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>>> CRITICAL ACCOUNTING POLICIES

The Company has identified the following accounting policies that require significant judgment. The Company believes its judgments related to these accounting policies are appropriate.

Sales under long-term government contracts are recorded under the percentage of completion method. Incurred costs and estimated gross margins are recorded as sales as work is performed based on the percentage that incurred costs bear to estimated total costs using the Company's estimates of costs and contract value. Cost estimates include direct and indirect costs such as labor, materials, warranty, and overhead. Some contracts contain incentive provisions based upon performance in relation to established targets which are included at estimated realizable value. Contract change orders and claims are included when they can be reliably estimated and realization is probable. Due to the long-term nature of many of the Company's programs, developing estimates of costs and contract value often requires significant judgment. Factors that must be considered in estimating the work to be completed and ultimate contract recovery include labor productivity and availability, the nature and complexity of the work to be performed, the impact of change orders, availability of materials, the impact of delayed performance, availability and timing of funding from the customer, award fee estimations, and the recoverability of claims. In 2003, 2002, and 2001, operating income as a percent of net sales for the defense businesses did not vary by more than 1.5 percent. If operating income as a percent of net sales for the defense businesses had been higher or lower by 1.5 percent in 2003, the Company's operating income would have changed by approximately \$250 million.

The Company uses lot accounting for new commercial aircraft introductions at Raytheon Aircraft. Lot accounting involves selecting an initial lot size at the time a new aircraft begins to be delivered and measuring an average cost over the entire lot for each aircraft sold. The costs attributed to aircraft delivered are based on the estimated average cost of all aircraft in the lot and are determined under the learning curve concept which anticipates a predictable decrease in unit costs from cost reduction initiatives and as tasks and production techniques become more efficient through repetition. Once production costs stabilize, which is expected by the time the initial lot has been completed, the use of lot accounting is discontinued. The selection of lot size is a critical judgment. The Company determines lot size based on several factors, including the size of firm backlog, the expected annual production for the aircraft, and experience on similar new aircraft. The size of the initial lot for the Beechcraft Premier I, the only aircraft the Company is currently utilizing lot accounting for, is 200 units. In 2003, the Company recorded a pretax charge of \$22 million to reflect the expected loss on the initial lot. A five percent increase in

the remaining estimated cost to produce the aircraft would reduce the Company's operating income by approximately \$20 million.

The valuation of used aircraft in inventories, which are stated at cost, but not in excess of realizable value, requires significant judgment. As part of the assessment of realizable value, the Company must evaluate many factors including current market conditions, future market conditions, the age and condition of the aircraft, and availability levels for the aircraft in the market. A five percent decrease in the aggregate realizable value of used aircraft in inventory at December 31, 2003, would result in an impairment charge of approximately \$20 million. The valuation of aircraft materials and parts which support the worldwide fleet of aircraft, which are stated at cost, but not in excess of realizable value, also requires significant judgment. As part of the assessment of realizable value, the Company must evaluate many factors including the expected useful life of the aircraft, some of which have remained in service for up to 50 years. A five percent decrease in the aggregate realizable value of aircraft materials and purchased parts at December 31, 2003, would result in an impairment charge of approximately \$15 million.

The Company evaluates the recoverability of long-lived assets upon indication of possible impairment by measuring the carrying amount of the assets against the related estimated undiscounted cash flows. When an evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value of the assets, the asset is adjusted to its estimated fair value. The determination of what constitutes an indication of possible impairment, the estimation of future cash flows, and the determination of estimated fair value are all significant judgments. In addition, the Company performs an annual goodwill impairment test in the fourth quarter of each year. The Company estimates the fair value of reporting units using a discounted cash flow model based on the Company's most recent five-year plan and compares the estimated fair value to the net book value of the reporting unit, including goodwill. Preparation of forecasts for use in the five-year plan involve significant judgments. Changes in these forecasts could affect the estimated fair value of certain of the Company's reporting units and could result in a goodwill impairment charge in a future period.

The Company has pension plans covering the majority of its employees, including certain employees in foreign countries. The selection of the assumptions used to determine pension expense or income involves significant judgment. The Company's long-term return on asset (ROA) and discount rate assumptions are considered to be the key variables in determining pension expense or income. To develop the long-term ROA assumption, the Company considered the current level of expected returns on risk-free investments, the historical level of the risk premium associated with the

\$766 million or 4.8 percent of sales in 2001. Excluding goodwill amortization, operating income was \$1,100 million or 6.9 percent of sales in 2001. The changes in operating income by segment are described below in Segment Results.

Interest expense from continuing operations was \$537 million in 2003, \$497 million in 2002, and \$696 million in 2001. In 2002 and 2001, the Company allocated \$79 million and \$18 million, respectively, of interest expense to discontinued operations. The Company did not allocate interest expense to discontinued operations in 2003 as described below in Discontinued Operations. Total interest expense was \$576 million in 2002 and \$714 million in 2001. The decrease in interest expense in 2003 was due to a lower weighted-average cost of borrowing. The decrease in 2002 was due to lower average debt and a lower weighted-average cost of borrowing due, in part, to the interest rate swaps entered into in 2001, described below in Capital Structure and Resources. The weighted-average cost of borrowing was 6.0 percent in 2003, 6.7 percent in 2002, and 7.1 percent in 2001.

Interest income was \$50 million in 2003, \$27 million in 2002, and \$36 million in 2001. The increase in interest income was due to interest on long-term receivables brought onto the Company's books as part of the buy-out of the Aircraft Receivables Facility in the fourth quarter of 2002, described below in Financial Condition and Liquidity.

Other expense, net was \$67 million in 2003, \$237 million in 2002, and \$6 million in 2001. Included in other expense, net in 2003 was a \$77 million charge related to the Company's repurchase of long-term debt, described below in Capital Structure and Resources, and \$20 million of equity losses related to Flight Options[®] LLC, offset by an \$82 million gain from the sale of the Company's investment in its former aviation support business, both described below in Major Affiliated Entities. Included in other expense, net in 2002 was a \$175 million charge to write off the Company's investment in Space Imaging, Inc. and accrue for a related credit facility guarantee which the Company paid in 2003, described below in Major Affiliated Entities. Other income and expense also includes gains and losses on divestitures and equity losses in unconsolidated subsidiaries, as described in Note S, Other Income and Expense of the Notes to Consolidated Financial Statements.

The effective tax rate was 29.8 percent in 2003 and 29.7 percent in 2002, reflecting the U.S. statutory rate of 35 percent reduced by ESOP dividend deductions, foreign sales corporation tax credits, and research and development tax credits applicable to certain government contracts. The effective tax rate was 98.0 percent in 2001, reflecting the U.S. statutory rate of 35 percent reduced by foreign sales corporation tax credits and research and development tax credits applicable to certain government contracts, increased by non-deductible amortization of goodwill.

Excluding the effect of goodwill amortization, the effective tax rate was 29.3 percent in 2001. At December 31, 2003, the Company had net operating loss carryforwards of \$1.4 billion that expire in 2020 through 2023. The Company believes it will be able to utilize all of these carryforwards over the next 3 years.

Income from continuing operations was \$535 million or \$1.29 per diluted share on 415.4 million average shares outstanding in 2003, \$756 million or \$1.85 per diluted share on 408.0 million average shares outstanding in 2002, and \$2 million or \$0.01 per diluted share on 361.3 million average shares outstanding in 2001. Excluding goodwill amortization, income from continuing operations was \$307 million or \$0.85 per diluted share in 2001. The increase in average shares outstanding in 2003 was due primarily to benefit plan-related activity. The increase in average shares outstanding in 2002 was due primarily to the issuance of 14,375,000 and 31,578,900 shares of common stock in May and October 2001, respectively.

The loss from discontinued operations, net of tax, described below in Discontinued Operations, was \$170 million or \$0.41 per diluted share in 2003, \$887 million or \$2.17 per diluted share in 2002, and \$757 million or \$2.10 per diluted share in 2001.

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). This accounting standard addresses financial accounting and reporting for goodwill and other intangible assets and requires that goodwill amortization be discontinued and replaced with periodic tests of impairment. In accordance with SFAS No. 142, goodwill amortization was discontinued as of January 1, 2002. In 2002, the Company recorded a goodwill impairment charge of \$360 million related to its former Aircraft Integration Systems business (AIS) as a cumulative effect of change in accounting principle. Due to the non-deductibility of this goodwill, the Company did not record a tax benefit in connection with this impairment. Also in 2002, the Company completed the transitional review of the other businesses for potential goodwill impairment in accordance with SFAS No. 142 and recorded a goodwill impairment charge of \$185 million pretax or \$149 million after-tax, which represented all of the goodwill at Raytheon Aircraft, as a cumulative effect of change in accounting principle. The Company also determined that there was no impairment of goodwill related to any of the defense businesses beyond the \$360 million related to AIS. The total goodwill impairment charge in 2002 was \$545 million pretax, \$509 million after-tax, or \$1.25 per diluted share.

Net income was \$365 million or \$0.88 per diluted share in 2003 versus a net loss of \$640 million or \$1.57 per diluted share in 2002 and a net loss of \$755 million or \$2.09 per diluted share in 2001. Excluding goodwill amortization, the net loss was \$422 million or \$1.17 per diluted share in 2001.

due to charges affecting operating income totaling \$237 million which also resulted in a \$228 million reduction in sales. Performance deterioration in ten programs primarily within the Air Traffic Management Systems business and the Communications business resulted in a charge in the third quarter of 2003 of \$147 million. There were a number of unfavorable events that occurred on these ten programs including unsuccessful resolution of technical issues, inability to achieve production rates and milestones, customer directed delays and reductions in scheduled deliveries, and unfavorable rulings and negotiations on contractual matters. In the first six months of 2003, the Company recorded a \$50 million charge on two of these programs related to schedule and production delays. In addition to the ten programs, the Company recorded a charge of \$40 million in the third quarter of 2003 resulting from negative developments on a few claims and other performance issues in other parts of the business.

