

Leidos Holdings, Inc.
 Form 10-Q
 December 03, 2014

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

Form 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2014

or

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

For the transition period from _____ to _____

| Commission File Number | Exact Name of Registrant as Specified in its Charter, Address of Principal Executive Offices and Telephone Number | State or other jurisdiction of incorporation or organization | I.R.S. Employer Identification No. |
|------------------------|-------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------|------------------------------------|
| 001-33072 | Leidos Holdings, Inc. 11951 Freedom Drive, Reston, Virginia 20190 (571) 526-6000 | Delaware | 20-3562868 |
| 000-12771 | Leidos, Inc. 11951 Freedom Drive, Reston, Virginia 20190 (571) 526-6000 | Delaware | 95-3630868 |

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.

Leidos Holdings, Inc. Yes No

Leidos, Inc. Yes 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).

Leidos Holdings, Inc. Yes No

Leidos, Inc. Yes 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.

Leidos Holdings, Inc. Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Leidos, Inc. Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Leidos Holdings, Inc.

Yes No

Leidos, Inc.

Yes No

The number of shares issued and outstanding of each issuer's classes of common stock as of November 24, 2014 was as follows:

Leidos Holdings, Inc. 74,066,871 shares of common stock (\$.0001 par value per share)

Leidos, Inc. 5,000 shares of common stock (\$.01 par value per share) held by Leidos Holdings, Inc.

Explanatory Note

This Quarterly Report on Form 10-Q is a combined report being filed by Leidos Holdings, Inc. ("Leidos") and Leidos, Inc. Leidos is a holding company and Leidos, Inc. is a direct, 100%-owned subsidiary of Leidos. Each of Leidos and Leidos, Inc. is filing on its own behalf all of the information contained in this report that relates to such company. Where information or an explanation is provided that is substantially the same for each company, such information or explanation has been combined in this report. Where information or an explanation is not substantially the same for each company, separate information and explanation has been provided. In addition, separate condensed consolidated financial statements for each company, along with combined notes to the condensed consolidated financial statements, are included in this report. Unless indicated otherwise, references in this report to the "Company," "we," "us," and "our" refer collectively to Leidos, Leidos, Inc., and its consolidated subsidiaries.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

LEIDOS HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | October 31, 2014 | January 31, 2014 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| | (in millions) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$418 | \$430 |
| Receivables, net | 1,021 | 1,082 |
| Inventory, prepaid expenses and other current assets | 228 | 256 |
| Assets of discontinued operations | 8 | 39 |
| Total current assets | 1,675 | 1,807 |
| Property, plant and equipment (less accumulated depreciation and amortization of \$311 million and \$341 million at October 31, 2014 and January 31, 2014, respectively) | 360 | 482 |
| Intangible assets, net | 39 | 93 |
| Goodwill | 1,207 | 1,693 |
| Deferred income taxes | 18 | 15 |
| Other assets | 99 | 72 |
| | \$3,398 | \$4,162 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$704 | \$716 |
| Accrued payroll and employee benefits | 287 | 285 |
| Notes payable and long-term debt, current portion | 2 | 2 |
| Liabilities of discontinued operations | 8 | 6 |
| Total current liabilities | 1,001 | 1,009 |
| Notes payable and long-term debt, net of current portion | 1,227 | 1,331 |
| Other long-term liabilities | 194 | 227 |
| Commitments and contingencies (Notes 12 and 13) | | |
| Stockholders' equity: | | |
| Preferred stock, \$.0001 par value, 10 million shares authorized and no shares issued and outstanding at October 31, 2014 and January 31, 2014 | — | — |
| Common stock, \$.0001 par value, 500 million shares authorized, 74 million and 80 million shares issued and outstanding at October 31, 2014 and January 31, 2014, respectively | — | — |
| Additional paid-in capital | 1,435 | 1,576 |
| Accumulated (deficit) earnings | (453 |) 25 |
| Accumulated other comprehensive loss | (6 |) (6 |
| Total stockholders' equity | 976 | 1,595 |
| | \$3,398 | \$4,162 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------------------------|-----------------------------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions, except per share amounts) | | | |
| Revenues | \$1,276 | \$1,414 | \$3,894 | \$4,464 |
| Costs and expenses: | | | | |
| Cost of revenues | 1,115 | 1,219 | 3,375 | 3,885 |
| Selling, general and administrative expenses | 72 | 113 | 239 | 343 |
| Bad debt expense | — | 43 | 3 | 45 |
| Goodwill impairment charges | — | — | 486 | — |
| Intangible asset impairment charges | 17 | 19 | 41 | 51 |
| Separation transaction and restructuring expenses | — | 25 | 1 | 58 |
| Operating income (loss) | 72 | (5 |) (251 |) 82 |
| Non-operating income (expense): | | | | |
| Interest income | — | 5 | 1 | 15 |
| Interest expense | (18 |) (21 |) (58 |) (59 |
| Other income, net | — | 2 | 1 | 3 |
| Income (loss) from continuing operations before income taxes | 54 | (19 |) (307 |) 41 |
| Income tax (expense) benefit | (16 |) 11 | (49 |) (4 |
| Income (loss) from continuing operations | 38 | (8 |) (356 |) 37 |
| Discontinued operations: | | | | |
| (Loss) income from discontinued operations before income taxes | (1 |) 19 | (12 |) 144 |
| Income tax (expense) benefit | (3 |) (14 |) 1 | (61 |
| (Loss) income from discontinued operations | (4 |) 5 | (11 |) 83 |
| Net income (loss) | \$34 | \$(3 |) \$(367 |) \$120 |
| Earnings (loss) per share: | | | | |
| Basic: | | | | |
| Income (loss) from continuing operations | \$0.52 | \$(0.10 |) \$(4.75 |) \$0.40 |
| (Loss) income from discontinued operations | (0.05 |) 0.06 | (0.14 |) 0.99 |
| | \$0.47 | \$(0.04 |) \$(4.89 |) \$1.39 |
| Diluted: | | | | |
| Income (loss) from continuing operations | \$0.51 | \$(0.10 |) \$(4.75 |) \$0.40 |
| (Loss) income from discontinued operations | (0.05 |) 0.06 | (0.14 |) 0.99 |
| | \$0.46 | \$(0.04 |) \$(4.89 |) \$1.39 |
| Cash dividends declared per share | \$0.32 | \$0.32 | \$0.96 | \$5.28 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS HOLDINGS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (UNAUDITED)

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Net income (loss) | \$34 | \$(3) | \$(367) | \$120 |
| Other comprehensive income, net of tax | — | — | — | — |
| Comprehensive income (loss) | \$34 | \$(3) | \$(367) | \$120 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(UNAUDITED)

| | Shares of common stock | Additional paid-in capital | Accumulated earnings (deficit) | Accumulated other comprehensive loss | Total |
|-------------------------------------------------------------------------------------|-----------------------------------------|----------------------------------|--------------------------------------|-----------------------------------------------|---------|
| | (in millions, except for share amounts) | | | | |
| Balance at January 31, 2014 | 80 | \$1,576 | \$25 | \$(6) | \$1,595 |
| Net loss | — | — | (367) | — | (367) |
| Other comprehensive income, net of tax | — | — | — | — | — |
| Issuances of stock, net of cancellations | — | 9 | — | — | 9 |
| Shares repurchased and retired or withheld for tax withholdings on equity awards | (6) | (176) | (37) | — | (213) |
| Dividends of \$0.96 per share | — | — | (74) | — | (74) |
| Adjustments for income tax benefits (deficiency) from stock-based compensation | — | (5) | — | — | (5) |
| Stock-based compensation | — | 33 | — | — | 33 |
| Other | — | (2) | — | — | (2) |
| Balance at October 31, 2014 | 74 | \$1,435 | \$(453) | \$(6) | \$976 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Nine Months Ended | |
|------------------------------------------------------------------------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 |
| | (in millions) | |
| Cash flows from operations: | | |
| Net (loss) income | \$(367 |) \$120 |
| Loss (income) from discontinued operations | 11 | (83 |
| Adjustments to reconcile net (loss) income to net cash provided by operations: | |) |
| Depreciation and amortization | 50 | 64 |
| Stock-based compensation | 33 | 43 |
| Goodwill impairment charges | 486 | — |
| Intangible asset impairment charges | 41 | 51 |
| Bad debt expense | 3 | 45 |
| Restructuring charges, net | 1 | 18 |
| Other | 3 | (3 |
| Change in assets and liabilities, net of effects of acquisitions and dispositions: | |) |
| Receivables | 29 | (142 |
| Inventory, prepaid expenses and other current assets | 2 | 27 |
| Deferred income taxes | 46 | 20 |
| Other assets | (2 |) 3 |
| Accounts payable and accrued liabilities | (11 |) (7 |
| Accrued payroll and employee benefits | 3 | (46 |
| Income taxes receivable/payable | (22 |) (14 |
| Other long-term liabilities | (12 |) (14 |
| Total cash flows provided by operating activities of continuing operations | 294 | 82 |
| Cash flows from investing activities: | | |
| Expenditures for property, plant and equipment | (26 |) (31 |
| Proceeds from sale of assets | — | 65 |
| Proceeds from U.S. Treasury cash grant | 80 | — |
| Net proceeds of cost method investments | — | 12 |
| Dividend received from the separation of New SAIC | — | 295 |
| Contribution paid related to the separation of New SAIC | — | (26 |
| Other | — | (3 |
| Total cash flows provided by investing activities of continuing operations | 54 | 312 |
| Cash flows from financing activities: | | |
| Payments of notes payable and long-term debt | (104 |) (1 |
| Payments of deferred financing costs | — | (5 |
| Payments from New SAIC for deferred financing costs | — | 5 |
| Proceeds from real estate financing transaction | — | 38 |
| Proceeds from debt issuance | — | 500 |
| Distribution of debt to New SAIC | — | (500 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS HOLDINGS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS [CONTINUED]
 (UNAUDITED)

| | Nine Months Ended | |
|----------------------------------------------------------------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 |
| | (in millions) | |
| Sales of stock and exercises of stock options | 6 | 11 |
| Repurchases of stock | (213 |) (17 |
| Dividend payments | (72 |) (452 |
| Other | 1 | 2 |
| Total cash flows used in financing activities of continuing operations | (382 |) (419 |
| Decrease in cash and cash equivalents from continuing operations | (34 |) (25 |
| Cash flows from discontinued operations: | | |
| Cash (used in) provided by operating activities of discontinued operations | (5 |) 121 |
| Cash provided by (used in) investing activities of discontinued operations | 27 | (17 |
| Increase in cash and cash equivalents from discontinued operations | 22 | 104 |
| Total (decrease) increase in cash and cash equivalents | (12 |) 79 |
| Cash and cash equivalents at beginning of period | 430 | 735 |
| Cash and cash equivalents at end of period | \$418 | \$814 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (UNAUDITED)

| | October 31, 2014 | January 31, 2014 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| | (in millions) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$418 | \$430 |
| Receivables, net | 1,021 | 1,082 |
| Inventory, prepaid expenses and other current assets | 228 | 256 |
| Assets of discontinued operations | 8 | 39 |
| Total current assets | 1,675 | 1,807 |
| Property, plant and equipment (less accumulated depreciation and amortization of \$311 million and \$341 million at October 31, 2014 and January 31, 2014, respectively) | 360 | 482 |
| Intangible assets, net | 39 | 93 |
| Goodwill | 1,207 | 1,693 |
| Deferred income taxes | 18 | 15 |
| Other assets | 99 | 72 |
| Note receivable from Leidos Holdings, Inc. | 1,394 | 1,137 |
| | \$4,792 | \$5,299 |
| LIABILITIES AND STOCKHOLDER'S EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$704 | \$716 |
| Accrued payroll and employee benefits | 287 | 285 |
| Notes payable and long-term debt, current portion | 2 | 2 |
| Liabilities of discontinued operations | 8 | 6 |
| Total current liabilities | 1,001 | 1,009 |
| Notes payable and long-term debt, net of current portion | 1,227 | 1,331 |
| Other long-term liabilities | 194 | 227 |
| Commitments and contingencies (Notes 12 and 13) | | |
| Stockholder's equity: | | |
| Common stock, \$.01 par value, 10,000 shares authorized, 5,000 shares issued and outstanding at October 31, 2014 and January 31, 2014 | — | — |
| Additional paid-in capital | 207 | 207 |
| Accumulated earnings | 2,169 | 2,531 |
| Accumulated other comprehensive loss | (6 |) (6 |
| Total stockholder's equity | 2,370 | 2,732 |
| | \$4,792 | \$5,299 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Revenues | \$1,276 | \$1,414 | \$3,894 | \$4,464 |
| Costs and expenses: | | | | |
| Cost of revenues | 1,115 | 1,219 | 3,375 | 3,885 |
| Selling, general and administrative expenses | 72 | 113 | 239 | 343 |
| Bad debt expense | — | 43 | 3 | 45 |
| Goodwill impairment charges | — | — | 486 | — |
| Intangible asset impairment charges | 17 | 19 | 41 | 51 |
| Separation transaction and restructuring expenses | — | 25 | 1 | 58 |
| Operating income (loss) | 72 | (5 |) (251 |) 82 |
| Non-operating income (expense): | | | | |
| Interest income | 3 | 5 | 9 | 15 |
| Interest expense | (18 |) (21 |) (58 |) (59 |
| Other income, net | — | 2 | 1 | 3 |
| Income (loss) from continuing operations before income taxes | 57 | (19 |) (299 |) 41 |
| Income tax (expense) benefit | (17 |) 11 | (52 |) (4 |
| Income (loss) from continuing operations | 40 | (8 |) (351 |) 37 |
| Discontinued operations: | | | | |
| (Loss) income from discontinued operations before income taxes | (1 |) 19 | (12 |) 144 |
| Income tax (expense) benefit | (3 |) (14 |) 1 | (61 |
| (Loss) income from discontinued operations | (4 |) 5 | (11 |) 83 |
| Net income (loss) | \$36 | \$(3 |) \$(362 |) \$120 |

See accompanying combined notes to condensed consolidated financial statements.

8

LEIDOS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (UNAUDITED)

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Net income (loss) | \$36 | \$(3) | \$(362) | \$120 |
| Other comprehensive income, net of tax | — | — | — | — |
| Comprehensive income (loss) | \$36 | \$(3) | \$(362) | \$120 |

See accompanying combined notes to condensed consolidated financial statements.

9

LEIDOS, INC.
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY
 (UNAUDITED)

| | Shares of common stock | Additional paid-in capital | Accumulated earnings | Accumulated other comprehensive loss | Total |
|----------------------------------------|-----------------------------------------|----------------------------------|-------------------------|-----------------------------------------------|---------|
| | (in millions, except for share amounts) | | | | |
| Balance at January 31, 2014 | 5,000 | \$207 | \$2,531 | \$(6) | \$2,732 |
| Net loss | — | — | (362) | — | (362) |
| Other comprehensive income, net of tax | — | — | — | — | — |
| Balance at October 31, 2014 | 5,000 | \$207 | \$2,169 | \$(6) | \$2,370 |

See accompanying combined notes to condensed consolidated financial statements.

10

LEIDOS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (UNAUDITED)

| | Nine Months Ended | |
|--------------------------------------------------------------------------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 |
| | (in millions) | |
| Cash flows from operations: | | |
| Net (loss) income | \$(362 |) \$120 |
| Loss (income) from discontinued operations | 11 | (83) |
| Adjustments to reconcile net (loss) income to net cash provided by operations: | | |
| Depreciation and amortization | 50 | 64 |
| Stock-based compensation | 33 | 43 |
| Goodwill impairment charges | 486 | — |
| Intangible asset impairment charges | 41 | 51 |
| Bad debt expense | 3 | 45 |
| Restructuring charges, net | 1 | 18 |
| Other | (2 |) (3) |
| Change in assets and liabilities, net of effects of acquisitions and dispositions: | | |
| Receivables | 29 | (142) |
| Inventory, prepaid expenses and other current assets | 2 | 27 |
| Deferred income taxes | 46 | 20 |
| Other assets | (2 |) 3 |
| Accounts payable and accrued liabilities | (11 |) (7) |
| Accrued payroll and employee benefits | 3 | (46) |
| Income taxes receivable/payable | (22 |) (14) |
| Other long-term liabilities | (12 |) (14) |
| Total cash flows provided by operating activities of continuing operations | 294 | 82 |
| Cash flows from investing activities: | | |
| Proceeds on obligations of Leidos Holdings, Inc. | 82 | — |
| Payments on obligations of Leidos Holdings, Inc. | (360 |) — |
| Expenditures for property, plant and equipment | (26 |) (31) |
| Proceeds from sale of assets | — | 65 |
| Proceeds from U.S. Treasury cash grant | 80 | — |
| Net proceeds of cost method investments | — | 12 |
| Contribution paid related to the separation of New SAIC | — | (26) |
| Other | — | (3) |
| Total cash flows (used in) provided by investing activities of continuing operations | (224 |) 17 |
| Cash flows from financing activities: | | |
| Proceeds on obligations of Leidos Holdings, Inc. | — | 11 |
| Payments on obligations of Leidos Holdings, Inc. | — | (442) |
| Payments of notes payable and long-term debt | (104 |) (1) |
| Payments of deferred financing costs | — | (5) |
| Payments from New SAIC for deferred financing costs | — | 5 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS [CONTINUED]
 (UNAUDITED)

| | Nine Months Ended | |
|----------------------------------------------------------------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 |
| | (in millions) | |
| Proceeds from real estate financing transaction | — | 38 |
| Other | — | 2 |
| Total cash flows used in financing activities of continuing operations | (104 |) (392 |
| Decrease in cash and cash equivalents from continuing operations | (34 |) (293 |
| Cash flows from discontinued operations: | | |
| Cash (used in) provided by operating activities of discontinued operations | (5 |) 121 |
| Cash provided by (used in) investing activities of discontinued operations | 27 | (17 |
| Increase in cash and cash equivalents from discontinued operations | 22 | 104 |
| Total decrease in cash and cash equivalents | (12 |) (189 |
| Cash and cash equivalents at beginning of period | 430 | 735 |
| Cash and cash equivalents at end of period | \$418 | \$546 |

See accompanying combined notes to condensed consolidated financial statements.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1—Summary of Significant Accounting Policies:

Nature of Operations and Basis of Presentation

Leidos Holdings, Inc. ("Leidos") is a holding company whose direct 100%-owned subsidiary is Leidos, Inc., a company focused on delivering science and technology solutions and services primarily in the areas of national security, health and engineering to agencies of the U.S. Department of Defense ("DoD"), the intelligence community, the U.S. Department of Homeland Security and other U.S. Government civil agencies, state and local government agencies, foreign governments, and customers across a variety of commercial markets. Unless indicated otherwise, references to the "Company," "we," "us," and "our" refer collectively to Leidos, Leidos, Inc., and its consolidated subsidiaries.

