operations were as follows:

	Three Months Ended			
	Pretax Income (Loss)		After-tax Income (Loss)	
(In millions)	Sept. 27, 2009	Sept. 28, 2008	Sept. 27, 2009	Sept. 28, 2008
Raytheon Aircraft	$ 2	$ 1	$ 1	$

Flight Options	(1)		(1)	
Other Discontinued Operations	(1)	(2)	(1)	
Total	$	$ (1)	$ (1)	$

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	Nine Months Ended			
	Pretax Income (Loss)		After-tax Income (Loss)	
(In millions)	Sept. 27, 2009	Sept. 28, 2008	Sept. 27, 2009	Sept. 28, 2008
Raytheon Aircraft	$ 5	$ 1	$ 5	$
Flight Options	(1)		(1)	
Other Discontinued Operations	(5)	(5)	(5)	(2)
Total	$ (1)	$ (4)	$ (1)	$ (2)

In 2007, we sold our Raytheon Aircraft Company (Raytheon Aircraft) and Flight Options LLC (Flight Options) businesses. As a result, we present Raytheon Aircraft, Flight Options and our other previously disposed businesses (Other Discontinued Operations) as discontinued operations for all periods. All residual activity relating to our disposed businesses appears in discontinued operations.

We retained certain assets and liabilities of these disposed businesses. At September 27, 2009 and December 31, 2008, we had $70 million and $71 million, respectively, in non-current assets primarily related to our subordinated retained interest in general aviation finance receivables previously sold by Raytheon Aircraft. At September 27, 2009 and December 31, 2008, we had $63 million and $77 million of liabilities, respectively, primarily in current liabilities related to certain environmental and product liabilities, aircraft lease obligations, non-income tax obligations and various contract obligations. We also have certain income tax obligations relating to these disposed businesses, which we include in our income tax disclosures. The Internal Revenue Service (IRS) concluded a federal excise tax audit and assessed us additional excise tax related to the treatment of certain Flight Options customer fees and charges, which we have appealed. We continue to believe that an unfavorable outcome is not probable and expect that any potential liability will not have a material adverse effect on our financial position, results of operations or liquidity. We also retained certain U.K. pension assets and obligations for a limited number of U.K. pension plan participants as part of the Raytheon Aircraft sale, which we include in our pension disclosures.

7. Noncontrolling Interests

On January 1, 2009, we adopted a newly issued accounting standard for noncontrolling interests. In accordance with the accounting standard, we changed the accounting and reporting for our minority interests by recharacterizing them as noncontrolling interests and classifying them as a component of Equity in our consolidated balance sheet. Our consolidated statements of operations include Net income, which represents Net income attributable to Raytheon Company and Net income attributable to noncontrolling interests, as well as a new line item titled Net income attributable to Raytheon Company, which is the equivalent of the prior Net income line item. The accounting standard requires enhanced disclosures to clearly distinguish between our interests and the interests of noncontrolling owners. Our primary noncontrolling interest relates to Thales-Raytheon Systems Co. LLC (TRS LLC), which we control and consolidate, and is a component in computing the operating results of our Network Centric Systems segment (NCS). The adoption of this accounting standard resulted in an increase in NCS Operating income by $8 million and $9 million for the three months ended September 27, 2009 and September 28, 2008, respectively, and by $28 million and $16 million for the nine months ended September 27, 2009 and September 28, 2008, respectively. This increase in Operating income also resulted in a corresponding increase in NCS operating margin of 0.7% and 0.8% for the three months ended September 27, 2009 and September 28, 2008, respectively, and 0.8% and 0.5% for the nine months ended September 27, 2009 and September 28, 2008, respectively.

As part of the adoption of this accounting standard, we have presented the noncontrolling interest in TRS LLC and the related equity method investment in Thales-Raytheon Systems Co. Ltd. (TRS) net of any obligations or interests of Raytheon. The result of the adoption of this accounting standard at December 31, 2008 was a reduction in the balance of the equity investment in TRS by $162 million with a corresponding decrease in the reported noncontrolling interest to $101 million, which was subsequently reclassified as a component of Equity.