Space and Airborne Systems (SAS) provides electro-optical/infrared sensors, airborne radars, solid state high energy lasers, precision guidance systems, electronic warfare systems, and space-qualified systems for civil and military applications. SAS had 2003 sales of \$3.7 billion versus \$3.2 billion in 2002 and \$2.7 billion in 2001. The increase in sales in 2003 was due to higher sales on classified and Airborne Radar programs for the Air Force such as Multi-platform Radar Technology Insertion Program, B-2 Radar Modernization Program, F-15 Korea, and increased production of the F/A-22 Radar. Operating income was \$492 million in 2003 versus \$428 million in 2002 and \$339 million in 2001. Excluding goodwill amortization, operating income was \$416 million in 2001 or 15.2 percent of net sales.

Technical Services (TS) provides technical, scientific, and professional services for defense, federal, and commercial customers worldwide. TS had 2003 sales of \$2.0 billion versus \$2.1 billion in 2002 and 2001. The decrease in sales in 2003 was due to the loss of several key programs. Operating income was \$107 million in 2003 versus \$116 million in 2002 and \$123 million in 2001. Excluding goodwill amortization, operating income was \$148 million in 2001 or 7.2 percent of net sales. The decrease in operating income in 2003 was primarily due to write-offs of \$39 million related to an unfavorable change in scope on a long-term contract of \$22 million and a provision for the collectibility of certain unbilled costs of \$17 million. Included in operating income for 2002 was a \$28 million write-off of contract costs that the Company determined to be unbillable. The decrease was offset by a similarly sized reserve at corporate established by the Company in the second half of 2001 to address the issue.

Raytheon Aircraft Company (RAC) designs, manufactures, markets, and provides after-market support for business jets, turboprops, and piston-powered aircraft for the world's commercial, fractional ownership, and military aircraft markets. RAC had 2003

sales of \$2.1 billion versus \$2.0 billion in 2002 and \$2.5 billion in 2001. The decrease in sales in 2002 was due to lower aircraft deliveries, the divestiture of a majority interest in the Company's aviation support business in June 2001, and the divestiture of a majority interest in the Company's aircraft fractional ownership business in March 2002. Operating income was \$2 million in 2003 versus an operating loss of \$39 million in 2002 and \$77 million in 2001. Excluding goodwill amortization, RAC had an operating loss of \$69 million in 2001 or (2.8) percent of net sales.

The increase in operating income in 2003 was due to higher productivity and cost saving initiatives implemented over the last year. Included in 2003 operating income was a \$46 million favorable profit adjustment on the Joint Primary Aircraft Training System (JPATS) program partially offset by a \$22 million charge on the Premier program reflecting cost estimate increases. Included in 2002 operating income was a \$26 million favorable profit adjustment on the JPATS program. The Company has made a significant investment in its Premier aircraft, the realization of which is contingent upon future sales at forecasted prices and reductions in production costs on future deliveries. The Company continues to monitor the development costs and certification and delivery schedule of the Horizon aircraft with anticipated certification in the third quarter of 2004 and first delivery by year-end 2004. The Company continues to believe there is risk in the market outlook for both new and used aircraft.

The Other segment, which is comprised of Flight Options LLC (FO), Raytheon Airline Aviation Services LLC (RAAS), and Raytheon Professional Services LLC (RPS) had 2003 sales of \$573 million versus \$210 million in 2002 and \$207 million in 2001. FO offers services in the aircraft fractional ownership industry. RAAS is a unit formed to manage the Company's commuter aircraft business and Starship[®] aircraft portfolio. RPS works with customers to design and execute learning solutions. The increase in sales was due to the consolidation of FO in June 2003 as described below in Major Affiliated Entities. The Other segment had an operating loss of \$34 million in 2003 versus \$12 million in 2002 and \$758 million in 2001. The loss in 2003 included a \$32 million operating loss at RAAS due, in part, to an increase in a loan reserve on one major customer.

Included in the 2001 results was a charge of \$693 million related to the commuter aircraft business. This was a result of continued weakness in the commuter aircraft market and the impact of the events of September 11, 2001 on the commuter airline industry. During the first half of 2001, the Company experienced a significant decrease in the volume of used commuter aircraft sales. An evaluation of commuter aircraft market conditions and the events of September 11, 2001 indicated the market weakness would continue into the foreseeable future. As a result, the Company completed an analysis of the estimated fair value of the various models

claims prior to the settlement and the project owners assumed responsibility for all post-settlement obligations, including completing the construction of the projects, and all punch list and warranty obligations. The Company believes that the obligations retained on these projects are not material.

The Company recorded charges of \$176 million in 2003, \$796 million in 2002, and \$814 million in 2001 related to the Massachusetts Projects. The charges resulted from delays, labor and material cost growth, productivity issues, equipment and subcontractor performance, schedule liquidated damages, inaccurate estimates of field engineered materials, and disputed changes.

In addition to the Massachusetts Projects, the Company has or had obligations under Support Agreements on a number of other projects. In several cases, the Company has entered into settlement agreements that resolve the Company's obligations under the related Support Agreements. In connection with a number of other projects on which the Company has obligations under Support Agreements, the Company is continuing to undertake the final stages of work, which includes warranty obligations, commercial closeout, and claims resolution. In 2003, the Company recorded charges of \$6 million primarily related to the settlement of warranty claims on one of these projects. In 2002 and 2001, the Company recorded charges of \$53 million and \$210 million, respectively, for various issues in connection with these projects, including but not limited to, punch list items, start-up costs, reliability testing, and turbine-related delays. Finally, there are projects with Support Agreements provided by the Company on which WGI is continuing to perform work, which could present risk to the Company if WGI fails to meet its obligations in connection with those projects.

In performing its obligations under the remaining Support Agreements, the Company has various risks and exposures, including delays, equipment and subcontractor performance, warranty closeout, various liquidated damages issues, collection of amounts due under contracts, and potential adverse claims resolution under various contracts and leases. In addition, the Company's cost estimates for these obligations are heavily dependent upon third parties, including WGI, and their ability to perform construction management, cost estimating, and other tasks requiring industry expertise that the Company no longer possesses.

In 2003, the Company recorded charges of \$49 million for legal, management, and other costs related to RE&C versus \$38 million in 2002 and \$30 million in 2001. In 2002 and 2001, the Company allocated \$79 million and \$18 million, respectively, of interest expense to RE&C based upon actual cash outflows since the date of disposition. Since the Massachusetts Projects were nearing completion, the Company did not allocate interest expense to RE&C in 2003. In addition, in 2001, the Company recorded a

charge of \$71 million to write off certain assets and liabilities as a result of the WGI bankruptcy filing.

In 2003, 2002, and 2001, the pretax loss from discontinued operations related to RE&C was \$231 million, \$966 million, and \$1,143 million, respectively.

Net cash used in operating activities from discontinued operations related to RE&C was \$513 million in 2003 versus \$1,129 million in 2002 and \$635 million in 2001. The Company expects its operating cash flow to be negatively affected by approximately \$50 million to \$75 million in 2004 which includes project completion, legal, and management costs related to RE&C. Further increases to project costs may increase the estimated operating cash outflow for RE&C in 2004.

In 2002, the Company sold its Aircraft Integration Systems business (AIS) for \$1,123 million, net, subject to purchase price adjustments. The Company is currently involved in a purchase price dispute related to the sale of AIS. There was no pretax gain or loss on the sale of AIS, however, due to the non-deductible goodwill associated with AIS, the Company recorded a tax provision of \$212 million, resulting in a \$212 million after-tax loss on the sale of AIS. As part of the transaction, the Company retained the responsibility for performance of the Boeing Business Jet[®] (BBJ) program. The Company also retained \$106 million of BBJ-related assets, \$18 million of receivables and other assets, and rights to a \$25 million jury award related to a 1999 claim against Learjet. At December 31, 2003, the balance of these retained assets was \$45 million.

In 2003, the Company recorded charges related to AIS of \$17 million related to cost growth on the BBJ program and \$13 million as a result of continued difficulty the Company has been experiencing liquidating the BBJ-related assets. In 2002, the Company recorded charges of \$66 million, which included a \$23 million write-down of a BBJ-related aircraft owned by the Company, a \$28 million charge for cost growth on one of the two BBJ aircraft not yet delivered, and a \$10 million charge to write down other BBJ-related assets to the then estimated net realizable value, offset by a \$13 million gain resulting from the finalization of the 1999 claim, described above. The write-down of the BBJ-related aircraft resulted from the Company's decision to market this aircraft unfinished due to the environment of declining prices for BBJ-related aircraft at the time. The Company was previously marketing this aircraft as a customized executive BBJ.

In 2003 and 2002, the pretax loss from discontinued operations related to AIS was \$30 million and \$47 million, respectively. In 2001, pretax income from discontinued operations related to AIS was \$5 million.

from 1.6% to 8.3% and matures at various dates through 2028. Total debt as a percentage of total capital was 44.7 percent and 48.3 percent at December 31, 2003 and 2002, respectively.

In 2003, the Company issued \$425 million of long-term debt and used the proceeds to reduce the amounts outstanding under the Company's lines of credit. Also in 2003, the Company issued \$500 million of fixed rate long-term debt and \$200 million of floating rate notes and used the proceeds to partially fund the repurchase of long-term debt with a par value of \$924 million. The Company has on file a shelf registration with the Securities and Exchange Commission registering the issuance of up to \$3.0 billion in debt securities, common or preferred stock, warrants to purchase any of the aforementioned securities, and/or stock purchase contracts, under which \$1.3 billion remained outstanding at December 31, 2003.

In December 2003, the Company entered into various interest rate swaps that correspond to a portion of the Company's fixed rate debt in order to effectively hedge interest rate risk. The \$250 million notional value of the interest rate swaps effectively converted a portion of the Company's total debt to variable rate debt.

In 2002, the Company issued \$575 million of long-term debt to reduce the amounts outstanding under the Company's lines of credit. Also in 2002, the Company repurchased debt with a par value of \$96 million.

In 2001, the Company entered into various interest rate swaps that corresponded to a portion of the Company's fixed rate debt in order to effectively hedge interest rate risk. In 2002, the Company closed out these interest rate swaps and received proceeds of \$95 million which are being amortized over the remaining life of the debt as a reduction to interest expense. At December 31, 2003, the unamortized balance was \$45 million. Also in 2001, the Company repurchased long-term debt with a par value of \$1,375 million.