On September 27, 2013 (the "Distribution Date"), Leidos completed the spin-off of its technical services and enterprise information technology services business into an independent, publicly traded company named Science Applications International Corporation ("New SAIC"). The separation was effected through a tax-free distribution to Leidos' stockholders of 100% of the shares of New SAIC's common stock. On the Distribution Date, New SAIC's common stock was distributed, on a pro rata basis, to Leidos' stockholders of record as of the close of business on September 19, 2013, the record date. Each holder of Leidos common stock received one share of New SAIC common stock for every seven shares of Leidos common stock held on the record date. Prior to the Distribution Date, Leidos Holdings, Inc. was named SAIC, Inc. and Leidos, Inc. was named Science Applications International Corporation. As a result of the spin-off, the assets, liabilities, results of operations, and cash flows of New SAIC have been classified as discontinued operations for all periods presented. References to financial data are to the Company's continuing operations, unless otherwise noted. See Note 2—Dispositions for further information.

Immediately following the spin-off, Leidos effectuated a one-for-four reverse stock split of its shares of common stock, so that every four shares of Leidos common stock issued and outstanding were combined and converted into one share of Leidos common stock. Each reference to the number of shares outstanding or per share amounts has been adjusted to reflect the reverse stock split for all periods presented.

The condensed consolidated financial statements of Leidos include the accounts of its majority-owned and 100%-owned subsidiaries, including Leidos, Inc. The condensed consolidated financial statements of Leidos, Inc. include the accounts of its majority-owned and 100%-owned subsidiaries. Leidos does not have separate operations, assets or liabilities independent of Leidos, Inc., except for a note with Leidos, Inc. (the "related party note"), on which interest is recognized. From time to time, Leidos issues stock to employees of Leidos, Inc. and its subsidiaries, which is reflected in Leidos' Condensed Consolidated Statement of Stockholders' Equity and results in an increase to the related party note. All intercompany transactions and accounts have been eliminated in consolidation.

The accompanying financial information has been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") and accounting principles generally accepted in the United States of America ("GAAP"). Certain disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and combined notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2014. 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 and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Estimates have been prepared by management on the basis of the most current and best available information at the time of estimation and actual results could differ from those estimates.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

In the opinion of management, the financial information as of October 31, 2014 and for the three and nine months ended October 31, 2014 and November 1, 2013 reflects all adjustments, which consist of normal recurring adjustments, necessary for a fair presentation thereof. Operating results for the three and nine months ended October 31, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending January 30, 2015, or any future period.

Unless otherwise noted, references to fiscal years are to fiscal years ended the Friday closest to January 31. Fiscal 2015 began on February 1, 2014 and ends on January 30, 2015. The third quarter of fiscal 2015 ended on October 31, 2014.

Separation Transaction and Restructuring Expenses

In anticipation of the spin-off of New SAIC from the Company, the Company initiated a program to align the Company's cost structure for post-spin-off. In fiscal 2014 the Company reduced headcount, which resulted in severance costs, and reduced its real estate footprint by vacating facilities that are not necessary for its future requirements, which resulted in lease termination and facility consolidation expenses.

Separation transaction and restructuring expenses related to New SAIC, exclusive of any tax impacts, of \$20 million and \$55 million for the three and nine months ended November 1, 2013, respectively, were reclassified as discontinued operations.

The separation transaction and restructuring expenses for continuing operations were as follows:

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Strategic advisory services | \$— | \$5 | \$— | \$7 |
| Legal and accounting services | — | 1 | — | 1 |
| Lease termination and facility consolidation expenses | — | 17 | 1 | 40 |
| Severance costs | — | 2 | — | 10 |
| Separation transaction and restructuring expenses in operating income (loss) | — | 25 | 1 | 58 |
| Less: income tax benefit | — | (10 |) — | (23 |
| Separation transaction and restructuring expenses, net of tax | \$— | \$15 | \$1 | \$35 |

During the nine months ended October 31, 2014, the lease termination and facility consolidation expenses related to an adjustment to the reserve established for loss on leases in connection with revised sublease income assumptions. For the nine months ended October 31, 2014 and November 1, 2013, all separation transaction and restructuring expenses for continuing operations were recorded in the Corporate and Other segment.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The following table represents the restructuring liability balance as of October 31, 2014 and summarizes the changes during the period attributable to costs incurred and charged to expense, costs paid or otherwise settled, and any adjustments to the liability:

| | Severance Costs | Lease Termination and Facility Consolidation Expenses | Total |
|--------------------------------|-----------------|----------------------------------------------------------------|-------|
| | (in millions) | | |
| Balance as of January 31, 2014 | \$1 | \$20 | \$21 |
| Charges | — | 1 | 1 |
| Cash payments | (1 |)(11 |)(12 |
| Balance as of October 31, 2014 | \$— | \$10 | \$10 |

Receivables

The Company's accounts receivable include both amounts billed and currently due from customers, and unbilled receivables consisting of costs and fees billable upon contract completion or the occurrence of a specified event, substantially all of which are expected to be billed and collected within one year. Unbilled receivables are stated at estimated realizable value. Since the Company's receivables are primarily with the U.S. Government, the Company does not have a material credit risk exposure. Contract retentions are billed when the Company has negotiated final indirect rates with the U.S. Government and, once billed, are subject to audit and approval by government representatives. Consequently, the timing of collection of retention balances is outside the Company's control. Based on the Company's historical experience, the majority of retention balances are expected to be collected beyond one year and write-offs of retention balances have not been significant.

The Company has extended deferred payment terms with contractual maturities that may exceed one year to commercial customers related to certain construction projects. As of October 31, 2014, the Company had outstanding receivables of \$28 million, net of allowance of \$7 million, related to one construction project with deferred payment terms, which have not been paid in accordance with the initial payment terms established with the customer. The Company has filed a legal claim to enforce the payment terms as established in the contract. Based on these events, the Company has determined that the receivables are not expected to be collected within the next 12 months. Accordingly, the receivables are classified as non-current in "Other Assets" on the condensed consolidated balance sheet as of October 31, 2014.

When events or conditions indicate that amounts outstanding from customers may become uncollectible, an allowance is estimated and recorded.

Fair Value Measurements

The accounting standard for fair value measurements establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: observable inputs such as quoted prices in active markets (Level 1); inputs other than the quoted prices in active markets that are observable either directly or indirectly (Level 2); and unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions (Level 3).

The fair value of financial instruments is determined based on quoted market prices, if available, or management's best estimate. It is management's belief that the carrying amounts of the Company's financial instruments other than derivatives (see below), which include cash equivalents and long-term investments in private equity securities are reasonable estimates of their related fair values.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Cash equivalents are recorded at historical cost which equals fair value based on quoted market prices (Level 1 input). The Company's cash equivalents were primarily comprised of investments in several large institutional money market funds and bank deposits. There are no restrictions on the withdrawal of the Company's cash and cash equivalents. Management evaluates its investments for other-than-temporary impairment at each balance sheet date. When testing long-term investments for recovery of carrying value, the fair value of long-term investments in private equity securities is determined using various valuation techniques and factors, such as market prices of comparable companies (Level 2 input), discounted cash flow models (Level 3 input) and recent capital transactions of the portfolio companies being valued (Level 3 input). If management determines that an other-than-temporary decline in the fair value of an investment has occurred, an impairment loss is recognized to reduce the investment to its estimated fair value (Level 2 input). The fair value of long-term debt is determined based on current interest rates available for debt with terms and maturities similar to the Company's existing debt arrangements (Level 2).

The carrying value of accounts receivable, accounts payable, and accrued expenses approximate their fair value.

Financial Instruments

The Company is exposed to certain market risks which are inherent in certain transactions entered into during the normal course of business. These transactions include sales or purchase contracts denominated in foreign currencies, investments in equity securities and exposure to changing interest rates. The Company uses a risk management policy to assess and manage cash flow and fair value exposure. The policy permits the use of derivative instruments with certain restrictions.

The Company uses interest rate swaps to hedge its fixed rate debt against changes in fair value due to variability in interest rates. The Company is party to interest rate swap agreements that have been designated as fair value hedges and are recorded at fair value on the condensed consolidated balance sheet. The fair value of the interest rate swaps are determined based on observed values for underlying interest rates on the LIBOR yield curve (Level 2).

The Company does not hold derivative instruments for trading or speculative purposes.

Changes in Estimates on Contracts

Changes in estimates related to certain types of contracts accounted for using the percentage of completion method of accounting are recognized in the period in which such changes are made for the inception-to-date effect of the changes. Changes in these estimates can routinely occur over the contract performance period for a variety of reasons, including changes in contract scope, changes in contract cost estimates due to unanticipated cost growth or retirements of risk for amounts different than estimated and changes in estimated incentive or award fees. Aggregate changes in contract estimates resulted in an increase to operating income of \$6 million and an increase of \$0.05 per diluted share for the three months ended October 31, 2014, and an increase to operating income of \$24 million and an increase of \$0.20 per diluted share for the nine months ended October 31, 2014. Aggregate changes in contract estimates resulted in a decrease to operating income of \$1 million and a decrease of \$0.02 per diluted share for the three months ended November 1, 2013, and a decrease to operating income of \$29 million and a decrease of \$0.22 per diluted share for the nine months ended November 1, 2013.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Goodwill and Intangible Assets

Goodwill

Goodwill represents purchase consideration paid in a business combination that exceeds the values assigned to the net assets of acquired businesses. Goodwill is not amortized, but instead is tested for impairment at the reporting unit level annually, at the beginning of the fourth quarter and during interim periods whenever events or circumstances indicate that the carrying value may not be recoverable. Goodwill is evaluated for impairment either under a qualitative assessment option or a two-step quantitative approach depending on facts and circumstances of a reporting unit, including the excess of fair value over carrying amount in previous assessments and changes in business environment.

When performing a qualitative assessment, the Company considers factors including, but not limited to, current macroeconomic conditions, industry and market conditions, cost factors, financial performance and other events relevant to the entity or reporting unit under evaluation to determine whether it is more likely or not that the fair value of a reporting unit is less than its carrying amount. If the Company determines that it is more likely than not that a reporting unit's fair value is less than its carrying amount, a quantitative two-step goodwill impairment test is performed.

In evaluating the first step of the two-step quantitative goodwill impairment test, the estimated fair value of each reporting unit is compared to its carrying value, which includes the allocated goodwill. If the estimated fair value of a reporting unit is more than its carrying value, including allocated goodwill, no further analysis is required. If the estimated fair value of a reporting unit is less than its carrying value, including allocated goodwill, a second step is performed to compute the amount of the impairment by determining an implied fair value of goodwill. The implied fair value of goodwill is the residual fair value derived by deducting the fair value of a reporting unit's identifiable assets and liabilities from its estimated fair value calculated in the first step. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then the Company records an impairment charge equal to the difference. The Company estimates the fair value of each reporting unit using both market and income approaches (Level 3) when a quantitative analysis is required.

The market approach consists of the guideline public company method which is a valuation technique where the fair value is calculated based on market prices obtained from a detailed market analysis of publicly traded companies that provide a reasonable basis of comparison for each reporting unit. Valuation ratios are selected that relate market prices to selected financial metrics from comparable companies. These ratios are applied after consideration of adjustments and weightings related to financial position, growth, volatility, working capital movement, and other factors. Due to the fact that stock prices of comparable companies represent minority interests the Company also considers an acquisition control premium to reflect the impact of additional value associated with a controlling interest.

The income approach is a valuation technique where the fair value is calculated based on forecasted future cash flows within the projection period discounted back to the present value with appropriate risk adjusted discount rates, which represent the weighted-average cost of capital ("WACC") for each reporting unit. This includes assessing the cost of equity and debt capital as of the valuation date. In addition, a terminal value is developed for forecasted future cash flows beyond the projection period discounted back to the present value. The forecasts used in the Company's estimation of fair value are developed by management based on known business and market considerations.

The goodwill impairment test process and valuation model is based upon certain key assumptions that require the exercise of significant judgment including judgments for the use of appropriate financial projections, economic expectations, discount rates and WACC as well as using available market data.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

An interim goodwill impairment evaluation was performed during the second quarter of fiscal 2015 and resulted in goodwill impairment charges of \$486 million for the three months ended August 1, 2014. See Note 4—Goodwill and Intangible Assets for further information.

Intangible assets

Intangible assets with finite lives are amortized using the method that best reflects how their economic benefits are utilized or, if a pattern of economic benefits cannot be reliably determined, on a straight-line basis over their estimated useful lives.

Intangible assets with finite lives are assessed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. See Note 4—Goodwill and Intangible Assets for impairment charges taken during the period. Intangible assets with indefinite lives are not amortized but are assessed for impairment at the beginning of the fourth quarter and whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Supplementary Cash Flow Information

Supplementary cash flow information, including non-cash investing and financing activities, for the periods presented was as follows:

| | Nine Months Ended | |
|---------------------------------------------------------------------------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 |
| | (in millions) | |
| Vested stock issued as settlement of annual bonus accruals | \$1 | \$2 |
| Stock issued in lieu of cash dividends | \$2 | \$17 |
| Fair value of assets acquired in acquisitions | \$— | \$259 |
| Cash paid in acquisitions | \$— | \$(1) |
| Forgiveness of accounts receivable to acquire equity interest in business combination | \$— | \$(105) |
| Accrued liability for acquisition of business | \$— | \$(5) |
| Liabilities assumed in acquisitions | \$— | \$(148) |
| Cash paid for interest (including discontinued operations) | \$41 | \$37 |
| Cash paid for income taxes, net of refunds (including discontinued operations) | \$22 | \$62 |

Accounting Standards Updates Adopted

In February 2013, the Financial Accounting Standards Board ("FASB") issued ASU 2013-04: Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. This standard requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of the provisions of ASU 2013-04 did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. This standard applies to the release of the cumulative translation adjustment into net income when a parent either sells a part of or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. In addition, the amendments resolve the diversity in practice for the treatment of business combinations achieved in stages (i.e., step acquisitions) involving a foreign entity. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of the provisions of ASU 2013-05 did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

In June 2014, the FASB issued ASU No. 2014-12, Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This standard was issued to provide guidance on share based payment awards in which a performance target may be achieved after an employee completes the requisite service period to achieve the award. In some instances, this has led to a performance award being granted subsequent to the employee no longer rendering services to the issuing company. Previously, no guidance had been included in the codification on how to account for these transactions. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this ASU are effective for all entities for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted. The amendments may be adopted prospectively or retrospectively. The Company elected to early adopt the provisions of ASU No. 2014-12 and the standard did not have a material effect on the Company's financial position, results of operations, or cash flows.

During the quarter presented, the Company adopted various other accounting standards issued by the FASB, none of which had a material effect on the Company's consolidated financial position, results of operations, or cash flows.

Accounting Standards Updates Issued But Not Yet Adopted

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The amendments in the ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Examples include a disposal of a major geographic location, a major line of business or a major equity method investment. In addition, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. This disclosure will provide users with information about the ongoing trends in a reporting organization's results from continuing operations. The amendments in the ASU are effective in the first quarter of 2015 for public organizations with calendar year ends. Early adoption is permitted. The Company is still evaluating the provisions of ASU 2014-08 and its impact on the Company's consolidated financial position, results of operations, or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the codification. Additionally, this ASU supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. The guidance's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue principles, an entity will identify the performance obligations, determine the transaction price, allocate the transaction price to the performance obligations and recognize revenue when the performance obligation is satisfied. The ASU further states that an entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The amendments in this ASU are effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016, for public companies. Early adoption is not permitted. The Company is still evaluating the provisions of ASU 2014-09 and its impact on the Company's consolidated financial position, results of operations, or cash flows.

Note 2—Dispositions:

Fiscal 2015 Discontinued Operations

In July 2014, the Company committed to plans to dispose of a business primarily focused on full service emergency management consulting for disaster preparedness, response, recovery, and mitigation historically included in the Company's Health and Engineering segment. The sale transaction was completed in the third quarter of fiscal 2015 with cash proceeds received of \$19 million, resulting in an immaterial loss on sale.

Fiscal 2014 Discontinued Operations

Separation of New SAIC

As discussed in Note 1, the Company completed the spin-off of New SAIC on September 27, 2013. New SAIC was a subsidiary of Leidos prior to the separation date. At separation, New SAIC made a \$295 million dividend payment to Leidos and reimbursed Leidos, Inc. \$5 million for financing costs previously advanced to New SAIC to secure a revolving and term credit facility, and Leidos, Inc. made a \$26 million capital contribution to New SAIC.

The spin-off was made pursuant to the terms of a Distribution Agreement and several other agreements entered into between the Company and New SAIC on September 25, 2013. These agreements set forth, among other things, the principal actions needed to be taken in connection with the separation and govern certain aspects of the relationship between the Company and New SAIC following the separation. These agreements generally provide, with certain exceptions, that each party is responsible for its respective assets, liabilities and obligations, including employee benefits, insurance and tax related assets and liabilities, whether accrued or contingent, except that unknown liabilities will be shared between the parties in certain circumstances. The agreements also describe the party's commitments to provide each other with certain services for a limited time to help ensure an orderly transition. The agreements also include the treatment of existing contracts, proposals, and teaming arrangements where New SAIC will jointly perform work after separation on Leidos contracts. While the Company is a party to the Distribution Agreement and the ancillary agreements, the Company has determined that it does not have significant continuing involvement in the operations of New SAIC, nor does the Company expect significant continuing cash flows from New SAIC.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The operating results of New SAIC through the Distribution Date, which have been classified as discontinued operations, for the periods presented were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Revenues | \$8 | \$598 | \$34 | \$2,712 |
| Costs and expenses: | | | | |
| Cost of revenues | 8 | 533 | 34 | 2,446 |
| Selling, general and administrative expenses | — | 22 | — | 42 |
| Separation transaction and restructuring expenses | — | 20 | — | 55 |
| Operating income | \$— | \$23 | \$— | \$169 |

Other Fiscal 2014 Discontinued Operations

Other fiscal 2014 non-strategic dispositions were historically included in the Company's National Security Solutions segment.