8. Fair Value Measurements

The estimated fair value of certain financial instruments, including cash, cash equivalents and short-term debt approximates their carrying value due to their short maturities and varying interest rates. The estimated fair value of notes

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receivable approximates the carrying value based principally on their underlying interest rates and terms, maturities, collateral and credit status of the receivables. The carrying value of Long-term debt of $2.3 billion at September 27, 2009 and December 31, 2008 was recorded at amortized cost. The estimated fair value of Long-term debt of approximately $2.6 billion and approximately $2.5 billion at September 27, 2009 and December 31, 2008, respectively, was based on quoted market prices.

On January 1, 2009, we adopted a newly issued accounting standard for fair value measurements of all nonfinancial assets and nonfinancial liabilities not recognized or disclosed at fair value in the financial statements on a recurring basis. The accounting standard for those assets and liabilities did not have a material impact on our financial position, results of operations or liquidity. We did not have any significant nonfinancial assets or nonfinancial liabilities that would be recognized or disclosed at fair value on a recurring basis as of September 27, 2009.

The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The accounting standard established a fair value hierarchy which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required as well as the assets and liabilities that we value using those levels of inputs.

Level 1: Quoted prices in active markets for identical assets or liabilities. Our Level 1 assets are investments in marketable securities held in Rabbi Trusts that we use to pay benefits under certain of our non-qualified deferred compensation plans which we include in Other assets, net. Our Level 1 liabilities include our obligations to pay certain non-qualified deferred compensation plan benefits which we include in Accrued retiree benefits and other long-term liabilities. Under these non-qualified deferred compensation plans, participants designate investment options (primarily mutual funds) to serve as the basis for measurement of the notional value of their accounts. We also include foreign exchange forward contracts that we trade in an active exchange market in our Level 1 assets and liabilities.

Level 2: Observable inputs, other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or that we corroborate with observable market data for substantially the full term of the related assets or liabilities. Our Level 2 assets were interest rate swaps whose fair value we determined using a pricing model predicated upon observable market inputs. We terminated our interest rate swaps in the three months ended March 29, 2009.

Level 3: Unobservable inputs supported by little or no market activity that are significant to the fair value of the assets or liabilities. Our Level 3 asset relates to our subordinated retained interest in general aviation finance receivables (Subordinated Retained Interest) that we sold in previous years, for which the underlying aircraft serve as collateral. We estimate the fair value for this asset based on the present value of the future expected cash flows using certain unobservable inputs, including the collection periods for the underlying receivables and a credit-adjusted rate of 5.3% at September 27, 2009 and 4.4% at December 31, 2008. These unobservable inputs reflect our suppositions about the assumptions market participants would use in pricing this asset.

The following tables set forth the financial assets and liabilities that we measured at fair value on a recurring basis by level within the fair value hierarchy. We classify assets and liabilities measured at fair value in their entirety based on the lowest level of input that is significant to their fair value measurement.

Assets and liabilities measured at fair value on a recurring basis consisted of the following at:

(In millions)	Level 1	Level 2	Level 3	Balances at Sept. 27, 2009
Assets				
Marketable securities	$ 279	$	$	$ 279
Foreign exchange forward contracts	92			92
Subordinated Retained Interest			66	66
Liabilities				
Deferred compensation	181			181
Foreign exchange forward contracts	41			41

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(In millions)	Level 1	Level 2	Level 3	Balances at Dec. 31, 2008
Assets				
Marketable securities	$ 220	$	$	$ 220
Foreign exchange forward contracts	81			81
Subordinated Retained Interest			66	66
Interest rate swaps		48		48
Liabilities				
Deferred compensation	150			150
Foreign exchange forward contracts	107			107

Activity related to our Subordinated Retained Interest, which is reflected in discontinued operations, was as follows:

	Nine Months Ended	
(In millions)	Sept. 27, 2009	Sept. 28, 2008
Balance at beginning of period	$ 66	$ 63
Total gains (realized/unrealized)		
Included in (Loss) income from discontinued operations	1	3
Included in Other comprehensive (loss) income	(1)	1
Balance at end of period	$ 66	$ 67

9. <u>Derivative Financial Instruments</u>

On January 1, 2009, we adopted a newly issued accounting standard regarding disclosure of derivative instruments and hedging activities. Our primary market exposures are to interest rates and foreign exchange rates. We use certain derivative financial instruments to help manage this exposure. We execute these instruments with financial institutions we judge to be credit-worthy and the majority of the foreign currencies are denominated in currencies of major industrial countries. We do not hold or issue derivative financial instruments for trading or speculative purposes.