The Company's most restrictive bank agreement covenant is an interest coverage ratio that currently requires earnings before interest, taxes, depreciation, and amortization (EBITDA), excluding certain charges, to be at least 2.5 times net interest expense for the prior four quarters. In July 2003, the covenant was amended to exclude pretax charges of \$100 million related to RE&C and in October 2003, the covenant was further amended to exclude \$226 million of pretax charges related to Network Centric Systems and Technical Services and \$78 million of pretax charges related to RE&C. In July 2002, the covenant was amended to exclude charges of \$450 million related to discontinued operations. In the third quarter of 2004, the interest coverage ratio will require EBITDA to be at least 3.0 times net interest expense for the prior four quarters. The Company was in compliance with the interest coverage ratio covenant, as amended, during 2003 and expects to continue to be in compliance throughout 2004.

Credit ratings for the Company were assigned by Fitch's at F3 for short-term borrowing and BBB- for senior debt, by Moody's at P-3 for short-term borrowing and Baa3 for senior debt, and by Standard and Poor's at A-3 for short-term borrowing and BBB- for senior debt.

Lines of credit with certain commercial banks exist to provide short-term liquidity. The lines of credit bear interest based upon LIBOR and were \$2.7 billion at December 31, 2003, consisting of \$1.4 billion which matures in November 2004 and \$1.3 billion which matures in 2006. The lines of credit were \$2.85 billion at December 31, 2002. There were no borrowings under the lines of credit at December 31, 2003, however, the Company had approximately \$300 million of outstanding letters of credit which effectively reduced the Company's borrowing capacity under the lines of credit to \$2.4 billion. There were no borrowings under the lines of credit at December 31, 2002.

Credit lines with banks are also maintained by certain foreign subsidiaries to provide them with a limited amount of short-term liquidity. These lines of credit were \$99 million and \$79 million at December 31, 2003 and 2002, respectively. There was \$1 million outstanding under these lines of credit at December 31, 2003 and 2002.

In May 2001, the Company issued 17,250,000, 8.25% equity security units for \$50 per unit totaling \$837 million, net of offering costs of \$26 million. The net proceeds of the offering were used to reduce debt and for general corporate purposes. Each equity security unit consists of a contract to purchase shares of the Company's common stock on May 15, 2004, which will result in cash proceeds to the Company of \$863 million, and a mandatorily redeemable equity security, with a stated liquidation amount of \$50 due on May 15, 2006, which will require a cash payment by the Company of \$863 million. The contract obligates the holder to purchase, for \$50, shares of common stock equal to the settlement rate. The settlement rate is equal to \$50 divided by the average market value of the Company's common stock at that time. The settlement rate cannot be greater than 1.8182 or less than 1.4903 shares of common stock per purchase contract. The terms of the equity security units required that the mandatorily redeemable equity securities be remarketed. On February 11, 2004, the mandatorily redeemable equity securities were remarketed and the quarterly distribution rate was reset at 7%. The Company did not receive any proceeds from the remarketing. The proceeds were pledged to collateralize the holders' obligations under the contract to purchase the Company's common stock on May 15, 2004.

In May 2001, the Company issued 14,375,000 shares of common stock for \$27.50 per share. In October 2001, the Company

venture in the joint venture's capacity as prime contractor. Accordingly, the Company records the work it performs for the joint venture as operating activity.

>>> COMMITMENTS AND CONTINGENCIES

Defense contractors are subject to many levels of audit and investigation. Agencies that oversee contract performance include: the Defense Contract Audit Agency, the Department of Defense Inspector General, the General Accounting Office, the Department of Justice, and Congressional Committees. The Department of Justice, from time to time, has convened grand juries to investigate possible irregularities by the Company. Except as noted in the following paragraphs, individually and in the aggregate, these investigations are not expected to have a material adverse effect on the Company's financial position or results of operations.

In 2002, the Company received service of a grand jury subpoena issued by the United States District Court for the Central District of California. The subpoena seeks documents related to the activities of an international sales representative engaged by the Company related to a foreign military sales contract in Korea in the late 1990s. The Company has cooperated fully in the investigation including producing documents in response to the subpoena. The Company has in place appropriate compliance policies and procedures, and believes its conduct has been consistent with those policies and procedures.

The Company continues to cooperate with the staff of the Securities and Exchange Commission (SEC) on a formal investigation related to the Company's accounting practices primarily related to the commuter aircraft business and the timing of revenue recognition at Raytheon Aircraft. The Company has been providing documents and information to the SEC staff. In addition, certain present and former officers and employees of the Company have provided testimony in connection with this investigation. The Company is unable to predict the outcome of the investigation or any action that the SEC might take.

In late 1999, the Company and two of its officers were named as defendants in several class action lawsuits which were consolidated into a single complaint in June 2000, when four additional former or present officers were named as defendants (the "Consolidated Complaint"). The Consolidated Complaint principally alleges that the defendants violated federal securities laws by making misleading statements and by failing to disclose material information concerning the Company's financial performance during the purported class period. In March 2000, the court certified the class of plaintiffs as those people who purchased the Company's stock between October 7, 1998 and October 12, 1999. In August 2001, the court issued an order dismissing most of the claims asserted against the Company and the individual defendants. In March 2003, the plaintiff filed an amendment to the Consolidated Complaint which sought to add the Company's

independent auditor as an additional defendant. In May 2003, the court issued an order dismissing one of the two claims that had been asserted against the Company's independent auditor. In February 2004, the Company and the individual defendants filed a motion for summary judgment, which the plaintiff opposes. A hearing on the summary judgment motion is scheduled for April 2004. The Court has scheduled a trial to begin in May 2004. The Company's independent auditor has also filed a motion for summary judgment which the plaintiff opposes.

In 1999 and 2000, the Company was named as a nominal defendant and all of its directors at the time (except one) were named as defendants in purported derivative lawsuits. The derivative complaints contain allegations similar to those included in the Consolidated Complaint and further allege that the defendants breached fiduciary duties to the Company and allegedly failed to exercise due care and diligence in the management and administration of the affairs of the Company. In December 2001, the Company and the individual defendants filed a motion to dismiss one of the derivative lawsuits. These actions have since been consolidated, and the plaintiffs have filed a consolidated amended complaint. In April 2003, the defendants filed a motion to dismiss the consolidated amended complaint.

In June 2001, a class action lawsuit was filed on behalf of all purchasers of common stock or senior notes of WGI during the class period of April 17, 2000 through March 1, 2001 (the "WGI Complaint"). The plaintiff class claims to have suffered harm by purchasing WGI securities because the Company and certain of its officers allegedly violated federal securities laws by misrepresenting the true financial condition of RE&C in order to sell RE&C to WGI at an artificially inflated price. An amended complaint was filed in October 2001 alleging similar claims. The Company and the individual defendants filed a motion seeking to dismiss the action in November 2001. In April 2002, the motion to dismiss was denied. The defendants have filed their answer to the amended complaint and discovery is proceeding. In April 2003, the District Court conditionally certified the class and defined the class period as that between April 17, 2000 and March 2, 2001, inclusive. The defendants have filed their answer to the amended complaint and discovery is proceeding.

In July 2001, the Company was named as a nominal defendant and all of its directors at the time have been named as defendants in two identical purported derivative lawsuits. These lawsuits were consolidated into one action (the "Consolidated Amended Derivative Complaint") in January 2004 and contain allegations similar to those included in the WGI Complaint and further allege that the individual defendants breached fiduciary duties to the Company and failed to maintain systems necessary for prudent management and control of the Company's operations. The defendants filed a motion to dismiss the Consolidated Amended Derivative Complaint in March 2004.

The Company currently estimates that pension plan cash contributions will be approximately \$320 million in 2004 and \$315 million in 2005. These estimates are based upon certain assumptions, outlined above in Critical Accounting Policies, and contemplate passage of the Pension Funding Equity Act, which will provide a certain amount of pension funding relief to the Company. The estimate for 2005 is subject to change and will not be known with certainty until the Company's SFAS No. 87 assumptions are updated at the end of 2004. Estimates for 2006 and beyond have not been provided due to the significant uncertainty of these amounts, which are subject to change until the Company's SFAS No. 87 assumptions can be updated at the appropriate times. In addition, pension contributions are eligible for future recovery through the pricing of products and services to the U.S. government, therefore, the amounts noted above are not necessarily indicative of the impact these contributions will have on the Company's liquidity.

At December 31, 2003, RAC had unconditional purchase obligations of \$29 million primarily related to component parts for the Horizon aircraft with varying purchase quantities for up to 200 aircraft. In addition, the Company's defense businesses may enter into purchase commitments which can generally be recovered through the pricing of products and services to the U.S. government. These unconditional purchase obligations are not included in the table above.

>>> ACCOUNTING STANDARDS

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 (FIN 46). FIN 46 addresses the consolidation of certain variable interest entities (VIEs) and may be applied prospectively with a cumulative effect adjustment or by restating previously issued financial statements with a cumulative effect adjustment as of the beginning of the first year restated. In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 (FIN 46R). FIN 46R significantly narrowed the original scope of FIN 46 by excluding entities possessing certain characteristics, among other things. FIN 46R deferred the effective date of FIN 46 for interests held in VIEs created before February 1, 2003, except for special purpose entities as defined by FIN 46R, until the end of the first interim period ending after March 15, 2004. The adoption of FIN 46R is not expected to have a material effect on the Company's financial position or results of operations.

In December 2003, the FASB issued Statement of Financial Accounting Standards No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106. Information about foreign plans is required by this accounting standard for

fiscal years ending after June 15, 2004, including additional disclosures about assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans.