In August 2013, the Company committed to plans to dispose of a business primarily focused on technology used to detect if an individual is concealing explosive devices or other hidden weapons. In the first quarter of fiscal 2015, the Company adjusted the carrying values of the business's assets to their fair value based on the estimated selling price of the business. The carrying value exceeded the fair value which resulted in approximately \$12 million of impairment charges recorded in discontinued operations, of which \$9 million related to fixed assets and inventory and the remainder related to intangible assets. The sale transaction was completed in the second quarter of fiscal 2015 with insignificant cash proceeds received, resulting in an immaterial loss on sale.

In November 2013, the Company sold a certain component of the Company's business focused on machine language translation with insignificant cash proceeds received, resulting in an immaterial gain on sale.

In January 2014, the Company committed to plans to dispose of Cloudshield Technologies, Inc. ("Cloudshield"), previously acquired in fiscal 2011, which is focused on producing a suite of cybersecurity hardware and associated software and services.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The pre-sale operating results through the date of disposal of the Company's discontinued operations discussed above, not including the separation of New SAIC, for the periods presented were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Revenues | \$5 | \$7 | \$25 | \$25 |
| Costs and expenses: | | | | |
| Cost of revenues | 2 | 10 | 19 | 27 |
| Selling, general and administrative expenses (including impairment charges of \$9 million for the nine months ended October 31, 2014) | 5 | 1 | 24 | 20 |
| Intangible asset impairment charges | — | — | 3 | 2 |
| Operating loss | \$(2) | \$(4) | \$(21) | \$(24) |
| Non-operating income (expense) | \$1 | \$— | \$9 | \$(1) |
| Total loss from discontinued operations before income taxes | \$(1) | \$(4) | \$(12) | \$(25) |

Note 3—Acquisitions:

Plainfield Renewable Energy Holdings LLC

On October 11, 2013, the Company and Plainfield Renewable Energy Owner, LLC ("project owner") entered into a consensual foreclosure agreement pursuant to which the project owners agreed to transfer 100% of the equity interest of Plainfield Renewable Energy Holdings, LLC ("PRE Holdings") to an indirect wholly-owned subsidiary of Leidos in full satisfaction of certain secured obligations owed by the project owner to the Company. Plainfield Renewable Energy LLC or "Plainfield" was a wholly-owned subsidiary of PRE Holdings. As a result of the entry into the foreclosure agreement, the Company determined that it has the power to direct the activities of the VIE and has the right to receive benefits from or the obligation to absorb the losses of the VIE. Accordingly, the Company was deemed the primary beneficiary of the VIE, resulting in the consolidation of Plainfield as of October 11, 2013 (the "transaction"). The Company also determined that Plainfield met the definition of a business and as such gained control of 100% of PRE Holdings equity through the consensual foreclosure agreement which constituted a change in control accounted for as a business combination.

The Plainfield Renewable Energy Project involves the design, construction, and financing of a 37.5 megawatt biomass-fueled power plant in Plainfield, Connecticut (the "plant"). Connecticut Light & Power will purchase approximately 80% of the power produced by the plant based on a 15-year off-take agreement, utilizing the plant's status as a renewable power source. In addition, there are fuel supply agreements with initial terms of 5 to 15 years and minimum purchase requirements either at prevailing market prices or a set price plus a CPI index.

At the time the Company became the primary beneficiary of Plainfield, the Company measured the assets acquired and liabilities assumed at their fair values. The difference between the estimated fair value of the plant in comparison to the carrying value of the Company's deferred payment term receivables forgiven as of the date of the transaction resulted in a \$32 million loss as bad debt expense in the Company's condensed consolidated statements of income

during the three months ended November 1, 2013. In addition as part of the transaction, contingent consideration of approximately \$3 million remains to be paid as of October 31, 2014, of which \$2 million will be paid on the earlier of November 2015 or the successful sale of the plant, and the remainder of which will be paid solely upon the successful sale of the plant.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

In July 2014, the Company received a cash grant of \$80 million from the U.S. Treasury Department, which was recorded as a reduction to the fixed asset basis of the plant on the condensed consolidated balance sheet, and will be recognized ratably over the life of the plant through reduced depreciation expense. For tax purposes, the tax basis of the plant was reduced by half of the amount of the cash grant. This difference between the excess tax basis of the plant over the book basis resulted in a \$27 million deferred tax asset which was recorded as a reduction to the fixed asset basis of the plant. The U.S. Treasury grant also contains a recapture provision that could require the Company to repay funds to the Treasury in certain circumstances which the Company deems not probable.

The aggregate purchase consideration that the Company exchanged for PRE Holdings is as follows (in millions):

| | |
|---------------------------------------------------------------------------|--------|
| Forgiveness of accounts receivable (net of \$32 million bad debt expense) | \$ 105 |
| Contingent consideration | 6 |
| Total purchase consideration | \$ 111 |

The fair values of the assets acquired and liabilities assumed at the date of acquisition were as follows (in millions):

| | |
|----------------------------------------------|--------|
| Property, plant and equipment | \$ 248 |
| Other assets | 8 |
| Notes payable assumed (net of debt discount) | (148) |
| Total identifiable net assets acquired | 108 |
| Intangible assets | 3 |
| Total purchase consideration | \$ 111 |

Note 4—Goodwill and Intangible Assets:

The Company's National Security Solutions ("NSS") and Health and Engineering ("HES") are the reportable segments that contain goodwill. Goodwill is tested for impairment at the reporting unit level annually, at the beginning of the fourth quarter, and during interim periods whenever events or circumstances indicate that the carrying value may not be recoverable. As disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2014, the annual goodwill impairment assessment was completed in the fourth quarter fiscal 2014 and it was concluded that the estimated fair value of all of the Company's reporting units exceeded their carrying value. In the second quarter of fiscal 2015, as part of its normal quarterly procedures, the Company considered both qualitative and quantitative factors associated with each of the Company's reporting units and determined that there were indicators that the carrying values of the Health Solutions and Engineering reporting units may not be fully recoverable due to operating performance shortfalls and forecasted declines of revenues and operating income. The Company performed an interim evaluation for these reporting units that resulted in impairments of the goodwill carrying value.

The changes in the carrying value of goodwill for NSS and HES were as follows:

| | NSS | HES | Total |
|------------------------------|---------------|--------|----------|
| | (in millions) | | |
| Goodwill at January 31, 2014 | \$ 788 | \$ 905 | \$ 1,693 |
| Goodwill impairment charges | — | (486 |) (486) |
| Goodwill at October 31, 2014 | \$ 788 | \$ 419 | \$ 1,207 |

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

During the second quarter of fiscal 2015, the Health Solutions reporting unit experienced a significant decline in both actual and forecasted revenue volumes primarily in the Company's commercial health consulting business resulting from a reduction in new project opportunities, delayed award decisions, and completion of several larger electronic health records ("EHR") implementation engagements that were not extended or replaced with other projects. The declines were also impacted by delays in legislative compliance deadlines (i.e., ICD-10 and Meaningful Use Stage 2). These events attributed to a significant reduction in the Company's sales pipeline, revenue, and operating income. The nature of the Company's commercial health consulting engagements are short term in nature and the aforementioned events transpired and became known during the second quarter of fiscal 2015 and triggered a revised and lower financial forecast.

During the second quarter of fiscal 2015, the Engineering reporting unit experienced delayed or lost award decisions and reductions in scope on several large engineering construction projects as clients shifted priorities and adjusted their capital expenditure plans that were anticipated to be awarded to the Company during the second quarter of fiscal 2015. The Engineering reporting unit was also impacted by significant reduction in scope of services with an existing client. These events culminated in a significant reduction in the Company's sales pipeline, revenue, and operating income. The aforementioned events transpired and became known during the second quarter of fiscal 2015 and triggered a revised and lower financial forecast.

Based on the unexpected impacts and other unanticipated factors discussed above, the Company conducted an interim goodwill impairment test using the two-step quantitative approach.

As described in Note 1, the Company utilized both the market and income approach as part of the first step of the two-step quantitative goodwill impairment test to determine the estimated fair value of both the Health Solutions and Engineering reporting units.

The Company performed the market approach, guideline public company method, by applying pricing multiples derived from publicly traded guideline companies that are comparable to the reporting units to determine their fair values. The Company utilized enterprise/earnings before interest, taxes, depreciation, and amortization ("EBITDA") multiples and enterprise/revenue multiples which averaged 6.0 and 0.5, respectively, for the Health Solutions reporting unit, and 6.8 and 0.4, respectively, for the Engineering reporting unit. In addition, the fair value under the guideline public company method included a control premium of 20%, which was determined based on a review of comparable market transactions.

The income approach was performed by calculating the fair value based on forecasted future cash flows discounted back to the present value, including significant judgments related to the risk adjusted discount rates, terminal growth rates, and weighted-average cost of capital ("WACC"). The projected cash flows were developed by management for planning purposes based on current known business and market conditions as well as future anticipated industry trends. The method included certain cost adjustments that a market participant buyer would not incur to operate the respective reporting units. A terminal value growth rate of 3% and 2% and WACC of 12% and 14% (which includes a specific company risk premium of 2%) were used for the Health Solutions and Engineering reporting units, respectively.

Based on the first step of the two-step quantitative goodwill impairment test, the Company determined that the fair values of the Health Solutions and Engineering reporting units were 62% and 91% of their carrying values, respectively. Due to the fact that indicators of impairment existed, the second step of the two-step quantitative

goodwill impairment test was performed to determine the implied fair value of goodwill and the impairment amount of the respective reporting units.

As a result of the second step evaluation, the Company recorded goodwill impairment charges in the Health Solutions and Engineering reporting units of \$369 million and \$117 million, respectively, for the three months ended August 1, 2014, which represents the difference between the carrying value and the implied fair value. There were

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

no other goodwill impairment charges recorded for the remaining reporting units. There were no goodwill impairments during the three months ended October 31, 2014.

Intangible assets consisted of the following:

| | October 31, 2014 | | | January 31, 2014 | | |
|------------------------------------------|---------------------------------------|--------------------------|--------------------|----------------------|--------------------------|--------------------|
| | Gross carrying value (in millions) | Accumulated amortization | Net carrying value | Gross carrying value | Accumulated amortization | Net carrying value |
| Finite-lived intangible assets: | | | | | | |
| Customer relationships | \$70 | \$(56) |) \$14 | \$94 | \$(47) |) \$47 |
| Software and technology | 52 | (40) |) 12 | 65 | (36) |) 29 |
| Other | — | — | — | 4 | (1) |) 3 |
| Total finite-lived intangible assets | 122 | (96) |) 26 | 163 | (84) |) 79 |
| Indefinite-lived intangible assets: | | | | | | |
| In-process research and development | 9 | — | 9 | 10 | — | 10 |
| Trade names | 4 | — | 4 | 4 | — | 4 |
| Total indefinite-lived intangible assets | 13 | — | 13 | 14 | — | 14 |
| Total intangible assets | \$135 | \$(96) |) \$39 | \$177 | \$(84) |) \$93 |

Amortization expense related to amortizable intangible assets was \$3 million and \$13 million for the three and nine months ended October 31, 2014, respectively, and \$7 million and \$29 million for the three and nine months ended November 1, 2013, respectively.

The Company recognized impairment charges for intangible assets of \$17 million and \$41 million during the three and nine months ending October 31, 2014, respectively, and \$19 million and \$51 million for the three and nine months ended November 1, 2013, respectively.

The Company determined that certain intangible assets consisting of software and technology, associated with the acquisition of Reveal Imaging Technologies, Inc. in fiscal 2011, were not recoverable due to lower projected revenue levels from the associated products and customers. As a result, the Health and Engineering reportable segment recognized impairment charges of \$14 million and \$30 million during the third quarter of fiscal 2015 and the second quarter of fiscal 2014, respectively, to reduce the carrying value of these intangible assets to their estimated fair values. Fair value was estimated using the income approach based on management's forecast of future cash flows to be derived from the assets' use.

The Company determined that certain customer relationship intangible assets associated with the acquisitions of Vitalize and maxIT in fiscal 2012 and 2013, respectively, were not recoverable due to lower projected revenue and operating income levels from the associated customers. As a result, the Health and Engineering reportable segment recognized impairment charges of \$24 million and \$19 million during the second quarter of fiscal 2015 and the third quarter of 2014, respectively, to reduce the carrying value of these intangible assets to their estimated fair values. Fair value was estimated using the income approach based on management's forecast of future cash flows to be derived

from the assets' use (Level 3).

During the third quarter of fiscal 2015, the Company determined that certain intangible assets associated with fuel supply contracts obtained through the Plainfield Renewable Energy Project foreclosure were not recoverable due to changes in the Company's fuel supply strategy and newly identified requirements to operate the plant which impacted expected benefits from the related fuel supply arrangements. As a result, the Health and Engineering

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

reportable segment recognized an impairment charge of \$3 million to write-off the carrying value associated with the intangible assets of three fuel supply agreements.

The estimated annual amortization expense related to finite-lived intangible assets as of October 31, 2014 was as follows:

Fiscal Year Ending January 31

| | (in millions) |
|-------------------------------------|---------------|
| 2015 (remainder of the fiscal year) | \$2 |
| 2016 | 8 |
| 2017 | 7 |
| 2018 | 5 |
| 2019 | 3 |
| 2020 and thereafter | 1 |
| | \$26 |

Actual amortization expense in future periods could differ from these estimates as a result of future acquisitions, dispositions, impairments, the outcome and timing of completion of in-process research and development projects (the assets of which will become amortizable upon completion and placement into service, or will be impaired if abandoned), adjustments to preliminary valuations of intangible assets and other factors.

Note 5—Derivative Instruments and Hedging Activities:

During the third quarter of fiscal 2015, the Company entered into interest rate swap agreements to hedge the fair value with respect to all of the \$450 million aggregate principal outstanding on the Company's fixed rate 4.45% notes maturing in December 2020 (the "Notes"). The objective of these instruments is to hedge the Notes against changes in fair value due to the variability in the six-month LIBOR rate (the benchmark interest rate), which effectively converted the debt into floating interest rate debt. Under the terms of the interest rate swap agreements, the Company will receive semi-annual interest payments at the coupon rate of 4.45% and will pay variable interest based on the six-month LIBOR rate. The counterparties to these agreements are financial institutions.

The interest rate swaps were accounted for as a fair value hedge of the Notes and qualified for the shortcut method of hedge accounting which allows for the assumption of no ineffectiveness reported in earnings. The resulting changes in the fair value of the interest rate swaps are fully offset by the changes in the fair value of the underlying debt (the hedged item).

The fair value of the Notes is stated at an amount that reflects changes in the benchmark interest rate subsequent to the inception of the interest rate swaps through the reporting date. The cash flows associated with the interest rate swaps are classified as operating activities in the condensed consolidated statement of cash flows.

The fair value of the interest rate swaps and their impact on the related fair value of the debt in the condensed consolidated balance sheet is as follows:

| Interest rate swaps | | Hedged items | | | |
|-------------------------|------------------|------------------|-------------------------|------------------|------------------|
| Balance sheet line item | October 31, 2014 | January 31, 2014 | Balance sheet line item | October 31, 2014 | January 31, 2014 |
| (in millions) | | | | | |
| Other assets | \$2 | \$— | | \$2 | \$— |

Notes payable and long-term
debt, net of current portion

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 6—Debt:

Leidos has a revolving credit facility, which is fully and unconditionally guaranteed by Leidos, Inc. which had provided for \$750 million in unsecured borrowing capacity at interest rates determined, at Leidos' option, based on either LIBOR plus a margin or a defined base rate. During the three months ended October 31, 2014, the Company amended the credit facility to, among other things, change the ratio of consolidated funded debt to EBITDA that the Company is required to maintain. A pro-rata portion of the unamortized deferred costs related to the prior arrangement was written off at the time of the amendment. The remaining unamortized deferred costs relating to the prior arrangement and the immaterial fee paid to amend the credit facility which were deferred, will be amortized over the term of the amended credit facility. In connection with the amendment to the credit facility, the Company exercised its right under the credit agreement to voluntarily reduce the combined commitments of the lenders from \$750 million to \$500 million. The maturity date of the credit facility is March 2017. As of October 31, 2014 and January 31, 2014, there were no borrowings outstanding under the credit facility.

The credit facility contains certain customary representations and warranties, as well as certain affirmative and negative covenants. The financial covenants contained in the amended credit facility require that, for a period of four trailing fiscal quarters, the Company maintains a ratio of consolidated funded debt, including borrowings under this credit facility, to EBITDA (adjusted for certain items as defined in the credit facility) of not more than 4.0 to 1.0 until no later than January 29, 2016 and 3.75 to 1.0 thereafter, and a ratio of EBITDA (adjusted for certain items as defined in the credit facility) to interest expense of greater than 3.5 to 1.0. The Company was in compliance with these financial covenants as of October 31, 2014. A failure by the Company to meet these financial covenants in the future could eliminate the Company's borrowing capacity under the credit facility.

The available borrowing capacity on the credit facility may vary each quarter based on the trailing four quarters of EBITDA. If the Company's trailing four quarters of EBITDA declines below a certain threshold in relation to outstanding debt, the borrowing capacity available under the credit facility is reduced. The available borrowing capacity based on the results of the Company's trailing four quarters of EBITDA as of October 31, 2014 was approximately \$500 million.