We recognize all derivative financial instruments as either assets or liabilities at fair value in our consolidated balance sheet. We designate foreign currency forward contracts as cash flow hedges of forecasted purchases and sales denominated in foreign currencies, and interest rate swaps as fair value hedges of our fixed-rate financing obligations. We classify the cash flows from these instruments in the same category as the cash flows from the hedged items.

Cash flow hedges - We enter into foreign currency forward contracts with commercial banks to fix the foreign currency exchange rates on specific commitments and payments to vendors, and customer receipts. Our foreign currency hedges are transaction driven and directly relate to a particular asset, liability or transaction for which commitments are in place. For foreign currency forward contracts designated and qualified for cash flow hedge accounting, we record the effective portion of the gain or loss on the derivative in Accumulated other comprehensive loss, net of tax, and reclassify it into earnings in the same period or periods during which the hedged revenue or cost of sales transaction affects earnings. We expect approximately $21 million of after-tax net unrealized gains, included in Accumulated other comprehensive loss at September 27, 2009, to be reclassified into earnings at then-current values over the next twelve months as the underlying hedged transactions occur. Realized gains and losses resulting from these cash flow hedges offset the foreign exchange gains and losses on the underlying transactions being hedged. Gains and losses on derivatives not designated for hedge accounting, or representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness, are recognized currently in earnings.

The fair value amounts in our consolidated balance sheet at September 27, 2009, related to foreign currency forward contracts were as follows:

	Asset Derivatives		Liability Derivatives	
(In millions)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments	Other assets, net	$ 77	Other accrued expenses	$ 28
Derivatives not designated as hedging instruments	Other assets, net	15	Other accrued expenses	13

Total	$ 92	$ 41

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The pretax derivative gains and losses in our consolidated statement of operations for the three months ended September 27, 2009, related to our foreign currency forward contracts were as follows:

Derivatives in Cash Flow Hedging Relationships (In millions)	Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative Amount	Gain (Loss) on Effective Portion of Derivative Reclassified from Accumulated Other Comprehensive Loss Location	Amount	Ineffective Portion of Gain (Loss) on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income Location	Amount
Foreign currency forward contracts	$ 21	Net sales	$	Cost of sales	$
		Cost of sales	4		

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative
Foreign currency forward contracts	Cost of sales	$ 13

The pretax derivative gains and losses in our consolidated statement of operations for the nine months ended September 27, 2009, related to our foreign currency forward contracts were as follows:

Derivatives in Cash Flow Hedging Relationships (In millions)	Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative Amount	Gain (Loss) on Effective Portion of Derivative Reclassified from Accumulated Other Comprehensive Loss Location	Amount	Ineffective Portion of Gain (Loss) on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income Location	Amount
Foreign currency forward contracts	$ 57	Net sales	$ (7)	Cost of sales	$
		Cost of sales	(14)		

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative
Foreign currency forward contracts	Cost of sales	$ 5

The notional amounts of outstanding foreign exchange forward contracts consisted of the following at:

(In millions)	Sept. 27, 2009 Buy	Sell	Dec. 31, 2008 Buy	Sell
British Pounds	$ 486	$ 535	$ 382	$ 489
Canadian Dollars	208	43	189	27
Euro Currency Units	140	2	87	1
Australian Dollars	67	8	98	8
All other	83	24	48	32
Total	$ 984	$ 612	$ 804	$ 557

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Buy amounts represent the U.S. Dollar equivalent of commitments to purchase foreign currencies and sell amounts represent the U.S. Dollar equivalent of commitments to sell foreign currencies. We have converted foreign exchange contracts that do not involve U.S. Dollars to U.S. Dollars for disclosure purposes.