>>> FORWARD-LOOKING STATEMENTS

Certain statements made in this report, including any statements related to the Company's future plans, objectives, and projected future financial performance, contain or are based on, forward-looking statements within the meaning of the federal security laws. Specifically, statements that are not historical facts, including statements accompanied by words such as "believe," "expect," "estimate," "intend," or "plan," and variations of these words and similar expressions, are intended to identify forward-looking statements and convey the uncertainty of future events or outcomes. The Company cautions readers that any such forward-looking statements are based on assumptions that the Company believes are reasonable, but are subject to a wide range of risks, and actual results may differ materially. The Company expressly disclaims any current intention to provide updates to forward-looking statements, and the estimates and assumptions associated with them, after the date of this report. Important factors that could cause actual results to differ include, but are not limited to: the ability to obtain or the timing of obtaining future government awards; the availability of government funding; changes in government or customer priorities due to program reviews or revisions to strategic objectives; difficulties in developing and producing operationally advanced technology systems; termination of government contracts; program performance, including resolution of claims, particularly at Network Centric Systems; timing of contract payments; the performance of critical subcontractors; government import and export policies and other government regulations; the ultimate resolution of contingencies and legal matters, including investigations; the effect of market conditions, particularly in relation to the general aviation and commuter aircraft markets; the uncertainty of the timing and amount of net realizable value of Boeing Business Jet-related assets; risks inherent with large long-term fixed price contracts, particularly the ability to contain cost growth and programs which anticipate significant future cost improvements; conflicts with other investors in joint ventures and less than wholly-owned businesses; the Company's lack of construction industry expertise resulting from the Company's sale of its former engineering and construction businesses; and the impact of change orders, the recoverability of the Company's claims, and the outcome of defending claims asserted against the Company; among other things. Further information regarding the factors that could cause actual results to differ materially from projected results can be found in the Company's filings with the Securities and Exchange Commission, including "Item 1-Business" in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

ALLOWANCE FOR DOUBTFUL ACCOUNTS The Company maintains an allowance for doubtful accounts to provide for the estimated amount of accounts receivable that will not be collected. The allowance is based upon an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivables, and collateral to the extent applicable. Activity related to the allowance for doubtful accounts was as follows:

<i>(In millions)</i>	
Balance at December 31, 2000	\$132
Provisions	2
Utilizations	(21)
Balance at December 31, 2001	113
Provisions	2
Utilizations	(42)
Balance at December 31, 2002	73
Provisions	1
Utilizations	(39)
Balance at December 31, 2003	\$ 35

PREPAID EXPENSES AND OTHER CURRENT ASSETS

Included in prepaid expenses and other current assets at December 31, 2002 was \$56 million of cash received in 2002 that was restricted for payment in connection with the Company's merger with the defense business of Hughes Electronics Corporation in December 1997. Also included at December 31, 2002 was \$48 million of restricted cash from the sale of the Company's corporate headquarters. This cash was used to fund the construction of the Company's new corporate headquarters and the acquisition of three other properties. In June 2003, the restrictions related to the use of this cash expired, therefore, the remaining \$10 million that had not yet been spent was reflected in the statement of cash flows as proceeds from sales of property, plant, and equipment in 2003.

CONTRACTS IN PROCESS Contracts in process are stated at cost plus estimated profit but not in excess of realizable value.

INVENTORIES Inventories are stated at cost (principally first-in, first-out or average cost), but not in excess of realizable value. A provision for excess or inactive inventory is recorded based upon an analysis that considers current inventory levels, historical usage patterns, and future sales expectations.

PROPERTY, PLANT, AND EQUIPMENT Property, plant, and equipment are stated at cost. Major improvements are capitalized while expenditures for maintenance, repairs, and minor improvements are charged to expense. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation and amortization are eliminated from the accounts and any resulting gain or loss is reflected in income. Gains and losses resulting from the sale of property, plant, and equipment at the defense busi-

nesses are included in overhead and reflected in the pricing of products and services to the U.S. government.

Provisions for depreciation are generally computed using a combination of accelerated and straight-line methods. Depreciation provisions are based on estimated useful lives as follows: buildings – 20 to 45 years, machinery and equipment – 3 to 10 years, and equipment leased to others – 5 to 10 years. Leasehold improvements are amortized over the lesser of the remaining life of the lease or the estimated useful life of the improvement.

IMPAIRMENT OF LONG-LIVED ASSETS Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). This accounting standard addresses financial accounting and reporting for goodwill and other intangible assets and requires that goodwill amortization be discontinued and replaced with periodic tests of impairment. A two-step impairment test is used to first identify potential goodwill impairment and then measure the amount of goodwill impairment loss, if any.

In 2002, the Company recorded a goodwill impairment charge of \$360 million related to its former Aircraft Integration Systems business (AIS) as a cumulative effect of change in accounting principle. The fair value of AIS was determined based upon the proceeds received by the Company in connection with the sale, as described in Note B, Discontinued Operations. Due to the non-deductibility of this goodwill, the Company did not record a tax benefit in connection with this impairment. Also in 2002, the Company completed the transitional review for potential goodwill impairment in accordance with SFAS No. 142 and recorded a goodwill impairment charge of \$185 million pretax or \$149 million after-tax, which represented all of the goodwill at Raytheon Aircraft, as a cumulative effect of change in accounting principle. The fair value of Raytheon Aircraft was determined using a discounted cash flow approach. The total goodwill impairment charge in 2002 was \$545 million pretax, \$509 million after-tax, or \$1.25 per diluted share. The Company performs the annual impairment test in the fourth quarter of each year. There was no goodwill impairment associated with the annual impairment test performed in the fourth quarter of 2003 and 2002.

The amount of goodwill by segment at December 31, 2003 was \$751 million for Integrated Defense Systems, \$1,349 million for Intelligence and Information Systems, \$3,438 million for Missile Systems, \$2,306 million for Network Centric Systems, \$2,639 million for Space and Airborne Systems, \$868 million for Technical Services, and \$128 million for Other. Information about additions to goodwill in 2003 is included in Note C, Acquisitions and Divestitures and Note H, Other Assets.

COMPREHENSIVE INCOME Comprehensive income and its components are presented in the statement of stockholders' equity.

Accumulated other comprehensive income consisted of the following at December 31:

<i>(In millions)</i>	2003	2002
Minimum pension liability	\$(2,240)	\$(2,122)
Unrealized losses on interest-only strips	(2)	(2)
Interest rate lock	(1)	(2)
Foreign exchange translation	24	(58)
Cash flow hedges	24	5
Unrealized gains (losses) on investments	1	(1)
Total	\$(2,194)	\$(2,180)

The minimum pension liability adjustment is shown net of tax benefits of \$1,195 million and \$1,132 million at December 31, 2003 and 2002, respectively. The unrealized losses on interest-only strips are shown net of tax benefits of \$1 million at December 31, 2003 and 2002. The interest rate lock is shown net of tax benefits of \$1 million at December 31, 2003 and 2002. The cash flow hedges are shown net of tax liabilities of \$13 million and \$3 million at December 31, 2003 and 2002, respectively.

TRANSLATION OF FOREIGN CURRENCIES Assets and liabilities of foreign subsidiaries are translated at current exchange rates and the effects of these translation adjustments are reported as a component of accumulated other comprehensive income in stockholders' equity. Deferred taxes are not recognized for translation-related temporary differences of foreign subsidiaries as their undistributed earnings are considered to be permanently invested. Income and expenses in foreign currencies are translated at the weighted-average exchange rate during the period. Foreign exchange transaction gains and losses in 2003, 2002, and 2001 were not material.

PENSION COSTS The Company has several pension and retirement plans covering the majority of employees, including certain employees in foreign countries. Annual charges to income are made for the cost of the plans, including current service costs, interest on projected benefit obligations, and net amortization and deferrals, increased or reduced by the return on assets. Unfunded accumulated benefit obligations are accounted for as a long-term liability. The Company funds annually those pension costs which are calculated in accordance with Internal Revenue Service regulations and standards issued by the Cost Accounting Standards Board.

INTEREST RATE AND FOREIGN CURRENCY CONTRACTS The Company meets its working capital requirements with a combination of variable rate short-term and fixed rate long-term financing. The Company enters into interest rate swap agreements or interest rate locks with commercial and investment banks primarily to manage interest rates associated with the Company's financing

arrangements. The Company also enters into foreign currency forward contracts with commercial banks only to fix the dollar value of specific commitments and payments to international vendors and the value of foreign currency denominated receipts. The hedges used by the Company are transaction driven and are directly related to a particular asset, liability, or transaction for which a commitment is in place. These instruments are executed with credit-worthy institutions and the majority of the foreign currencies are denominated in currencies of major industrial countries. The Company does not hold or issue financial instruments for trading or speculative purposes.

FAIR VALUE OF FINANCIAL INSTRUMENTS The estimated fair value of certain financial instruments, including cash, cash equivalents, and short-term debt approximates the carrying value due to their short maturities and varying interest rates. The estimated fair value of notes receivable approximates the carrying value based principally on the underlying interest rates and terms, maturities, collateral, and credit status of the receivables. The estimated fair value of investments, other than those accounted for under the cost or equity method, are based on quoted market prices. The estimated fair value of long-term debt of approximately \$7.0 billion at December 31, 2003 was based on quoted market prices.

Estimated fair values for financial instruments are based on pricing models using current market information. The amounts realized upon settlement of these financial instruments will depend on actual market conditions during the remaining life of the instruments.

EMPLOYEE STOCK PLANS Proceeds from the exercise of stock options under employee stock plans are credited to common stock at par value and the excess is credited to additional paid-in capital. The fair value at the date of award of restricted stock is credited to common stock at par value and the excess is credited to additional paid-in capital. The fair value is charged to income as compensation expense over the vesting period. Income tax benefits arising from employees' premature disposition of stock option shares and exercise of nonqualified stock options are credited to additional paid-in capital.

The Company applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, in accounting for its stock-based compensation plans. Accordingly, no compensation expense has been recognized for its stock-based compensation plans other than for restricted stock.

Had compensation expense for the Company's stock option plans been determined based on the fair value at the grant date for awards under these plans, consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, the

claims prior to the settlement and the project owners assumed responsibility for all post-settlement obligations, including completing the construction of the projects, and all punch list and warranty obligations. The Company believes that the obligations retained on these projects are not material.

The Company recorded charges of \$176 million in 2003, \$796 million in 2002, and \$814 million in 2001 related to the Massachusetts projects. The charges resulted from delays, labor and material cost growth, productivity issues, equipment and subcontractor performance, schedule liquidated damages, inaccurate estimates of field engineered materials, and disputed changes.