Other covenants in the credit facility restrict certain of the Company's activities, including, among other things, its ability to create liens, dispose of certain assets and merge or consolidate with other entities. The credit facility also contains certain customary events of default, including, among others, defaults based on certain bankruptcy and insolvency events, nonpayment, cross-defaults to other debt, breach of specified covenants, Employee Retirement Income Security Act (ERISA) events, material monetary judgments, change of control events, and the material inaccuracy of the Company's representations and warranties. In addition, the Company's ability to declare and pay future dividends on Leidos stock may be restricted by the provisions of Delaware law and covenants in the revolving credit facility.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company's notes payable and long-term debt consisted of the following:

| | Stated interest rate | Effective interest rate | October 31, 2014 | January 31, 2014 |
|------------------------------------------------------------------------------------|-------------------------|----------------------------|---------------------|---------------------|
| (dollars in millions) | | | | |
| Leidos Holdings, Inc. senior unsecured notes: | | | | |
| \$450 million notes, which mature in December 2020 ⁽¹⁾ | 4.45 | % 4.53 | % \$451 | \$449 |
| \$300 million notes, which mature in December 2040 | 5.95 | % 6.03 | % 291 | 300 |
| Leidos, Inc. senior unsecured notes: | | | | |
| \$250 million notes, which mature in July 2032 | 7.13 | % 7.43 | % 248 | 248 |
| \$300 million notes, which mature in July 2033 | 5.50 | % 5.83 | % 201 | 296 |
| Capital leases and other notes payable due on various dates through fiscal 2021 | 0%-3.7% | Various | 38 | 40 |
| Total notes payable and long-term debt | | | \$1,229 | \$1,333 |
| Less current portion | | | 2 | 2 |
| Total notes payable and long-term debt, net of current portion | | | \$1,227 | \$1,331 |
| Fair value of notes payable and long-term debt | | | \$1,228 | \$1,350 |

As a result of executing the interest rate swap agreements, the carrying value of \$451 million includes a fair value (1) adjustment of \$2 million attributable to changes in the benchmark interest rate, the six-month LIBOR rate, from the inception of the interest rate swap agreements to October 31, 2014.

The fair value of long-term debt is determined based on current interest rates available for debt with terms and maturities, and credit risk similar to the Company's existing debt arrangements.

During the third quarter of fiscal 2015, the Company repurchased in the open market and retired principal amounts of \$9 million on its \$300 million 5.95% notes issued by Leidos Holdings, Inc. maturing in December 2040 and \$96 million on its \$300 million 5.50% notes issued by Leidos, Inc. maturing in July 2033. The Company recorded an immaterial loss on extinguishment of debt for the Leidos Holdings, Inc. notes and an immaterial gain for the Leidos, Inc. notes as part of the partial repayment of the respective notes. The net combined gain represents the difference between the repurchase price of \$102 million and the net carrying amount of the notes repurchased less the write-off of a portion of the unamortized debt discount and deferred financing costs on a pro-rata basis to the reduction of debt. The Company recorded the gain (loss) on extinguishment of debt in Other income, net in the Company's condensed consolidated statements of income.

The senior unsecured notes contain customary restrictive covenants, including, among other things, restrictions on the Company's ability to create liens and enter into sale and leaseback transactions under certain circumstances. The Company was in compliance with all covenants as of October 31, 2014.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 7—Related Party Transactions:

Leidos, Inc. has fully and unconditionally guaranteed the obligations of Leidos under its \$450 million 4.45% notes and \$300 million 5.95% notes. These notes have been reflected as debt of Leidos, Inc. in these condensed consolidated financial statements. Leidos, Inc. has fully and unconditionally guaranteed any borrowings under Leidos' amended and restated revolving credit facility maturing in fiscal 2018. Leidos has fully and unconditionally guaranteed the obligations of Leidos, Inc. under its \$300 million 5.50% notes and \$250 million 7.13% notes. Leidos and Leidos, Inc. have a related party note in connection with a loan of cash between the entities, which is adjusted to reflect issuances of stock by Leidos to employees of Leidos, Inc. and its subsidiaries and Leidos Inc.'s payment of certain obligations on behalf of Leidos. The related party note bears interest based on LIBOR plus a market-based premium. Portions of the related party note may be repaid at any time. The note automatically extends for successive one-year periods unless either Leidos or Leidos, Inc. provides prior notice to the other party. As of October 31, 2014, the note receivable from Leidos Holdings, Inc. to Leidos, Inc. was \$1.4 billion. The note receivable also includes the distribution of the assets and liabilities of New SAIC of \$736 million that occurred at the time of the separation in September 2013.

Note 8—Accumulated Other Comprehensive Loss:

The components of accumulated other comprehensive loss were as follows:

| | October 31, 2014 | January 31, 2014 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| | (in millions) | |
| Foreign currency translation adjustments, net of taxes of \$(1) million as of October 31, 2014 and January 31, 2014 | \$2 | \$2 |
| Unrecognized net loss on settled derivative instruments associated with outstanding debt, net of taxes of \$3 million as of October 31, 2014 and January 31, 2014 | (5 |) (5 |
| Unrecognized net loss on defined benefit plan, net of taxes of \$2 million as of October 31, 2014 and January 31, 2014 | (3 |) (3 |
| Total accumulated other comprehensive loss, net of taxes of \$4 million as of October 31, 2014 and January 31, 2014 | \$(6 |) \$(6 |

Reclassifications from other comprehensive income to net income, relating to foreign currency translation adjustments, unrecognized gain (loss) on settled derivative instruments and the unrecognized net gain (loss) on the defined benefit plan for the three and nine months ended October 31, 2014, were not material. Reclassifications for foreign currency translation adjustments and unrecognized gain (loss) on settled derivative instruments are recorded in other income, net, and reclassifications for the unrecognized net gain (loss) on the defined benefit plan is recorded in selling, general, and administrative expenses.

Note 9—Earnings (Loss) Per Share (EPS):

The Company is required to allocate a portion of its earnings to its unvested stock awards containing nonforfeitable rights to dividends or dividend equivalents (participating securities) in calculating EPS using the two-class method. Unvested stock awards granted prior to fiscal 2013 are participating securities requiring application of the two-class method. In fiscal 2013, the Company began issuing unvested stock awards that have forfeitable rights to dividends or dividend equivalents. These stock awards are not participating securities requiring application of the two-class

method, but are dilutive common share equivalents subject to the treasury stock method. Basic EPS is computed by dividing income less earnings allocable to participating securities by the basic weighted average number of shares outstanding. Diluted EPS is computed similar to basic EPS, except the weighted average number of shares outstanding is increased to include the dilutive effect of outstanding stock options and other stock-based awards.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

A reconciliation of the income (loss) used to compute basic and diluted EPS for the periods presented was as follows:

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Basic EPS: | | | | |
| Income (loss) from continuing operations, as reported | \$38 | \$(8) | \$(356) | \$37 |
| Less: allocation of distributed and undistributed earnings to participating securities | — | — | — | (3) |
| Income (loss) from continuing operations, for computing basic EPS | \$38 | \$(8) | \$(356) | \$34 |
| Net income (loss), as reported | \$34 | \$(3) | \$(367) | \$120 |
| Less: allocation of distributed and undistributed earnings to participating securities | — | — | — | (3) |
| Net income (loss), for computing basic EPS | \$34 | \$(3) | \$(367) | \$117 |
| Diluted EPS: | | | | |
| Income (loss) from continuing operations, as reported | \$38 | \$(8) | \$(356) | \$37 |
| Less: allocation of distributed and undistributed earnings to participating securities | — | — | — | (3) |
| Income (loss) from continuing operations, for computing diluted EPS | \$38 | \$(8) | \$(356) | \$34 |
| Net income (loss), as reported | \$34 | \$(3) | \$(367) | \$120 |
| Less: allocation of distributed and undistributed earnings to participating securities | — | — | — | (3) |
| Net income (loss), for computing diluted EPS | \$34 | \$(3) | \$(367) | \$117 |

The following table provides a reconciliation of the weighted average number of shares outstanding used to compute basic and diluted EPS for the periods presented. The presentation for the three and nine months ended November 1, 2013 gives effect to the one-for-four reverse stock split which occurred after market close on September 27, 2013.

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Basic weighted average number of shares outstanding | 73 | 84 | 75 | 84 |
| Dilutive common share equivalents—stock options and other stock awards | 1 | — | — | — |
| Diluted weighted average number of shares outstanding | 74 | 84 | 75 | 84 |

For the nine months ended October 31, 2014, all outstanding common stock equivalents were excluded in the computation of diluted income (loss) per share because their effect would have been anti-dilutive due to the net loss

for the period.

For the three months ended November 1, 2013, all outstanding common stock equivalents were excluded in the computation of diluted income (loss) per share because their effect would have been anti-dilutive due to the net loss for the quarter. For the nine months ended November 1, 2013, the declared dividends exceeded current period earnings. Therefore, the Company was in a loss position for computing diluted income (loss) per share and all

30

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

outstanding common stock equivalents were excluded in the computation because their effect would have been anti-dilutive.

The following anti-dilutive stock-based awards were excluded from the weighted average number of shares outstanding used to compute basic and diluted EPS for the periods presented:

| | Three Months Ended | | Nine Months Ended | |
|----------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Stock options | 2 | 5 | 4 | 5 |
| Vesting stock awards | — | 3 | 3 | 3 |

In December 2013, the Company entered into an Accelerated Share Repurchase ("ASR") agreement with a financial institution to repurchase shares of its outstanding common stock for an aggregate purchase price of \$300 million. During the fourth quarter of fiscal 2014, the Company paid \$300 million to the financial institution and received an initial delivery of 5.6 million shares of its outstanding shares of common stock for an aggregate value of \$255 million. The final delivery of approximately 1.0 million shares for a total value of \$45 million under the program was completed during the first quarter of fiscal 2015. The purchase was allocated between additional paid in capital and retained earnings. All shares delivered were immediately retired.

In March 2014, the Company entered into a second Accelerated Share Repurchase agreement with a different financial institution to repurchase shares of its outstanding common stock for an aggregate purchase price of \$200 million. During the first quarter of fiscal 2015, the Company paid \$200 million to the financial institution and received an initial delivery of 4.5 million shares of its outstanding shares of common stock for an aggregate value of approximately \$168 million. The final delivery of approximately 0.8 million shares for a total value of approximately \$32 million under the program was completed during the second quarter of fiscal 2015. The purchase was allocated between additional paid in capital and retained earnings. All shares delivered were immediately retired.

The delivery of 6.3 million shares of Leidos common stock for both ASR purchases for the nine months ended October 31, 2014 reduced the Company's outstanding shares used to determine the weighted average shares outstanding for purposes of calculating basic and diluted EPS for the periods presented.

Note 10—Stock-Based Compensation:

Plan Summaries: At October 31, 2014, the Company had stock-based compensation awards outstanding under the following plans: the 2006 Equity Incentive Plan, the Management Stock Compensation Plan, the Stock Compensation Plan, and the 2006 Employee Stock Purchase Plan (ESPP). Leidos issues new shares upon the issuance of stock awards or exercise of stock options under these plans.

The 2006 Equity Incentive Plan provides the Company's and its affiliates' employees, directors, and consultants the opportunity to receive various types of stock-based compensation and cash awards. The Company has issued stock options, vested stock awards, restricted stock awards including stock units (vesting stock), performance-based awards, and cash awards under this plan.

Stock awards granted under the plan prior to fiscal 2015 generally vest or become exercisable 20% a year for the first three years and 40% in the fourth year. In fiscal 2015, the Company has begun granting awards that generally vest or become exercisable 25% a year over four years.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Total Stock-Based Compensation. Total stock-based compensation expense and related tax benefits recognized for the periods presented was as follows:

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Stock-based compensation expense: | | | | |
| Stock options | \$1 | \$4 | \$4 | \$9 |
| Vesting stock awards | 9 | 10 | 27 | 35 |
| Vested stock awards | — | — | 2 | — |
| Total stock-based compensation expense recorded in continuing operations | \$10 | \$14 | \$33 | \$44 |
| Total stock-based compensation expense recorded in discontinued operations | \$— | \$6 | \$— | \$21 |
| Tax benefits recognized from stock-based compensation | \$4 | \$5 | \$13 | \$17 |

New SAIC Separation Adjustments. As a result of the separation of New SAIC, effective September 27, 2013, all outstanding equity awards related to New SAIC employees were assumed by New SAIC. Also in connection with the separation, adjustments were made to the share amounts and exercise prices of all remaining outstanding Leidos stock options, and the share amounts for vesting stock awards and performance-based stock awards as of the Distribution Date such that the adjustments were generally made to preserve the aggregate intrinsic value at the distribution date pursuant to the terms of the stock based compensation plans under which they were issued. Taking into account the change in the value of the Company's common stock as a result of the distribution of the New SAIC shares, the conversion ratio applied to all outstanding equity awards at the distribution date was 1.4523. In addition, all outstanding equity awards reflected the Company's one-for-four reverse stock split.

Stock Options

Stock options granted during the nine months ended October 31, 2014 and November 1, 2013 have terms of seven years and a vesting period of four years based upon required service conditions, except for stock options granted to the Company's outside directors, which have a vesting period of one year.

The fair value of the Company's stock option awards is estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average grant date fair value and assumptions used to determine the fair value of stock options granted for the periods presented were as follows:

| | Nine Months Ended | | | |
|----------------------------------------|---------------------|------------------------|----------------------------|---|
| | October 31, 2014 | October 2013 Grants | 2013 Grants Before Spin | |
| Options granted (in millions) | 0.6 | 0.1 | 1.4 | * |
| Weighted average grant-date fair value | \$6.14 | \$9.48 | \$6.96 | * |
| Expected term (in years) | 4.7 | 5.0 | 5.0 | |
| Expected volatility | 25.1 | % 30.0 | % 25.0 | % |
| Risk-free interest rate | 1.6 | % 1.4 | % 0.8 | % |

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| | | | | | | |
|------------------------------------------------------------------------------|-----|---|-----|---|-----|---|
| Dividend yield | 2.9 | % | 2.8 | % | 3.8 | % |
| *Adjusted for additional awards granted for the \$4.00 special cash dividend | | | | | | |

32

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In March 2013, Leidos' board of directors declared a special cash dividend of \$4.00 per share of Leidos common stock and paid an aggregate \$342 million on June 28, 2013 to stockholders of record on June 14, 2013. In connection with the special cash dividend, anti-dilutive adjustments were made to all outstanding stock options on the dividend record date to preserve their value following the special cash dividend, as required by the Company's 2006 Equity Incentive Plan. The modifications were made to reduce the exercise prices of the outstanding stock options and to increase the number of shares issuable upon the exercise of each option such that the aggregate difference between the market price and exercise price times the number of shares issuable upon exercise was substantially the same immediately before and after the payment of the special dividend. These adjustments did not result in additional share-based compensation expense, as the fair value of the outstanding options immediately following the payment of the special cash dividend was equal to the fair value immediately prior to such distribution.

As of October 31, 2014, compensation cost related to unvested stock options not yet recognized in the income statement was \$7 million and is expected to be recognized over an average period of 1.6 years.

Vesting Stock

Compensation expense is measured at the grant date fair value and generally vests over a four-year vesting period, or seven-years for certain stock awards, based upon required service conditions and in some cases performance conditions. The grant date fair value is based on the closing price of the Company's common stock generally on the day before the date of grant.

During the nine months ended October 31, 2014, the Company granted 0.7 million shares of vesting stock at a weighted average grant date fair value of \$36.92.

As of October 31, 2014, compensation cost related to unvested shares not yet recognized in the income statement was \$55 million and is expected to be recognized over an average period of 1.7 years.

Performance-Based Awards

The Company grants performance-based stock awards to certain officers and key employees of the Company under the 2006 Equity Incentive Plan. The Company's performance-based stock awards vest and the stock is issued at the end of a three-year period based upon the achievement of specific performance criteria, with the number of shares ultimately awarded, if any, ranging up to 150% of the specified target awards. If performance is below the threshold level of performance, no shares will be issued. The performance period for performance-based stock awards granted in fiscal 2013 was deemed completed as of the last fiscal quarter prior to the separation of New SAIC with the target shares prorated for the completed period earned. For all of the remaining target shares in the original award, the performance condition was removed and the awards are subject to vesting based on continued employment through the original performance period.

During the nine months ended October 31, 2014, the Company granted approximately 50 thousand shares of performance based awards at a weighted average grant date fair value of \$36.88.

There were no performance-based stock awards granted in fiscal 2014. For the fiscal 2015 awards granted, one-third of the target number of shares of stock granted under the awards will be allocated to each fiscal year over the three-year performance period and the actual number of shares to be issued with respect to each fiscal year will be based upon the achievement of that fiscal year's performance criteria.

As of October 31, 2014, compensation cost related to unvested performance-based awards not yet recognized in the income statement was \$1 million and is expected to be recognized over an average period of 2.0 years.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 11—Business Segment Information:

The Company defines its reportable segments based on the way the chief operating decision maker ("CODM"), currently its chief executive officer, manages the operations of the Company for purposes of allocating resources and assessing performance.

The Company's reportable segments are as follows: National Security Solutions, Health and Engineering, and Corporate and Other.

National Security Solutions provides solutions and systems for air, land, sea, space, and cyberspace for the U.S. intelligence community, the DoD, the military services, and the U.S. Department of Homeland Security. The Company's solutions deliver technology, large scale intelligence systems, data analytics, cyber solutions, logistics, and intelligence analysis and operations support to critical missions around the world. Major customers of National Security Solutions include national and military intelligence agencies and other federal, civilian, and commercial customers in the national security complex.

Health and Engineering provides health systems integration services to implement and optimize the use of electronic health records, apply data analytics and behavioral health research to help enable customers to improve healthcare quality and patient outcomes, detect and prevent diseases, enhance scientific discovery, and reduce costs to the healthcare system. Health and Engineering also provides engineering services and solutions focused on solving energy, environmental, and infrastructure challenges. These include products and solutions in energy generation, efficiency and management, environmental services, securing critical infrastructure, and designing and building construction projects. Major customers of Health and Engineering primarily include the U.S. federal government, state and local governmental agencies, foreign governments, and commercial enterprises in various industries.

Corporate and Other includes the operations of the Company's internal real estate management subsidiary, various corporate activities, certain corporate expense items that are not reimbursed by the Company's U.S. Government customers and certain revenue and expense items excluded from the CODM's evaluation of a reportable segment's performance.