Our foreign exchange forward contracts contain offset, or netting provisions, to mitigate credit risk in the event of counterparty default, including payment default and cross default. At September 27, 2009, these netting provisions effectively reduced our exposure to approximately $52 million, which is spread across several counterparties.

Fair value hedges - We periodically enter into interest rate swap agreements with commercial and investment banks to manage interest rates associated with our financing arrangements. The $575 million notional value of the interest rate swaps that was outstanding at December 31, 2008 effectively converted $250 million of our 4.85% Notes due 2011 and $325 million of our 5.375% Notes due 2013 to variable-rate debt based on the six-month LIBOR. We terminated these interest rate swaps in the first quarter of 2009, and collected cash of $37 million related to the early termination. We will include the amortization of the $37 million gain in Interest expense over the remaining life of the related debt. In the three and nine months ended September 27, 2009, we recorded $3 million and $8 million, respectively, related to the amortization of the gain on the termination of our interest rate swaps. There were no interest rate swaps outstanding at September 27, 2009.

10. Commitments and Contingencies

We are involved in various stages of investigation and cleanup related to remediation of various environmental sites. Our estimate of total environmental remediation costs was $200 million and $157 million at September 27, 2009 and December 31, 2008, respectively. Discounted at a weighted-average risk-free rate of 5.7%, we estimated the liability at September 27, 2009 to be $135 million before U.S. Government recovery and had this amount accrued. Discounted at a weighted-average risk-free rate of 5.7%, we estimated the liability at December 31, 2008 to be $105 million before U.S. Government recovery and had this amount accrued. A portion of these costs is eligible for future recovery through the pricing of our products and services to the U.S. Government. We consider such recovery probable based on government contracting regulations and our long history of receiving reimbursement for such costs. Accordingly, we recorded $97 million and $69 million in Contracts in process through September 27, 2009 and December 31, 2008, respectively, for the estimated future recovery of these costs from the U.S. Government. We also lease certain government-owned properties and are generally not liable for environmental remediation at these sites; as a result, we generally do not reflect the provision for these costs in our Financial Statements. Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage and the unresolved extent of our responsibility, it is difficult to determine the ultimate outcome of these matters; however, we do not expect any additional liability to have a material adverse effect on our financial position, results of operations or liquidity.

We issue guarantees and banks and surety companies issue, on our behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention and advance payment obligations of us or our affiliates. Approximately $225 million, $953 million and $107 million of these guarantees, letters of credit and surety bonds, respectively, for which there were stated values, were outstanding at September 27, 2009, and $281 million, $1,012 million and $111 million, respectively, were outstanding at December 31, 2008. These instruments expire on various dates through 2016. Additional guarantees of project performance for which there is no stated value also remain outstanding.

Included in guarantees and letters of credit described above were $76 million and $172 million, respectively, at September 27, 2009, and $59 million and $180 million, respectively, at December 31, 2008, related to our joint venture in TRS.

We provide these guarantees and letters of credit to TRS and other affiliates to assist these entities in obtaining financing on more favorable terms, making bids on contracts and performing their contractual obligations. While we expect these entities to satisfy their loans, project performance and other contractual obligations, their failure to do so may result in a future obligation to us. At September 27, 2009 and December 31, 2008, we had an estimated liability of $2 million related to these guarantees and letters of credit. We periodically evaluate the risk of TRS and other affiliates failing to satisfy their loans, project performance and other contractual obligations described above. At September 27, 2009, we believe the risk that TRS and other affiliates will not be able to perform or meet their obligations is minimal for the foreseeable future based on their current financial condition. All obligations were current at September 27, 2009.

Also included in guarantees and letters of credit described above were $13 million and $6 million at September 27, 2009, respectively, and $86 million and $6 million at December 31, 2008, respectively, related to discontinued operations.