In addition to the Massachusetts Projects, the Company has or had obligations under Support Agreements on a number of other projects. In several cases, the Company has entered into settlement agreements that resolve the Company's obligations under the related Support Agreements. In connection with a number of other projects on which the Company has obligations under Support Agreements, the Company is continuing to undertake the final stages of work, which includes warranty obligations, commercial closeout, and claims resolution. In 2003, the Company recorded charges of \$6 million primarily related to the settlement of warranty claims on one of these projects. In 2002 and 2001, the Company recorded charges of \$53 million and \$210 million, respectively, for various issues in connection with these projects, including but not limited to, punch list items, start-up costs, reliability testing, and turbine-related delays. Finally, there are projects with Support Agreements provided by the Company on which WGI is continuing to perform work, which could present risk to the Company if WGI fails to meet its obligations in connection with those projects.

In performing its obligations under the remaining Support Agreements, the Company has various risks and exposures, including delays, equipment and subcontractor performance, warranty closeout, various liquidated damages issues, collection of amounts due under contracts, and potential adverse claims resolution under various contracts and leases. In addition, the Company's cost estimates for these obligations are heavily dependent upon third parties, including WGI, and their ability to perform construction management, cost estimating, and other tasks requiring industry expertise that the Company no longer possesses.

In 2003, the Company recorded charges of \$49 million for legal, management, and other costs related to RE&C versus \$38 million in 2002 and \$30 million in 2001. In 2002 and 2001, the Company allocated \$79 million and \$18 million, respectively, of interest expense to RE&C based upon actual cash outflows since the date of disposition. Since the projects were nearing completion, the Company did not allocate interest expense to RE&C in 2003. In addition, in 2001, the Company recorded a charge of \$71 million to write off certain assets and liabilities as a result of the WGI bankruptcy filing.

The loss from discontinued operations, net of tax, related to RE&C was \$151 million, \$645 million, and \$752 million in 2003, 2002, and 2001, respectively.

Assets and liabilities related to RE&C consisted of the following at December 31:

<i>(In millions)</i>	2003	2002
Current liabilities	\$ 37	\$ 319
Total liabilities	\$ 37	\$ 319

In 2002, the Company sold its Aircraft Integration Systems business (AIS) for \$1,123 million, net, subject to purchase price adjustments. The Company is currently involved in a purchase price dispute related to the sale of AIS. There was no pretax gain or loss on the sale of AIS, however, due to the non-deductible goodwill associated with AIS, the Company recorded a tax provision of \$212 million, resulting in a \$212 million after-tax loss on the sale of AIS. As part of the transaction, the Company retained the responsibility for performance of the Boeing Business Jet (BBJ) program. The Company also retained \$106 million of BBJ-related assets, \$18 million of receivables and other assets, and rights to a \$25 million jury award related to a 1999 claim against Learjet. At December 31, 2003, the balance of these retained assets was \$45 million.

In 2003, the Company recorded charges related to AIS of \$17 million related to cost growth on the BBJ program and \$13 million as a result of continued difficulty the Company has been experiencing liquidating the BBJ-related assets. In 2002 the Company recorded charges of \$66 million, which included a \$23 million write-down of a BBJ-related aircraft owned by the Company, a \$28 million charge for cost growth on one of the two BBJ aircraft not yet delivered, and a \$10 million charge to write down other BBJ-related assets to the then estimated net realizable value, offset by a \$13 million gain resulting from the finalization of the 1999 claim, described above. The write-down of the BBJ-related aircraft resulted from the Company's decision to market this aircraft unfinished due to the environment of declining prices for BBJ-related aircraft at the time. The Company was previously marketing this aircraft as a customized executive BBJ.

The income (loss) from discontinued operations related to AIS, including the \$212 million after-tax loss on the sale, was as follows:

<i>(In millions)</i>	2003	2002	2001
Net sales	\$ -	\$ 202	\$ 850
Operating expenses	-	196	845
Income before taxes	-	6	5
Federal and foreign income taxes	-	2	10
Income (loss) from discontinued operations	-	4	(5)
Loss on disposal of discontinued operations, net of tax	-	(212)	-
Adjustments, net of tax	(19)	(34)	-
Total	\$ (19)	\$(242)	\$ (5)

Activity related to restructuring initiatives was as follows:

Exit Costs <i>(In millions)</i>	2003	2002	2001
Accrued liability at beginning of year	\$4	\$17	\$47
Changes in estimate			
Severance and other employee-related costs	-	-	-
Facility closure and related costs	-	(1)	-
	-	(1)	-
Costs incurred			
Severance and other employee-related costs	-	2	3
Facility closure and related costs	3	10	27
	3	12	30
Accrued liability at end of year	\$1	\$ 4	\$17
Cash expenditures	\$3	\$ 4	\$18
Restructuring <i>(In millions)</i>	2003	2002	2001
Accrued liability at beginning of year	\$-	\$ 7	\$28
Changes in estimate			
Severance and other employee-related costs	-	(3)	(4)
Facility closure and related costs	-	(4)	(4)
	-	(7)	(8)
Costs incurred			
Severance and other employee-related costs	-	-	6
Facility closure and related costs	-	-	7
	-	-	13
Accrued liability at end of year	\$-	\$-	\$ 7
Cash expenditures	\$-	\$-	\$ 8

>>> NOTE E: CONTRACTS IN PROCESS

Contracts in process consisted of the following at December 31, 2003:

<i>(In millions)</i>	Cost Type	Fixed Price	Total
U.S. government end-use contracts			
Billed	\$ 424	\$ 315	\$ 739
Unbilled	569	3,813	4,382
Less progress payments	-	(3,233)	(3,233)
	993	895	1,888
Other customers			
Billed	13	322	335
Unbilled	10	925	935
Less progress payments	-	(396)	(396)
	23	851	874
Total	\$1,016	\$ 1,746	\$ 2,762

Contracts in process consisted of the following at December 31, 2002:

<i>(In millions)</i>	Cost Type	Fixed Price	Total
U.S. government end-use contracts			
Billed	\$ 428	\$ 112	\$ 540
Unbilled	670	3,793	4,463
Less progress payments	-	(2,740)	(2,740)
	1,098	1,165	2,263
Other customers			
Billed	15	391	406
Unbilled	-	861	861
Less progress payments	-	(514)	(514)
	15	738	753
Total	\$1,113	\$ 1,903	\$ 3,016

The U.S. government has title to the assets related to unbilled amounts on contracts that provide for progress payments. Unbilled amounts are primarily recorded on the percentage of completion method and are recoverable from the customer upon shipment of the product, presentation of billings, or completion of the contract.

Included in contracts in process at December 31, 2003 and 2002 was \$77 million and \$113 million, respectively, related to claims on contracts, which were recorded at their estimated realizable value. The Company believes that it has a legal basis for pursuing recovery of these claims and that collection is probable. The settlement of these amounts depends on individual circumstances and negotiations with the counterparty, therefore, the timing of the collection will vary and approximately \$18 million of collections are expected to extend beyond one year.

Billed and unbilled contracts in process include retentions arising from contractual provisions. At December 31, 2003, retentions amounted to \$22 million and are anticipated to be collected as follows: \$12 million in 2004, \$1 million in 2005, and the balance thereafter.

>>> NOTE F: INVENTORIES

Inventories consisted of the following at December 31:

<i>(In millions)</i>	2003	2002
Finished goods	\$ 669	\$ 597
Work in process	1,023	1,042
Materials and purchased parts	306	393
Total	\$1,998	\$2,032

Company irrevocably and without recourse, transferred the receivables to the QSPE which in turn, issued beneficial interests in these receivables to a commercial paper conduit. The assets of the QSPE are not available to pay the claims of the Company or any other entity. The Company retained a subordinated interest in the receivables sold of approximately 17 percent. The conduit obtained the funds to purchase the interest in the receivables, other than the retained interest, by selling commercial paper to third-party investors. The Company retained responsibility for the collection and administration of receivables. The Company continues servicing the sold receivables and charges the third party conduit a monthly servicing fee at market rates.

The Company accounted for the sale under Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. The gain was determined at the date of transfer based upon the relative fair value of the assets sold and the interests retained. The Company estimated the fair value at the date of transfer and at December 31, 2003 based on the present value of future expected cash flows using certain key assumptions, including collection period and a discount rate of 5.0%. At December 31, 2003 a 10 and 20 percent adverse change in the collection period and discount rate would not have a material effect on the Company's financial position or results of operations.

At December 31, 2003, the outstanding balance of securitized accounts receivable held by the third party conduit totaled \$320 million, of which the Company's subordinated retained interest was \$58 million, and the fair value of the servicing asset was \$6 million.

The Company also maintained a program under which it sold general aviation and commuter aircraft long-term receivables under a receivables purchase facility through the end of 2002. The Company bought out the receivables that remained in the facility in 2002 for \$1,029 million and brought the related assets onto the Company's books. In connection with the buyback, the Company recorded the long-term receivables at estimated fair value using the reserves established in 2001, as described in Note A, Accounting Policies, Impairment of Long-Lived Assets. The loss resulting from the sale of receivables was \$6 million and \$2 million in 2002 and 2001, respectively.

The increase in computer software in 2003 was due to the Company's conversion of significant portions of its existing financial systems to a new integrated financial package. Accumulated amortization of computer software was \$241 million and \$219 million at December 31, 2003 and 2002, respectively.

Investments, which are included in other assets, consisted of the following at December 31:

<i>(In millions)</i>	2003 Ownership %	2003	2002
Equity method investments:			
Thales-Raytheon Systems Co. Ltd.	50.0	\$ 78	\$ 59
HRL Laboratories, LLC	33.3	30	29
Indra ATM S.L.	49.0	12	12
TelASIC Communications	23.5	7	2
Hughes Arabia Limited	49.0	1	13
Raytheon Aerospace	-	-	5
Other	n/a	8	-
		136	120
Other investments:			
Alliance Laundry Systems		-	19
Other		10	15
		10	34
Total		\$146	\$154

In 2003, the Company sold the remaining interest in its former aviation support business (Raytheon Aerospace) for \$97 million and recorded a gain of \$82 million. The Company had sold a majority interest in Raytheon Aerospace in 2001 for \$154 million in cash and retained \$47 million in trade receivables and \$66 million in preferred and common equity in the business. The \$66 million represented a 26 percent ownership interest and was recorded at zero because the new entity was highly-leveraged.