The segment information for the periods presented was as follows:

| | Three Months Ended | | Nine Months Ended | |
|-----------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Revenues: | | | | |
| National Security Solutions | \$906 | \$1,011 | \$2,775 | \$3,107 |
| Health and Engineering | 373 | 406 | 1,126 | 1,368 |
| Corporate and Other | (3 |) (2 |) (7 |) (8 |
| Intersegment elimination | — | (1 |) — | (3 |
| Total revenues | \$1,276 | \$1,414 | \$3,894 | \$4,464 |
| Operating income (loss): | | | | |
| National Security Solutions | \$72 | \$66 | \$227 | \$209 |
| Health and Engineering | 4 | (30 |) (455 |) 2 |

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| | | | | | |
|-------------------------------|------|-------|----------|--------|---|
| Corporate and Other | (4 |) (41 |) (23 |) (129 |) |
| Total operating income (loss) | \$72 | \$(5 |) \$(251 |) \$82 |) |

34

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Asset information by segment is not a key measure of performance used by the CODM. Interest income, interest expense, and provision for income taxes, as reported in the condensed consolidated financial statements, are not part of operating income and are primarily recorded at the corporate level. Under U.S. Government Cost Accounting Standards, indirect costs including depreciation expense are collected in numerous indirect cost pools which are then collectively allocated out to the Company's reportable segments based on a representative causal or beneficial relationship of the costs in the pool to the costs in the base.

Note 12—Legal Proceedings:

Timekeeping Contract with City of New York

In March 2012, the Company reached a settlement with the U.S. Attorney's Office for the Southern District of New York and the City of New York (City) relating to investigations being conducted by the U.S. Attorney's Office and the City with respect to the Company's contract to develop and implement an automated time and attendance and workforce management system (CityTime) for certain agencies of the City. As part of this settlement, the Company entered into a deferred prosecution agreement with the U.S. Attorney's Office, under which the Company paid approximately \$500 million and the U.S. Attorney's Office deferred prosecution of a single criminal count against the Company, which alleged that the Company, through the conduct of certain managerial employees and others, caused the City to significantly overpay for the CityTime system. If the Company complies with the terms of the deferred prosecution agreement, the U.S. Attorney will dismiss the criminal count at the end of a three-year period. In August 2012, the Company entered into an administrative agreement with the U.S. Army, on behalf of all agencies of the U.S. Government that confirms the Company's continuing eligibility to enter into and perform contracts with all agencies of the U.S. Government following the CityTime settlement. The Army has determined that the U.S. Government will have adequate assurances under the terms of the administrative agreement that initiation of suspension or debarment is not necessary to protect the U.S. Government's interests following the CityTime settlement. Under the terms of the administrative agreement, the Company has agreed, among other things, to maintain a contractor responsibility program having the specific elements described in the administrative agreement, including retaining a monitor and providing certain reports to the U.S. Army. The administrative agreement will continue in effect for five years, provided that the Company may request earlier termination after three years.

Data Privacy Litigation

The Company was previously a defendant in a putative class action, *In Re: Science Applications International Corporation ("SAIC") Backup Tape Data Theft Litigation*, which was an Multidistrict Litigation ("MDL") action in U.S. District Court for the District of Columbia relating to the theft of computer back-up tapes from a vehicle of a company employee. In May 2014, the District Court dismissed all but two plaintiffs from the MDL action. In June 2014, Leidos and its co-defendant, TRICARE, entered into settlement agreements with the remaining two plaintiffs who subsequently dismissed their claims with prejudice.

On September 20, 2014, the Company was named as a defendant in a putative class action, *Martin Fernandez, on Behalf Of Himself And All Other Similarly Situated v. Leidos, Inc.* in the Eastern District Court of California, related to the same theft of computer backup tapes. The recent complaint includes allegations of violations of the California Confidentiality of Medical Information Act, the California Unfair Competition Law, and other claims. The Company intends to vigorously defend against these claims.

Derivative and Securities Litigation

Between February and April 2012, six stockholder derivative lawsuits were filed, each purportedly on the Company's behalf. Two cases have been withdrawn and the four remaining cases were consolidated in the U.S. District Court for the Southern District of New York in *In re SAIC, Inc. Derivative Litigation*. On June 10, 2013, the District Court dismissed the consolidated complaint with prejudice and on January 30, 2014, the United States Court of Appeals for the Second Circuit affirmed the dismissal.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company has also received four stockholder demand letters related to CityTime (one of which is also related to the TRICARE matter described above). An independent committee of the Company's board of directors reviewed the demands and the Company's lead director has notified all four stockholders' attorneys, on behalf of the board of directors, that the Company has decided not to pursue the claims outlined in their demand letters.

Between February and April 2012, alleged stockholders filed three putative securities class actions. One case was withdrawn and two cases were consolidated in the U.S. District Court for the Southern District of New York in *In re SAIC, Inc. Securities Litigation*. The consolidated securities complaint names as defendants the Company, its chief financial officer, two former chief executive officers, a former group president and the former program manager on the CityTime program, and was filed purportedly on behalf of all purchasers of the Company's common stock from April 11, 2007 through September 1, 2011. The consolidated securities complaint asserted claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 based on allegations that the Company and individual defendants made misleading statements or omissions about the Company's revenues, operating income and internal controls in connection with disclosures relating to the CityTime project. The plaintiffs sought to recover from the Company and the individual defendants an unspecified amount of damages class members allegedly incurred by buying Leidos' stock at an inflated price. On October 1, 2013, the District Court dismissed many claims in the complaint with prejudice and on January 30, 2014, the District Court entered an order dismissing all remaining claims with prejudice and without leave to replead. The plaintiffs moved to vacate the District Court's judgment or obtain relief from the judgment and for leave to file an amended complaint. On September 30, 2014, the District Court denied plaintiffs' motions. The plaintiffs filed a notice of appeal on October 30, 2014 to the United States Court of Appeals for the Second Circuit.

Greek Government Contract

Background and Arbitration. In May 2003, the Company entered into a firm-fixed-price contract with the Hellenic Republic of Greece (the "Customer") to provide a Command, Control, Communications, Coordination and Integration System (the "System") to support the 2004 Athens Summer Olympic Games (the "Olympics") and to serve as the security system for the Customer's public order departments following completion of the Olympics.

In November 2008, the Customer accepted the System in writing pursuant to the requirements of the contract. At the time, the Customer determined that the System substantially complied with the terms of the contract and accepted the System with certain alleged minor omissions and deviations. Upon System acceptance, the Company invoiced the Customer for approximately \$17 million, representing the undisputed portion of the contract balance owed to the Company. The Customer has not paid this final invoice.

In June 2009, the Company initiated arbitration before the International Chamber of Commerce against the Customer seeking damages for breaches of contract by the Customer. In July 2013, the Company received an arbitral award for approximately \$49 million. The Customer has yet to satisfy the arbitral award. The Company is pursuing an enforcement action in U.S. District Court for the District of Columbia. In September 2013, the Customer filed a petition in a Greek court seeking to nullify the arbitral award and to stay enforcement of the award in Greece. A hearing on the Customer's nullification request was held in Greece in April 2014. The parties agreed to a stay of the Company's enforcement action in U.S. District Court until the Greek court issued a ruling on the Customer's nullification request. In June 2014, the Athens Court of Appeals annulled the arbitral award. The Company has a right to appeal the annulment decision to the Supreme Court of Greece to have the arbitral award reinstated. The Company

is continuing to pursue enforcement of the award in the U.S. District Court as is still its right under U.S. and international law. The outcomes of a possible appeal in Greece and the Company's pending enforcement action are uncertain.

Financial Status and Contingencies. As a result of the significant uncertainties on this contract, the Company converted to the completed-contract method of accounting and ceased recognizing revenues for the System development portion of this contract in fiscal 2006. No profits or losses were recorded on the Greek contract during the three and nine months ended October 31, 2014 and November 1, 2013. As of October 31, 2014, the Company

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

has recorded \$123 million of losses under the Greek contract, reflecting the Company's estimated total cost to complete the System, assuming the Greek contract value was limited to the cash received to date. Based on the complex nature of this contractual situation and the difficulties encountered to date, significant uncertainties exist and the Company is unable to reliably estimate the ultimate outcome. The Company may reverse a portion of the losses from the Greek contract if it receives payments as provided in the arbitral award.

As of October 31, 2014, the Company has \$14 million of receivables relating to value added tax ("VAT") that the Company has paid and believes it is entitled to recover either as a refund from the taxing authorities or as a payment under the Greek contract. The Company has invoiced the Customer for \$32 million for VAT and the Customer has failed to make payment. If the Customer fails to pay the outstanding VAT amounts or the Company is unable to recover the amount as a refund from the taxing authorities, the Company's total losses on the Greek contract could increase.

The Company has met certain advance payment and performance bonding requirements through the issuance of euro-denominated standby letters of credit. As of October 31, 2014, there were \$2 million in standby letters of credit outstanding relating to the support and maintenance of the System. In the arbitration, the Company was awarded but has not received \$24 million representing the amounts drawn by the Customer in fiscal 2011 on certain standby letters of credit as well as damages. The principal subcontractor has provided to the Company euro-denominated standby letters of credit in the amount of \$20 million as of October 31, 2014, of which \$18 million relates to the delivery of the System. The Company may draw on the subcontractor's standby letters of credit under certain circumstances by providing a statement to the responsible bank that the subcontractor has not fulfilled its obligations under the subcontract.

Nuclear Regulatory Commission

The U.S. Department of Justice filed a lawsuit against the Company in September 2004 in U.S. District Court for the District of Columbia alleging civil False Claims Act violations and breach of contract by the Company on two contracts that the Company had with the Nuclear Regulatory Commission ("NRC"). The complaint alleged that the Company's performance of several subcontracts on separate U.S. Department of Energy ("DOE") programs, the participation of a Company employee in an industry trade association, and certain other alleged relationships created organizational conflicts of interest under the two NRC contracts. The Company disputed that the work performed on the DOE programs and the alleged relationships raised by the government created organizational conflicts of interest. In July 2008, the jury found in favor of the government on the breach of contract and two False Claims Act counts. The jury awarded a nominal amount in damages for breach of contract and \$2 million in damages for the False Claims Act claims. The judge entered the judgment in October 2008, trebling the False Claims Act damages and awarding \$585,000 in civil penalties, for total damages of \$7 million. The Company appealed to the U.S. Court of Appeals for the District of Columbia Circuit. In December 2010, the Court of Appeals affirmed the District Court's judgment as to both liability and damages on the breach of contract count and rescinded the judgment on the False Claims Act counts, including the aggregate damages and penalties. The Court of Appeals sent the False Claims Act counts back to the District Court for further proceedings. In October 2014, the parties entered into a settlement agreement to resolve the False Claims Act claims, with no admission of liability, and payment by the Company of \$2 million. The case was dismissed with prejudice on November 13, 2014.

Other

The Company is also involved in various claims and lawsuits arising in the normal conduct of its business, none of which, in the opinion of the Company's management, based upon current information, will likely have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 13—Other Commitments and Contingencies:

VirnetX, Inc.

In fiscal 2007, the Company transferred several patents to VirnetX Inc., a subsidiary of VirnetX Holding Corp. In consideration of this transfer, the Company received certain license rights and the right to receive a percentage of the consideration received in patent infringement or enforcement claims against third parties. In November 2012, a jury found that Apple Corporation infringed two of the patents that the Company previously transferred to VirnetX and awarded approximately \$368 million to VirnetX. Under its agreements with VirnetX, the Company would receive 25% of the proceeds obtained by VirnetX in this lawsuit against Apple after reduction for attorneys' fees and costs incurred in litigating those claims. Apple filed an appeal of the jury verdict with the United States Court of Appeals for the Federal Circuit, and on September 16, 2014, the appeals court vacated and remanded the jury's \$368 million damages award. On October 16, 2014, VirnetX petitioned the appeals court for an en banc rehearing of this decision. No assurances can be given as to when or if the Company will receive any proceeds in connection with this matter. In addition, if the Company receives any proceeds under its agreements with VirnetX, the Company is required to pay a royalty on the proceeds received to the customer who paid for the development of the technology. The Company does not have any assets or liabilities recorded in connection with this matter as of October 31, 2014.

Government Investigations and Reviews

The Company is routinely subject to investigations and reviews relating to compliance with various laws and regulations with respect to its role as a contractor to federal, state, and local government customers and in connection with performing services in countries outside of the United States. Adverse findings in these investigations or reviews can lead to criminal, civil or administrative proceedings, and the Company could face penalties, fines, compensatory damages, and suspension or debarment from doing business with governmental agencies. In addition, the Company could suffer serious reputational harm if allegations of impropriety were made against Leidos. Adverse findings could also have a material adverse effect on the Company's business, consolidated financial position, results of operations, and cash flows due to its reliance on government contracts.

U.S. Government agencies, including the Defense Contract Audit Agency ("DCAA"), Defense Contract Management Agency ("DCMA"), and others, routinely audit and review a contractor's performance on government contracts, indirect rates and pricing practices, and compliance with applicable contracting and procurement laws, regulations, and standards. They also review the adequacy of the contractor's compliance with government standards for its business systems, including: a contractor's accounting system, earned value management system, estimating system, materials management and accounting system, property management system, and purchasing system. Both contractors and the U.S. Government agencies conducting these audits and reviews have come under increased scrutiny including such subjects as billing practices, labor charging, and accounting for unallowable costs. As a result, audits and reviews have become more rigorous and the standards to which the Company is held are being more strictly interpreted, increasing the likelihood of an audit or review resulting in an adverse outcome. During the course of its current audits, the DCAA is closely examining and questioning costs and several of the Company's long established and disclosed practices increasing the uncertainty as to the ultimate conclusion that will be reached. In addition, the Company also monitors compliance with these practices and has an obligation under its contracts to make disclosures of specific improprieties based on credible evidence.

The Company changed its indirect rate structure used in its indirect cost system and its direct labor bid structure used for its estimating system for fiscal 2011 and future years. The DCAA is performing reviews of these changes and the Company's compliance with certain other U.S. Government Cost Accounting Standards. A finding of significant control deficiencies in the Company's system audits or other reviews can result in cash withholds and potentially decremented billing rates to its U.S. Government customers until the control deficiencies are corrected and their remediation is accepted by the DCMA.

LEIDOS HOLDINGS, INC.

LEIDOS, INC.

COMBINED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company's indirect cost audits by the DCAA remain open for fiscal 2009 and subsequent fiscal years. Although the Company has recorded contract revenues subsequent to and including fiscal 2009 based upon an estimate of costs that the Company believes will be approved upon final audit or review, the Company does not know the outcome of any ongoing or future audits or reviews and adjustments, and if future adjustments exceed the Company's estimates, its profitability would be adversely affected. Pursuant to the Distribution Agreement with New SAIC and upon the separation date, the Company's liability of \$45 million of net amounts to be refunded to customers for potential adjustments from such audit or review of contract costs was allocated to New SAIC in the amount of \$18 million and the Company in the amount of \$27 million. For open periods prior to the spin-off, matters may be settled by the Company with reimbursements due from New SAIC. Subsequent to the separation date, any amounts owed in addition to the \$45 million liability for periods prior to the separation date will be proportioned between Leidos and New SAIC in accordance with the Distribution Agreement.

As of October 31, 2014, the Company has recorded a total liability of \$29 million for its current best estimate of net amounts to be refunded to customers for potential adjustments from such audits or reviews of contract costs. This amount includes potential adjustments related to both pre-separation and post-separation audits or reviews.

Tax Audits and Reviews

The Company files income tax returns in the United States and various state and foreign jurisdictions and is subject to routine compliance reviews by the IRS and other taxing authorities. The Company has effectively settled with the IRS for all fiscal years prior to fiscal 2014.

As of October 31, 2014, the Company has a liability for unrecognized tax benefits, including liabilities for uncertain tax positions of \$10 million of which \$6 million were classified as other long-term liabilities in the condensed consolidated balance sheet.

During the next twelve months, it is reasonably possible that resolution of reviews by taxing authorities, both domestic and international, could be reached with respect to \$4 million of the Company's unrecognized tax benefits depending on the timing of ongoing examinations or any litigation and expiration of statute of limitations, either because the Company's tax positions are sustained or because the Company agrees to their disallowance and pays the related income tax.

While the Company believes it has adequate accruals for uncertain tax positions, the tax authorities may determine that the Company owes taxes in excess of recorded accruals or the recorded accruals may be in excess of the final settlement amounts agreed to by the tax authorities.

The Company is subject to periodic audits by government agencies for taxes other than income taxes. The Company does not believe that the outcome of any other such tax matters would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Letters of Credit and Surety Bonds

The Company has outstanding letters of credit of \$55 million as of October 31, 2014, principally related to guarantees on contracts. The Company also has outstanding surety bonds in the amount of \$135 million, principally related to performance and subcontractor payment bonds on the Company's contracts.

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

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

The following combined discussion and analysis of Leidos Holdings, Inc.'s ("Leidos") and Leidos, Inc.'s financial condition and results of operations and quantitative and qualitative disclosures about market risk should be read in conjunction with our condensed consolidated financial statements and related combined notes. As Leidos is a holding company and consolidates Leidos, Inc. for financial statement purposes, disclosures that relate to activities of Leidos, Inc. also apply to Leidos, unless otherwise noted. Leidos, Inc.'s revenues and operating expenses comprise 100% of Leidos' revenues and operating expenses. In addition, Leidos, Inc. comprises approximately the entire balance of Leidos' assets, liabilities and operating cash flows. Therefore, the following discussion is applicable to both Leidos and Leidos, Inc., unless otherwise noted.

The following discussion contains forward-looking statements, including statements regarding our intent, belief, or current expectations with respect to, among other things, trends affecting our financial condition or results of operations, backlog, our industry, government budgets and spending, the impact of competition, and the performance and carrying values of our assets, including Plainfield. Such statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statements as a result of various factors. Some of these factors include, but are not limited to, the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended January 31, 2014, as updated periodically through our subsequent quarterly reports on Form 10-Q. Due to such uncertainties and risks, you are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to update these factors or to publicly announce the results of any changes to our forward-looking statements due to future events or developments.

All amounts in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" are presented for our continuing operations.