Our residual turbo-prop commuter aircraft portfolio has exposure to outstanding financing arrangements with the aircraft serving as collateral. We have sold and leased commuter aircraft globally to thinly capitalized companies, whose financial condition could be significantly affected by a number of factors, including fuel and other costs, industry consolidation, declining commercial aviation market conditions and the U.S. Government budget for the Essential Air Service program. Based on recent economic trends, including tightening credit markets and volatile fuel costs, these companies may increasingly experience difficulties meeting their financial commitments. At September 27, 2009 and December 31, 2008, our exposure on commuter aircraft assets held as inventory, collateral on notes or as leased assets, was approximately $134 million relating to 116 aircraft and approximately $170 million relating to 127 aircraft, respectively. The carrying value of our commuter aircraft portfolio assumes an orderly disposition of these assets, consistent with our historical experience and strategy. The tightening of credit markets and economic conditions have reduced the number of potential buyers who are able to obtain financing and have negatively impacted the ability of existing note holders to refinance their aircraft through a third party. If the long-term market prospects for these aircraft were to significantly erode or cease, our valuation of these assets would likely be less than the carrying value. We periodically evaluate potential alternative strategies for the disposal of these assets. If we were to dispose of these assets in an other than orderly manner or sell the portfolio in its entirety, the value realized would likely be less than the carrying value.

In 1997, we provided a first loss guarantee of $133 million on $1.3 billion of U.S. Export-Import Bank loans (maturing in 2015) to the Brazilian Government related to Network Centric Systems System for the Vigilance of the Amazon (SIVAM) program. Loan repayments by the Brazilian Government were current at September 27, 2009.

Government contractors are subject to many levels of audit and investigation. Agencies that oversee contract performance include: the Defense Contract Audit Agency, the Inspector General of the Department of Defense and other departments and agencies, the Government Accountability Office, the Department of Justice and Congressional Committees. The Department of Justice has, from time to time, convened grand juries to investigate possible irregularities by us. We also provide products and services to customers outside of the U.S. and those sales are subject to local government laws, regulations and procurement policies and practices. Our compliance with such local government regulations or any applicable U.S. Government regulations (e.g., the Foreign Corrupt Practices Act and the International Traffic in Arms Regulations) may also be investigated or audited.

We are currently conducting a self-initiated internal review of certain of our international operations, focusing on compliance with the Foreign Corrupt Practices Act. In the course of the review, we have identified several possible areas of concern relating to payments made in connection with certain international operations related to a jurisdiction where we do business. We have voluntarily contacted the Securities and Exchange Commission and the Department of Justice to advise both agencies that an internal review is underway. Because the internal review is ongoing, we cannot predict the ultimate consequences of the review. Based on the information available to date, we do not believe that the results of this review will have a material adverse effect on our financial condition, results of operations or liquidity.

In May 2006, international arbitration hearings commenced against us as the successor to the Hughes Electronics defense business, in connection with certain claims brought in 2004 relating to an alleged 1995 Workshare Agreement. The asserted claims involve breach of contract, intellectual property infringement and other related matters. The arbitration panel stayed further proceedings, including the issuance of the liability decision on the non-IP claims presented during the May 2006 hearing, while the parties engaged in settlement efforts. The parties were unable to conclude an enforceable settlement, and in August 2009, the panel released its liability decision, rejecting some of MBDA s non-IP claims, while finding Raytheon liable for some other non-IP claims. We did not record any significant additional financial liability as a result of our estimate of the impact of the decision. The proceedings will now resume to determine liability for the asserted IP claims and to assess overall damages, if any. We believe that we have meritorious defenses to the remaining asserted IP claims and intend to continue to contest them vigorously; however, an adverse resolution of this matter could have a material effect on our results of operations.

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In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened against us. We do not expect any additional liability from these proceedings to have a material adverse effect on our financial position, results of operations or liquidity.

11. Stockholders   Equity

In the nine months ended September 27, 2009 and September 28, 2008, we repurchased the following shares of our common stock under our stock repurchase programs:

	Nine Months Ended	
(In millions)	**Sept. 27, 2009**	**Sept. 28, 2008**
Amount of stock repurchased	$ 900	$ 1,020
Shares of stock repurchased	19.8	16.7

As of September 27, 2009, we had $1.2 billion available under our stock repurchase program.

In March 2009, our Board of Directors authorized an 11% increase to our annual dividend payout rate from $1.12 to $1.24 per share. We declared three dividends totaling $0.93 per share during the nine months ended September 27, 2009, compared to three dividends totaling $0.84 per share during the nine months ended September 28, 2008. Dividends are subject to quarterly approval by our Board of Directors.