In 2003, the Company sold its investment in Alliance Laundry Systems for \$15 million and recorded a loss of \$4 million. The Company had sold its commercial laundry business unit to Alliance in 1998 for \$315 million in cash and \$19 million in securities.

In 2001, the Company formed a joint venture, Thales-Raytheon Systems (TRS) that has two major operating subsidiaries, one of which the Company controls and consolidates. TRS is a system of systems integrator and provides fully customized solutions through the integration of command and control centers, radars, and communication networks. HRL Laboratories is a scientific research facility whose staff engages in the areas of space and defense technologies. Indra develops flight data processors for air traffic control automation systems. TelASIC Communications delivers high performance, cost-effective radio frequency (RF), analog mixed signal, and digital solutions for both the commercial and defense electronics markets. Hughes Arabia Limited was formed in connection with the award of the Peace Shield program and offers certain tax advantages to the Company.

The principal amounts of long-term debt were reduced by debt issue discounts and interest rate hedging costs of \$102 million and \$105 million, respectively, on the date of issuance, and are reflected as follows at December 31:

<i>(In millions)</i>	2003	2002
Principal	\$6,593	\$ 7,511
Unamortized issue discounts	(41)	(39)
Unamortized interest rate hedging costs	(35)	(40)
Installments due within one year	-	(1,152)
Total	\$6,517	\$ 6,280

The aggregate amounts of installments due on long-term debt for the next five years are:

<i>(In millions)</i>	
2004	\$ -
2005	1,048
2006	228
2007	1,149
2008	544

The Company's most restrictive bank agreement covenant is an interest coverage ratio that currently requires earnings before interest, taxes, depreciation, and amortization (EBITDA), excluding certain charges, to be at least 2.5 times net interest expense for the prior four quarters. In July 2003, the covenant was amended to exclude pretax charges of \$100 million related to RE&C and in October 2003 the covenant was further amended to exclude \$226 million of pretax charges related to Network Centric Systems and Technical Services, and \$78 million of pretax charges related to RE&C. In July 2002, the covenant was amended to exclude charges of \$450 million related to discontinued operations. The Company was in compliance with the interest coverage ratio covenant, as amended, during 2003.

Lines of credit with certain commercial banks exist to provide short-term liquidity. The lines of credit bear interest based upon LIBOR and were \$2.7 billion at December 31, 2003, consisting of \$1.4 billion which matures in November 2004 and \$1.3 billion which matures in 2006. The lines of credit were \$2.85 billion at December 31, 2002. There were no borrowings under the lines of credit at December 31, 2003, however, the Company had approximately \$300 million of outstanding letters of credit which effectively reduced the Company's borrowing capacity under the lines of credit to \$2.4 billion. There were no borrowings under the lines of credit at December 31, 2002.

Credit lines with banks are also maintained by certain foreign subsidiaries to provide them with a limited amount of short-term liquidity. These lines of credit were \$99 million and \$79 million at December 31, 2003 and 2002, respectively. There was \$1 million outstanding under these lines of credit at December 31, 2003 and 2002. Compensating balance arrangements are not material.

Total cash paid for interest was \$515 million, \$522 million, and \$705 million in 2003, 2002, and 2001, respectively, including amounts classified as discontinued operations.

>>> NOTE J: EQUITY SECURITY UNITS

The Company has 17,250,000, 8.25%, \$50 par value equity security units outstanding. Each equity security unit consists of a contract to purchase shares of the Company's common stock on May 15, 2004 and a mandatorily redeemable equity security with a stated liquidation amount of \$50 due on May 15, 2006.

The contract obligates the holder to purchase, for \$50, shares of common stock equal to the settlement rate. The settlement rate is equal to \$50 divided by the average market value of the Company's common stock at that time. The settlement rate cannot be greater than 1.8182 or less than 1.4903 shares of common stock per purchase contract. The contract requires a quarterly distribution, which is recorded as a reduction in additional paid-in capital, of 1.25% per year of the stated amount of \$50 per purchase contract. Cash paid for the quarterly distribution on the contract was \$11 million in 2003 and 2002, and \$6 million in 2001.

The mandatorily redeemable equity security represents preferred stock of RC Trust I (RCTI), a subsidiary of the Company that initially issued this preferred stock to the Company in exchange for a subordinated note. The subordinated notes payable have the same terms as the mandatorily redeemable equity security and represent an undivided interest in the assets of RCTI, a Delaware business trust formed for the purpose of issuing these securities and whose assets consist solely of subordinated notes receivable issued by the Company. RCTI is considered to be a variable interest entity under the provisions of FIN 46, described above in Note A, Accounting Policies, Accounting Standards, and because the preferred stock was a part of the equity security units issued by the Company, the Company is not considered the primary beneficiary of RCTI. As a result, RCTI is not consolidated by the Company under the provisions of FIN 46. The subordinated notes payable were previously reported as mandatorily redeemable equity securities on the Company's balance sheet and in accordance with FIN 46 prior periods have been restated to reflect this change.

The subordinated notes payable pay a quarterly distribution, which is included in interest expense, of 7% per year until May 15, 2004. Cash paid for the quarterly distribution on the subordinated notes payable was \$60 million in 2003 and 2002, and \$31 million in 2001.

The terms of the equity security units required that the mandatorily redeemable equity securities be remarketed. On February 11, 2004, the mandatorily redeemable equity securities were remarketed and the quarterly distribution rate on the mandatorily redeemable equity securities and the subordinated notes payable

>>> NOTE L: FEDERAL AND FOREIGN INCOME TAXES

The provision for federal and foreign income taxes consisted of the following:

<i>(In millions)</i>	2003	2002	2001
Current income tax expense			
Federal	\$130	\$ 51	\$ 87
Foreign	3	5	4
Deferred income tax expense (benefit)			
Federal	94	243	(30)
Foreign	-	21	37
Total	\$227	\$320	\$ 98

The provision for state income taxes was included in general and administrative expenses as these costs can generally be recovered through the pricing of products and services to the U.S. government.

The provision for income taxes differs from the U.S. statutory rate due to the following:

	2003	2002	2001
Statutory tax rate	35.0%	35.0%	35.0%
Foreign sales corporation tax benefit	(3.1)	(3.5)	(36.0)
ESOP dividend deduction benefit	(1.7)	(1.1)	(11.0)
Research and development tax credit	(0.8)	(1.0)	(5.0)
Goodwill amortization	-	-	109.0
Other, net	0.4	0.3	6.0
Effective tax rate	29.8%	29.7%	98.0%

Effective January 1, 2002, the Company discontinued the amortization of goodwill as required by SFAS No. 142, as described in Note A, Accounting Policies, Impairment of Long-lived Assets. The higher effective tax rate in 2001 resulted from the increased effect of non-deductible amortization of goodwill on lower income before taxes resulting primarily from the charges at Raytheon Airline Aviation Services.

In 2003, 2002, and 2001, domestic income (loss) before taxes was \$493 million, \$(12) million, and \$(1,156) million, respectively, and foreign income before taxes was \$8 million, \$75 million, and \$118 million, respectively. Income reported for federal and foreign tax purposes differs from pretax accounting income due to differences between U.S. Internal Revenue Code requirements and the Company's accounting practices. No provision has been made for deferred taxes on undistributed earnings of non-U.S. subsidiaries as these earnings have been indefinitely reinvested. Net cash (payments) refunds were \$(13) million, \$145 million, and \$27 million in 2003, 2002, and 2001, respectively.

Deferred federal and foreign income taxes consisted of the following at December 31:

<i>(In millions)</i>	2003	2002
Current deferred tax assets		
Other accrued expenses	\$ 289	\$ 378
Accrued salaries and wages	105	104
Contracts in process and inventories	72	119
Deferred federal and foreign income taxes—current	\$ 466	\$ 601
Noncurrent deferred tax assets (liabilities)		
Net operating loss and foreign tax credit carryforwards	\$ 631	\$ 533
Pension benefits	310	348
Other retiree benefits	226	235
Depreciation and amortization	(703)	(711)
Revenue on leases and other	(127)	(124)
Deferred federal and foreign income taxes-noncurrent	\$ 337	\$ 281

There were \$12 million and \$1 million of taxes refundable included in prepaid expenses and other current assets at December 31, 2003 and 2002, respectively. Federal tax benefits related to discontinued operations were \$91 million in 2003 and \$126 million in 2002 and were included in deferred federal and foreign income taxes in the table above.

At December 31, 2003, the Company had net operating loss carryforwards of \$1.4 billion that expire in 2020 through 2023, foreign tax credit carryforwards of \$41 million that expire in 2006 through 2008, and research tax credit carryforwards of \$26 million that expire in 2018 to 2023. The Company believes it will be able to utilize all of these carryforwards over the next 3 to 4 years.

>>> NOTE M: COMMITMENTS AND CONTINGENCIES

At December 31, 2003, the Company had commitments under long-term leases requiring annual rentals on a net lease basis as follows:

<i>(In millions)</i>	
2004	\$294
2005	271
2006	236
2007	198
2008	151
Thereafter	327

Rent expense in 2003, 2002, and 2001 was \$441 million, \$449 million, and \$276 million, respectively. In the normal course of business, the Company leases equipment, office buildings, and other facilities under leases that include standard escalation clauses for adjusting rent payments to reflect changes in price indices, as well as renewal options.

The Company continues to cooperate with the staff of the Securities and Exchange Commission (SEC) on a formal investigation related to the Company's accounting practices primarily related to the commuter aircraft business and the timing of revenue recognition at Raytheon Aircraft. The Company has been providing documents and information to the SEC staff. In addition, certain present and former officers and employees of the Company have provided testimony in connection with this investigation. The Company is unable to predict the outcome of the investigation or any action that the SEC might take.