We use the terms "Company," "we," "us," and "our" to refer to Leidos, Leidos, Inc., and its consolidated subsidiaries. Effective in fiscal 2014, we changed our fiscal year to a 52/53 week fiscal year ending on the Friday closest to January 31, with fiscal quarters typically consisting of 13 weeks. For example, we refer to the fiscal year ending January 30, 2015 as "fiscal 2015." Unless otherwise noted, references to fiscal years are to fiscal years ended the Friday closest to January 31.

Overview

We are an applied technology company delivering solutions and services that leverage the power of data analytics, systems integration, and cyber security across our three markets of national security, health, and engineering to agencies of the U.S. Department of Defense ("DoD"), the intelligence community, the U.S. Department of Homeland Security, and other U.S. Government civil agencies, state and local government agencies, foreign governments, and customers across a variety of commercial markets. We operate in the following segments: National Security Solutions, Health and Engineering, and Corporate and Other.

Our National Security Solutions segment provides solutions and systems for air, land, sea, space, and cyberspace for the U.S. intelligence community, the DoD, the military services, and the U.S. Department of Homeland Security. Our solutions deliver technology, large-scale intelligence systems, data analytics, cyber solutions, logistics and intelligence analysis, and operations support to critical missions around the world.

Our Health and Engineering segment provides health systems integration services to implement and optimize the use of electronic health records, apply data analytics, and conduct behavioral health research to help enable customers to improve healthcare quality and patient outcomes, detect and prevent diseases, enhance scientific discovery, and reduce costs to the healthcare system. We also provide engineering services and solutions focused on solving energy, environmental, and infrastructure challenges. These include products and solutions in energy generation, efficiency

and management, environmental services, securing critical infrastructure, and designing and building construction projects.

40

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

Our significant management initiatives include the following:

Achieving internal, or non-acquisition related, revenue growth through internal collaboration and better leveraging of key differentiators across our company and the deployment of resources and investments into higher growth markets; Increasing the growth of our operating profits through improving the quality of our revenues and contract profitability, continued improvement in our information technology (IT) systems infrastructure, and related business processes for greater effectiveness and efficiency across all business functions; and Disciplined deployment of our cash resources and use of our capital structure to enhance shareholder value while retaining an appropriate amount of financial leverage, through internal growth initiatives, stock repurchases, dividends, strategic acquisitions, debt level management, and other uses to achieve our goals.

Key financial results during the three months ended October 31, 2014 include:

Revenues for the three months ended October 31, 2014 decreased 10% from the corresponding period in the prior year. The revenue contraction for the quarter was due to a decrease in National Security Solutions segment revenues of 10% and a decrease in Health and Engineering segment revenues of 8%.

Operating income from continuing operations was \$72 million for the three months ended October 31, 2014 as compared to an operating loss from continuing operations of \$5 million for the corresponding period in the prior year. Operating income from continuing operations for the three months ended October 31, 2014 includes \$17 million of intangible asset impairment charges. The prior year's operating loss from continuing operations includes \$43 million of bad debt expense primarily related to receivables for two energy design-build construction projects, a \$19 million intangible asset impairment charge, and \$25 million in separation and restructuring expenses associated with the spin-off which was completed in fiscal 2014.

Diluted income per share from continuing operations for the three months ended October 31, 2014 was \$0.51 as compared to a diluted loss per share from continuing operations of \$0.10 in the corresponding period in the prior year, primarily due to the aforementioned operating income from continuing operations increase of \$77 million and a decrease in the diluted weighted average number of shares outstanding of 10 million shares, or 12%.

Cash and cash equivalents increased \$60 million during the three months ended October 31, 2014 primarily due to cash provided by operations of \$179 million, partially offset by debt payments of \$102 million and dividend payments of \$24 million.

Net bookings (as defined in "Key Performance Measures—Bookings and Backlog") were approximately \$1.2 billion for the three months ended October 31, 2014. Total backlog was \$8.3 billion at October 31, 2014 as compared to \$8.4 billion at August 1, 2014 and \$8.8 billion at May 2, 2014.

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

Spin-off Transaction

In accordance with a distribution agreement, on September 27, 2013 (the "Distribution Date"), Leidos completed a spin-off of its technical services and enterprise information technology services business into an independent, publicly traded company named Science Application International Corporation ("New SAIC"). The spin-off was effected through a tax-free distribution to Leidos' stockholders of 100% of the shares of New SAIC's common stock. On the Distribution Date, New SAIC's common stock was distributed, on a pro rata basis, to Leidos' stockholders of record as of the close of business on September 19, 2013, the record date. Each holder of Leidos common stock received one share of New SAIC common stock for every seven shares of Leidos common stock held on the record date. As a result of the spin-off, the assets, liabilities, results of operations, and cash flows of New SAIC have been classified as discontinued operations for all periods presented. References to financial information are to our continuing operations, unless otherwise noted.

In fiscal 2014, in connection with the spin-off transaction and in order to align our cost structure for post-separation, we incurred approximately \$46 million in expenses related to lease termination costs, facility consolidation costs and other costs in connection with vacating facilities that were not necessary for our future requirements as well as \$10 million of severance costs and \$9 million of other separation transaction and restructuring expenses. For the three and nine months ended November 1, 2013, we incurred approximately \$17 million and \$40 million of lease termination and facility consolidation expenses, respectively, and \$2 million and \$10 million of severance costs, respectively. For the three and nine months ended November 1, 2013, we incurred \$6 million and \$8 million of other separation transaction and restructuring expenses, respectively. There were no separation transaction and restructuring expenses for the three months ended October 31, 2014. For the nine months ended October 31, 2014, we incurred approximately \$1 million of lease termination and facility consolidation expenses related to an adjustment to the prior year reserve established for loss on leases in connection with revised sublease income assumptions. We do not expect to incur significant additional separation transaction and restructuring expenses in fiscal 2015 related to the spin-off transaction.

Dispositions

Fiscal 2015 Discontinued Operations

In July 2014, we committed to plans to dispose of a business primarily focused on full service emergency management consulting for disaster preparedness, response, recovery, and mitigation historically included in our Health and Engineering segment. The sale transaction was completed in the third quarter of fiscal 2015 with cash proceeds received of \$19 million, resulting in an immaterial loss on sale.

Fiscal 2014 Discontinued Operations

In addition to the spin-off of New SAIC discussed above, in order to better align our business portfolio with our strategy, we sold or committed to plans to dispose of certain other components of our business that were historically included in our National Security Solutions segment.

In August 2013, we committed to plans to dispose of a business primarily focused on technology used to detect if an individual is concealing explosive devices or other hidden weapons. In the first quarter of fiscal 2015, we adjusted the carrying values of the business's assets to their fair value based on the estimated selling price of the business. The carrying value exceeded the fair value which resulted in approximately \$12 million of impairment charges recorded in discontinued operations, of which \$9 million related to fixed assets and inventory and the remainder related to intangible assets. The sale transaction was completed in the second quarter of fiscal 2015 with insignificant cash proceeds received, resulting in an immaterial loss on sale.

In November 2013, we sold a certain component of our business focused on machine language translation with insignificant cash proceeds received, resulting in an immaterial gain on sale.

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

In January 2014, we committed to plans to dispose of Cloudshield Technologies, Inc., previously acquired in fiscal 2011, which is focused on producing a suite of cybersecurity hardware and associated software and services.

The operating results of our discontinued operations discussed above for the periods presented were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 | October 31, 2014 | November 1, 2013 |
| | (in millions) | | | |
| Revenues | \$ 13 | \$ 605 | \$ 59 | \$ 2,737 |
| Costs and expenses: | | | | |
| Cost of revenues | 10 | 543 | 53 | 2,473 |
| Selling, general and administrative expenses (including impairment charges of \$9 million for the nine months ended October 31, 2014) | 5 | 23 | 24 | 62 |
| Intangible asset impairment charges | — | — | 3 | 2 |
| Separation transaction and restructuring expenses | — | 20 | — | 55 |
| Operating (loss) income | \$(2) | \$ 19 | \$(21) | \$ 145 |
| Non-operating income (expense) | \$ 1 | \$ — | \$ 9 | \$(1) |
| Total (loss) income from discontinued operations before income taxes | \$(1) | \$ 19 | \$(12) | \$ 144 |

Business Environment and Trends

U.S. Government Markets

In fiscal 2014, we generated approximately 78% of our total revenues from contracts with the U.S. Government, either as a prime contractor or a subcontractor to other contractors engaged in work for the U.S. Government. Revenues under contracts with the DoD, including subcontracts under which the DoD is the ultimate purchaser, represented approximately 68% of our total revenues in fiscal 2014. Accordingly, our business performance is affected by the overall level of U.S. Government spending, especially national security, homeland security, and intelligence spending, and the alignment of our service and product offerings and capabilities with current and future budget priorities of the U.S. Government. Contributing to long term fiscal uncertainty is the continuing uncertainty over the debt ceiling extension, which will expire in March 2015.

We believe that U.S. Government budget deficits and the national debt have created increasing pressure to examine and reduce spending across all federal agencies. The Budget Control Act of 2011 raised the U.S. Government's debt ceiling and imposed 10-year discretionary spending sequestration caps expected to generate over \$1 trillion in savings for the U.S. Government. According to the Office of Management and Budget, these savings include nearly \$500 billion in DoD baseline spending reductions over 10 years, which began to be implemented in the U.S. Government fiscal year ended September 30, 2013.

In December 2013, the President signed into law the Bipartisan Budget Act of 2013, which reduced the effects of sequestration in Government FY 2014 and Government FY 2015 for national security, but did not make the same concessions for the cuts in medical reimbursements. Roughly 60% of all healthcare costs in the United States are reimbursed by a government program. These reimbursements are tied to the government spending level and were significantly reduced as part of the Budget Control Act. We believe this has had a direct effect in the amount of available discretionary spending on IT modernization in U.S. hospitals and has therefore slowed the growth we had previously experienced in our commercial health IT practice.

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

The implementation of sequestration spending cuts and associated government guidance and planning activities has impacted existing contracts, caused program delays and cancellations and caused delays in other government contracting actions. In addition, future implementation of spending cuts as we return to Sequestration in Government FY 2016 could cause further delays in contract awards and continued uncertainty. We continue to evaluate the impact of spending reductions on our businesses. The amount and nature of these federal budget spending reductions could adversely impact our operations, future revenues, and growth prospects.

Trends in the U.S. Government contracting process, including a shift towards multiple-awards contracts (in which certain contractors are preapproved using indefinite-delivery/indefinite-quantity ("IDIQ") and U.S. General Services Administration ("GSA") contract vehicles) and awarding contracts on a low price, technically acceptable basis, have increased competition for U.S. Government contracts, reduced backlogs by shortening periods of performance on contracts, and increased pricing pressure. We expect that a majority of the business that we seek in the foreseeable future will be awarded through a competitive bidding process. For more information on these risks and uncertainties, see "Risk Factors" in Part I of our Annual Report on Form 10-K for the fiscal year ended January 31, 2014.

Commercial and International Markets

Sales to customers in commercial and international markets serve to diversify us from reliance upon U.S. Government business. In addition, the timing of sales to customers in our commercial health business is partially dependent upon regulations which impact implementation time lines for Meaningful Use of certified electronic health record ("EHR") technology and International Statistical Classification of Diseases and Related Health Problems ("ICD-10"). Implementation requirements for both of these catalysts have been delayed, which we believe has adverse impacts to the near-term performance of our commercial health business.

Key Performance Measures

The primary financial performance measures we use to manage our business and monitor results of operations are revenue, operating income, cash flows from operations, and diluted EPS. We also believe that bookings and backlog are useful measures for management and investors to evaluate our potential future revenues. In addition, we consider measures such as contract types and revenue mix to be useful measures to management and investors evaluating our operating income and margin performance. We previously reported in our fiscal 2014 Quarterly Reports on Form 10-Q internal revenue growth (contraction), which is a non-GAAP financial measure due to acquisitions occurring in prior periods. In this quarterly report, there were no acquisitions for the current and comparable periods presented, therefore we are not presenting this non-GAAP measure in this quarterly report.

Bookings and Backlog. We received net bookings worth an estimated \$1.2 billion and \$2.9 billion during the three and nine months ended October 31, 2014, respectively. Net bookings represent the estimated amount of revenues to be earned in the future from funded and unfunded contract awards that were received during the period, net of any adjustments to previously awarded backlog amounts. We calculate net bookings as the period's ending backlog plus the period's revenues less the prior period's ending backlog and less the backlog obtained in acquisitions during the period.

Backlog represents the estimated amount of future revenues to be recognized under negotiated contracts as work is performed. We segregate our backlog into two categories as follows:

Funded Backlog. Funded backlog for contracts with government agencies primarily represents contracts for which funding is appropriated less revenues previously recognized on these contracts, and does not include the unfunded portion of contracts where funding is incrementally appropriated or authorized on a quarterly or annual basis by the U.S. Government and other customers, even though the contract may call for performance over a number of years. Funded backlog for contracts with non-government agencies and commercial customers represents the estimated value on contracts, which may cover multiple future years, under which we are obligated to perform, less revenues

previously recognized on these contracts.

44

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Negotiated Unfunded Backlog. Negotiated unfunded backlog represents estimated amounts of revenues to be earned in the future from (1) negotiated contracts for which funding has not been appropriated or otherwise authorized and (2) unexercised priced contract options. Negotiated unfunded backlog does not include future potential task orders expected to be awarded under IDIQ, GSA Schedule, or other master agreement contract vehicles.

The estimated value of our total backlog as of the dates presented, with the prior period recast for consistency with the current period's presentation, was as follows:

| | October 31, 2014 | August 1, 2014 | May 2, 2014 | January 31, 2014 |
|--------------------------------------------------|---------------------|-------------------|----------------|---------------------|
| | (in millions) | | | |
| National Security Solutions: | | | | |
| Funded backlog | \$1,594 | \$1,837 | \$1,986 | \$1,854 |
| Negotiated unfunded backlog | 4,947 | 4,778 | 5,005 | 5,604 |
| Total National Security Solutions backlog | \$6,541 | \$6,615 | \$6,991 | \$7,458 |
| Health and Engineering: | | | | |
| Funded backlog | \$1,092 | \$1,048 | \$1,112 | \$1,144 |
| Negotiated unfunded backlog | 698 | 750 | 728 | 694 |
| Total Health and Engineering backlog | \$1,790 | \$1,798 | \$1,840 | \$1,838 |
| Total: | | | | |
| Funded backlog | \$2,686 | \$2,885 | \$3,098 | \$2,998 |
| Negotiated unfunded backlog | 5,645 | 5,528 | 5,733 | 6,298 |
| Total backlog | \$8,331 | \$8,413 | \$8,831 | \$9,296 |

Bookings and backlog fluctuate from period to period depending on our success rate in winning contracts and the timing of contract awards, renewals, modifications, and cancellations. Contract awards continue to be negatively impacted by ongoing industry-wide delays in procurement decisions, and budget cuts, including sequestration, by the U.S. Government as discussed in "Business Environment and Trends" in this Quarterly Report on Form 10-Q.

We expect to recognize a substantial portion of our funded backlog as revenues within the next 12 months. However, the U.S. Government may cancel any contract at any time through a termination for the convenience of the U.S.

Government. In addition, certain contracts with commercial customers include provisions that allow the customer to cancel at any time. Most of our contracts have cancellation terms that would permit us to recover all or a portion of our incurred costs and fees for work performed.

Contract Types. Our earnings and profitability may vary materially depending on changes in the proportionate amount of revenues derived from each type of contract. For additional information regarding the types of contracts under which we generate revenues, see "Business—Contract Types" in Part I of our Annual Report on Form 10-K for the fiscal year ended January 31, 2014. The following table summarizes revenues by contract type as a percentage of total revenues for the periods presented:

| | Nine Months Ended | | | |
|-------------------------------------------------------------------|---------------------|---------------------|--|----------|
| | October 31, 2014 | November 1, 2013 | | |
| Cost-reimbursement | 47 | % 47 | | % |
| Time and materials (T&M) and fixed-price-level-of-effort (FP-LOE) | 26 | 27 | | |
| Firm-fixed price (FFP) | 27 | 26 | | |
| Total | 100 | % 100 | | % |

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Revenue Mix. We generate revenues under our contracts from (1) the efforts of our technical staff, which we refer to as labor-related revenues, and (2) the materials provided on a contract and efforts of our subcontractors, which we refer to as M&S revenues. M&S revenues are generated primarily from large, multi-year systems integration contracts and contracts in our logistics, readiness, and sustainment business area, as well as through sales of our proprietary products, such as our border, port, and mobile security products and our checked baggage explosive detection systems.

The following table presents changes in labor-related revenues and M&S revenues for the periods presented:

| | Three Months Ended | | November 1, 2013 | Nine Months Ended | | November 1, 2013 |
|--------------------------------|-----------------------|-------------------|---------------------|---------------------|-------------------|---------------------|
| | October 31, 2014 | Percent change | | October 31, 2014 | Percent change | |
| | (dollars in millions) | | | | | |
| Labor-related revenues | \$763 | (11)% | \$857 | \$2,356 | (14)% | \$2,733 |
| As a percentage of revenues | 60 | % | 61 | % 61 | % | 61 % |
| M&S revenues | 513 | (8)% | 557 | 1,538 | (11)% | 1,731 |
| As a percentage of revenues | 40 | % | 39 | % 39 | % | 39 % |

Geographic Location. Substantially all of our revenues and tangible long-lived assets are generated by or owned by entities located in the United States.