The changes in shares of our common stock outstanding for the nine months ended September 27, 2009 were as follows:

(In millions)	**Shares**
Balance at December 31, 2008	400.1
Common stock plan activity	3.6
Treasury stock activity	(20.7)
Balance at September 27, 2009	383.0

Earnings Per Share (EPS)

We compute Basic EPS attributable to Raytheon Company common stockholders by dividing Income from continuing operations attributable to Raytheon Company common stockholders, Income from discontinued operations attributable to Raytheon Company common stockholders and Net income attributable to Raytheon Company, by the weighted-average common shares outstanding, including participating securities outstanding as discussed below, during the period. Diluted EPS reflects the potential dilution beyond shares for basic EPS that could occur if securities or other contracts to issue common stock were exercised, converted into common stock or resulted in the issuance of common stock that would have shared in our earnings. We compute basic and diluted EPS using actual income from continuing operations attributable to Raytheon Company common stockholders, income from discontinued operations attributable to Raytheon Company common stockholders, Net income attributable to Raytheon Company, and the actual weighted-average shares and participating securities outstanding rather than the numbers presented within our consolidated statements of operations, which are rounded to the nearest million. As a result, it may not be possible to recalculate EPS as presented in our consolidated statement of operations. Furthermore, it may not be possible to recalculate EPS attributable to Raytheon Company stockholders by adjusting EPS from continuing operations by EPS from discontinued operations.

On January 1, 2009, we adopted a newly issued accounting standard related to whether instruments granted in share-based payment transactions are participating securities. This accounting standard requires us to include all unvested stock awards which contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, in the number of shares outstanding in our basic and diluted EPS calculations. As a result, we have included all of our outstanding unvested restricted stock and Long-Term Performance Plan (LTPP) awards in our calculation of basic and diluted EPS for current and prior periods. Additionally, the accounting standard requires disclosure of EPS for common stock and unvested share-based payment awards, separately disclosing distributed and undistributed earnings.

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Distributed earnings represent common stock dividends and dividends earned on unvested share-based payment awards of retirement eligible employees. Undistributed earnings represent earnings that were available for distribution but were not distributed. Common stock and unvested share-based payment awards earn dividends equally as shown in the table below.

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

	Three Months Ended		Nine Months Ended	
	Sept. 27, 2009	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$ 0.31	$ 0.28	$ 0.92	$ 0.84
Undistributed earnings	0.96	0.75	2.72	2.15
Total	$ 1.27	$ 1.03	$ 3.64	$ 2.99
Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$ 0.30	$ 0.27	$ 0.91	$ 0.82
Undistributed earnings	0.95	0.74	2.69	2.10
Total	$ 1.25	$ 1.01	$ 3.60	$ 2.92

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

	Three Months Ended		Nine Months Ended	
	Sept. 27, 2009	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$	$	$	$
Undistributed earnings (loss)				(0.01)
Total	$	$	$	$ (0.01)
Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$	$	$	$
Undistributed earnings (loss)				(0.01)
Total	$	$	$	$ (0.01)

EPS attributable to Raytheon Company common stockholders and unvested share-based payment awards was as follows:

	Three Months Ended		Nine Months Ended	
	Sept. 27, 2009	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Basic EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$ 0.31	$ 0.28	$ 0.92	$ 0.84
Undistributed earnings	0.95	0.75	2.72	2.14
Total	$ 1.26	$ 1.03	$ 3.64	$ 2.98

Diluted EPS attributable to Raytheon Company common stockholders:				
Distributed earnings	$ 0.30	$ 0.27	$ 0.91	$ 0.82
Undistributed earnings	0.95	0.73	2.68	2.09
Total	$ 1.25	$ 1.00	$ 3.59	$ 2.91

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The amount of Income from continuing operations attributable to participating securities was $8 million and $6 million for the three months ended September 27, 2009 and September 28, 2008, respectively, and was $21 million and $17 million for the nine months ended September 27, 2009 and September 28, 2008, respectively. The amount of income (loss) from discontinued operations attributable to participating securities was less than $1 million for the three and nine months ended September 27, 2009 and September 28, 2008. The amount of Net income attributable to participating securities was $8 million and $6 million for the three months ended September 27, 2009 and September 28, 2008, respectively, and was $21 million and $17 million for the nine months ended September 27, 2009 and September 28, 2008, respectively.