In late 1999, the Company and two of its officers were named as defendants in several class action lawsuits which were consolidated into a single complaint in June 2000, when four additional former or present officers were named as defendants (the "Consolidated Complaint"). The Consolidated Complaint principally alleges that the defendants violated federal securities laws by making misleading statements and by failing to disclose material information concerning the Company's financial performance during the purported class period. In March 2000, the court certified the class of plaintiffs as those people who purchased the Company's stock between October 7, 1998 and October 12, 1999. In August 2001, the court issued an order dismissing most of the claims asserted against the Company and the individual defendants. In March 2003, the plaintiff filed an amendment to the Consolidated Complaint (the "Second Consolidated and Amended Complaint") which sought to add the Company's independent auditor as an additional defendant. In May 2003, the court issued an order dismissing one of the two claims that had been asserted against the Company's independent auditor. In February 2004, the Company and the individual defendants filed a motion for summary judgment, which the plaintiff opposes. The Company's independent auditor also filed a motion for summary judgment which the plaintiff opposes. A hearing on the summary judgment motion is scheduled for April 2004. The Court has scheduled a trial to begin in May 2004.

In 1999 and 2000, the Company was also named as a nominal defendant and all of its directors at the time (except one) were named as defendants in purported derivative lawsuits. The derivative complaints contain allegations similar to those included in the Consolidated Complaint and further allege that the defendants breached fiduciary duties to the Company and allegedly failed to exercise due care and diligence in the management and administration of the affairs of the Company. In December 2001, the Company and the individual defendants filed a motion to dismiss one of the derivative lawsuits. These actions have since been consolidated, and the plaintiffs have filed a Consolidated Amended Complaint. In April 2003, the defendants filed a motion to dismiss the Consolidated Amended Complaint.

In June 2001, a class action lawsuit was filed on behalf of all purchasers of common stock or senior notes of WGI during the class period of April 17, 2000 through March 1, 2001 (the "WGI Complaint"). The plaintiff class claims to have suffered harm by purchasing WGI securities because the Company and certain of its officers allegedly violated federal securities laws by misrepresenting the true financial condition of RE&C in order to sell RE&C to WGI at an artificially inflated price. An amended complaint was filed in October 2001 alleging similar claims. The Company and the individual defendants filed a motion seeking to dismiss the action in November 2001. In April 2002, the motion to dismiss was denied. The defendants have filed their answer to the amended complaint and discovery is proceeding. In April 2003, the District Court conditionally certified the class and defined the class period as that between April 17, 2000 and March 2, 2001, inclusive. The defendants have filed their answer to the amended complaint and discovery is proceeding.

In July 2001, the Company was named as a nominal defendant and all of its directors at the time have been named as defendants in two identical purported derivative lawsuits. These lawsuits were consolidated into one action (the "Consolidated Amended Derivative Complaint") in January 2004 and contain allegations similar to those included in the WGI Complaint and further allege that the individual defendants breached fiduciary duties to the Company and failed to maintain systems necessary for prudent management and control of the Company's operations. The defendants filed a motion to dismiss the Consolidated Amended Derivative Complaint in March 2004.

Also in July 2001, the Company was named as a nominal defendant and members of its Board of Directors and several current and former officers have been named as defendants in another purported shareholder derivative action which contains allegations similar to those included in the WGI Complaint and further alleges that the individual defendants breached fiduciary duties to the Company and failed to maintain systems necessary for prudent management and control of the Company's operations. In June 2002, the defendants filed a motion to dismiss the complaint. In September 2002, the plaintiff agreed to voluntarily dismiss this action without prejudice so that it can be re-filed in another jurisdiction.

In May 2003, two purported class action lawsuits were filed on behalf of participants in the Company's savings and investment plans who invested in the Company's stock between August 19, 1999 and May 27, 2003. The two class action complaints are brought pursuant to the Employee Retirement Income Security Act (ERISA). Both lawsuits are substantially similar and have been consolidated into a single action. The complaints allege that the Company and certain members of the Company's Investment Committee breached ERISA fiduciary and co-fiduciary duties by allegedly failing to (1) disseminate necessary information regarding the savings and investment plans' investment in the Company's

The following tables summarize information about stock options outstanding and exercisable at December 31, 2003:

Exercise Price Range	Options Outstanding		
	Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
\$18.19 to \$29.92	15,609	7.0 years	\$25.48
\$30.00 to \$48.97	18,837	7.6 years	\$38.20
\$51.06 to \$59.44	7,409	3.9 years	\$54.35
\$67.66 to \$73.78	4,231	5.5 years	\$68.49
Total	46,086		

Exercise Price Range	Options Exercisable	
	Shares	Weighted-Average Exercise Price
\$18.19 to \$29.92	11,398	\$24.03
\$30.00 to \$48.97	7,059	\$40.00
\$51.06 to \$59.44	7,409	\$54.35
\$67.66 to \$73.78	4,231	\$68.49
Total	30,097	

Shares exercisable at the corresponding weighted-average exercise price at December 31, 2003, 2002, and 2001, were 30.1 million at \$41.49, 24.8 million at \$45.06, and 24.2 million at \$47.78, respectively.

>>> NOTE O: PENSION AND OTHER EMPLOYEE BENEFITS

The Company has pension plans covering the majority of its employees, including certain employees in foreign countries (Pension Benefits). In addition to providing pension benefits, the Company provides certain health care and life insurance benefits to retired employees through other postretirement benefit plans (Other Benefits). Substantially all of the Company's U.S. employees may become eligible for the Other Benefits. The measurement date for the Company's domestic Pension Benefits and Other Benefits plans is October 31.

The strategic asset allocation of the Company's domestic Pension Benefits and Other Benefits plans is diversified with an average and moderate level of risk consisting of investments in equity securities (including domestic and international equities and the Company's stock), debt securities, real estate, and other areas such as private equity and cash. The Company seeks to produce an active return on investment over the long-term commensurate with levels of investment risk which are prudent and reasonable given the prevailing capital market expectations. Target allocations are 48 to 77 percent for equity securities, 20 to 40 percent for debt securities, 2 to 7 percent for real estate, and 4 to 17 percent for other

areas. The long-term return on asset assumption for the Company's domestic Pension Benefits plans for 2004 is 8.75%. The long-term return on asset assumption for the Company's domestic Pension Benefits plans was 8.75% in 2003 and 9.50% in 2002 and 2001. The long-term return on asset assumption for the Company's domestic Other Benefits plans was 7.75% in 2003 and 8.50% in 2002 and 2001. To develop the expected long-term rate of return on asset assumption, the Company considered the current level of expected returns on risk free investments, the historical level of the risk premium associated with the other asset classes in which the Company has invested domestic Pension Benefits and Other Benefits plan assets, and the expectations for future returns of each asset class. Since the Company's investment policy is to employ active management strategies in all asset classes, the potential exists to outperform the broader markets, therefore, the expected returns were adjusted upward. The expected return for each asset class was then weighted based on the target asset allocation to develop the long-term return on asset assumption.

The tables below detail assets by category for the Company's domestic Pension Benefits and Other Benefits plans. These assets consist primarily of publicly-traded equity securities (including 2,279,000 shares of the Company's common stock with a fair value of \$68 million at December 31, 2003 and 705,000 of the Company's equity security units, with a fair value of \$38 million at December 31, 2003) and publicly-traded fixed income securities.

Pension Asset Information

Asset Categories	Percent of Plan Assets at October 31	
	2003	2002
Equity securities	67%	57%
Debt securities	26	30
Real estate	3	3
Other	4	10
Total	100%	100%

Other Benefits Asset Information

Asset Categories	Percent of Plan Assets at October 31	
	2003	2002
Equity securities	45%	19%
Debt securities	41	71
Real estate	1	1
Other	13	9
Total	100%	100%

The tables below provide a reconciliation of benefit obligations, plan assets, funded status, and related actuarial assumptions of the Company's domestic and foreign Pension Benefits and Other Benefits plans.

Net periodic benefit cost (income) also includes expense from foreign pension plans of \$20 million in 2003, \$11 million in 2002, and \$5 million in 2001. Net periodic benefit costs (income) includes expense from discontinued operations, including curtailments, of \$9 million in 2002 and \$11 million in 2001.

Components of Net Periodic Benefit Cost

<i>(In millions)</i>	2003	Other Benefits	
		2002	2001
Service cost	\$ 15	\$ 21	\$ 19
Interest cost	106	105	95
Expected return on plan assets	(26)	(30)	(34)
Amortization of transition obligation	25	25	25
Amortization of prior service cost	(45)	—	(1)
Recognized net actuarial loss (gain)	41	9	(10)
Gain due to curtailments/settlements	—	(47)	(5)
Net periodic benefit cost	\$116	\$ 83	\$ 89

Net periodic benefit cost includes income from discontinued operations, including curtailments, of \$47 million in 2002.

Weighted-Average Net Periodic Benefit Cost Assumptions

	2003	Pension Benefits	
		2002	2001
Discount rate	6.95%	7.21%	7.70%
Expected return on plan assets	8.67%	9.43%	9.44%
Rate of compensation increase	4.46%	4.47%	4.47%

Weighted-Average Net Periodic Benefit Cost Assumptions

	2003	Other Benefits	
		2002	2001
Discount rate	7.00%	7.25%	7.75%
Expected return on plan assets	8.50%	8.50%	8.50%
Rate of compensation increase	4.50%	4.50%	4.50%
Health care trend rate			
in the next year	12.00%	11.00%	8.25%
Gradually declining to a trend			
rate of	5.50%	5.00%	5.00%
In the years beyond	2013	2013	2006

The effect of a one percent increase or decrease in the assumed health care trend rate for each future year for the aggregate of service cost and interest cost is \$8 million or \$(7) million, respectively, and for the accumulated postretirement benefit obligation is \$122 million or \$(106) million, respectively.

The projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets were \$12,390 million and \$8,731 million, respectively, at

December 31, 2003, and \$11,023 million and \$8,022 million, respectively, at December 31, 2002.

The accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were \$11,118 million and \$8,731 million, respectively, at December 31, 2003, and \$9,964 million and \$8,022 million, respectively, at December 31, 2002. The accumulated benefit obligation for all pension plans was \$12,184 million and \$10,929 million at December 31, 2003 and 2002, respectively.

The Company expects total contributions (required and discretionary) to the domestic Pension Benefits and Other Benefits plans to be approximately \$320 million and \$115 million, respectively, in 2004.