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Results of Operations

The following table summarizes our results of operations for the periods presented:

| | Three Months Ended | | | | Nine Months Ended | | | |
|--------------------------------------------------------------|-----------------------|---------------------|------------------|-------------------|---------------------|---------------------|------------------|-------------------|
| | October 31, 2014 | November 1, 2013 | Dollar change | Percent change | October 31, 2014 | November 1, 2013 | Dollar change | Percent change |
| | (dollars in millions) | | | | | | | |
| Revenues | \$1,276 | \$1,414 | \$(138) | (10)% | \$3,894 | \$4,464 | \$(570) | (13)% |
| Cost of revenues | 1,115 | 1,219 | (104) | (9)% | 3,375 | 3,885 | (510) | (13)% |
| Selling, general and administrative expenses: | | | | | | | | |
| General and administrative | 47 | 86 | (39) | (45)% | 156 | 254 | (98) | (39)% |
| Bid and proposal | 16 | 13 | 3 | 23 % | 54 | 54 | — | — % |
| Internal research and development | 9 | 14 | (5) | (36)% | 29 | 35 | (6) | (17)% |
| Bad debt expense | — | 43 | (43) | (100)% | 3 | 45 | (42) | (93)% |
| Goodwill impairment charges | — | — | — | — % | 486 | — | 486 | 100 % |
| Intangible asset impairment charges | 17 | 19 | (2) | (11)% | 41 | 51 | (10) | (20)% |
| Separation transaction and restructuring expenses | — | 25 | (25) | (100)% | 1 | 58 | (57) | (98)% |
| Operating income (loss) | 72 | (5) | 77 | NM | (251) | 82 | (333) | NM |
| Operating income (loss) margin | 5.6 % | (0.4)% | | | (6.4)% | 1.8 % | | |
| Non-operating expense, net | (18) | (14) | (4) | (29)% | (56) | (41) | (15) | (37)% |
| Income (loss) from continuing operations before income taxes | 54 | (19) | 73 | NM | (307) | 41 | (348) | NM |
| Income tax (expense) benefit | (16) | 11 | (27) | NM | (49) | (4) | (45) | NM |
| Income (loss) from continuing operations | 38 | (8) | 46 | NM | (356) | 37 | (393) | NM |
| (Loss) income from discontinued operations, net of tax | (4) | 5 | (9) | (180)% | (11) | 83 | (94) | (113)% |
| Net income (loss) | \$34 | \$(3) | \$37 | NM | \$(367) | \$120 | \$(487) | NM |

NM - Not meaningful

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We classify indirect costs incurred within or allocated to our government customers as overhead (included in cost of revenues) and general and administrative expenses in the same manner as such costs are defined in our disclosure statements under U.S. Government Cost Accounting Standards. General and administrative expenses decreased in fiscal 2015 as compared to fiscal 2014 in part due to the aforementioned restructuring plan in fiscal 2014 to align our cost structure for post-separation.

Changes in Estimates on Contracts. Changes in estimates related to certain types of contracts accounted for using the percentage of completion method of accounting are recognized in the period in which such changes are made for the inception-to-date effect of the changes. Changes in these estimates can routinely occur over the contract performance period for a variety of reasons, including changes in contract scope, changes in contract cost estimates due to unanticipated cost growth or retirements of risk for amounts different than estimated and changes in estimated incentive or award fees. Aggregate changes in contract estimates resulted in an increase to operating income of \$6 million and an increase of \$0.05 per diluted share for the three months ended October 31, 2014, and an increase to operating income of \$24 million and an increase of \$0.20 per diluted share for the nine months ended October 31, 2014. Aggregate changes in contract estimates resulted in a decrease to operating income of \$1 million and a decrease of \$0.02 per diluted share for the three months ended November 1, 2013, and a decrease to operating income of \$29 million and a decrease of \$0.22 per diluted share for the nine months ended November 1, 2013.

Long-Lived Asset Impairment Evaluations

Goodwill Interim Impairment Evaluation. In the second quarter of fiscal 2015, our Health Solutions and Engineering reporting units within the Health and Engineering reportable segment were adversely impacted by certain unexpected events that caused us to reassess current year and future year performance expectations for both reporting units. Based on significant declines in revenue volumes and delayed award decisions, we conducted an interim goodwill impairment test using the two-step quantitative approach.

Based on the first step of the two-step quantitative goodwill impairment test, we determined that the carrying value of the both the Health Solutions and Engineering reporting units were greater than the respective estimated fair values of the reporting units, and the second step of the two-step quantitative goodwill impairment test was performed in order to determine the amount of the impairment of the respective reporting units.

As a result of the second step evaluation, we recorded goodwill impairment charges in the Health Solutions and Engineering reporting units of \$369 million and \$117 million, respectively, for the three months ended August 1, 2014. There were no other goodwill impairment charges recorded for the remaining reporting units. See Note 4 within our combined notes to the condensed consolidated financial statements for further information.

Property, Plant & Equipment Evaluation. During the three months ended October 31, 2014, our 37.5 megawatt Plainfield biomass-powered generating facility ("Plainfield") emerged from an extended outage where we implemented performance optimizations designed to improve fuel management, quality, and distribution to enhance Plainfield's availability and power generation as well as allow for compliance with certain emissions requirements. While we believe these optimizations delivered the intended improvements, we continue to assess Plainfield's operating performance in order to diagnose and implement further optimizations to allow for the forecasted performance. For the three months ended October 31, 2014, the plant has operated with 51% availability with generation during available periods averaging 24 megawatts of net generation for an operating income loss of \$6 million, excluding the \$3 million impairment associated with the three fuel supply agreements. In the remaining months of the current fiscal year we expect Plainfield to implement additional optimizations intended to improve availability to approximately 80% with generation during available periods averaging 30 megawatts of net generation.

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The current carrying value of Plainfield at October 31, 2014 was \$161 million. To the extent that our optimizations efforts do not yield the intended near-term performance improvements, the carrying value of Plainfield may be negatively impacted.

Reportable Segment Results. The following table summarizes changes in National Security Solutions revenues and operating income for the periods presented:

| National Security Solutions | Three Months Ended | | | | Nine Months Ended | | | |
|-----------------------------|-----------------------|------------------|---------------|----------------|-------------------|------------------|---------------|----------------|
| | October 31, 2014 | November 1, 2013 | Dollar change | Percent change | October 31, 2014 | November 1, 2013 | Dollar change | Percent change |
| | (dollars in millions) | | | | | | | |
| Revenues | \$906 | \$1,011 | \$(105) | (10)% | \$2,775 | \$3,107 | \$(332) | (11)% |
| Operating income | 72 | 66 | 6 | 9 % | 227 | 209 | 18 | 9 % |
| Operating income margin | 7.9 | % 6.5 | % | | 8.2 | % 6.7 | % | |

National Security Solutions revenues decreased \$105 million, or 10%, for the three months ended October 31, 2014 as compared to the corresponding period in the prior year. Revenue contraction was primarily attributable to contract activities tied to the drawdown of overseas U.S. military forces (\$51 million) which includes a reduction of airborne programs that support intelligence collection (\$21 million) and the ramp down of the Joint Logistics Integration (JLI) program for tactical mine resistant ambush protected vehicles (\$16 million). The remainder of the decline was primarily driven by overall reductions in defense and U.S. government spending resulting from sequestration and budget cuts, and higher competition resulting in lower contract awards.

National Security Solutions revenues decreased \$332 million, or 11%, for the nine months ended October 31, 2014 as compared to the corresponding period in the prior year. Revenue contraction was primarily attributable to contract activities tied to the drawdown of overseas U.S. military forces (\$204 million) which includes a reduction of airborne programs (\$77 million) and the ramp down of the JLI program (\$77 million). The remainder of the decline was primarily driven by overall reductions in defense and U.S. government spending resulting from sequestration and budget cuts, and higher competition resulting in lower contract awards.

National Security Solutions operating income increased \$6 million, or 9%, for the three months ended October 31, 2014 as compared to the corresponding period in the prior year. The increase in operating income was primarily due to net favorable changes in contract estimates for the three months ended October 31, 2014 (\$4 million), as compared to net unfavorable changes in contract estimates the prior year (\$1 million). This increase was also attributable to lower indirect costs which were partially offset by a decrease in revenues (\$7 million).

National Security Solutions operating income increased \$18 million, or 9%, for the nine months ended October 31, 2014 as compared to the corresponding period in the prior year. The increase in operating income was primarily due to net favorable changes in contract estimates for the nine months ended October 31, 2014 (\$18 million), as compared to net unfavorable changes in contract estimates the prior year (\$17 million) which was negatively impacted by two international fixed price development programs. This increase was also attributable to lower indirect costs which were partially offset by a decrease in revenues (\$23 million).

The following table summarizes changes in Health and Engineering revenues and operating (loss) income for the periods presented:

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| Health and Engineering | Three Months Ended | | | | Nine Months Ended | | | |
|--------------------------------|-----------------------|------------------|---------------|----------------|-------------------|------------------|---------------|----------------|
| | October 31, 2014 | November 1, 2013 | Dollar change | Percent change | October 31, 2014 | November 1, 2013 | Dollar change | Percent change |
| | (dollars in millions) | | | | | | | |
| Revenues | \$373 | \$406 | \$(33) | (8)% | \$1,126 | \$1,368 | \$(242) | (18)% |
| Operating income (loss) | 4 | (30) | 34 | 113 % | (455) | 2 | (457) | NM |
| Operating income (loss) margin | 1.1 | % (7.4)% | | | (40.4)% | 0.1 % | | |
| NM - Not meaningful | | | | | | | | |

Health and Engineering revenues decreased \$33 million, or 8%, for the three months ended October 31, 2014 as compared to the corresponding period in the prior year. The revenue contraction reflects lower sales volume in our health business (\$20 million) attributed to our commercial sales and lower sales volumes in our security products business primarily due to the completion of an international support contract for the Army (\$13 million).

Health and Engineering revenues decreased \$242 million, or 18%, for the nine months ended October 31, 2014 as compared to the corresponding period of the prior year. The revenue contraction reflects a decline in engineering services (\$128 million) primarily due to the completion of two energy design-build construction projects in the fourth quarter of fiscal year 2014 (\$118 million of the \$128 million), lower sales volumes in our security products business due to the completion of an international support contract for the Army (\$38 million) and timing of product shipments (\$20 million), and lower sales in our health business (\$56 million) primarily related to commercial sales.

Health and Engineering operating income was \$4 million for the three months ended October 31, 2014 as compared to an operating loss of \$30 million for the corresponding period in the prior year. Operating income for the three months ended October 31, 2014 was impacted by impairment charges of intangible assets associated with our security products business (\$14 million) and Plainfield (\$3 million). In addition, there was an operating loss due to power generation shortfalls at the Plainfield plant (\$6 million), and lower revenue volumes, including our business areas that typically generate higher margins. Operating loss for the three months ended November 1, 2013 primarily included bad debt expense for certain receivables primarily related to two energy design-build construction projects (\$43 million) and a impairment of customer related intangible assets for our health business (\$19 million).

Health and Engineering operating loss was \$455 million for the nine months ended October 31, 2014 as compared to operating income of \$2 million for the corresponding period of the prior year. Operating loss for the nine months ended October 31, 2014 was impacted by impairment charges of goodwill for our health business (\$369 million) and engineering business (\$117 million), and impairment charges for intangibles assets associated with our health business (\$24 million), our security products business (\$14 million), and Plainfield (\$3 million). In addition, there was an operating loss due to power generation shortfalls at the Plainfield plant (\$22 million). Operating income for the nine months ended November 1, 2013 included bad debt expense for certain receivables primarily related to two energy design-build construction projects (\$43 million), impairment charges for intangible assets associated with our security products business (\$30 million) and our health business (\$19 million), and an unfavorable change in contract estimates on the Plainfield construction projects (\$17 million).

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The following table summarizes changes in Corporate and Other revenues and operating loss for the periods presented:

| Corporate and Other | Three Months Ended | | | | Nine Months Ended | | | |
|---------------------|--------------------|------------------|---------------|----------------|-------------------|------------------|---------------|----------------|
| | October 31, 2014 | November 1, 2013 | Dollar change | Percent change | October 31, 2014 | November 1, 2013 | Dollar change | Percent change |
| | (in millions) | | | | | | | |
| Operating loss | \$(4) | \$(41) | \$37 | 90 % | \$(23) | \$(129) | \$106 | 82 % |

Corporate and Other operating loss for the three and nine months ended October 31, 2014 represents corporate costs that are unallowable under U.S. Government Cost Accounting Standards and the net effect of various items that are not directly related to the operating performance of the reportable segments. In addition, operating loss for the three and nine months ended October 31, 2014 was \$4 million and \$23 million down from \$41 million and \$129 million for the corresponding prior year periods, respectively. This decrease was primarily due to a decrease in separation transaction and restructuring expenses (\$25 million and \$57 million, respectively) associated with the spin-off which was completed in fiscal 2014 and costs to establish infrastructures for two separate companies (\$11 million and \$32 million, respectively).

Non-Operating Expense. Non-operating expense for the three and nine months ended October 31, 2014 increased \$4 million and \$15 million, respectively, as compared to the corresponding period of the prior year. The increase is primarily attributable to a decrease in interest income of \$5 million and \$14 million for the three and nine months ended October 31, 2014, respectively, when compared to the corresponding periods of the prior year primarily due to the collection or forgiveness of deferred receivables for commercial customers related to certain construction contracts.

During the three months ended October 31, 2014, we entered into interest rate swap agreements on our \$450 million fixed rate 4.45% notes maturing in December 2020. The interest rate swap agreements effectively converted a portion of our fixed-rate debt to floating-rate debt tied to the changes in the six-month LIBOR benchmark interest rate.

Interest expense decreased \$3 million and \$1 million for the three and nine months ended October 31, 2014, respectively, primarily attributable to the repurchase of \$105 million of outstanding debt and entering into interest rate swap agreements.

Interest income on Leidos Inc.'s note with Leidos increased \$3 million and \$8 million, respectively, compared to the corresponding periods of the prior year. This note may fluctuate significantly from year to year based on changes in the underlying note balance and interest rates throughout the fiscal year.

Provision for Income Taxes. We recorded an income tax expense of \$16 million for the three months ended October 31, 2014, resulting in a 29.6% effective tax rate, compared to an income tax benefit of \$11 million on a pre-tax loss for the corresponding period in the prior year. During the three months ended October 31, 2014, we recorded a \$3 million income tax benefit compared to \$7 million in the corresponding period in the prior year from the resolution of certain tax contingencies with the tax authorities. The increase in income tax expense was also impacted by the expiration of the federal research and development credit on December 31, 2013 and a decrease in the domestic manufacturer's deduction. In addition, the income tax benefit recorded for the three months ended November 1, 2013 included the tax benefit from the special dividend, which was declared and paid in fiscal 2014, on shares held by the Leidos Retirement Plan.

We recorded an income tax expense of \$49 million for the nine months ended October 31, 2014, resulting in a negative effective tax rate, compared to an income tax expense of \$4 million, resulting in an effective tax rate of 9.8% for the corresponding period in the prior year. The goodwill impairment charge recorded in the three months ended

August 1, 2014, which was mostly not deductible for tax purposes, had a significant impact on the effective tax rate for the nine months ended October 31, 2014. The income tax expense was also impacted by the expiration

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of the federal research and development credit on December 31, 2013 and a decrease in the domestic manufacturer's deduction, partially offset by the tax benefit from state income tax refunds recorded in the first quarter. The income tax expense for the nine months ended November 1, 2013 included the estimated non-deductible portion of settlements of legal and regulatory matters and the tax benefit from the special dividend, which was declared and paid in fiscal 2014, on shares held by the Leidos Retirement Plan.

We file income tax returns in the United States and various state and foreign jurisdictions and have effectively settled with the IRS for all fiscal years prior to fiscal 2014.

As of October 31, 2014, we had liabilities for uncertain tax positions of \$10 million, \$6 million of which were classified as other long-term liabilities in the condensed consolidated balance sheet. The resolution of certain of these tax matters could result in an \$4 million reduction in our uncertain tax positions within the next twelve months.

Liquidity and Capital Resources

Overview of Liquidity

We had \$418 million in cash and cash equivalents at October 31, 2014, which were primarily comprised of cash held in investments in several large institutional money market funds and bank deposits. We anticipate our principal sources of liquidity for the next 12 months and beyond will be our existing cash and cash equivalents and cash flows from operations. We may also borrow up to \$500 million under our revolving credit facility. The available borrowing capacity under the revolving credit facility is \$500 million as of October 31, 2014.

Our revolving credit facility is backed by a number of financial institutions, matures in March 2017 and, by its terms, can be accessed on a same-day basis. We anticipate our principal uses of cash for the next 12 months and beyond will be for operating expenses, capital expenditures, stock repurchases, dividends, debt retirement, and acquisitions of businesses.

We may from time to time seek to retire or purchase our outstanding debt through cash purchases in the open market, privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions, and other factors. The amounts involved may be material. During the three months ended October 31, 2014, we repurchased and retired \$105 million of outstanding debt.

In December 2013, we entered into an Accelerated Share Repurchase ("ASR") agreement with a financial institution to repurchase shares of our outstanding common stock for an aggregate purchase price of \$300 million. The delivery of all shares under the December 2013 ASR agreement was completed during the first quarter of fiscal 2015. In March 2014, we entered into a second ASR agreement with a different financial institution to repurchase shares of our outstanding common stock for an aggregate purchase price of \$200 million. The delivery of all shares under the March 2014 ASR agreement was completed during the second quarter of fiscal 2015.

We anticipate that our operating cash flows, existing cash and cash equivalents, which have no restrictions on withdrawal, and borrowing capacity under our revolving credit facility will be sufficient to meet our anticipated cash requirements for at least the next 12 months.

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Summary of Cash Flows

The following table summarizes cash flow information for the periods presented:

| | Nine Months Ended | |
|----------------------------------------------------------------------------|---------------------|---------------------|
| | October 31, 2014 | November 1, 2013 |
| | (in millions) | |
| Cash provided by operating activities of continuing operations | \$294 | \$82 |
| Cash provided by investing activities of continuing operations | 54 | 312 |
| Cash used in financing activities of continuing operations | (382 |) (419 |
| Cash (used in) provided by operating activities of discontinued operations | (5 |) 121 |
| Cash provided by (used in) investing activities of discontinued operations | 27 | (17 |
| Total (decrease) increase in cash and cash equivalents | \$(12 |) \$79 |

Cash Provided by Operating Activities of Continuing Operations. Cash flows provided by operating activities of continuing operations increased \$212 million for the nine months ended October 31, 2014 as compared to the corresponding period in the prior year primarily attributable to changes in working capital of \$209 million. Collections on accounts receivable for the nine months ended October 31, 2013 were negatively impacted by our name change and our system shutdown to effect the spin-off of New SAIC which caused delays in our customer invoicing. Days sales outstanding were 73 days for the three months ended October 31, 2014 as compared to 74 days for the corresponding period in the prior year.