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

	Three Months Ended		Nine Months Ended	
(In millions)	**Sept. 27, 2009**	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Shares for basic EPS (including 6.0 and 5.7 participating securities for the three months ended September 27, 2009 and September 28, 2008, respectively, and 5.8 and 5.7 for the nine months ended September 27, 2009 and September 28, 2008, respectively)	388.1	415.6	393.2	419.6
Dilutive effect of stock options and LTPP	3.0	5.0	3.0	5.5
Dilutive effect of warrants	2.3	4.3	2.0	4.7
Shares for diluted EPS	393.4	424.9	398.2	429.8

Stock options to purchase the following number of shares of common stock had exercise prices that were less than the average market price of our common stock and were included in our calculations of diluted EPS:

	Three Months Ended		Nine Months Ended	
(In millions)	**Sept. 27, 2009**	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Stock options	9.5	10.3	7.3	11.1

Stock options to purchase the following number of shares of common stock were not included in our calculations of diluted EPS, as the effect of including them would be anti-dilutive:

	Three Months Ended		Nine Months Ended	
(In millions)	**Sept. 27, 2009**	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Stock options		2.5		2.5

In June 2006, we issued 12.0 million warrants to purchase our common stock, of which 12.0 million were outstanding at September 27, 2009 and September 28, 2008, in connection with our settlement of a class action lawsuit. We issued these warrants, expiring in 2011, with an exercise price of $37.50 per share and have included them in our calculations of diluted EPS.

Stock-based compensation plans

Restricted stock activity for the nine months ended September 27, 2009 was as follows:

(In millions)	**Shares**
Outstanding at December 31, 2008	5.0
Granted	2.2
Vested	(1.6)
Forfeited	(0.2)
Outstanding at September 27, 2009	5.4

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During the three months ended March 29, 2009 and March 30, 2008, we issued 0.9 million shares and 0.4 million shares, respectively, of our common stock in connection with the vesting of our 2006-2008 and 2005-2007 LTPP awards. We funded the vesting of the 2006-2008 LTPP award through treasury shares. During the same periods, we also granted our 2009-2011 and 2008-2010 LTPP awards with an aggregate target award of 0.5 million and 0.4 million units, respectively.

The performance goals for the 2009-2011 LTPP award are independent of each other and based on three metrics, as defined in the award agreements: return on invested capital, weighted at 50%; total shareholder return relative to a peer group, weighted at 25%; and cumulative free cash flow, weighted at 25%. The ultimate award, which is determined at the end of the three-year cycle, can range from zero to 200% of the target award and includes dividend equivalents, which are not included in the aggregate target award numbers above.

Other comprehensive income (loss)

Other comprehensive income (loss) generally includes amortization of unfunded benefit obligations, foreign exchange translation adjustments and gains and losses on effective cash flow hedges. The computation of other comprehensive income (loss) was as follows:

	Three Months Ended		**Nine Months Ended**	
(In millions)	**Sept. 27, 2009**	**Sept. 28, 2008**	**Sept. 27, 2009**	**Sept. 28, 2008**
Net income	$ 498	$ 437	$ 1,459	$ 1,268
Other comprehensive (loss) income, net of tax:				
Amortization of unfunded pension benefit obligation	69	48	191	139
Impact to revalue unfunded projected benefit obligation	(101)	(22)	(101)	(22)
Foreign exchange translation adjustments	16	(57)	75	(37)
Cash flow hedges	11	(15)	51	(26)
Other, net		2	(1)	2
Total other comprehensive (loss) income, net of tax	(5)	(44)	215	56
Comprehensive income	493	393	1,674	1,324
Less: Comprehensive income attributable to noncontrolling interests	8	10	28	17
Comprehensive income attributable to Raytheon Company	$ 485	$ 383	$ 1,646	$ 1,307

12. <u>Pension and Other Employee Benefits</u>

We have pension plans covering the majority of our employees, including certain empl