The Company also maintains an additional supplemental executive retirement plan or similar contractual benefits for its top executive officers. The Company's benefit obligation of \$16 million at December 31, 2003 has been accrued.

On December 8, 2003, Medicare reform legislation (the "Legislation") was enacted, providing a Medicare prescription drug benefit beginning in 2006 and federal subsidies to employers who provide drug coverage to retirees. Because of significant uncertainties about accounting issues raised by the Legislation, the eventual regulations required to implement the Legislation, and the Legislation's overall effect on plan participants' behavior and the level of health care costs, the Company has not reflected any potential effects of the Legislation. At December 31, 2003, specific authoritative guidance on accounting for the federal subsidy is pending, and that guidance, when issued, could require the Company to change previously reported information.

The Company maintains an employee stock ownership plan (ESOP) which includes the Company's 401(k) plan (defined contribution plan), under which covered employees are allowed to contribute up to a specific percentage of their pay. The Company matches the employee's contribution, up to a maximum of generally between three and four percent of the employee's pay, by making a contribution to the Company stock fund (Company Match). Total expense for the Company Match was \$159 million, \$166 million, and \$183 million in 2003, 2002, and 2001, respectively, including expense from discontinued operations of \$2 million in 2002 and \$9 million in 2001.

which can generally be recovered through the pricing of products and services to the U.S. government. Previously, the Company's individual segment results included FAS pension expense or income, which consisted of CAS pension expense and an adjustment to reconcile CAS pension expense to FAS pension expense or income. Information for all periods presented was restated to reflect these changes.

Segment net sales and operating income generally include intersegment sales and profit recorded at cost plus a specified fee, which may differ from what the selling entity would be able to obtain on external sales. Corporate and Eliminations include Company-wide accruals and over/under applied overhead that have not been attributed to a particular segment and intersegment sales and profit eliminations.

Segment financial results were as follows:

Net Sales <i>(In millions)</i>	2003	2002	2001
Integrated Defense Systems	\$ 2,864	\$ 2,366	\$ 2,265
Intelligence and Information Systems	2,045	1,887	1,736
Missile Systems	3,538	3,038	2,901
Network Centric Systems	2,809	3,091	2,865
Space and Airborne Systems	3,677	3,243	2,738
Technical Services	1,963	2,133	2,050
Aircraft	2,088	2,040	2,471
Other	573	210	207
Corporate and Eliminations	(1,448)	(1,248)	(1,216)
Total	\$18,109	\$16,760	\$16,017

Intersegment sales in 2003, 2002, and 2001, respectively, were \$140 million, \$103 million, and \$105 million for Integrated Defense Systems, \$52 million, \$35 million, and \$26 million for Intelligence and Information Systems, \$7 million, \$1 million, and \$1 million for Missile Systems, \$316 million, \$218 million, and \$223 million for Network Centric Systems, \$402 million, \$298 million, and \$320 million for Space and Airborne Systems, \$529 million, \$590 million, and \$537 million for Technical Services, and \$2 million, \$3 million, and \$4 million for Aircraft. Aircraft net sales do not include intersegment aircraft sales to FO.

Operating Income

<i>(In millions)</i>	2003	2002	2001
Integrated Defense Systems	\$ 331	\$ 289	\$ 238
Intelligence and Information Systems	194	180	139
Missile Systems	424	373	257
Network Centric Systems	19	278	246
Space and Airborne Systems	492	428	339
Technical Services	107	116	123
Aircraft	2	(39)	(77)
Other	(34)	(12)	(758)
FAS/CAS Pension Adjustment	(109)	210	386
Corporate and Eliminations	(110)	(40)	(127)
Total	\$1,316	\$1,783	\$ 766

Aircraft operating income does not include profit on intersegment aircraft sales to FO until the underlying aircraft has been sold by FO.

Free Cash Flow

<i>(In millions)</i>	2003	2002	2001
Integrated Defense Systems	\$ 318	\$ 194	\$ 127
Intelligence and Information Systems	88	121	43
Missile Systems	244	176	293
Network Centric Systems	115	88	59
Space and Airborne Systems	365	153	215
Technical Services	104	174	(57)
Aircraft	20	24	(316)
Other	(55)	(61)	(134)
Corporate	377	770	(51)
Total	\$1,576	\$1,639	\$ 179

**>>> NOTE Q: QUARTERLY
OPERATING RESULTS (UNAUDITED)**

(In millions except per share amounts and stock prices)

2003	First	Second	Third	Fourth
Net sales	\$4,201	\$4,429	\$4,378	\$5,101
Gross margin	721	859	602	927
Income from				
continuing operations	111	186	21	217
Net income (loss)	95	100	(35)	205
Earnings per share from				
continuing operations				
Basic	\$ 0.27	\$ 0.45	\$ 0.05	\$ 0.52
Diluted	0.27	0.45	0.05	0.52
Earnings (loss) per share				
Basic	0.23	0.24	(0.08)	0.49
Diluted	0.23	0.24	(0.08)	0.49
Cash dividends per share				
Declared	0.20	0.20	0.20	0.20
Paid	0.20	0.20	0.20	0.20
Common stock prices				
High	\$32.09	\$33.69	\$33.97	\$30.24
Low	24.31	27.15	27.74	25.45

2002	First	Second	Third	Fourth
Net sales	\$3,911	\$4,095	\$4,092	\$4,662
Gross margin	751	888	852	911
Income from				
continuing operations	150	223	228	155
Income (loss) before				
accounting change	(74)	(136)	147	(68)
Net income (loss)	(583)	(136)	147	(68)
Earnings per share from				
continuing operations				
Basic	\$ 0.38	\$ 0.56	\$ 0.56	\$ 0.38
Diluted	0.37	0.54	0.56	0.38
Earnings (loss) per share				
before accounting change				
Basic	(0.19)	(0.34)	0.36	(0.17)
Diluted	(0.19)	(0.33)	0.36	(0.17)
Earnings (loss) per share				
Basic	(1.47)	(0.34)	0.36	(0.17)
Diluted	(1.44)	(0.33)	0.36	(0.17)
Cash dividends per share				
Declared	0.20	0.20	0.20	0.20
Paid	0.20	0.20	0.20	0.20
Common stock prices				
High	\$40.95	\$44.52	\$38.63	\$30.75
Low	30.88	37.54	28.61	26.86

Note: Earnings per share are computed independently for each of the quarters presented, therefore, the sum of the quarterly earnings per share may not equal the total computed for the year.

>>> NOTE R: FINANCIAL INSTRUMENTS

At December 31, 2003, the Company recorded forward exchange contracts designated as cash flow hedges at their fair value. Unrealized gains of \$76 million were included in noncurrent assets and unrealized losses of \$39 million were included in current liabilities. The offset was included in other comprehensive income, net of tax, of which approximately \$5 million of net unrealized gains are expected to be reclassified to earnings over the next twelve months as the underlying transactions mature. Gains and losses resulting from these cash flow hedges offset the foreign exchange gains and losses on the underlying assets or liabilities being hedged. The maturity dates of the forward exchange contracts outstanding at December 31, 2003 extend through 2013. Certain immaterial contracts were not designated as effective hedges and therefore were included in other expense. The amount charged to other expense related to these contracts was less than \$1 million in 2003 and 2002.

In 2003, the Company entered into interest rate swaps, as described in Note I, Notes Payable and Long-term Debt. These interest rate swaps were designated as fair value hedges. There was no hedge ineffectiveness during 2003.

The Company has one outstanding interest rate swap agreement related to long-term receivables at Raytheon Aircraft with a notional amount of \$33 million that matures in 2004. Under this agreement, the Company pays interest at a fixed rate of 6.2% and receives a variable rate equal to one-month LIBOR. The variable rate applicable to this agreement was 1.2% at December 31, 2003. This interest rate swap is considered a cash flow hedge. At December 31, 2003, the Company had recorded the interest rate swap at fair value consisting of an unrealized loss of \$1 million included in current liabilities with the offset included in other comprehensive income, net of tax, which is expected to be reclassified to earnings over the next twelve months. The ineffective portion was not material in 2003, 2002, and 2001.

Major currencies and the approximate amounts associated with foreign exchange contracts consisted of the following at December 31:

<i>(In millions)</i>	2003		2002	
	Buy	Sell	Buy	Sell
British Pounds	\$485	\$210	\$438	\$149
Canadian Dollars	95	38	7	1
European Euros	47	31	22	31
Arab Emirates Dirham	20	45	–	–
Australian Dollars	14	9	8	6
Swiss Francs	4	44	–	31
Norwegian Kroner	4	1	4	–
All other	1	–	1	–
Total	\$670	\$378	\$480	\$218

Buy amounts represent the U.S. dollar equivalent of commitments to purchase foreign currencies and sell amounts represent the U.S. dollar equivalent of commitments to sell foreign currencies. Foreign exchange contracts that do not involve U.S. dollars have been converted to U.S. dollars for disclosure purposes.

Foreign currency forward contracts, used only to fix the dollar value of specific commitments and payments to international vendors and the value of foreign currency denominated receipts, have maturities at various dates through 2013 as follows: \$617 million in 2004, \$180 million in 2005, \$106 million in 2006, \$56 million in 2007, and \$89 million thereafter.

>>> NOTE S: OTHER INCOME AND EXPENSE

The components of other expense (income), net were as follows:

<i>(In millions)</i>	2003	2002	2001
Gain on sale of aviation support business	\$ (82)	–	\$(35)
Loss (gain) on debt repurchase	77	\$ (2)	24
Equity losses in unconsolidated affiliates	14	26	27
Loss (gain) on sale of investments	7	(4)	–
Space Imaging charge	–	175	–
Gain on sale of recreational marine business	–	–	(39)
Other	51	42	29
Total	\$ 67	\$237	\$ 6

In 1995, through the acquisition of E-Systems, Inc., the Company invested in Space Imaging and currently has a 31 percent equity investment in Space Imaging LLC. In 2002, the Company recorded a \$175 million charge to write off the Company's investment in Space Imaging and accrue for payment under the Company's guarantee of a Space Imaging credit facility that matured in March 2003. In the first quarter of 2003, the Company paid \$130 million related to the credit facility guarantee. In exchange for this payment, the Company received a note from Space Imaging for this amount that the Company has valued at zero.