Cash Provided by Investing Activities of Continuing Operations. We had cash flows provided by investing activities of continuing operations of \$54 million during the nine months ended October 31, 2014, including \$80 million of proceeds from the U.S. Treasury cash grant, offset by \$26 million to purchase property, plant, and equipment. We had cash flows provided by investing activities of continuing operations of \$312 million during the nine months ended November 1, 2013, including a \$295 million dividend from New SAIC, \$65 million of proceeds from the sale of facilities, and \$12 million of proceeds from the sale of cost method investments, partially offset by \$31 million to purchase property, plant, and equipment and a \$26 million capital contribution to New SAIC.

Cash Used in Financing Activities of Continuing Operations. We used \$382 million of cash in support of financing activities of continuing operations during the nine months ended October 31, 2014, including the repurchase and retirement of debt of \$102 million, the payment of dividends of \$72 million and \$213 million to repurchase shares of our stock primarily from the March 2014 ASR as well as repurchases related to employee benefit compensation plans. We used \$419 million of cash in support of financing activities of continuing operations during the nine months ended November 1, 2013, including the payment of dividends of \$452 million and \$17 million to repurchase shares of our stock related to employee benefit compensation plans, offset by consideration received of \$38 million related to a real estate financing transaction. New SAIC received proceeds from the issuance of debt of \$500 million, prior to the separation, and retained the debt obligation after the separation.

Cash (Used in) Provided by Operating Activities of Discontinued Operations. Cash flows from discontinued operations decreased \$126 million for the nine months ended October 31, 2014, primarily due to a decrease of net income of \$94 million and the spin-off of new SAIC.

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Cash Provided by (Used in) Investing Activities of Discontinued Operations. We had cash flows provided by investing activities of discontinued operations of \$27 million during the nine months ended October 31, 2014, due to cash proceeds received for the sale of certain components of our business in fiscal 2015. We used \$17 million of cash in support of investing activities of discontinued operations during the nine months ended November 1, 2013 to purchase property, plant, and equipment.

Leidos, Inc.'s Cash Flows. Any differences in cash flows from operating activities of continuing operations for Leidos, Inc. as compared to Leidos are primarily attributable to changes in interest payments (which reduce cash flow from operating activities of Leidos, Inc.) made by Leidos, Inc. on its note to Leidos and changes in excess tax benefits related to stock-based compensation (which reduce cash flows from operating activities for Leidos).

Leidos, Inc. used cash in investing activities of \$224 million during the nine months ended October 31, 2014, including repayments on its related party note with Leidos of \$360 million and \$26 million to purchase property, plant, and equipment offset by proceeds from the related party note with Leidos of \$82 million and \$80 million of proceeds from the U.S. Treasury cash grant. Leidos, Inc. used cash in financing activities of continuing operations of \$392 million during the nine months ended November 1, 2013 including repayments on its note with Leidos of \$442 million partially offset by proceeds from the note of \$11 million and consideration received of \$38 million related to a real estate financing transaction.

Outstanding Indebtedness

During the third quarter of fiscal 2015, we entered into interest rate swap agreements to hedge the fair value with respect to all of the \$450 million aggregate principal outstanding on our fixed rate 4.45% notes maturing in December 2020 (the "Notes"). The objective of these instruments is to hedge the Notes against changes in fair value due to the variability in the six month LIBOR rate (the benchmark interest rate), which effectively converted a portion of our debt into floating interest rate debt. Under the terms of the interest rate swap agreements, we will receive semi-annual interest payments at the coupon rate of 4.45% and will pay variable interest based on the six-month LIBOR rate.

Our outstanding notes payable and long-term debt consisted of the following:

| | Stated interest rate | Effective interest rate | October 31, 2014 | January 31, 2014 |
|---------------------------------------------------------------------------------|-------------------------|----------------------------|---------------------|---------------------|
| | (dollars in millions) | | | |
| Leidos Holdings, Inc. senior unsecured notes: | | | | |
| \$450 million notes, which mature in December 2020 ⁽¹⁾ | 4.45 | % 4.53 | % \$451 | \$449 |
| \$300 million notes, which mature in December 2040 | 5.95 | % 6.03 | % 291 | 300 |
| Leidos, Inc. senior unsecured notes: | | | | |
| \$250 million notes, which mature in July 2032 | 7.13 | % 7.43 | % 248 | 248 |
| \$300 million notes, which mature in July 2033 | 5.50 | % 5.83 | % 201 | 296 |
| Capital leases and other notes payable due on various dates through fiscal 2021 | 0%-3.7% | Various | 38 | 40 |
| Total notes payable and long-term debt | | | \$1,229 | \$1,333 |
| Less current portion | | | 2 | 2 |
| Total notes payable and long-term debt, net of current portion | | | \$1,227 | \$1,331 |
| Fair value of notes payable and long-term debt | | | \$1,228 | \$1,350 |

As a result of executing the interest rate swap agreements, the carrying value of \$451 million includes a fair value (1) adjustment of \$2 million attributable to changes in the benchmark interest rate, the six-month LIBOR rate, from the inception of the interest rate swap agreements to October 31, 2014.

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During the third quarter of fiscal 2015, we repurchased in the open market and retired principal amounts of \$9 million on our \$300 million 5.95% notes issued by Leidos Holdings, Inc. maturing in December 2040 and \$96 million on our \$300 million 5.50% notes issued by Leidos, Inc. maturing in July 2033. We recorded an immaterial loss on extinguishment of debt for the Leidos Holdings, Inc. notes and an immaterial gain for the Leidos, Inc. notes as part of the partial repayment of the respective notes. The net combined gain represents the difference between the repurchase price of \$102 million and the net carrying amount of the notes repurchased less the write-off of a portion of the unamortized debt discount and deferred financing costs on a pro-rata basis to the reduction of debt. We recorded the gain (loss) on extinguishment of debt in Other income, net in the condensed consolidated statements of income. The notes payable outstanding as of October 31, 2014 contain financial covenants and customary restrictive covenants, including, among other things, restrictions on our ability to create liens and enter into sale and leaseback transactions under certain circumstances. We were in compliance with all covenants as of October 31, 2014. Credit Facility. We have a revolving credit facility, which is fully and unconditionally guaranteed by Leidos, Inc. which had provided for \$750 million in unsecured borrowing capacity at interest rates determined, at our option, based on either LIBOR plus a margin or a defined base rate. During the three months ended October 31, 2014, amended the credit facility to, among other things, change the ratio of consolidated funded debt to EBITDA that we are required to maintain. A pro-rata portion of the unamortized deferred costs related to the prior arrangement were written off at the time of the amendment. The remaining unamortized deferred costs relating to the prior arrangement and the immaterial fee paid to amend the credit facility which were deferred, will be amortized over the term of the amended credit facility. In connection with the amendment to the credit facility, we exercised our right under the credit agreement to voluntarily reduce the combined commitment of the lenders from \$750 million to \$500 million. The maturity date of the facility is March 2017. As of October 31, 2014 and January 31, 2014, there were no borrowings outstanding under the credit facility.

The credit facility contains certain customary representations and warranties, as well as certain affirmative and negative covenants. The financial covenants contained in the amended credit facility require that, for a period of four trailing fiscal quarters, we maintain a ratio of consolidated funded debt, including borrowings under this facility, to EBITDA (adjusted for other items as defined in the credit facility) of not more than 4.0 to 1.0 no later than January 29, 2016 and 3.75 to 1.0 thereafter and a ratio of EBITDA (adjusted for certain items as defined in the credit facility) to interest expense of greater than 3.5 to 1.0. We were in compliance with these financial covenants as of October 31, 2014. A failure to meet these financial covenants in the future could eliminate our borrowing capacity under the credit facility.

The available borrowing capacity on the credit facility may vary each quarter based on the trailing four quarters of EBITDA. If the our trailing four quarters of EBITDA declines below a certain threshold in relation to outstanding debt, the borrowing capacity available under the credit facility is reduced. Our available borrowing capacity based on the results of our trailing four quarters of EBITDA as of October 31, 2014 is approximately \$500 million.

Off-Balance Sheet Arrangements

We have outstanding performance guarantees and cross-indemnity agreements in connection with certain of our unconsolidated joint venture investments. We also have letters of credit outstanding principally related to guarantees on contracts with foreign government customers and surety bonds outstanding principally related to performance and payment bonds. These arrangements have not had, and management does not believe it is likely that they will in the future have, a material effect on our liquidity, capital resources, operations or financial condition.

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Commitments and Contingencies

We are subject to a number of reviews, investigations, claims, lawsuits and other uncertainties related to our business. For a discussion of these items, see Notes 12 - Legal Proceedings and Note 13 - Other Commitments and Contingencies of the combined notes to the condensed consolidated financial statements for the three months ended October 31, 2014 contained within this Quarterly Report on Form 10-Q.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Management evaluates these estimates and assumptions on an ongoing basis. Our estimates and assumptions have been prepared by management on the basis of the most current reasonably available information. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates under different assumptions and conditions.

We have several critical accounting policies, which were described in our Annual Report on Form 10-K for the fiscal year ended January 31, 2014, that are both important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective, and complex judgments. Typically, the circumstances that make these judgments difficult, subjective, and complex have to do with making estimates about the effect of matters that are inherently uncertain. There were no material changes to our critical accounting policies for revenue recognition, changes in estimates on contracts, receivables, business combinations, and intangible assets impairment, and stock-based compensation as described in our Annual Report on Form 10-K for the fiscal year ended January 31, 2014. We recorded goodwill impairment charges in the nine months ended October 31, 2014 and our goodwill impairment critical accounting policy is described below.

Goodwill

Goodwill represents purchase consideration paid in a business combination that exceeds the values assigned to the net assets of acquired businesses. Goodwill is not amortized, but instead is tested for impairment at the reporting unit level annually, at the beginning of the fourth quarter and during interim periods whenever events or circumstances indicate that the carrying value may not be recoverable. Goodwill is evaluated for impairment either under a qualitative assessment option or a two-step quantitative approach depending on facts and circumstances of a reporting unit, including the excess of fair value over carrying amount in previous assessments and changes in business environment.

When performing a qualitative assessment, we consider factor including, but not limited to, current macroeconomic conditions, industry and market conditions, cost factors, financial performance, and other events relevant to the entity or reporting unit under evaluation to determine whether it is more likely or not that the fair value of a reporting unit is less than its carrying amount. If we determine that it is more likely than not that a reporting unit's fair value is less than its carrying amount, a quantitative two-step goodwill impairment test is performed.

In evaluating the first step of the two-step quantitative goodwill impairment test, the estimated fair value of each reporting unit is compared to its carrying value, which includes the allocated goodwill. If the estimated fair value of a reporting unit is more than its carrying value, including allocated goodwill, no further analysis is required. If the estimated fair value of a reporting unit is less than its carrying value, including allocated goodwill, a second step is performed to compute the amount of the impairment by determining an implied fair value of goodwill. The implied

fair value of goodwill is the residual fair value derived by deducting the fair value of a reporting unit's identifiable

55

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

assets and liabilities from its estimated fair value calculated in the first step. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we record an impairment charge equal to the difference.

We estimate the fair value of each reporting unit using both market and income approaches.

The market approach consists of the guideline public company method which is a valuation technique where the fair value is calculated based on market prices obtained from a detailed market analysis of publicly traded companies that provide a reasonable basis of comparison for each reporting unit. Valuation ratios are selected that relate market prices to selected financial metrics from comparable companies. These ratios are applied after consideration of adjustments and weightings related to financial position, growth, volatility, working capital movement and other factors. Due to the fact that stock prices of comparable companies represent minority interests we also consider an acquisition control premium to reflect the impact of additional value associated with a controlling interest.

The income approach is a valuation technique where the fair value is calculated based on forecasted future cash flows within the projection period discounted back to the present value with appropriate risk adjusted discount rates, which represent the weighted-average cost of capital (WACC) for each reporting unit. This includes assessing the cost of equity and debt capital as of the valuation date. In addition, a terminal value is developed for forecasted future cash flows beyond the projection period discounted back to the present value. The forecasts used in our estimation of fair value are developed by management based on known business and market considerations.

Each model is based upon certain key assumptions that require the exercise of significant judgment including judgments for the use of appropriate financial projections, economic expectations, discount rates and WACC as well as using available market data. The goodwill impairment test process also requires management to make significant judgments and assumptions, including revenue, profit, expected long-term growth rates, and cash flow forecasts about the reporting units to which goodwill is assigned.

As described in our risk factors disclosed in our Annual Report Form 10-K for the fiscal year ended January 31, 2014, we face continued uncertainty in our business environment due to the substantial fiscal and economic challenges facing the U.S. Government, our primary customer, as well as challenges in our commercial businesses. Adverse changes in fiscal, regulatory, and economic conditions, such as the manner in which the budget cuts are implemented, including sequestration, and issues related to the nation's debt ceiling, could adversely impact our future revenues and profitability. These circumstances could result in an impairment of goodwill. Also, adverse equity market conditions that result in a decline in market multiples and our stock price could result in an impairment of goodwill.

Recently Adopted and Issued Accounting Pronouncements

For a discussion of these items, see Note 1 - Summary of Significant Accounting Policies of the combined notes to the condensed consolidated financial statements for the three months ended October 31, 2014 contained within this Quarterly Report on Form 10-Q.

Effects of Inflation

Approximately 47% of our revenues are derived from cost-reimbursement type contracts, which are generally completed within one year. Bids for long-term FFP and T&M and FP-LOE contracts typically include sufficient provisions for labor and other cost escalations to cover anticipated cost increases over the period of performance. As a result, our revenues and costs have generally both increased commensurate with inflation and net income as a percentage of total revenues has not been significantly affected.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to certain market rate risks in the normal course of business. Our current market risk exposures are primarily related to interest rates and foreign currency fluctuations. Our risk management policy authorizes, with board of directors' approval, the limited use of derivative instruments to hedge specific interest rate risks.

During the third quarter of fiscal 2015, we entered into interest rate swap agreements on our \$450 million fixed rate 4.45% notes maturing in December 2020. The interest rate swap agreements effectively converted a portion of our fixed-rate debt to floating-rate debt tied to the changes in the six-month LIBOR benchmark interest rate. As a result, we may experience fluctuations in interest expense.

For further discussion of our market risk associated with interest rate risk and foreign currency risk as of January 31, 2014, see "Quantitative and Qualitative Disclosures about Market Risk" in Part II of our Annual Report on Form 10-K for the fiscal year ended January 31, 2014.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer (our Chief Executive Officer) and principal financial officer (our Executive Vice President and Chief Financial Officer), has evaluated the effectiveness of Leidos' and Leidos, Inc.'s disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) as of October 31, 2014, and our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in Leidos' or Leidos, Inc.'s internal control over financial reporting that occurred in the quarterly period covered by this report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

We have provided information about legal proceedings in which we are involved in Note 12 - Legal Proceedings of the combined notes to the condensed consolidated financial statements for the three months ended October 31, 2014 contained within this Quarterly Report on Form 10-Q.

In addition to the matters disclosed in Note 12, we are routinely subject to investigations and reviews relating to compliance with various laws and regulations. Additional information regarding such investigations and reviews is set forth in Note 13 - Other Commitments and Contingencies—Government Investigations and Reviews of the combined notes to the condensed consolidated financial statements for the three months ended October 31, 2014 contained within this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors.

There were no material changes from the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(c) Purchases of Equity Securities by the Company

In December 2013, our board of directors authorized a stock repurchase program (2013 Stock Repurchase Program) under which we may repurchase up to 20 million shares of Leidos common stock. This share repurchase authorization replaced the March 2012 share repurchase authorization of 10 million shares. Stock repurchases may be made on the open market or in privately negotiated transactions with third parties including through accelerated share repurchase agreements. Whether repurchases are made and the timing and actual number of shares repurchased depends on a variety of factors including price, corporate capital requirements, other market conditions, and regulatory requirements. The repurchase program may be accelerated, suspended, delayed or discontinued at any time.

The following table presents repurchases of Leidos common stock during the quarter ended October 31, 2014:

| Period | (a) Total Number of Shares (or Units) Purchased ⁽¹⁾ | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Repurchase Plans or Programs ⁽²⁾ | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs ⁽²⁾ |
|----------------------------------------|----------------------------------------------------------------------------|-----------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| August 2, 2014 - August 31, 2014 | 599 | \$ 37.20 | — | 8,113,674 |
| September 1, 2014 - September 30, 2014 | 10,984 | 37.27 | — | 8,113,674 |
| October 1, 2014 - October 31, 2014 | 292 | 34.68 | — | 8,113,674 |
| Total | 11,875 | \$ 37.20 | — | |

The total number of shares purchased includes: (i) shares surrendered to satisfy statutory tax withholdings (1) obligations related to vesting of restricted stock awards; and (ii) shares surrendered in payment of the exercise price of non-qualified stock options and/or to satisfy statutory tax withholdings obligations.

(2) We may repurchase up to 20 million shares of Leidos common stock under the 2013 Stock Repurchase Program, which was publicly announced in December 2013.

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

| Exhibit Number | Description of Exhibit |
|----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Amendment No. 2 to the Amended and Restated Four Year Credit Agreement dated as of March 11, 2011, as amended by Amendment No.1 dated as of April 19, 2013, among Leidos Holdings, Inc., as borrower, and Leidos, Inc., as guarantor, Citibank, N.A., as administrative agent and the other lending institutions party thereto. Incorporated by reference to Exhibit 10.1 to our Form 8-K filed on October 20, 2014 with the SEC. |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | Interactive Data File. |

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

SIGNATURES

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

Date: December 3, 2014

Leidos Holdings, Inc.

/s/ Mark W. Sopp

Mark W. Sopp

Executive Vice President and Chief Financial Officer and
as a duly authorized officer

Date: December 3, 2014

Leidos, Inc.

/s/ Mark W. Sopp

Mark W. Sopp

Executive Vice President and Chief Financial Officer and
as a duly authorized officer

LEIDOS HOLDINGS, INC.
LEIDOS, INC.

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